Fundamental Financial Accounting Concepts 10th edition Edmonds Test Bank

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Fundamental Financial Accounting Concepts, 10e **(Edmonds)**
Chapter 2 Accounting for Accruals and Deferrals

1) Bledsoe Company acquired $17,000 cash by issuing common stock on January 1, Year 1. During Year 1, Bledsoe earned $8,500 of revenue on account. The company collected $6,000 cash from customers in partial settlement of its accounts receivable and paid $5,400 cash for operating expenses. Based on this information alone, what was the impact on total assets during Year 1?
A) Total assets increased by $20,100.
B) Total assets increased by $600.
C) Total assets increased by $26,100.
D) Total assets did not change.

2) Addison Company experienced an accounting event that affected its financial statements as indicated below:

Assets	=	Liab.	+	Equity		Rev.	−	Exp.	=	Net Inc.		Stmt of Cash Flows
+		NA		+		+		NA		+		NA

Which of the following accounting events could have caused these effects on Addison's statements?
A) Issued common stock
B) Earned revenue on account
C) Earned cash revenue
D) Collected cash from customers in partial settlement of its accounts receivable.

3) Which of the following choices accurately reflects how the recording of accrued salary expense affects the financial statements of a business?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
A.	NA	=	+	+	−	−	−	+	=	NA	NA
B.	NA	=	NA	+	+−	NA	−	NA	=	NA	NA
C.	NA	=	+	+	−	NA	−	+	=	−	NA
D.	+	=	+	+	NA	NA	−	+	=	−	-OA

A) Option A
B) Option B
C) Option C
D) Option D

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4) Which of the following adjustments would **not** be described as an accrual?
A) Recording interest that has been earned but will not be collected until the next accounting period.
B) Recording operating expenses that have been incurred but not paid as of the end of the accounting period.
C) Recording salary expense that has been incurred but not paid as of the end of the accounting period.
D) Recording insurance expense relating to insurance premiums that were paid in advance.

5) Janzen Company recorded employee salaries earned but not yet paid. Which of the following represents the effect of this transaction on the financial statements?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Cash Flow
A.	+	=	+	+	NA	+	−	NA	=	+	−OA
B.	NA	=	+	+	−	NA	−	+	=	−	−IA
C.	−	=	NA	+	−	NA	−	+	=	−	NA
D.	NA	=	+	+	−	NA	−	+	=	−	NA

A) Option A
B) Option B
C) Option C
D) Option D

6) Revenue on account amounted to $5,000. Cash collections of accounts receivable amounted to $2,300. Expenses for the period were $2,100. The company paid dividends of $450. What was net income for the period?
A) $1,200
B) $2,900
C) $2,850
D) $2,450

7) Recognizing an expense may be accompanied by which of the following?
A) An increase in liabilities
B) A decrease in liabilities
C) A decrease in revenue
D) An increase in assets

8) Which of the following statements is true regarding accrual accounting?
A) Revenue is recorded only when cash is collected.
B) Expenses are recorded when they are incurred.
C) Revenue is recorded in the period when it is earned.
D) Revenue is recorded in the period when it is earned and expenses are recorded when they are incurred.

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9) Recognition of revenue **may** be accompanied by which of the following?
A) A decrease in a liability
B) An increase in a liability
C) An increase in an asset
D) An increase in an asset or a decrease in a liability

10) Mize Company provided $45,500 of services on account, and collected $38,000 from customers during the year. The company also incurred $37,000 of expenses on account, and paid $32,400 against its payables. How do these events impact the elements of the financial statements model?
A) Total assets would increase.
B) Total liabilities would increase.
C) Total equity would increase.
D) All of these answer choices are correct.

11) Which of the following events would **not** require a year-end adjusting entry?
A) Purchasing supplies for cash during the year.
B) Paying for one year's rent during the year.
C) Providing services on account during the year.
D) Each of these events would require a year-end adjusting entry.

12) How does the adjusting entry to recognize the portion of the unearned revenue that a company earned during the accounting period affect the elements of the financial statements?
A) An increase in assets and a decrease in liabilities.
B) An increase in liabilities and a decrease in equity.
C) A decrease in liabilities and an increase in equity.
D) A decrease in assets and a decrease in liabilities.

13) On December 1, Year 1, Jack's Snow Removal Company received $6,000 of cash in advance from a customer and promised to provide services for that customer during the months of December, January, and February. How will the Year 1 year-end adjustment to recognize the partial expiration of the contract impact the elements of the financial statements model?
A) Total assets will increase by $2,000.
B) Equity will increase by $2,000.
C) Total liabilities will increase by $2,000.
D) Total assets will increase by $2,000 and equity will increase by $2,000.

