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Chapter 2 - Basic Accounting Systems: Cash Basis

1. The basic elements of a financial accounting system include a framework for preparing financial statements.
   a. True
   b. False

ANSWER: True

2. The accounting equation is expressed as follows: Assets = Liabilities + Stockholders' Equity.
   a. True
   b. False

ANSWER: True

3. Any given transaction must affect at least two different parts of the accounting equation.
   a. True
   b. False

ANSWER: False

4. The accounting equation can be expressed as: Assets − Liabilities = Revenues.
   a. True
   b. False

ANSWER: False

5. On a statement of cash flows, each cash transaction is recorded and classified as an operating, investing, or financing activity.
   a. True
   b. False

ANSWER: True

6. Dividends are an example of an expense.
   a. True
   b. False

ANSWER: False

7. Retained earnings will be increased by the amount in the dividend account.
   a. True
   b. False

ANSWER: False

8. By keeping a running total of the effects of transactions, the accounting equation provides a framework for summarizing the effects of a series of transactions.
   a. True
   b. False

ANSWER: True

9. The effect of every transaction is an increase or a decrease in one or more of the accounting equation elements.
   a. True
   b. False

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Chapter 2 - Basic Accounting Systems: Cash Basis

ANSWER: True

10. When a note payable is paid with cash, the stockholders' equity in the business increases.
    a. True
    b. False
ANSWER: False

11. It is possible for a transaction to change the makeup of assets but *not* affect assets in total.
    a. True
    b. False
ANSWER: True

12. When common stock is issued by a corporation for cash, both the income statement and the balance sheet are affected.
    a. True
    b. False
ANSWER: False

13. Fees earned and received in cash will increase cash flows from operating activities as well as retained earnings.
    a. True
    b. False
ANSWER: True

14. Miscellaneous expenses are expenses that have an undetermined amount to be paid.
    a. True
    b. False
ANSWER: False

15. The payment of wage expense with cash would affect the operating activities in the statement of cash flows and the income statement but *not* the balance sheet.
    a. True
    b. False
ANSWER: False

16. The integrated financial statement approach has built-in controls to ensure that all transactions are correctly analyzed, recorded, and summarized.
    a. True
    b. False
ANSWER: True

17. Inventory is less liquid than furniture, so it is listed after furniture on a balance sheet.
    a. True
    b. False
ANSWER: False

18. When comparing operating performance across companies within the same industry, companies prefer common-sized

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income statements prepared using net income rather than those prepared using operating income. This is because other income and expenses are influenced by a variety of factors that are independent of operations and that can vary significantly across companies.

a. True
b. False

ANSWER: False

19. The financial statements include the _____.
a. trial balance
b. bank reconciliation statement
c. balance sheet
d. ledger account

ANSWER: c

20. Which of the following is a control that is built into the integrated financial statement approach?
a. Assets + Liabilities = Stockholders' Equity.
b. Cash from operating activities is equal to cash on the balance sheet.
c. Net income on the income statement must equal the net effects of revenues and expenses on retained earnings.
d. Total assets on the balance sheet should equal income from investing activities on the statement of cash flows.

ANSWER: c

21. Which of the following groups of accounts includes only assets?
a. Cash, Accounts Payable, Land
b. Accounts Receivable, Revenue, Cash
c. Prepaid Expenses, Land, Patents
d. Unearned Revenues, Supplies, Cash

ANSWER: c

22. Expenses can be defined as _____.
a. assets consumed
b. services used in the process of generating revenues
c. costs that have been incurred during the normal course of business
d. All of these choices

ANSWER: d

23. The increases in stockholders' equity attributable to business activities are called _____.
a. assets
b. liabilities
c. revenues
d. net expenses

ANSWER: c

24. The stockholders' equity will increase as a result of the _____.
a. issue of common stock

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b. repayment of long-term debt
c. buyback of common stock
d. issue of long-term debt

ANSWER: a

25. A _____ is an economic event that under generally accepted accounting principles (GAAP) affects an element of the financial statements and must be recorded.
a. framework
b. control
c. set of rules
d. transaction

