

Chapter 1

What Is Financial Accounting, and Why Is It Important?

Section 1

True/False Questions

1. Financial accounting is limited to analyzing the financial information conveyed through financial statements.
False; Easy
2. The knowledge of financial accounting can assist people with decisions such as whether to extend credit to a business.
True; Easy
3. Employees of a company would not have a reason to use the information provided by financial accounting.
False; Easy
4. Financial accounting should be used for assessing the financial health of large organizations only.
False; Moderate
5. Financial accounting can be helpful for a job candidate who is assessing the financial future of a potential employer.
True; Easy
6. Lenders might use the information produced by financial accounting when making loan decisions.
True; Easy
7. Credit analysts prefer not to use information provided by financial accounting, as it is not accurate.
False; Easy
8. Financial accounting is helpful to investment advisors.
True; Easy
9. Financial accounting is more useful than managerial accounting.
False; Easy
10. The decision to buy or rent equipment is an example of a decision aided by managerial accounting.
True; Moderate

Multiple Choice Questions

11. Which of the following statements is true of financial accounting?
- a. It is used to make lease or purchase decisions.
 - b. It is primarily used to make internal decisions of a business.
 - c. It is used by external parties to make investment decisions.
 - d. Managerial accounting is another name for financial accounting.
 - e. The effectiveness of advertising can be judged using financial accounting.
- c; Moderate**
12. The charge for using money over time, often associated with long-term loans, is known as:
- a. cash dividend.
 - b. interest.
 - c. preferred dividend.
 - d. principal.
 - e. distribution charge.
- b; Easy**
13. Which of the following is a decision that would most likely involve managerial accounting information?
- a. Loaning money to another company
 - b. Deciding whether to buy or rent equipment
 - c. Investing in the stock of another company
 - d. Deciding whether to extend credit to a potential customer
 - e. Choosing which employer to work for based on future prospects
- b; Moderate**
14. Which of the following decisions would be considered more of a managerial accounting decision than a financial accounting decision?
- a. Loaning money to Company X instead of Company Y
 - b. Determining that Company J is more profitable than Company K
 - c. Investing in the stock of Company T instead of Company U
 - d. Deciding the price to be charged for a new product
 - e. Deciding whether to extend credit to Company L
- d; Moderate**

15. Who among the following are the users of managerial accounting information?
- a. Lender
 - b. Competitors
 - c. Government
 - d. Third Party Investor
 - e. Board of Directors
- e; Moderate**
16. Who are the common users of financial and managerial accounting information?
- a. Government
 - b. Managers
 - c. Shareholders
 - d. Competitors
 - e. Customers
- b; Moderate**
17. Which of the following is a common feature of financial and managerial accounting?
- a. Both have same objectives
 - b. Both are reported at year end in the annual report
 - c. Both are analyzed by external users while making investment decisions
 - d. Both are used by the management in making decisions
 - e. Both are prepared according to U.S. GAAP
- d; Moderate**
18. Financial accounting rules require interest to be reported at a reasonable rate:
- a. at the beginning of the accounting period.
 - b. when a floating rate is set by the creditor.
 - c. when specified interest rate is higher than market rate.
 - d. when specified interest rate is less than market rate.
 - e. when interest rate is not specifically mentioned in the debt agreement.
- e; Moderate**
19. Which of the following statements is true of financial accounting?
- a. Managerial accounting is a branch of financial accounting.
 - b. Financial accounting reports are based on accounting principles.
 - c. Financial accounting and managerial accounting have same objectives.
 - d. Financial accounting information has no relevance for the employees of a company.
 - e. Financial accounting is optional for companies.
- b; Moderate**

20. The communication of financial information within an organization so that internal decisions can be made in an appropriate manner is known as:
- a. financial accounting.
 - b. managerial accounting.
 - c. cost analysis.
 - d. tax accounting.
 - e. information analysis.
- b; Moderate**

Fill In the Blanks

21. _____ accounting is the communication of information about a business so that its financial health can be assessed.
Financial; Easy
22. The two types of accounting are _____ accounting and _____ accounting.
financial, managerial; Easy
23. _____ is the communication of financial information for decision-making purposes.
Accounting; Easy

Short Answer Questions

24. Explain why non-accountants need an understanding of financial accounting.
- Financial accounting conveys information, which helps users make decisions about the financial health of an organization. Employees, prospective employees, loan officers, and investment counselors are just a few of the groups who could benefit from understanding financial accounting.
Easy
25. Explain the difference between financial accounting and managerial accounting.
- Financial accounting provides information to external users to make decisions about that organization. Managerial accounting provides information for internal decision makers.
Easy

Section 2

True/False Questions

26. To be considered an owner of a corporation, one must own at least five shares of the corporation's stock.

False; Easy

27. Stockholders of a corporation are granted all rights as specified by the state government or the stock certificate.

True; Moderate

28. Stocks traded on a stock exchange will continually go up and down in value.

True; Easy

29. Owners of business wishing to form a corporation must apply to the federal government for recognition as a legal entity.

False; Hard

30. To have a business identified as a corporation, its owners must apply to the state government for incorporation.

True; Easy

31. Stockholders in large corporations like The Coca Cola Company do not typically have a say in the day-to-day operations of the company.

True; Easy

32. Management of a corporation votes to elect the Board of Directors to make the day-to-day decisions for the company.

False; Easy

33. A company's stock price is affected by its past profitability.

True; Moderate

34. Investors hope to make money by investing in stock that will rise in price.

True; Easy

35. Investors enjoy tax benefits if they sell their stock before they have held it for a year.

False; Moderate

36. Dividends are required to be paid to stockholders on an annual basis.

False; Easy

37. An individual who owns one or more shares of stock in a corporation is an owner of that corporation.

True; Easy

38. Corporations do not exist as separate legal entities apart from their owners.

False; Moderate

39. Federal laws prohibit one investor from owning the majority of shares in a corporation.

False; Hard

40. Stock markets match up investors who wish to buy shares with those who wish to sell them.

True; Easy

41. It is very difficult to buy or sell ownership shares of a corporation in a stock exchange.

False; Moderate

42. An investor expecting a company's stock price to rise believes that the company has a bright future.

True; Easy

43. An investment in stock is considered virtually risk free.

False; Moderate

44. The only way for stockholders to make money on their investment is when the stock price rises.

False; Moderate

Multiple Choice Questions

45. Which of the following has the authority to formally recognize a business as a separate legal entity?

- a. FASB
- b. State Government
- c. NASDAQ
- d. Board of Directors
- e. SEC

b; Easy

46. NASDAQ refers to:
- a. National Association of Securities Dealers Automated Quotations.
 - b. National Association of Stock Dealers Automated Quotations.
 - c. National Association of Shares Dealers Automated Quotations.
 - d. National Administration for Shares Dealers Automated Quotations.
 - e. National Administration of Securities Dealers Automated Quotations.
- a; Easy**
47. Legal process by which owners of an organization apply to a state government to have it identified as an entity legally separate from its owners is called:
- a. incorporation.
 - b. registration.
 - c. filling.
 - d. stocking.
 - e. attributing.
- a; Moderate**
48. Which of the following is the largest stock exchange in the world?
- a. NASDAQ
 - b. New York Stock Exchange
 - c. London Stock Exchange
 - d. Tokyo Stock Exchange
 - e. Shanghai Stock Exchange
- b; Easy**
49. An advantage of ownership in a sole proprietorship over ownership in a corporation is:
- a. separation of owner and business as legal entities.
 - b. tax benefits.
 - c. the ability to raise capital through issuance of stock.
 - d. limited liability for debts.
 - e. having a board of directors.
- b; Moderate**
50. An advantage of ownership in a corporation over ownership in a partnership is:
- a. tax benefits.
 - b. easy establishment.
 - c. each stockholder has a say in the operation of the corporation.
 - d. the ability to raise capital through issuance of stock.
 - e. owner decides the amount of dividend to be distributed.
- d; Moderate**