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14) The following account balances were drawn from the Year 1 financial statements of Grayson Company:

Cash	$ 8,800	Accounts payable	$ 2,500
Accounts receivable	$ 3,000	Common stock	?
Land	$ 16,000	Retained earnings, Jan. 1	$ 5,400
		Revenue	$ 19,000
		Expenses	$ 14,500

What is the balance of the Common Stock account?
A) $15,400
B) $19,900
C) $900
D) $20,800

15) Prior to closing, Syracuse Company's accounting records showed the following balances:

Retained earnings	$ 16,800
Service revenue	21,750
Interest revenue	1,800
Salaries expense	12,300
Operating expense	3,450
Interest expense	900
Dividends	2,700

After closing, what is the balance of the Retained Earnings account?
A) $16,800
B) $23,700
C) $21,000
D) $26,400

16) On January 1, Year 2, the Supplies account of Sheldon Company had a balance of $1,200. During the year, the company purchased $3,400 of supplies on account and made partial payments totaling $3,000 on those accounts. On December 31, Year 2, Sheldon determined that there were $1,400 of supplies on hand. Which of the following would be reported on Sheldon's Year 2 financial statements?
A) $1,600 of supplies; $200 of supplies expense
B) $1,400 of supplies; $2,000 of supplies expense
C) $1,400 of supplies; $3,200 of supplies expense
D) $1,600 of supplies; $3,400 of supplies expense

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17) On October 1, Year 1, Jason Company paid $7,200 to lease office space for one year beginning immediately. What is the amount of rent expense that will be reported on the Year 1 income statement and what is the cash outflow for rent that would be reported on the Year 1 statement of cash flows?
A) $7,200; $7,200
B) $1,800; $1,800
C) $1,800; $7,200
D) $1,200; $7,200

18) What do accountants commonly do when the connection between an expense and the corresponding revenue is vague?
A) Accelerate revenue recognition and delay expense recognition.
B) Match the expense with the period in which it is incurred.
C) Recognize the expense at the time payment is made.
D) Delay expense recognition until it can be matched with revenue.

19) How would a payment for rent paid in advance be classified?
A) Asset source transaction
B) Asset use transaction
C) Asset exchange transaction
D) Claims exchange transaction

20) Revenue on account amounted to $9,000. Cash collections of accounts receivable amounted to $8,100. Cash paid for operating expenses was $7,500. The amount of employee salaries accrued at the end of the year was $900. What was the net cash flow from operating activities?
A) $900
B) $600
C) $1,500
D) $8,700

21) Which of the following accounts would **not** appear on a balance sheet?
A) Service Revenue
B) Salaries Payable
C) Unearned Revenue
D) Interest Payable

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22) Warren Enterprises began operations during Year 1. The company had the following events during Year 1:

The business issued $40,000 of common stock to its stockholders.
The business purchased land for $24,000 cash.
Services were provided to customers for $32,000 cash.
Services were provided to customers for $10,000 on account.
The company borrowed $32,000 from the bank.
Operating expenses of $24,000 were incurred and paid in cash.
Salary expense of $1,600 was accrued.
A dividend of $8,000 was paid to the stockholders of Warren Enterprises.

After closing, what is the balance of the Retained Earnings account as of December 31, Year 1?
A) $10,000
B) $8,400
C) $16,400
D) $42,000

23) Which of the following would cause net income on the accrual basis to be different from (either higher or lower than) "cash provided by operating activities" on the statement of cash flows?
A) Purchased land for cash
B) Purchased supplies for cash
C) Paid advertising expense
D) Paid dividends to stockholder

24) Rushmore Company provided services for $45,000 cash during Year 1. Rushmore incurred $36,000 of operating expenses on account during Year 1, and by the end of the year, $9,000 of that amount had been paid with cash. If these are the only accounting events that affected Rushmore during Year 1, which of the following statements is true?
A) The amount of net loss shown on the income statement is $9,000.
B) The amount of net income shown on the income statement is $27,000.
C) The amount of net income shown on the income statement is $9,000.
D) The amount of net cash flow from operating activities shown on the statement of cash flows is $18,000.

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[The following information applies to the questions displayed below.]