ANSWER: d

26. The statement of cash flows is integrated with the balance sheet because _____.
a. the cash at the beginning of the period plus or minus the cash flows from operating, investing, and financing activities equals the end-of-period cash reported on the balance sheet
b. the cash at the beginning of the period plus or minus the net income equals the end-of-period cash reported on the balance sheet
c. the cash at the beginning of the period plus or minus assets and liabilities equals the end-of-period cash reported on the balance sheet
d. the cash at the beginning of the period plus or minus the cash flows from operating activities equals the end-of-period cash reported on the balance sheet

ANSWER: a

27. Which of the following statements is true about liabilities?
a. Liabilities include insurance premiums paid in advance.
b. Liabilities arise when a company sells goods on account.
c. Liabilities equal assets plus stockholders' equity.
d. Liabilities are the debts owed by a company.

ANSWER: d

28. Which of the following situations increases stockholders' equity?
a. Supplies are purchased with cash.
b. Services are provided for cash.
c. Expenses are paid with cash.
d. Dividends are paid to stockholders.

ANSWER: b

29. Write Company had the following assets and liabilities at the end of the year:

Assets	$73,200
Liabilities	38,500

What is the year-end stockholders' equity of Write Company?
a. $111,700
b. $38,500
c. $34,700

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d. Cannot be determined with this information

ANSWER: c

30. Moon, Inc. had the following assets and liabilities as of November 30, 20X2:

Assets	$55,600
Liabilities	28,250

If assets increased by $4,250 and equity increased by $1,800 during December, what is the increase or decrease in liabilities of Moon Inc. as of December 31, 20X2?

a. $(6,050)

b. $6,050

c. $(2,450)

d. $2,450

ANSWER: d

31. Rush Corporation borrowed $20,000 from the bank. Which of the following accurately shows the effects of the transaction?

a. Increase Cash, $20,000, and decrease Notes Payable, $20,000

b. Increase Cash, $20,000, and increase Notes Payable, $20,000

c. Decrease Cash, $20,000, and decrease Notes Payable, $20,000

d. Decrease Cash, $20,000, and increase Notes Payable, $20,000

ANSWER: b

32. Flow Inc. received cash from fees earned. How does this transaction affect the statement of cash flows?

a. Increase cash from operating activities

b. Increase cash from investing activities

c. Increase cash from financing activities

d. No effect on the statement of cash flows

ANSWER: a

33. Yuan Corporation purchased office equipment for cash. What is the effect of this transaction?

a. Cash will increase, and office equipment will increase.

b. Total assets will increase, and shareholders' equity will decrease.

c. Total assets will remain unchanged.

d. Cash flows from financing activities will decrease.

ANSWER: c

34. Johnson, Inc. paid rent expense of $5,500 for the month of October. How are the accounts affected due to this transaction?

a. Increase in Cash, $5,500, and increase in Retained Earnings, $5,500

b. Increase in Cash, $5,500, and decrease in Retained Earnings, $5,500

c. Decrease in Cash, $5,500, and decrease in Retained Earnings, $5,500

d. Decrease in Cash, $5,500, and increase in Retained Earnings, $5,500

ANSWER: c

35. Johnson, Inc. purchased land for cash. What effect does this transaction have on its accounts?

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Name:_____ Class:_____ Date:_____

a. Increase in Cash and decrease in Land
b. Decrease in Cash and decrease in Land
c. Increase in Cash and increase in Land
d. Decrease in Cash and increase in Land

ANSWER: d

36. Johnson, Inc. issued $35,000 in common stock in exchange for cash. What is the effect of this transaction?
a. Total assets remain unchanged.
b. Cash flows from financing activities increase.
c. Net income increases.
d. Retained Earnings increases.

ANSWER: b

37. Johnson, Inc. receives $15,000 cash for fees earned. What is the effect of this transaction?
a. Total assets remain unchanged.
b. Cash flows from financing activities increase.
c. Net income increases.
d. Retained Earnings remains unchanged.