51. The group stockholders elected to oversee their corporation is _____.
a. management
b. the board of directors
c. employees
d. a stock exchange
e. investors
b; Easy
52. Who elects a corporation's board of directors?
a. Management
b. Stockholders
c. Employees
d. Creditor
e. Government
b; Easy
53. Who hires the management of a corporation?
a. Board of directors
b. Stockholders
c. Government
d. Creditors
e. SEC
a; Easy
54. Who is involved in the day-to-day operations of a corporation?
a. Board of directors
b. Stockholders
c. Government
d. Creditors
e. Management
e; Easy
55. Which of the following statements is true of stock?
a. A capital gain is recorded by the corporation when the stock prices increase over a year.
b. The stock prices are expected to fall after a company declares dividend.
c. The dividends to be distributed on stock is determined by stockholders.
d. Investor should own 1% of total stock of a company to become a stockholder of the company.
e. The value of stock traded on a stock exchange fluctuate based on the future prospects of an organization.
e; Easy

56. One of the advantages of a sole proprietorship or a partnership over incorporation is:
- a. easy access to equity capital.
 - b. easy access to debt capital.
 - c. potential income tax benefits.
 - d. limited liability.
 - e. access to government funding during distress
- c; Moderate**
57. Who makes the decision to pay dividends in a company?
- a. Employees
 - b. Management
 - c. Stockholders
 - d. The Board of Directors
 - e. Creditors
- d; Moderate**
58. Dividend refers to a(n):
- a. reward for being an owner of a prospering business.
 - b. reward for being a creditor of a prospering business.
 - c. ownership right on a corporation.
 - d. liability for holding shares of a corporation.
 - e. tax benefit received for holding stocks for over twelve months.
- a; Easy**
59. Which of the following benefits can a stockholder accrue from the ownership of capital shares?
- a. Cash Dividend
 - b. Receipt of interest
 - c. Decrease in stock price
 - d. Increase in competitor's stock price
 - e. Increase in subsidiary's stock price
- a; Easy**
60. Kendra Jackson purchases 120 shares of Kingdom Corporation on May 30 for \$36 per share. During July, Kingdom paid dividends of \$4.00 per share. On October 19, Kendra is considering selling all of her shares, which are now selling for \$40 per share. The value of Kendra's investment on October 19 is ____.
- a. \$5,280
 - b. \$4,800
 - c. \$4,320
 - d. \$4,000
 - e. \$5,000
- a; Moderate**

61. Jonathan purchases 100 shares of Carnival Corporation on July 1, Year One for \$20 per share. During September, Carnival distributed dividends of \$5 per share. The market price of the stock was \$28 per share as of December 31, Year One. Jonathan decided to sell the stock on December 31, Year Two when the stock price was \$30 per share. Determine the capital gain to be reported by Jonathan in Year One.
- a. \$0
 - b. \$200
 - c. \$800
 - d. \$1,000
 - e. \$1,500
- c; Moderate**
62. A company purchases shares on 1/1/X1 for \$150. During the year, quarterly dividends of \$1.50 per share were declared and paid. The market price of the stock on 12/31/X1 is \$162. What is the investor's return for the year?
- a. 4%
 - b. 8%
 - c. 9%
 - d. 11%
 - e. 12%
- e; Moderate**
63. Which of the following is a factor influencing the movement of a company's stock price?
- a. The perceived quality of the company's management
 - b. The number of employees working in the company
 - c. The death of a shareholder of the company
 - d. The salary of the chief executive officer of the company
 - e. The movement of a company's stock which is not in the same industry
- a; Easy**
64. The strategy of a corporation is approved by:
- a. an investor.
 - b. a stockholder.
 - c. a lender.
 - d. the government.
 - e. the board of directors.
- e; Moderate**

65. The annual rate of return on stock:
- a. quantifies the financial benefit earned due to change in net income.
 - b. quantifies the financial benefit due to change in cash position of a corporation.
 - c. helps select from among multiple investment opportunities.
 - d. compares the benefit due to change in stock price with dividend earned on stock.
 - e. determines the income earned by holding a stock for less than a year.
- c; Moderate**

Fill In the Blanks

66. In income taxes, the difference between the buy and sale price for stock held for over twelve months is a _____.
long-term capital gain or loss; Moderate
67. A _____ is a reward for being an owner of a business that is prospering.
dividend; Easy
68. A _____ is a type of organization legally separate from its owners.
corporation; Easy
69. An individual must own at least _____ share(s) to be considered an owner in a corporation.
one; Moderate
70. Stock is sold and bought on _____.
stock exchanges or markets; Moderate

Short Answer Questions

71. Why would a person or organization choose to become a stockholder in a corporation?

Individuals and organizations invest in the stock of corporations to earn a return. In other words, they hope to see the value of their investment increase. This can be accomplished in two ways: 1) the stock price rises after the stock is purchased and/or 2) the corporation pays dividends to its stockholders.

Easy

72. What is the role of the board of directors of a corporation?

Not all the stockholders can be a part of the day-to-day operations of a corporation. Therefore, they elect the board of directors to oversee the management of the corporation. The board of directors selects the management of the company as well as determines the timing and amount of dividends.

Moderate

73. Name three factors that influence a stock's price.

- 1) The perceived quality of the company's management
- 2) Historical trends in profitability
- 3) The viability of the industry in which it operates
- 4) The health of the economy as a whole

Moderate

Problems

74. Marjorie Reynolds recently received a bonus at work and has decided to invest it in the stock of either Fabulous Corporation or Terrific Corporation. Following information is provided:

	<u>Fabulous Corp.</u>	<u>Terrific Corp.</u>
Stock price, 1/1/X1	\$98	\$76
Stock price, 12/31/X1	\$103	\$92
Dividend per share during year	\$3	\$0

- a. Determine the value of each share of stock on December 31 as compared with January 1.

Fabulous Corp: $\$103 + \$3 = \$106 \text{ per share}$
Terrific Corp: $\$92 + \$0 = \$92 \text{ per share}$

- b. Determine the annual rate of return on the two stocks.

Fabulous Corp: $(\$106 - \$98)/\$98 = 8.2\%$
Terrific Corp: $(\$92 - \$76)/\$76 = 21.1\%$

- c. Based on only your calculations above, in which stock would you recommend Marjorie invest?

Based on only the annual rate of return, it appears that Terrific Corporation would be the better investment alternative as its rate of return of 21.1% far outpaces the rate of return of Fabulous Corporation at 8.2%.

Moderate

75. Jacqueline Jackson is an investor in Ophelia Corporation. On February 4, 2018, she purchased 1,000 shares of stock at a price of \$15 per share. On June 15, 2018, Ophelia distributed dividends of \$3.00 per share. On December 31, 2018, Ophelia's stock is selling for \$18 per share.