The following pre-closing accounts and balances were drawn from the records of Carolina Company on December 31, Year 1:

Cash	$ 4,000	Accounts receivable	$ 3,400
Dividends	2,000	Common stock	3,900
Land	3,200	Revenue	3,200
Accounts payable	1,800	Expense	2,200
Retained earnings	5,900		

25) What is the amount of total assets that will be reported on the balance sheet as of December 31, Year 1?
A) $12,600
B) $13,800
C) $7,200
D) $10,600

26) What is the amount of net income that will be reported on the Year 1 income statement?
A) $2,200
B) $3,200
C) $1,000
D) $200

27) After closing, what is the balance of the Retained Earnings account on December 31, Year 1?
A) $5,900
B) $7,200
C) $3,900
D) $4,900

[The following information applies to the questions displayed below.]

Nelson Company experienced the following transactions during Year 1, its first year in operation.

Acquired $12,000 cash by issuing common stock
Provided $4,600 of services on account
Paid $3,200 cash for operating expenses
Collected $3,800 of cash from customers in partial settlement of its accounts receivable
Paid a $200 cash dividend to stockholders

28) What is the amount of net income that will be reported on the Year 1 income statement?
A) $1,400
B) $800
C) $1,000
D) $1,200

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29) What is the amount of net cash flows from operating activities that will be reported on the Year 1 statement of cash flows?
A) $400
B) $600
C) $1,400
D) $1,200

30) What is the amount of total assets that will be reported on the balance sheet as of December 31, Year 1?
A) $12,400
B) $12,600
C) $13,400
D) $13,200

31) What is the balance of the retained earnings that will be reported on the balance sheet as of December 31, Year 1?
A) $1,200
B) $1,000
C) $1,400
D) $13,200

32) On December 31, Year 1, Gaskins Co. owed $4,500 in salaries to employees who had worked during December but will not be paid until January, Year 2. If the year-end adjustment is properly recorded on December 31, Year 1, what will be the effect of this accrual on net income and cash flows from operating activities reported for Year 1?
A) No effect on net income; no effect on cash flow from operating activities
B) Decrease in net income; no effect on cash flow from operating activities
C) Increase in net income; decrease in cash flow from operating activities
D) No effect on net income; decrease in cash flow from operating activities

33) Duluth Co. collected a $6,000 cash advance from a customer on November 1, Year 1 for services to be provided over a six-month period beginning on that date. If the year-end adjustment is properly recorded, what will be the effect of the adjusting entry on Duluth's Year 1 financial statements?
A) Increase assets and decrease liabilities
B) Increase assets and increase revenues
C) Decrease liabilities and increase revenues
D) No effect

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34) On September 1, Year 1, Gomez Company collected $9,000 in advance from a customer for services to be provided over a one-year period beginning on that date. How much revenue would Gomez Company report related to this contract on its income statement for the year ended December 31, Year 1? How much would the company report as net cash flows from operating activities for Year 1?
A) $3,000; $3,000
B) $9,000; $9,000
C) $3,000; $9,000
D) $0; $9,000

35) Which of the following are "matched" under the matching concept?
A) Expenses and revenues
B) Expenses and liabilities
C) Assets and equity
D) Assets and liabilities

36) Which of the following financial statements is impacted most significantly by the matching concept?
A) Balance sheet
B) Income statement
C) Statement of changes in stockholders' equity
D) Statement of cash flows

37) Which of the following is frequently used to describe the expenses that are matched in the same accounting period in which they are incurred?
A) Market expenses
B) Matching expenses
C) Period costs
D) Working costs

38) If retained earnings decreased during the year, and no dividends were paid, which of the following statements must be **true**?
A) Expenses for the year exceeded revenues.
B) The company did not have enough cash to pay its expenses.
C) Total equity decreased.
D) Liabilities increased during the year.

39) Which of the following correctly states the proper order of the steps in the accounting cycle?
A) Record transactions, adjust accounts, close temporary accounts, prepare statements.
B) Adjust accounts, record transactions, close temporary accounts, prepare statements.
C) Record transactions, adjust accounts, prepare statements, close temporary accounts.
D) Adjust accounts, prepare statements, record transactions, close temporary accounts.

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40) What is the purpose of the accrual basis of accounting?
A) Recognize revenue when it is collected from customers.
B) Match assets with liabilities during the proper accounting period.
C) Recognize expenses when cash disbursements are made.
D) Recognizing revenue when it is earned and expenses when they are incurred, regardless of when cash changes hands.