ANSWER: c

38. Stockholders' equity will be reduced by _____.
a. a payment of dividends
b. an increase in revenues
c. owners' investments
d. an issuance of bonds

ANSWER: a

39. ABC Company received $20,000 cash from issuing shares of stock in the corporation. This transaction would affect which two financial statement elements?
a. Assets and stockholders' equity
b. Assets and liabilities
c. Liabilities and stockholders' equity
d. None of these choices

ANSWER: a

40. JNC Company provides services for cash. Which of the following financial statement elements would be affected as a result of this transaction?
a. Assets and expenses
b. Assets and liabilities
c. Liabilities and stockholders' equity
d. Assets and stockholders' equity

ANSWER: d

41. Laser Company paid a utility bill of $15,000 and rent of $25,000. As a result of these transactions, the stockholders'

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equity _____.

a. decreases by $40,000
b. increases by $10,000
c. increases by $15,000
d. decreases by $25,000

ANSWER: a

42. ABC Inc. paid taxes of $25,000 and received interest of $50,000. As a result of these transactions, the stockholders' equity _____.

a. increases by $75,000
b. decreases by $50,000
c. decreases by $75,000
d. increases by $25,000

ANSWER: d

43. If liabilities total $20,000 and stockholders' equity totals $70,000, then assets must total _____.

a. $90,000
b. $70,000
c. $50,000
d. $20,000

ANSWER: a

44. Which of the following transactions changes the mix of assets only?

a. Paid for supplies with cash
b. Borrowed money from Second National Bank
c. Received money for fees earned
d. Received and paid a utility bill

ANSWER: a

45. If assets total $110,000 and stockholders' equity totals $75,000, then liabilities must total _____.

a. $110,000
b. $185,000
c. $35,000
d. $75,000

ANSWER: c

46. Dim Co. issues common stock of $15,000. Which of the following statements regarding the effect of this transaction on the company's liquidity and profitability metrics is true?

a. The transaction increases the liquidity and decreases the profitability of the company.
b. The transaction decreases the liquidity and increases the profitability of the company.
c. The transaction increases the liquidity and has no effect on the profitability of the company.
d. The transaction has no effect on the liquidity and increases the profitability of the company.

ANSWER: c

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Chapter 2 - Basic Accounting Systems: Cash Basis

47. Green Ivy Inc. has the following transactions for the month of June:

Issued common stock	$ 50,000
Purchased land by paying cash	110,000
Paid expenses	30,000
Earned cash fees	95,000

As a cumulative result of these transactions, the liquidity of Green Ivy Inc. _____.

a. increases by $5,000
b. increases by $65,000
c. decreases by $15,000
d. decreases by $35,000

ANSWER: a

48. Jade Inc. paid rent of $45,000 for the current month. This transaction _____.

a. decreases the profitability of the company
b. has no effect on the profitability of the company
c. increases the liquidity of the company
d. has no effect on the liquidity of the company

ANSWER: a

49. Lilly Pad Co. paid $30,000 of dividends to stockholders. As a result of this transaction, _____.

a. the liquidity of Lilly Pad Co. increases
b. the profitability of Lilly Pad Co. remains unchanged
c. the profitability of Lilly Pad Co. decreases
d. the liquidity of Lilly Pad Co. remains unchanged

ANSWER: b

50. JNC Co. buys equipment for $1,500,000 cash. This transaction _____.

a. decreases JNC Co.'s liquidity and has no effect on its profitability metric
b. has no effect on JNC Co.'s liquidity and profitability
c. increases JNC Co.'s liquidity and profitability
d. has no effect on JNC Co.'s liquidity and decreases its profitability

ANSWER: a

51. ABC Inc. borrows $50,000 from a bank to finance its operations. Which of the following statements regarding the effect of this transaction on the company's liquidity and profitability metrics is true?

a. The transaction decreases the liquidity and increases the profitability of ABC Inc.
b. The transaction increases the liquidity and decreases the profitability of ABC Inc.
c. The transaction has no effect on the liquidity and profitability of ABC Inc.
d. The transaction increases the liquidity and has no effect on the profitability of ABC Inc.