- a) Determine the value of a share of Ophelia's stock on December 31.

$$\text{\$18} + \text{\$3} = \text{\$21 per share}$$

- b) Determine the value of Ms. Jackson's investment on December 31.

$$\text{\$21} \times 1,000 \text{ shares} = \text{\$21,000}$$

Moderate

76. Mark Ballows is an investment advisor at Young and Ballows. He is looking at the value of two stocks and is considering recommending to clients. Information about these two stocks is as follows:

	<u>Parham Corp.</u>	<u>Ontario Corp.</u>
Stock price, 1/1/X1	\$14	\$52
Stock price, 12/31/X1	\$18	\$60
Dividend per share during year	\$.50	\$1.00

- a. Determine the value of each share of stock on December 31 as compared with January 1.

$$\text{Parham Corp.: } \$18 + \$0.5 = \$18.50 \text{ per share}$$

$$\text{Ontario Corp.: } \$60 + \$1 = \$61 \text{ per share}$$

- b. Determine the annual rate of return on the two stocks.

$$\text{Parham Corp.: } (\$18.50 - \$14) / \$14 = 32.1\%$$

$$\text{Ontario Corp.: } (\$61 - \$52) / \$52 = 17.3\%$$

Moderate

Section 3

True/False Questions

77. Potential creditors are interested in the existing amount of debt of a company.
True; Easy
78. Financial data includes information, which can be measured in both monetary and nonmonetary terms.
False; Easy
79. The number of employees of a company is not considered as financial information.
True; Moderate
80. The number of mp3 players in a company's inventory is not financial information, but the fact that they have a value of \$489,000 is considered financial information.
True; Moderate
81. Verbal explanations of financial information are not permitted.
False; Easy
82. Financial data is only beneficial to investors and potential investors.
False; Easy
83. Financial data is measured in monetary terms.
True; Easy
84. The fact that a company has a cash balance of \$456,000 is financial information.
True; Easy
85. Financial information can be accompanied by verbal explanations.
True; Easy

Multiple Choice Questions

86. A company's creditors are those who:
- a. have invested in the company's shares.
 - b. have purchased the company's inventory.
 - c. have lent the company money.
 - d. the company have lent money.
 - e. are eligible to receive dividends declared by the company.
- c; Easy**

87. Hank Dowell is a loan officer at Small Town Bank. He is reviewing Chessney Company for a loan. Which of the following is likely to be the most important in Hank's decision whether to approve the loan for Chessney?
- a. Chessney has paid dividends to stockholders for the past two years
 - b. Chessney's stock price has risen over the past year
 - c. Chessney has sufficient cash flow to pay interest
 - d. Analysts predict that Chessney's stock will continue to rise
 - e. Chessney's board of directors has indicated that the company will pay dividends again this year

c; Moderate

88. Inventory refers to the:
- a. excess amount paid for an asset over its fair value.
 - b. amount of net income reinvested by company for future operations.
 - c. merchandise bought or manufactured for the purpose of selling.
 - d. intangible assets of a business.
 - e. revenue generated from investment.

c; Easy

89. Investors use financial information to predict whether a:
- a. company has invested in buildings.
 - b. company will pay salaries.
 - c. company will recruit more employees.
 - d. company's stock price will increase
 - e. company's bond price will increase.

d; Easy

90. Creditors use financial information to predict whether a:
- a. company will be able to pay dividends.
 - b. company will be able to pay interest.
 - c. company will be able to pay salaries.
 - d. company will be able to issue additional shares..
 - e. company's stock price will increase.

b; Easy

91. Which of the following would be considered as financial information reported by a corporation?
- a. Buildings – \$4,800,000
 - b. Goods sold last year – 5,000 units
 - c. Investment – 500 shares of Coco Cola Inc.
 - d. Number of employees – 800
 - e. Production rate – 5 units per hour

a; Easy

92. Financial information reported by an organization consists of data that can be:
- a. explained verbally.
 - b. explained in quantifiable terms.
 - c. measured in monetary terms.
 - d. measured in numerical terms.
 - e. measured in percentage.

c; Easy

93. Which of the following would be considered as verbal explanation for Bullox Corporation?

- a. Bullox has buildings worth \$4,800,000
- b. Bullox had sales last year of \$15,699,000
- c. Bullox owes James River Bank \$800,000
- d. Bullox owns 7,000 acres of land
- e. Bullox pays its employees \$490,000

d; Easy

94. Saturn Corporation is facing a lawsuit for copyright infringement. The case is filed by Dealin Corporation. Determine which of the following estimates will be reported as financial information by Saturn Corporation.

- a. The market price of Saturn Corporation will drop in the current fiscal year.
- b. The case is expected to resolve in 2 years.
- c. The case is expected to be in favor of Dealin Corporation.
- d. The loss on lawsuit is expected to be \$20,000.
- e. The company is expecting a 5% drop in sale after the lawsuit is resolved.

d; Moderate

95. Which of the following statements provide rationale for investor's preference to invest in capital stock rather than other forms of investment like real estate?

- a. The rate of return is fixed in capital market.
- b. The capital stock market is liquid.
- c. The price of capital stock is not as volatile as prices of real estate.
- d. The capital stocks generally provide a smaller rate of return than real estate.
- e. The price of capital stock is not affected by changes in the taxation policy.

b; Moderate

Fill in the blanks

96. _____ explanations are included with financial information to clarify information.
Verbal; Easy

Short Answer Questions

97. Discuss how the assessment of a company's financial information by a potential stockholder would differ from the assessment of a potential creditor.

Potential stockholders are primarily interested in assessing 1) the likelihood of company's stock price rise in the future and 2) the amount of cash dividends the company is likely to pay in the future. Potential creditors are more interested in the whether or not the company has sufficient cash flows to meet principle and interest payments.

Moderate

98. Name at least three potential users of a company's financial information and briefly explain how each user might use the information.

Choose three:

- 1) Investors predict the fluctuations in stock price of a company and the amount of dividends it may pay in the future.
- 2) Creditors are interested in how much debt a company already has and whether it has sufficient cash flows to meet principle and interest obligations.
- 3) Current employees are interested in whether their employer will remain in business and how much will be available for pay hikes and bonuses.
- 4) Prospective employees would want to see the likelihood of a company to remain in business.
- 5) Suppliers and others extending credit are interested in how much a company currently owes and the likelihood they will be paid.

Easy

99. Explain why verbal explanations are included with financial information.

Verbal explanations are included to clarify or expand on the monetary information presented. For example, the potential loss on a lawsuit might be included in the financial statements. A verbal explanation about the lawsuit could be included to provide more information to users.

Easy

Problems

100. Mark each of the following with an (F) to indicate if it is financial information or an (N) to indicate if it is non-financial information.

- a. _____ Building worth \$5,000,000
- b. _____ Number of employees = 900
- c. _____ Inventory balance of \$30,000
- d. _____ Number of shares of stock = 840
- e. _____ 11 locations around the city

- a. F
- b. N
- c. F
- d. N
- e. N

Easy

101. Mark each of the following with an (F) to indicate if it is financial information or an (N) to indicate if it is non-financial information.

- a. _____ 3,000 vehicles in stock
- b. _____ 500 locations across the country
- c. _____ Cash balance of \$560
- d. _____ Owes \$450,000 to the bank
- e. _____ Salaries for last year = \$2,300,000

- a. N
- b. N
- c. F
- d. F
- e. F

Easy

C1hapter 2

What Should Decision Makers Know in Order to Make Good Decisions about an Organization?