41) Which of the following types of accounts is closed at the end of an accounting cycle?
A) Dividends
B) Common stock
C) Assets
D) Liabilities

42) Which of the following types of accounts is **not** closed at the end of an accounting cycle?
A) Revenues
B) Retained earnings
C) Dividends
D) Expenses

43) Which of the following statements best describes the balance in a revenue account at the beginning of an accounting period?
A) Zero
B) Last period's ending balance
C) Higher than the previous period's beginning balance
D) Equal to the amount of retained earnings for the previous period

44) What should an accountant do when there is no traceable connection between expenses and revenue?
A) Apply the matching concept
B) Design a system of internal control
C) Exercise judgment
D) Be as uniform as possible

45) Which of the following is **not** an element of the fraud triangle?
A) Reliance
B) Rationalization
C) Opportunity
D) Pressure

46) Which of the following is **not** a principle of the AICPA Code of Professional Conduct?
A) Due Care
B) Objectivity and Independence
C) Integrity
D) Internal Controls

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47) Which of the following is **not** one of the common elements that are typically present when fraud occurs?
A) The capacity to rationalize
B) The existence of pressure leading to an incentive
C) The assistance of others
D) The presence of an opportunity

48) What is the term used to describe the policies and procedures that are designed to reduce the opportunities for fraud?
A) Internal controls
B) Asset source transactions
C) Accounting standards
D) Financial systems

49) What action did the U.S. Congress take because of the audit failures at Enron, WorldCom and other companies?
A) Required publicly-traded companies to be audited by a government agency
B) Passed the Sarbanes-Oxley Act
C) Required companies to begin preparing an additional financial statement
D) Passed an amendment to the Securities and Exchange Act

50) Which of the following describes the effects of a claims exchange transaction on a company's financial statements?

	Assets	**=**	**Liab.**	**+**	**Equity**	**Rev.**	**−**	**Exp.**	**=**	**Net Inc.**	**Stmt of Cash Flows**
A.	NA	=	NA	+	NA	NA	−	NA	=	NA	+OA
B.	+	=	+	+	NA	NA	−	NA	=	NA	+OA
C.	NA	=	+	+	−	NA	−	+	=	−	NA
D.	All of these could represent the effects of a claims exchange transaction.										

A) Option A
B) Option B
C) Option C
D) Option D

51) Which of the following is an asset source transaction?
A) Issued common stock
B) Paid a cash dividend to stockholders
C) Collected cash from customers in settlement of accounts receivable
D) Accrued salary expense

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52) Which of the following is an asset use transaction?
A) Purchased machine for cash.
B) Recorded insurance expense at the end of the period.
C) Invested cash in an interest earning account.
D) Accrued salary expense at the end of the period.

53) Which of the following is a claims exchange transaction?
A) Recognized revenue earned on a contract where the cash had been collected at an earlier date.
B) Issued common stock.
C) Invested cash in an interest earning account.
D) Purchased machine for cash.

54) Which of the following is an asset exchange transaction?
A) Issued common stock.
B) Accrued salary expense at the end of the accounting period.
C) Collected cash on accounts receivable.
D) Recognized revenue earned on a contract where the cash had been collected at an earlier date.

55) If a company provides services to clients but has not yet collected any cash, how should that transaction be classified?
A) Claims exchange transaction
B) Asset use transaction
C) Asset source transaction
D) Asset exchange transaction

56) The term "recognition" means to report an economic event in the financial statements.

57) Companies that use accrual accounting recognize revenues and expenses at the time that cash is received or paid, respectively.

58) The term "accrual" describes an earnings event that is recognized before cash is received or paid.

59) A company may recognize a revenue or expense without a corresponding cash collection or payment in the same accounting period.

60) A payment to an employee in settlement of salaries payable decreases an asset and decreases equity.

61) An increase in an expense may be accompanied by a decrease in a liability.

62) Revenues and expenses are temporary accounts.

63) The balances of the temporary accounts are transferred to Net Income, a permanent account, during the closing process.

64) Accounts that are closed include expenses, dividends, and unearned revenues.

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65) After the closing process, all income statement accounts have balances that carry forward into the next accounting period.

66) Two of the steps in the accounting cycle are adjusting the accounts and closing the accounts.

67) Accrual accounting usually fails to match expenses with revenues.

68) The matching concept leads accountants to select the recognition alternative that produces the lowest amount of net income.

69) Adjusting entries never affect a business's cash account.

70) Asset use transactions always involve the payment of cash.

71) The governance of a corporation includes the roles and responsibilities of the board of directors, managers, shareholders, and auditor.

72) The ethical standards for certified public accountants only require that such accountants comply with applicable laws and regulations.

73) Certified public accountants are obligated to act in a way that serves the public interest.

74) The bankruptcies of Enron and WorldCom both indicated the occurrence of major audit failures.

75) The Sarbanes-Oxley Act includes several significant reforms that affect the auditing profession, but it did not reduce an audit firm's ability to provide non-audit services to its audit clients.

76) The internal controls of a business are designed to reduce the probability of occurrence of fraud.

77) Providing services to customers on account is an asset exchange transaction.