ANSWER: d

52. The statement of stockholders' equity is prepared _____.

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a. before the income statement
b. after the statement of cash flows
c. before the balance sheet
d. after the audit of the financial statements

ANSWER: c

53. The following is a summary of the balance sheet of BCR Inc.:

	Total Assets	Total Liabilities
Beginning of the year	$260,000	$170,000
End of the year	490,000	410,000

Determine the net income (or loss) for the year, assuming no common stock was issued and no dividends were paid during the year.

a. $(90,000)
b. $(10,000)
c. $(80,000)
d. $(170,000)

ANSWER: b

54. If total assets increased by $550,000 during a period and total liabilities increased by $450,000 during the same period, determine the net income (or loss) for the period, assuming no common stock was issued and dividends of $35,000 were paid.

a. $(35,000)
b. $100,000
c. $65,000
d. $135,000

ANSWER: d

55. The following is a summary of the balance sheet of HRP Enterprises:

	Total Assets	Total Liabilities
Beginning of the year	$290,000	$185,000
End of the year	525,000	310,000

Determine the net income (or loss) for the year, assuming $60,000 of common stock was issued and no dividends were paid during the year.

a. $(105,000)
b. $170,000
c. $50,000
d. $(215,000)

ANSWER: c

56. Global Inc. has retained earnings of $50,000, common stock of $90,000, and liabilities of $55,000. The total assets of the company are worth _____.

a. $140,000
b. $115,000
c. $195,000

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Name:_____ Class:_____ Date:_____

d. $85,000

ANSWER: c

57. Jones Company has $30,000 in retained earnings, $45,000 in assets, and $9,000 in liabilities. How much is in common stock?

a. $39,000
b. $6,000
c. $66,000
d. $15,000

ANSWER: b

58. A to Z Corporation paid a $10,000 cash dividend. On the statement of cash flows, the transaction would be classified as a(n) _____.

a. operating activity
b. investing activity
c. financing activity
d. noncash transaction

ANSWER: c

59. A to Z Corporation purchased a building for $110,000 cash. On the statement of cash flows, the transaction would be classified as a(n) _____.

a. operating activity
b. investing activity
c. financing activity
d. noncash transaction

ANSWER: b

60. A to Z Corporation issued a $40,000 note payable to borrow cash from the bank. On the statement of cash flows, the transaction would be classified as a(n) _____.

a. operating activity
b. investing activity
c. financing activity
d. noncash transaction

ANSWER: c

61. An increase in stockholders' equity from revenues earned will also result in an increase in _____.

a. liabilities
b. assets
c. expenses
d. cash flows from financing activities

ANSWER: b

62. For EFG Co., the transaction "cash sales to customers at a profit" would _____.

a. increase total assets

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b. decrease total assets
c. have no effect on total assets
d. decrease stockholders' equity

ANSWER: a

63. For EFG Co., the transaction "payment of interest expense" would _____.
a. increase total assets
b. decrease total assets
c. have no effect on total assets
d. increase stockholders' equity

ANSWER: b

64. For EFG Co., the transaction "purchase of store equipment with cash" would _____.
a. increase total assets
b. decrease total assets
c. have no effect on total assets
d. decrease stockholders' equity

ANSWER: c

65. For EFG Co., the transaction "payment of dividends" would _____.
a. increase total assets
b. decrease total assets
c. have no effect on total assets
d. increase stockholders' equity

ANSWER: b

66. For EFG Co., the transaction "received and paid utility bill" would _____.
a. increase total assets
b. decrease total assets
c. have no effect on total assets
d. decrease total liabilities

ANSWER: b

67. For EFG Co., the transaction "received cash from a customer for fees earned" would _____.
a. increase total assets
b. decrease total assets
c. have no effect on total assets
d. increase total liabilities

ANSWER: a

68. The income statement for March indicates net income of $80,000. The corporation also paid $20,000 in dividends during the same period. If the company is in operation for only one month and has no beginning balance in retained earnings, what is the ending balance in retained earnings?
a. $100,000