Section 1

True/False Questions

1. Financial accounting can be compared to a portrait.
True; Easy
2. Financial statements provide the form and structure for the conveyance of financial information that will create a likeness of the reporting organization.
True; Moderate
3. The information reported in financial statements must be exact for an investor to make any decision.
False; Easy
4. Investors and creditors do not need absolute accurate information to make decisions on a company.
True; Easy
5. Financial information should be free of material misstatements
True; Easy
6. A misstatement is deemed to be material if its presence impacts a decision.
True; Moderate
7. Errors and frauds are the two types of misstatements.
True; Easy
8. No material misstatements are allowed if financial statements are to be called fairly presented.
True; Moderate
9. Materiality is relative to the size of an organization.
True; Moderate
10. Fraud includes intent to deceive and is more troublesome to decision makers than a mere error.
True; Easy
11. Size is the only consideration in determining whether a misstatement will have an impact on a decision maker's actions or not.

False; Hard

12. Material misstatements prevent financial information from being fairly presented.

True; Moderate

Multiple Choice Questions

13. Which of the following is true of financial statements?

- a. Financial statements are distributed only to the employees of a company.
- b. Financial statements are limited to a representation of a company's operation.
- c. Financial statements will create a likeness of the reporting organization.
- d. Financial statements provide employee details.
- e. Financial statements are exactly accurate.

c; Easy

14. Which of the following is a factor pertaining to knowledge of information that will affect a decision made by a user from that information?

- a. Materiality
- b. Representation faithfulness
- c. Error
- d. Misstatement
- e. Fraud

a; Moderate

15. Financial statements are a representation of an organization's:

- a. frauds.
- b. operations.
- c. competitors.
- d. threats.
- e. work union.

b, Moderate

16. Which of the following are the two types of misstatements?

- a. Materiality and fraud
- b. Fraud and errors
- c. Errors and mismatch
- d. Materiality and errors
- e. Fraud and issues

b; Moderate

17. Which of the following is an intentional misstatement?
- a. Error
 - b. Mistake
 - c. Representational faithfulness
 - d. Fraud
 - e. Materiality
- d; Easy**
18. Which of the following is an accidental misstatement?
- a. Error
 - b. Materiality
 - c. Representational faithfulness
 - d. Irrelevance
 - e. Fraud
- a; Easy**
19. Which of the following factors is considered in judging if the misstatements are material?
- a. People responsible for the misstatement
 - b. Profits made by the company
 - c. Number of employees in the company
 - d. Size and cause of the misstatement
 - e. Competitor's profits
- d; Moderate**
20. Financial information is not fairly presented if it contains:
- a. verbal explanations
 - b. intangible assets.
 - c. material misstatement.
 - d. contingent liability.
 - e. assumptions.
- c; Easy**
21. Which of the following is true of misstatement?
- a. A misstatement is of two types: inconsistency and inaccuracy.
 - b. Misstatement always leads to liquidation of a company.
 - c. Only the cause should be weighed in considering whether the misstatement is material or not.
 - d. A misstatement is deemed to be material if it is so significant that its presence would impact a decision made by an interested party
 - e. Financial information is said to be fairly presented, even though material misstatement exists.
- d; Moderate**
22. The communication of an appropriate picture of an organization, which can serve as the basis for appropriate decisions is termed as:

- a. representational faithfulness.
- b. material misstatement.
- c. conservatism.
- d. principle of prudence.
- e. certainty.

a; Easy

23. An error (made accidentally) or fraud (done intentionally) where reported figures or words actually differ from the underlying reality is called a(n):

- a. inconsistency.
- b. insincerity.
- c. misstatement.
- d. uncertainty.
- e. materiality.

c; Easy

24. Which of the following statements is true of financial information?

- a. It should always be exactly accurate.
- b. It does not represent the likeliness of an organization, if it is not exact.
- c. It is free from uncertainties.
- d. It can be useful even if it is not exact.
- e. It almost always does contains material misstatements.

d; Moderate

25. Financial information that contains no material misstatements in accordance with an accepted standard for financial reporting is termed as:

- a. free from uncertainty.
- b. fairly presented .
- c. fraudulent reporting.
- d. universal reporting.
- e. inconsistent.

b; Easy

26. Quantitative reports and related verbal disclosures that convey monetary information as a basis for representing its financial health and future prospects are called:

- a. misstatements.
- b. supplemental statements.
- c. financial statements.
- d. statement of notes and disclosures.
- e. annexures.

c; Easy

27. A company constructs a building and reports the cost of construction at \$400 million. Which of the following is a true statement?
- a. The company cannot spend more than \$400 million on the building.
 - b. The accountant would never let the amount of \$400 million be reported if it were not right down to the penny.
 - c. Reporting \$400 million in the financial statement will lead to material misstatement.
 - d. To be fairly presented, the true cost of the building cannot be materially different from \$400 million.
 - e. Investors will expect that \$400 million was the exact cost of the building.
- d; Moderate**

Fill In the Blanks

28. Financial information reported to decision makers should not contain _____.
misstatements.
material; Easy
29. The two types of misstatements are _____ and _____.
errors and fraud; Easy
30. A misstatement is _____ if its presence would impact a decision made by an interested party.
material; Moderate
31. The two factors that influence the materiality of a misstatement are the _____ and the _____ of the misstatement.
size, cause; Easy

Short Answer Questions

32. Explain the difference between a material and a non-material misstatement.
- A misstatement is material if a decision maker would make a different decision if the correct information had been reported. A non-material misstatement will not cause the user to make a different decision than if the correct information had been reported.**
Easy
33. Explain how financial accounting is like painting a portrait.
- The purpose of a portrait is to capture a person's likeness; the purpose of financial accounting is to capture the likeness of an organization that can help decision makers. Just as portraits are not a perfect copy of a person, financial accounting does not purport to be exact.**
Easy

34. Name the two types of misstatements and explain how they differ.

The two types of misstatements are errors and fraud. Errors are made accidentally, while fraud is done intentionally.

Easy

35. Explain why decision makers do not expect financial information to be exact.

Exactness with financial information is rarely possible. Users understand this. As long as no material misstatements exist, users can rely on the financial information to help them make decisions.

Moderate

Section 2

True/False Questions

36. Many of the events encountered everyday by an organization contains some degree of uncertainty.

True; Easy

37. Salary Expense to be paid by a company would be an example of an uncertainty faced by a company.

False; Easy

38. Accounting is the language of business.

True; Easy

39. Effective communication requires set terminology and, structural rules and principles.

True; Moderate

40. Financial accounting has its own terminology.

True; Easy

41. It is important for non-accountants to understand the terminology of accounting if they wish to make financial decisions about a company.

True; Easy

Multiple Choice Questions

- 42.** Which of the following is an example of an uncertainty faced by an organization?
- a. Monthly rent expense paid on office building
 - b. Cash balance reported on a bank statement
 - c. Annual salary paid to an employee
 - d. Current cash balance reported on a company's financial statement
 - e. Cash bonus to be paid to employees based on company's stock price
- e; Easy**
- 43.** Which of the following statements is true of financial accounting?
- a. Exactness is the goal of financial accounting.
 - b. Financial accounting information is free from uncertainties.
 - c. Accounting is referred to as the "language of business".
 - d. Financial accounting doesn't have its own set of terminology, making it difficult to interpret financial information.
 - e. Financial accounting is limited to access the future prospects of an organization.
- c; Easy**
- 44.** Which of the following is a requirement for successful communication of financial information?
- a. Presence of exact numbers
 - b. Nonexistence of uncertainties
 - c. The structural rules must be understood by all parties involved.
 - d. Receiver being a close-minded
 - e. Nonexistence of defined set of terminology
- c; Easy**
- 45.** As accounting is a business language, which of the following guides the reporting process so that the resulting accounting information will be fairly presented and readily understood by all interested parties?
- a. Guidance document attached to financial statements
 - b. Grammar rules
 - c. Syntax and punctuation
 - d. Structural rules and principles
 - e. Decision-making process
- d; Moderate**