78) An adjusting entry that decreases unearned revenue and increases service revenue is a claims exchange transaction.

79) Sometimes the recognition of revenue is accompanied by an increase in liabilities.

80) The collection of an account receivable is a claims exchange transaction.

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81) Joseph Company purchased a delivery van on January 1, Year 1 for $35,000. The van is estimated to have a 5-year useful life and a $5,000 salvage value. How much expense should Joseph recognize in Year 1 related to the use of the van?
A) $6,000
B) $7,000
C) $30,000
D) $5,000

82) Which of the following events involves a deferral?
A) Recording interest that has been earned but not received.
B) Recording revenue that has been earned but not yet collected in cash.
C) Recording supplies that have been purchased with cash but not yet used.
D) Recording salaries owed to employees at the end of the year that will be paid during the following year.

83) The entry to recognize depreciation expense incurred on equipment involves which of the following?
A) A decrease in assets
B) An increase in liabilities
C) An increase in assets
D) A decrease in liabilities

84) The following accounts and balances were drawn from the records of Barnes Company:

Cash	$ 4,500
Accounts receivable	$ 2,700
Equipment	$ 10,000
Accumulated depreciation	$ 3,200
Accounts payable	$ 2,800
Common stock	$ 6,000

Based on this information alone the amount of Barnes's retained earnings is:
A) $11,600.
B) $17,200.
C) $5,200.
D) None of these answers is correct.

85) Which of the following would be included in the cash flow from operating activities section of the statement of cash flows?
A) Accrual of salary expense at year-end.
B) Purchase of equipment for cash.
C) Payments of cash dividends to the owners of the business.
D) Cash paid for interest on a note payable.

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86) Chester Company began Year 2 with a note payable of $20,000 and an interest payable of $800. During the year, the company accrued an additional $400 of interest expense, and paid off the note with interest. What is the amount of cash flows for financing activities that will be reported on the statement of cash flows as a result of these transactions?
A) $1,200 outflow
B) $20,000 outflow
C) $20,400 outflow
D) $21,200 outflow

87) Consider how each of the transactions listed below affect net income reported on the income statement and the net cash flows from operating activities reported on the statement of cash flows. Which transaction(s) would affect the income statement in a different period from the statement of cash flows?
A) Recognized depreciation expense on equipment.
B) Incurred operating expenses on account.
C) Paid interest that was accrued in a prior year.
D) All of these answer choices would affect the income statement in a different period from the statement of cash flows.

88) On January 1, Year 1, Alabama Company purchased a machine for $26,000. The machine has an estimated useful life of 4 years and an estimated salvage value of $6,000. What is the book value of the machine reported on Alabama's balance sheet as of December 31, Year 1?
A) $26,000
B) $19,500
C) $21,000
D) $15,000

89) Recognition of depreciation expense is an asset use transaction.

90) Recognition of depreciation expense on equipment decreases the equipment account.

91) When a company purchases a depreciable asset, it must estimate the asset's useful life and salvage value.

92) The cash payment of interest is classified as a financing activity on the statement of cash flows.

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Chapter 2 Accounting for Accruals and Deferrals

1) Bledsoe Company acquired $17,000 cash by issuing common stock on January 1, Year 1. During Year 1, Bledsoe earned $8,500 of revenue on account. The company collected $6,000 cash from customers in partial settlement of its accounts receivable and paid $5,400 cash for operating expenses. Based on this information alone, what was the impact on total assets during Year 1?
A) Total assets increased by $20,100.
B) Total assets increased by $600.
C) Total assets increased by $26,100.
D) Total assets did not change.

Answer: A
Explanation: $17,000 (cash) + $8,500 (accounts receivable) + $6,000 (cash) - $6,000 (accounts receivable) - $5,400 (cash) = $20,100 increase
Difficulty: 3 Hard
Topic: Accounting for Receivables
Learning Objective: 02-01 Show how receivables affect financial statements.
Bloom's: Apply
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

2) Addison Company experienced an accounting event that affected its financial statements as indicated below:

Assets	=	Liab.	+	Equity		Rev.	−	Exp.	=	Net Inc.		Stmt of Cash Flows
+		NA		+		+		NA		+		NA

Which of the following accounting events could have caused these effects on Addison's statements?
A) Issued common stock
B) Earned revenue on account
C) Earned cash revenue
D) Collected cash from customers in partial settlement of its accounts receivable.