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b. $80,000
c. $20,000
d. $60,000

ANSWER: d

69. Anthony, Inc. buys land for $50,000 cash. The net effect on assets is _____.
a. a $50,000 increase
b. $0
c. a $50,000 decrease
d. a $25,000 increase

ANSWER: b

70. Declaring and paying cash dividends affects which account(s)?
a. Cash only
b. Common Stock only
c. Cash and Retained Earnings
d. Cash and Common Stock

ANSWER: c

71. Buying equipment for cash affects which account(s)?
a. Cash only
b. Retained Earnings only
c. Equipment and Retained Earnings
d. Cash and Equipment

ANSWER: d

72. Paying expenses affects which financial statement elements?
a. Assets only
b. Stockholders' equity only
c. Assets and stockholders' equity
d. Assets and liabilities

ANSWER: c

73. Red Inc. has the following transactions for the month of September:

Fees earned in cash	$580,000
Expenses paid	400,000
Dividends paid	45,000

As a result of these transactions, Red Inc.'s profitability metric _____.
a. increases by $225,000
b. decreases by $135,000
c. increases by $180,000
d. decreases by $400,000

ANSWER: c

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Name:_____ Class:_____ Date:_____

Chapter 2 - Basic Accounting Systems: Cash Basis

74. Navy Inc. buys land for $500,000 cash in the month of March. In March, it also paid wages of $100,000. Which of the following statements is true with regards to these transactions?

a. Navy Inc.'s profitability decreases by $500,000, and liquidity decreases by $100,000.
b. Navy Inc.'s liquidity decreases by $600,000, and profitability remains unchanged.
c. Navy Inc.'s liquidity and profitability decrease by $600,000.
d. Navy Inc.'s liquidity decreases by $600,000, and profitability decreases by $100,000.

ANSWER: d

75. The first month of operations showed the net cash from operating activities to be $2,225, the net cash from investing activities to be $(5,000), and the ending cash balance to be $1,400. The net cash from financing activities must be _____.

a. $825
b. $2,775
c. $4,175
d. $7,775

ANSWER: c

76. A common-sized income statement is prepared by expressing income statement amounts as a percent of _____.

a. sales
b. purchases
c. total assets
d. profit

ANSWER: a

77. A common-sized balance sheet is prepared by expressing each liability item as a percent of _____.

a. total sales
b. total stockholders' equity
c. total liabilities
d. total liabilities plus stockholders' equity

ANSWER: d

78. A common-sized balance sheet is prepared by expressing each asset as a percent of _____.

a. total current assets
b. total assets
c. total long-term assets
d. total liabilities

ANSWER: b

79.

	Year 2	**Year 1**
Sales	$195,000	$140,000
Cost of sales	(150,000)	(110,000)
Gross profit	$ 45,000	$ 30,000

Using the information in the table, calculate the percentage increase or decrease in cost of sales from Year 1 to Year 2.

a. Increase of 1.7%

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b. Decrease of 3.4%

c. Increase of 3.4%

d. Decrease of 1.7%

ANSWER: d

80. What are the basic elements of a financial accounting system?

ANSWER: A financial accounting system is designed to produce financial statements. The basic elements of a financial accounting system include:

(1) A set of rules for determining what, when, and the amount that should be recorded
(2) A framework for preparing financial statements
(3) One or more controls to determine whether errors may have arisen in the recording process

81. The accounting equation Assets = Liabilities + Stockholders' Equity is affected by transactions. Is it possible to have a transaction that only impacts one financial element of the equation? Can a transaction impact two elements of the equation? Give examples.

ANSWER: Yes, to both questions. Examples include (1) purchasing equipment with cash [decreases Cash (an asset) and increases Equipment (an asset)]; (2) issuing common stock for cash [increases Cash (an asset) and increases Common Stock (stockholders' equity)].