46. Which of the following is one of the major challenges faced by an accountant?
- a. Deciding which accounting standard to follow
 - b. Determining if a transaction is affecting asset, liability, revenue or expense
 - c. Setting structural rules and principles for reporting
 - d. Reporting events in the face of uncertainty
 - e. Developing terminologies for financial accounting
- d; Easy**
47. Accounting is sometimes referred to as the language of business because:
- a. it overstates profit and understates loss made by the company.
 - b. it give the details of employees working in a company.
 - c. it communicates a portrait of financial health of an organization.
 - d. it has less terminologies.
 - e. it uses generally accepted accounting standards.
- c; Easy**

Fill In the Blanks

48. _____ is sometimes referred to as the language of business.
Accounting; Easy
49. Almost every Organization faces _____ like lawsuits when presenting financial information.
uncertainties; Easy

Short Answer Questions

50. Explain how accounting is like a language.

Accounting is the language that allows organizations to communicate their financial health and future prospects to decision makers using words and numbers. Like other languages, accounting has a set terminology and structural rules and principles, which allow for effective communication.
Easy

51. Explain how knowledge of the language of accounting will benefit a non-accountant.

Financial accounting conveys information, which helps users make decisions about the financial health of an organization. Those who evaluate loan applications, buy capital stock, grant credit, make employment decisions, and provide investment advice need to speak the language of accounting just as accountants do. The more such individuals know about financial accounting terminology, rules, and principles, the more likely it is that they will arrive at appropriate decisions.

Easy

52. Name three uncertainties faced by businesses trying to present their financial information.

Uncertainties faced by organization are:

- 1) Lawsuits**
- 2) Sales of merchandise on credit**
- 3) Promises to pay employee bonus based on future earnings**

Easy

Section 3

True/False Questions

53. If both the accountant and the decision maker understand U.S. GAAP, financial statements should be conveyed successfully.

True; Easy

54. Accounting principles evolve quickly as the nature of business changes and new reporting issues, problems, and resolutions arise.

True; Easy

55. U.S. companies grow and prosper by convincing investors and creditors to contribute money to them.

True; Moderate

56. Investors and creditors want to assess the risks and rewards before providing financing for a company.

True; Easy

57. U.S. GAAP is primarily created by the Securities and Exchange Commission.

False; Moderate

58. A change in U.S. GAAP can take years, as changes are never made without proper consideration.

True; Easy

59. The FASB is the only creator of U.S. GAAP.

False; Easy

60. The United States has not yet adopted IFRS for financial reporting.

True; Moderate

61. IFRS is more rules based, while U.S. GAAP is more principles based.

False; Hard

Multiple Choice Questions

62. GAAP stands for:

- a. Generally Accepted Accounting Principles.
- b. Generally Applied Accounting Principles.
- c. Generally Accepted Accounting Procedures.
- d. Governmentally Applied Accounting Procedures.
- e. Governmentally Accepted Accounting Procedures.

a; Easy

63. The FASB stands for:

- a. Federal Accounting Standards Board.
- b. Foreign Average Standards Business.
- c. Federal Accounting Securities Business.
- d. Financial Accounting Securities Board.
- e. Financial Accounting Standards Board.

e; Easy

64. The group primarily responsible for setting accounting standards in the United States is the:

- a. American Institute of Certified Public Accountants (AICPA)
- b. Securities and Exchange Commission (SEC)
- c. Standing Interpretations Committee (SIC)
- d. International Accounting Standards Board (IASB)
- e. Financial Accounting Standards Board (FASB)

e; Easy

65. Which of the following is true of U.S. GAAP?
- a. U.S. GAAP is principles-based set of standards. .
 - b. U.S. GAAP is primarily created by the International Accounting Standards Board.
 - c. U.S. GAAP is currently not used by any countries in U.S.
 - d. A company in Georgia and a company in Virginia are both subject to the rules of U.S. GAAP.
 - e. U.S. GAAP has been in existence since World War I.

d; Moderate

66. International Financial Reporting Standards (IFRS) are produced by the:
- a. Standing Interpretations Committee (SIC).
 - b. International Accounting Standards Board (IASB).
 - c. Financial Accounting Standards Board (FASB).
 - d. Securities and Exchange Commission (SEC).
 - e. Public Company Accounting Oversight Board (PCAOB).

b; Easy

67. Which of the following is true of IFRS?
- a. IFRS are applied to most of financial information presented within the United States.
 - b. IFRS is rules-based set of standards.
 - c. The Financial Accounting Standards Board (FASB) has held the authority to develop IFRS since 1973.
 - d. IFRS is more based on principles.
 - e. IFRS is entirely different from standards set by U.S. GAAP.

d; Moderate

68. A few companies in the U.S. do not favor switching financial reporting from U.S. GAAP to IFRS. Which of the following is a possible reason for this?
- a. The switching will cost the companies lot of money.
 - b. Switching would make it difficult to raise capital around the world.
 - c. IFRS allows the preparers of financial information more judgment in applying general rules, which leads to inconsistency.
 - d. IFRS are very rules-based set of standards that is difficult to navigate.
 - e. Consolidated bookkeeping is a very complex task.

a; Moderate

69. Which of the following is an importance of accounting standards?
- a. It helps in making financial reporting free from uncertainties.
 - b. It helps in projecting a loss-incurring company as a profit-making company..
 - c. It helps in evaluating the financial health and future prospects of an organization.
 - d. It helps in reporting the financial information with exactness.
 - e. It helps in covering the material misstatements made unintentionally.

c; Easy

70. The Financial Accounting Standards Board (FASB) is:
- a. a governmental organization.
 - b. in charge of the creation of IFRS.
 - c. an independent group supported by the U.S. government, various accounting organizations, and many private businesses.
 - d. responsible for amending present accounting rules, but doesn't have the right to pass new rules.
 - e. against the switching of financial reporting from U.S GAAP to IFRS in United States.

c; Moderate

71. Which of the following statement is true of U.S. GAAP?
- a. The IASB issues U.S. GAAP.
 - b. Investors and creditors would be just as likely to contribute money to companies even if U.S. GAAP did not exist.
 - c. U.S. GAAP can also be called as International Financial Reporting Standards.
 - d. Without U.S. GAAP, investors and creditors would encounter significant difficulties in evaluating the financial health and future prospects of an organization.
 - e. U.S. GAAP has limited the development and expansion of thousands of businesses.

d; Easy

72. Which of the following is a true statement?
- a. U.S. GAAP enables decision makers to obtain information needed to reduce the risk of investment.
 - b. The Financial Accounting Standards Board (FASB) has held the authority to develop IFRS since 1973.
 - c. IFRS is used only by the countries with capitalist economy.
 - d. Changes to U.S. GAAP are made without proper changes.
 - e. U.S. GAAP is used only by governmental organizations.

a; Easy

73. IFRS is more principles based, whereas, U.S. GAAP is more:
- a. ethics based.
 - b. rules based.
 - c. codes based.
 - d. ideologies based.
 - e. philosophies based.

b; Easy

Fill In the Blanks

74. The _____ is primarily responsible for creating U.S. GAAP.
FASB; Easy
75. _____ allows businesses in Oregon and Mississippi to account for financial information in the same manner.
U.S. GAAP; Easy
76. To grow, U.S. companies must convince _____ and _____ to contribute money voluntarily.
creditors and investors; Easy
77. There continues to be conversation regarding the United States considering switching from U.S. GAAP to _____.
IFRS; Moderate