Answer: B
Explanation: Earning revenue on account increases assets (accounts receivable) and increases revenue, which increases net income and equity (retained earnings). It does not affect cash flows.
Difficulty: 2 Medium
Topic: Accounting for Receivables
Learning Objective: 02-01 Show how receivables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

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3) Which of the following choices accurately reflects how the recording of accrued salary expense affects the financial statements of a business?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
A.	NA	=	+	+	−	−	−	+	=	NA	NA
B.	NA	=	NA	+	+−	NA	−	NA	=	NA	NA
C.	NA	=	+	+	−	NA	−	+	=	−	NA
D.	+	=	+	+	NA	NA	−	+	=	−	-OA

A) Option A
B) Option B
C) Option C
D) Option D

Answer: C
Explanation: Accruing salary expense increases liabilities (salaries payable) and increases expenses, which decreases net income and equity (retained earnings). It does not affect cash flows.
Difficulty: 2 Medium
Topic: Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-02 Show how payables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

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4) Which of the following adjustments would **not** be described as an accrual?
A) Recording interest that has been earned but will not be collected until the next accounting period.
B) Recording operating expenses that have been incurred but not paid as of the end of the accounting period.
C) Recording salary expense that has been incurred but not paid as of the end of the accounting period.
D) Recording insurance expense relating to insurance premiums that were paid in advance.

Answer: D
Explanation: The term *deferral* describes a revenue or an expense event that is recognized *after* cash has been exchanged. Commonly, deferred expenses include prepaid insurance. On the other hand, the term *accrual* describes a revenue or an expense event that is recognized *before* cash is exchanged. The other three answer choices describe accruals: interest receivable, accounts payable, and salaries payable.
Difficulty: 3 Hard
Topic: Accounting for Receivables; Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-01 Show how receivables affect financial statements.; 02-02 Show how payables affect financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

5) Janzen Company recorded employee salaries earned but not yet paid. Which of the following represents the effect of this transaction on the financial statements?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Cash Flow
A.	+	=	+	+	NA	+	−	NA	=	+	−OA
B.	NA	=	+	+	−	NA	−	+	=	−	−IA
C.	−	=	NA	+	−	NA	−	+	=	−	NA
D.	NA	=	+	+	−	NA	−	+	=	−	NA

A) Option A
B) Option B
C) Option C
D) Option D

Answer: D
Explanation: Accruing salaries expense increases liabilities (salaries payable) and increases expenses, which decreases net income and equity (retained earnings). It does not affect cash flows.
Difficulty: 2 Medium
Topic: Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-02 Show how payables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

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6) Revenue on account amounted to $5,000. Cash collections of accounts receivable amounted to $2,300. Expenses for the period were $2,100. The company paid dividends of $450. What was net income for the period?
A) $1,200
B) $2,900
C) $2,850
D) $2,450

Answer: B
Explanation: Net income = Revenue of $5,000 - Expenses of $2,100 = $2,900; dividends decrease retained earnings but do not affect net income.
Difficulty: 2 Medium
Topic: Accounting for Receivables
Learning Objective: 02-01 Show how receivables affect financial statements.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

7) Recognizing an expense may be accompanied by which of the following?
A) An increase in liabilities
B) A decrease in liabilities
C) A decrease in revenue
D) An increase in assets

Answer: A
Explanation: Recognizing an expense may be accompanied by an increase in liabilities (i.e. accounts payable, salaries payable) or a decrease in assets (i.e. cash, prepaid rent or insurance).
Difficulty: 2 Medium
Topic: Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-02 Show how payables affect financial statements.
Bloom's: Understand
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AICPA: BB Critical Thinking; FN Measurement

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8) Which of the following statements is true regarding accrual accounting?
A) Revenue is recorded only when cash is collected.
B) Expenses are recorded when they are incurred.
C) Revenue is recorded in the period when it is earned.
D) Revenue is recorded in the period when it is earned and expenses are recorded when they are incurred.

Answer: D
Explanation: Revenue is recognized when earned and expenses are recognized when incurred, regardless of when cash is exchanged.
Difficulty: 2 Medium
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

9) Recognition of revenue **may** be accompanied by which of the following?
A) A decrease in a liability
B) An increase in a liability
C) An increase in an asset
D) An increase in an asset or a decrease in a liability

Answer: D
Explanation: Recognizing revenue may be accompanied by either an increase in assets (cash or accounts receivable) or a decrease in liabilities (unearned revenue).
Difficulty: 2 Medium
Topic: Accounting for Unearned Revenue; Accounting for Receivables
Learning Objective: 02-01 Show how receivables affect financial statements.; 02-07 Show how accounting for unearned revenues affects financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
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10) Mize Company provided $45,500 of services on account, and collected $38,000 from customers during the year. The company also incurred $37,000 of expenses on account, and paid $32,400 against its payables. How do these events impact the elements of the financial statements model?
A) Total assets would increase.
B) Total liabilities would increase.
C) Total equity would increase.
D) All of these answer choices are correct.