82. Linda's Laundry and Dry Cleaning, Inc. incorporated and started business on January 1, 20X2, and incurred the following select transactions:

1 Deposited $25,000 in a checking account in the name of Linda's Laundry and Dry Cleaning, Inc. for which common stock was issued.
2 Borrowed $7,500 from National Bank.
3 Purchased equipment for cash from Washers Wholesale, $17,300.
4 Purchased supplies costing $4,200 from Suds 'n Stuff for cash.
5 Paid one month's rent for business space in Pine Plaza, $1,500.
6 Provided $14,300 of services to cash-paying customers during January.
7 Paid employees for January, $2,480.
8 Received and paid the utility bill, $450.
9 Received and paid the telephone bill, $200.
10 Paid dividends to the stockholders, $3,140.

Indicate the effect of each transaction on the accounting equation by listing the numbers identifying the transactions, (1) through (10) in a vertical column, and inserting at the right of each number the appropriate letter from the following list:

a.	Increase in an asset, decrease in another asset
b.	Increase in an asset, increase in a liability
c.	Increase in an asset, increase in stockholders' equity
d.	Decrease in an asset, decrease in a liability
e.	Decrease in an asset, decrease in stockholders' equity

ANSWER:
1. c
2. b
3. a
4. a
5. e
6. c
7. e
8. e

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9. e
10. e

83. Explain how the four financial statements are linked.

ANSWER: A financial accounting system is designed to produce four financial statements. The income statement, statement of stockholders' equity, and statement of cash flows are linked to an element of the balance sheet.

(1) The income statement shows the net effects of revenues and expenses, which affects the retained earnings on the balance sheet.
(2) The statement of stockholders' equity reflects the net income and dividends paid and shows how retained earnings in the balance sheet moves from the beginning balance to the ending balance.
(3) The statement of cash flows explains how the cash balance in the balance sheet moves from the beginning balance to the ending balance by looking at the cash effects of operating, investing, and financing activities.

84. How can a company earn a large net income and have a small balance in retained earnings?

ANSWER: The company may pay out most of its earnings in dividends.

85. Determine the cash receipts for February based on the following data:

Cash payments during February	$32,750
Cash account balance, February 1	4,200
Cash account balance, February 28	6,750

ANSWER: $35,300 ($6,750 + $32,750 − $4,200)

86. On June 1, the cash account balance was $82,300. During June, cash receipts totaled $435,600, and the June 30 balance was $97,235. Determine the cash payments made during June.

ANSWER: $97,235 = $82,300 + $435,600 −?
Cash Payments = $420,665

87. The following are included on Ace Auto Parts, Inc.'s December 31, 20X2, balance sheet:

Accounts receivable	$ 45,000
Building	110,000
Cash	58,000
Land	125,000
Accounts payable	45,000
Notes payable	75,000
Stockholders' equity	**?**

The following are the amounts appearing for the same items on the December 31, 20X3, balance sheet:

Accounts receivable	$85,000
Building	110,000
Cash	135,000
Land	125,000
Accounts payable	55,000
Notes payable	65,000
Stockholders' equity	**?**

Analyze the changes in these balance sheet items and determine net income for 20X3, assuming that the only change to stockholders' equity is from net income.

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Name:_____ Class:_____ Date:_____

Chapter 2 - Basic Accounting Systems: Cash Basis

ANSWER:

	Assets =	Liabilities +	Stockholders' Equity
	$ 45,000		
	110,000		
	58,000	$ 45,000	
	125,000	75,000	
Bal. 12/31/ 20X2	$338,000	$120,000	$ 218,000

	Assets =	Liabilities +	Stockholders' Equity
	$ 85,000		
	110,000		
	135,000	$ 55,000	
	125,000	65,000	
Bal. 12/31/ 20Y8	$455,000	$120,000	$335,000

Ending stockholders' equity	$335,000
Beginning stockholders' equity	218,000
Change in net income	$117,000

88. East Company had beginning retained earnings of $40,000, issued additional common stock of $30,000, had net income of $25,000, and paid dividends of $10,000. What is the ending balance of retained earnings on the statement of stockholders' equity?

a. $55,000

b. $80,000

c. $105,000

d. $45,000

ANSWER: a

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