Short Answer Questions

78. Explain the role of the Financial Accounting Standards Board.

The Financial Accounting Standards Board is an independent body that has been tasked with creating accounting standards for businesses in the United States. It has been in existence since 1973. When an accounting issue arises about which companies need guidance, FASB steps in to study the issues and alternatives. After a period of study, the board might pass new rules or make amendments to previous ones. FASB is methodical in its deliberations and the entire process can take years. Changes to U.S. GAAP are never made without proper consideration.
Moderate

79. Explain the importance of U.S. GAAP to businesses in the United States.

Businesses in the United States must convince outside investors and creditors to invest or loan them money if they wish to operate and grow. Obviously, this entails risk on the part of the investor or creditor. Decision makers must believe that they are using reliable data to make reasonable estimations of future stock prices, cash dividends, and cash flows. Without rules for financial reporting, this analysis would be difficult, if not impossible. U.S. GAAP enables outside parties to obtain the financial information they need to reduce their perceived risk to acceptable levels. It provides rules for financial reporting. If investors and creditors understand these rules, they can analyze a company's financial statements to help them determine whether they should invest in a particular company or not. The U.S. economy would not be what it is today without GAAP.
Moderate

Section 4

True/False Questions

80. An asset is a probable future economic benefit owned or controlled by an organization.
True; Easy
81. Inventory is an example of an asset.
True; Easy
82. Liabilities are amounts contributed by owners.
False; Moderate
83. Notes due to banks are an example of a liability.
True; Easy
84. A retained earnings is an example of an asset.
False; Easy
85. Sale of office building by a textile manufacturing company is considered as revenue.
False; Easy
86. Revenue is a measure of the financial impact on an organization that results from a sale.
True; Easy
87. The balance of total net assets is also known as equity.
True; Moderate
88. An expense is an inflow of net assets.
False; Easy
89. Salaries paid to employees are an example of an expense.
True; Easy

Multiple Choice Questions

90. Probable future sacrifice of economic benefits arising from present obligations is termed as a(n):
- a. revenue.
 - b. expense.
 - c. net asset.
 - d. asset.
 - e. liability.
- e; Easy**

- 91.** Which of the following is true of revenue?
- a. It is a probable future economic benefit owned or controlled by an organization.
 - b. Unearned revenue and investments are examples of revenue.
 - c. It is the lifeblood of any organization.
 - d. It reflects decrease in net assets.
 - e. It is opposite of liability.
- c; Easy**
- 92.** Which of the following is true of an expense?
- a. It is a probable future sacrifice of economic benefits arising from present obligation.
 - b. Note payable and outstanding expenses are examples of expense.
 - c. It reflects decrease in net assets.
 - d. It is incurred in hopes of generating assets.
 - e. It is the lifeblood of any organization.
- c; Easy**
- 93.** Unearned revenue and outstanding expense are examples of a(n):
- a. asset.
 - b. liability.
 - c. revenue.
 - d. expense.
 - e. Owners' equity.
- b; Easy**
- 94.** Which of the following is an example of an expense?
- a. Building
 - b. Debt
 - c. Salaries
 - d. Sales
 - e. Cash
- c; Easy**
- 95.** Which of the following is an example of an asset?
- a. Note payable
 - b. Inventory
 - c. Sales
 - d. Retained earnings
 - e. Unearned revenue
- b; Easy**

96. Sales is an example of a(n):

- a. revenue.
- b. asset.
- c. expense.
- d. misstatement.
- e. liability.

a; Easy

97. Equipment is an example of a(n):

- a. liability.
- b. expense.
- c. error.
- d. revenue.
- e. asset.

e; Easy

98. Net asset is calculated by subtracting:

- a. current liabilities from current assets.
- b. total liabilities from total assets.
- c. current assets from current liabilities.
- d. current assets from total assets.
- e. expenses from revenue.

b; Easy

99. Vistas Wind Systems pays salaries to its employees at the end of each month. At the end of February, the company paid \$3,000 towards salaries expenses. Out of \$3,000, \$1,200 is for the month of February and \$1,800 is for the month of March. Which of the following statements is true?

- a. \$3,000 will be reported as expense for the month.
- b. \$1,800 will be reported as expense for the month.
- c. \$3,000 will be reported as asset for the month.
- d. \$1,200 will be reported as expense and \$1,800 will be reported as asset for the month.
- e. \$1800 will be reported as expense and \$1,200 will be reported as a liability for the month.

d; Hard

100. In Year One, Double Design Corporation purchased equipment costing \$5,000 for cash. Which of the following statements is true of this transaction?

- a. The company will report an expense of \$5,000.
- b. The company's net asset will increase by \$5,000.
- c. The company's net asset would have decreased had the equipment been purchased on account.
- d. The company will report a liability of \$5,000.
- e. The company's net asset will not change because of this transaction.

e; Moderate

101. Roberto's Autos sells used cars and trucks. Roberto pays a monthly rental for the building in which his salespeople operate. The company owns the land on which the cars and building sit. Roberto makes most of his sales on credit. Last month, sales amounted to \$45,000. Roberto pays salaries to his employees and pays to advertise his business. Which of the following is an asset owned by Roberto?

- a. Tax paid on land
- b. Advertising
- c. Rent expense
- d. Credit sales
- e. Amounts owed by customers

e; Easy

102. Haley's Hair Salon specializes in cuts and color for all hair types. Haley also sells beauty products. Last week, Haley borrowed \$10,000 from the bank to buy new equipment for the salon. Which of the following is a true statement?

- a. If Haley sells the equipment, the amount realized from the sale will be reported as revenue.
- b. The amount borrowed from bank will increase the amount of owners' equity.
- c. The \$10,000 received from the bank is revenue for Haley.
- d. The beauty products Haley has in stock are an expense to her.
- e. Haley earns revenue by cutting hair.

e; Moderate

Fill in the blanks

103. A(n) _____ is an amount owed to another party.

liability; Easy

104. A(n) _____ is a decrease in net assets to generate revenue.

expense; Easy

105. A(n) _____ is a future economic benefit owned or controlled by a company.

asset; Easy

Short Answer Questions

106. Fill in each of the following with a (A) if it is an asset, a (L) if it is a liability, a (R) if it is revenue, and a (E) if it is an expense.

- a. Building__ **A**__
- b. Bank note__ **L**__
- c. Sale of services__ **R**__
- d. Equipment__ **A**__
- e. Insurance expense__ **E**__
- f. Cash__ **A**__
- g. Inventory__ **A**__
- h. Sale of goods__ **R**__

Moderate

107. Explain the terms asset, liability, revenue, and expense.

Asset: A probable future economic benefit owned or controlled by the reporting company, such as inventory, land, or equipment.

Liability: A probable future economic sacrifice or, in simple terms, a debt.

Revenue: A measure of the inflow or increase in net assets generated by the sales made by a business. It is a reflection of the amounts brought in by the sales process during a specified period of time.

Expense: A measure of the outflow or reduction in net assets caused by a business's attempt to generate revenue.

Easy

108. Give two examples for each of the following: asset, liability, revenue, expenses.

Asset: Cash and Building

Liability: Note Payable and Outstanding expenses

Revenue: Sale of goods and sale of services

Expense: Rent expense and Salary expense

Easy

1Chapter 3

How is Financial Information Delivered to Decision Makers Such as Investors and Creditors?