Answer: D
Explanation: Change in total assets = Increase in accounts receivable because of services provided on account of $45,500 - Decrease in account receivable because of collections on account of $32,400 = $13,100 increase
Change in total liabilities = Increase in accounts payable because of expenses incurred on account $37,000 - Decrease in accounts payable because of payments on account of $32,400 = $4,600 increase
Change in equity = Increase in retained earnings (revenue) of $45,500 - Decrease in retained earnings (expenses) of $37,000 = $8,500 increase
Difficulty: 3 Hard
Topic: Accounting for Receivables; Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-01 Show how receivables affect financial statements.; 02-02 Show how payables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

11) Which of the following events would **not** require a year-end adjusting entry?
A) Purchasing supplies for cash during the year.
B) Paying for one year's rent during the year.
C) Providing services on account during the year.
D) Each of these events would require a year-end adjusting entry.

Answer: C
Explanation: Providing services on account does not require an adjusting entry at the end of the accounting period. Accounts receivable is increased when services are provided on account and is decreased when payment is received from customers. Supplies and prepaid rent both require year-end adjusting entries to recognize expense.
Difficulty: 3 Hard
Topic: Accounting for Prepaid Items; Accounting for Supplies; Accounting for Receivables
Learning Objective: 02-01 Show how receivables affect financial statements.; 02-05 Show how accounting for supplies affects financial statements.; 02-06 Show how accounting for prepaid items affects financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

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12) How does the adjusting entry to recognize the portion of the unearned revenue that a company earned during the accounting period affect the elements of the financial statements?
A) An increase in assets and a decrease in liabilities.
B) An increase in liabilities and a decrease in equity.
C) A decrease in liabilities and an increase in equity.
D) A decrease in assets and a decrease in liabilities.

Answer: C
Explanation: Recognizing the portion of the unearned revenue that a company earned during the accounting period involves a decrease in liabilities (unearned revenue) and an increase in equity (retained earnings as a result of revenue).
Difficulty: 2 Medium
Topic: Accounting for Unearned Revenue
Learning Objective: 02-07 Show how accounting for unearned revenues affects financial statements.
Bloom's: Analyze
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

13) On December 1, Year 1, Jack's Snow Removal Company received $6,000 of cash in advance from a customer and promised to provide services for that customer during the months of December, January, and February. How will the Year 1 year-end adjustment to recognize the partial expiration of the contract impact the elements of the financial statements model?
A) Total assets will increase by $2,000.
B) Equity will increase by $2,000.
C) Total liabilities will increase by $2,000.
D) Total assets will increase by $2,000 and equity will increase by $2,000.

Answer: B
Explanation: The year-end adjustment to recognize one month's work on the three-month contract results in a $2,000 decrease in liabilities (unearned revenue) and a $2,000 increase in equity (retained earnings due to recognizing revenue).
Difficulty: 2 Medium
Topic: Accounting for Unearned Revenue
Learning Objective: 02-07 Show how accounting for unearned revenues affects financial statements.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

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14) The following account balances were drawn from the Year 1 financial statements of Grayson Company:

Cash	$ 8,800	Accounts payable	$ 2,500
Accounts receivable	$ 3,000	Common stock	?
Land	$ 16,000	Retained earnings, Jan. 1	$ 5,400
		Revenue	$ 19,000
		Expenses	$ 14,500

What is the balance of the Common Stock account?
A) $15,400
B) $19,900
C) $900
D) $20,800

Answer: A
Explanation: Assets = Liabilities + Equity
$8,800 + $3,000 + $16,000 = $2,500 + Equity
Equity = $25,300
Equity = Common stock + Retained earnings
$25,300 = Common Stock + ($5,400 + $19,000 - $15,500)
$25,300 = Common Stock + $9,900
Common Stock = $15,400
Difficulty: 3 Hard
Topic: Steps in an Accounting Cycle; Preparing Financial Statements with Accruals
Learning Objective: 02-04 Identify the steps in the accounting cycle.; 02-03 Prepare financial statements that include accruals.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

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15) Prior to closing, Syracuse Company's accounting records showed the following balances:

Retained earnings	$ 16,800
Service revenue	21,750
Interest revenue	1,800
Salaries expense	12,300
Operating expense	3,450
Interest expense	900
Dividends	2,700

After closing, what is the balance of the Retained Earnings account?
A) $16,800
B) $23,700
C) $21,000
D) $26,400