Section 1

True/False Questions

1. Financial statements provide a formal structure for conveying financial information to decision makers.
True; Easy
2. Financial statements can be issued only once a year.
False; Easy
3. The statement of cash flows is one of the financial statements produced by companies.
True; Easy
4. The statement of assets is one of the financial statements produced by companies.
False; Easy
5. Dividends paid are reported on the income statement.
False; Moderate
6. A gain is an increase in net assets created by an occurrence central to an organization's activities.
False; Easy
7. If a clothing store sells equipment for an amount less than its carrying value on the date of sale, the store should report a loss on sale rather than an expense.
True; Easy
8. A realtor sells a piece of land for an amount more than its original cost. The realtor should report this as a gain rather than revenue.
False; Moderate
9. On June 1, Ronald purchased inventory worth \$2,000 on account from Kelly Corporation. On June 12, the company sold the entire inventory for \$3,500. On June 22, Ronald paid Kelly the total amount due. The cost of goods sold expense for this sale should be recognized on June 22
False; Easy
10. Gross profit is the difference between a company's revenues and total expenses.
False; Easy

11. Income tax expenses are expected to help an organization in generating additional revenue in the future.

False; Easy

12. Tax expense is typically shown at the bottom of the income statement.

True; Easy

13. Max Book Store buys inventory and a piece of land. When the company sells both, on the income statement, it will report cost of goods sold in connection with the inventory but not in connection with the land.

True; Moderate

Multiple Choice Questions

14. Which of the following is a financial statement produced by companies?

- a. Assessment sheet
- b. Statement of cash flows
- c. Statement of gross Income
- d. Expense statement
- e. Tax statement

b; Easy

15. Which of the following statements is also called the statement of financial position?

- a. Income statement
- b. Statement of retained earnings
- c. Balance sheet
- d. Statement of cash flows
- e. Profitability statement

c; Easy

16. Which of the following is an account found on the income statement?

- a. Dividends Paid
- b. Gains
- c. Equipment
- d. Retained Earnings
- e. Goodwill

b; Easy

17. Cost of sales refers to the cost of the merchandise that:

- a. company purchased during the period.
- b. customers returned during the period.
- c. company have at the end of the period.
- d. customers purchased during the period.
- e. company have at the beginning of the period.

d; Easy

18. The difference between a company's sales and cost of goods sold is referred to as the:
- a. gross profit.
 - b. net income.
 - c. retained earnings.
 - d. gain on sale.
 - e. operating profit.

a; Easy

19. A company's gross profit percentage is its gross profit divided by its:
- a. net sales.
 - b. cost of goods sold.
 - c. net income.
 - d. total expenses.
 - e. total assets.

a; Easy

20. Shields Corporation purchases 5 flashlights for \$5 each and sells them to customers for \$9 each. What is Shield's total gross profit?

- a. \$4
- b. \$20
- c. \$25
- d. \$45
- e. \$5

b; Moderate

21. A gain created by an occurrence that is outside a company's primary or central operations is reported on the:

- a. income statement.
- b. statement of retained earnings.
- c. balance sheet.
- d. statement of working capital.
- e. cost sheet.

a; Easy

22. Which of the following financial statements classify business activities into operating, investing, and financing activities?

- a. Income statement
- b. Trial balance
- c. Balance sheet
- d. Statement of cash flows
- e. Profitability statement

d; Easy

23. Traylor Beauty Supply is in the business of selling hair care and other beauty products. It recently sold an old piece of equipment to Shaw Company for an amount more than what it had originally paid. Traylor should record a(an) _____ on the sale of the equipment.

- a. revenue
 - b. expense
 - c. gain
 - d. loss
 - e. gross profit
- c; Moderate**

24. Jenkins Corporation made sales of \$900 during the month of October. Cost of goods sold for the month was \$540. What was Jenkins gross profit percentage for the month?
- a. 40%
 - b. 45%
 - c. 50%
 - d. 55%
 - e. 60%
- a; Moderate**

25. Robin Company reported cost of goods sold of \$12,000 for the year. If the markup percentage was 25 percent, what was the revenue for the year? Assume a tax rate of 10 percent.
- a. \$9,600
 - b. \$10,000
 - c. \$14,400
 - d. \$16,000
 - e. \$18,500
- d; Moderate**

26. Elenor Corporation sold goods that originally cost \$605,000 for \$1,100,000. What is Elenor's gross profit?
- a. \$605,000
 - b. \$1,100,00
 - c. \$495,000
 - d. \$1,705,000
 - e. \$-0-
- c; Easy**

27. For the year 20X1, Thompson, Inc. reported cost of goods sold of \$2,300. Revenue during the same period was \$4,200. Thompson's accountant mistakenly recorded cost of goods sold as \$3,200 instead of \$2,300. Which of the following statements is true?
- a. Thompson's gross profit would be overstated.
 - b. Thompson's net income would be understated.
 - c. Thompson's retained earnings would be overstated.
 - d. Thompson's reported expenses would be understated.
 - e. Thompson's revenues would be understated.
- b; Hard**

28. On which financial statement should income tax expense be reported?

- a. Statement of cash flows
 - b. Balance sheet
 - c. Statement of retained earnings
 - d. Income statement
 - e. Statement of working capital
- d; Easy**

29. Which of the following statements is true of income tax expense?

- a. It is reported at the top of income statement.
- b. It is reported in the statement of retained earnings.
- c. It is incurred to generate revenue.
- d. It is recognized only on payment of cash.
- e. It is caused by a company's revenues.

e; Moderate

Fill In the Blanks

30. Revenues, expenses, gains and _____ are found on the income statement.

losses; Easy

31. _____ is an expense that reflects the cost of all inventory items acquired by customers.

Cost of goods sold; Easy

32. A _____ is a decrease in net assets from an event incidental to the company's business.

loss; Moderate

33. A _____ is an increase in net assets from an event incidental to the company's business.

gain; Moderate

Short Answer Questions

34. Compare and contrast revenue and gain.

Both revenues and gains are an increase in the net assets for a company. The difference is in the manner in which they are earned. Revenue results from a sale of inventory or service—an event central to the organization's operations. Gain results from an event which is incidental to the company's operations.

Moderate

Problems

35. Determine the missing balance.

Gross Profit	\$45,600
Sales	99,000
Advertising Expense	6,700

Rent Expense	9,800
Cost of Goods Sold	?

\$53,400;
Moderate

36. Determine the missing balance.

Insurance Expense	\$ 340,000
Rent Expense	970,000
Sales	?
Net Income	270,000
Cost of Goods Sold	1,900,000

\$3,480,000;
Moderate

37. Adonis, Inc. sells exercise equipment. The owners of Adonis want to know if they made a net income or a net loss for the year ended December 31, 20X1. Given the following account balances, prepare an income statement for this company.

Sales Revenue	\$6,100
Salaries Expense	500
Cost of Goods Sold	3,200
Income Tax Expense	600
Loss on Sale of Building	100
Advertising Expense	590

Adonis, Inc. Income Statement for Year Ended December 31, 20X1

Sales Revenue	\$6,100
Expenses:	
Cost of Goods Sold	\$3,200
Salaries	500
Advertising Expense	590
Total Expenses	(4,290)
Operating income	1,810
Other Gains And Losses:	
Loss on Sale of Building	(100)
Income Before Income Taxes	1,710
Income Tax Expense	(600)
Net Income	\$1,110

Moderate

38. Coffee Break, Inc. sells premium coffee beans.

- Given the following account balances, prepare an income statement for Coffee Bean, Inc. for the year ended December 31, 20X1.

Cost of Goods Sold	\$290,200
Income Tax Expense	59,300
Rent Expense	89,000
Gain on Sale of Land	2,000
Sales Revenue	710,100
Insurance Expense	12,000
Salaries Expense	123,200

Coffee Bean, Inc. Income Statement for Year Ended December 31, 20X1

Sales Revenue	\$710,100
Expenses:	
Cost of Goods Sold	\$290,200
Salaries	123,200
Rent	89,000
Insurance	12,000
Total Expenses	(514,400)
Operating Income	195,700
Other Gains and Losses:	
Gain on Sale of Land	2,000
Income Before Income Taxes	197,700
Income Tax Expense	(59,300)
Net Income	\$138,400

2. Calculate the gross profit for Coffee Bean, Inc.

Gross Profit = Sales Revenue – Cost of Goods Sold

Gross Profit = \$710,100 – \$290,200

Gross Profit = \$419,900

3. Calculate the gross profit percentage for Coffee Bean, Inc.

Gross Profit Percentage = $\frac{\text{Gross Profit}}{\text{Sales Revenue}}$

Gross Profit Percentage = $\frac{\$419,900}{\$710,100}$

Gross Profit Percentage = 59%
Hard

Section 2

True/False Questions

39. A cost that has already helped a company generate revenues in the past should be classified as an expense.
True; Easy
40. Conservatism exists to protect the users of financial statements from information that is too optimistic.
True; Easy
41. Dividends paid are reported on the income statement.
False; Easy
42. Dividends paid are distributions of income made to owners.
True; Easy
43. Dividends payments usually reduce the size of the company and—possibly—its future profitability.
True; Easy
44. An investor can predict stock prices by just evaluating the net income reported by the corporation.
False; Easy
45. Conservatism holds that whenever an accountant faces two or more equally likely possibilities, the one that makes the reporting company look worse should be selected.

True; Easy

46. Reporting a past benefit rather than a future benefit has a detrimental impact on the company's appearance to a decision maker.

True; Easy

Multiple Choice Questions

47. Which of the following states that if a company faces two equally likely possibilities, the one which makes the company look worse should be chosen?

- a. Matching principle
- b. Practice of conservatism
- c. Materiality convention
- d. Principle of consistency
- e. Principle of continuity

b; Easy

48. Which of the following best represents the practice of conservatism?

- a. A company's accountants try to make sure that its expenses are reported in the same period as the revenues they helped generate.
- b. A company needs a loan, so it makes accounting choices that allow the company to look as good as possible.
- c. An accountant is unsure if a cost should be reported as an expense or an asset. Even though it is most likely an asset, the accountant reports it as an expense.
- d. An accountant purposefully understates a company's revenues to make the company's financial position look worse.
- e. A company is faced with a cost that could be reported as an expense or an asset. Both choices face equally likely possibilities, so the company reports the cost as an expense.

e; Moderate

49. The practice of conservatism while preparing financial statements usually results in:

- a. lower net income.
- b. lower expense.
- c. higher dividends.
- d. higher stockholders' equity.
- e. lower liabilities.

a; Easy

50. Which of the following is reported on the income statement?

- a. Dividends Paid
- b. Salaries Expense
- c. Prepaid Insurance
- d. Supplies
- e. Bank Overdraft

b; Easy

51. Which of the following is reported as an asset?

- a. Insurance expense paid for next year
- b. Income tax paid for the current year
- c. Salaries paid for the current year
- d. Dividends paid during the year
- e. Rent paid for last year

a; Easy

52. A cost which is expected to help in generation of additional revenue in the future is classified as a(an):

- a. expense.
- b. asset.
- c. liability.
- d. retained earnings.
- e. gain.

b; Easy

53. A company makes cash payment for ads which will run over the next three months. The amount paid for advertising should be reported as a(an):

- a. expense.
- b. dividend.
- c. loss.
- d. asset.
- e. liability.

d; Easy

54. A dividend is a reward paid by a corporation to:

- a. its creditors.
- b. the government.
- c. its board of directors.
- d. the owners of its capital stock.
- e. the suppliers of its inventory.

d; Easy

55. Which of the following statements is true of dividends paid?

- a. It is paid by a corporation to its creditors.
- b. It is a cost incurred to generate revenue.
- c. It is reported on the income statement.
- d. It increases the size of the company.
- e. It decreases the retained earnings balance.

e; Easy

56. Which of the following statements is true of net income?

- a. It reflects the growth in an organization's net assets during a period resulting from all revenues, expenses, gains, and losses.
- b. It represents the total dividend distributed to the shareholder's, both in the form of cash and stock.
- c. It is also known as income before income tax.
- d. It is equal to the total amount of cash received less total cash payments made during a period.
- e. It is used to determine the amount of interest to be paid during a period.

a; Easy

Fill In the Blanks

57. _____ are not included in the computation of net income because they reflect a sharing of profits with owners and not a cost incurred to generate revenue.

Dividends paid; Easy

58. _____ is a cost that helped a business generate revenue in the past.

Expense; Easy

Short Answer Questions

59. Explain why accounting adheres to the principle of conservatism.

Accountants know that the financial statements they produce will be relied on by decision makers, especially for monetary decisions. These decision makers face potential losses that can be substantial. Thus, accountants believe that decision makers are best protected by reporting the least optimistic financial picture of a company rather than the most optimistic. When two possibilities exist which are equally likely, the one which makes the company look worse is chosen.

Hard

60. Explain why dividends are not reported on the income statement.

Dividends are not expenses. They are a distribution of earnings to a company's owners. These distributions do not generate revenue for the company, so they are not expenses. An income statement reports revenues, expenses, gains and losses, thus dividends are not included.

Moderate

Problems

61. You are an accountant for Right Way Enterprises. Determine if the following should be classified as an expense or an asset. The financial statements are being prepared as of December 31, 20X1.

- a) On December 31, 20X1, Right Way paid \$2,000 for insurance to cover the company for the next year.

Asset

- b) On December 31, 20X1, Right way purchased \$500 in supplies to be used in January, next year.

Asset

- c) On September 9, 20X1, Right Way paid its rent for the last quarter of 20X1.

Expense

Moderate

Section 3

True/False Questions

62. The balance in retained earnings is the net income of a period plus dividends paid to stockholders during that period.

False; Easy

63. A company can increase its net assets by earning income.

True; Easy

64. Retained earnings is the amount of external investment in a business.

False; Easy

65. Retained earnings figure indicates the amount of the net assets that came from the operations over the life of the organization.

True; Easy

66. A business can increase its net assets by receiving contributions from investors who become owners through the acquisition of capital stock.
True; Easy
67. Capital stock indicates the amount received in contributions from stockholders to obtain an ownership interest.
True; Easy
68. The net assets of a company are its assets less its liabilities.
True; Moderate
69. A company's total assets increase every time its stock is bought and sold on an exchange.
False; Easy
70. Exchanges between investors on a stock exchange do not affect a business's net assets or its financial reporting.
True; Easy
71. A company starts the year with net assets of \$300,000 and ends with net assets of \$430,000. For that year, the company's stockholders' equity increased by \$130,000.
True; Moderate

Multiple Choice Questions

72. Which of the following statements is true of net assets?
- a. Net assets of a corporation is the excess of its current assets over its current liabilities.
 - b. Net assets indicate the amount generated from investing activities of the business.
 - c. Net assets is equal to the balance of retained earnings account.
 - d. Net assets of a corporation is the excess of its assets over its liabilities.
 - e. Net assets of a corporation increases when its stock is traded on a stock exchange.
- d; Easy**
73. Which of the following terms indicate the balance of a company's net income earned over time less the dividends it has distributed?
- a. Retained Earnings
 - b. Assets
 - c. Cash
 - d. Gross Profit
 - e. Capital Stock
- a; Easy**