Answer: C
Explanation: Ending balance of retained earnings = Beginning balance + Net income - Dividends
Ending balance of retained earnings = $16,800 + ($21,750 + $1,800 - $12,300 - $3,450 - $900) - $2,700 = $21,000
Difficulty: 3 Hard
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

16) On January 1, Year 2, the Supplies account of Sheldon Company had a balance of $1,200. During the year, the company purchased $3,400 of supplies on account and made partial payments totaling $3,000 on those accounts. On December 31, Year 2, Sheldon determined that there were $1,400 of supplies on hand. Which of the following would be reported on Sheldon's Year 2 financial statements?
A) $1,600 of supplies; $200 of supplies expense
B) $1,400 of supplies; $2,000 of supplies expense
C) $1,400 of supplies; $3,200 of supplies expense
D) $1,600 of supplies; $3,400 of supplies expense

Answer: C
Explanation: Supplies = Amount on hand at end of year of $1,400
Supplies expense = Beginning balance of Supplies account of $1,200 + Supplies purchased of $3,400 − Ending balance of Supplies account of $1,400 = $3,200
Difficulty: 2 Medium
Topic: Accounting for Supplies
Learning Objective: 02-05 Show how accounting for supplies affects financial statements.
Bloom's: Apply
AACSB: Knowledge Application
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17) On October 1, Year 1, Jason Company paid $7,200 to lease office space for one year beginning immediately. What is the amount of rent expense that will be reported on the Year 1 income statement and what is the cash outflow for rent that would be reported on the Year 1 statement of cash flows?
A) $7,200; $7,200
B) $1,800; $1,800
C) $1,800; $7,200
D) $1,200; $7,200

Answer: C
Explanation: Monthly rent expense = Payment of $7,200 ÷ 12 months = $600 per month
Rent expense (on the income statement) = $600 per month × 3 months = $1,800
The $7,200 payment is the cash outflow for rent that will be reported on the statement of cash flows.
Difficulty: 3 Hard
Topic: Accounting for Prepaid Items
Learning Objective: 02-06 Show how accounting for prepaid items affects financial statements.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

18) What do accountants commonly do when the connection between an expense and the corresponding revenue is vague?
A) Accelerate revenue recognition and delay expense recognition.
B) Match the expense with the period in which it is incurred.
C) Recognize the expense at the time payment is made.
D) Delay expense recognition until it can be matched with revenue.

Answer: B
Explanation: When the connection between an expense and the corresponding revenue is vague, accountants commonly match the expense with the period in which it is incurred.
Difficulty: 2 Medium
Topic: Preparing Financial Statements with Accruals
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Decision Making

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19) How would a payment for rent paid in advance be classified?
A) Asset source transaction
B) Asset use transaction
C) Asset exchange transaction
D) Claims exchange transaction

Answer: C
Explanation: Purchasing prepaid rent increases one asset (prepaid rent) and decreases another asset (cash). Therefore, it is classified as an asset exchange transaction.
Difficulty: 1 Easy
Topic: Transaction Classification; Accounting for Prepaid Items
Learning Objective: 02-06 Show how accounting for prepaid items affects financial statements.; 02-09 Classify accounting events into one of four categories.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

20) Revenue on account amounted to $9,000. Cash collections of accounts receivable amounted to $8,100. Cash paid for operating expenses was $7,500. The amount of employee salaries accrued at the end of the year was $900. What was the net cash flow from operating activities?
A) $900
B) $600
C) $1,500
D) $8,700

Answer: B
Explanation: Cash collected on accounts receivable of $8,100 − Cash paid for operating expenses of $7,500 = $600. Revenue earned on account and accrued salaries are not cash flow activities.
Difficulty: 2 Medium
Topic: Accounting for Receivables; Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-01 Show how receivables affect financial statements.; 02-02 Show how payables affect financial statements.
Bloom's: Apply
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21) Which of the following accounts would **not** appear on a balance sheet?
A) Service Revenue
B) Salaries Payable
C) Unearned Revenue
D) Interest Payable

Answer: A
Explanation: Service Revenue and Interest Expense are income statement accounts and, as such, they do not appear on the balance sheet. Unearned Revenue, despite having the word "revenue" in its title, is a liability account that appears on the balance sheet, as does Salaries Payable.
Difficulty: 2 Medium
Topic: Preparing Financial Statements with Accruals
Learning Objective: 02-03 Prepare financial statements that include accruals.
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22) Warren Enterprises began operations during Year 1. The company had the following events during Year 1:

The business issued $40,000 of common stock to its stockholders.
The business purchased land for $24,000 cash.
Services were provided to customers for $32,000 cash.
Services were provided to customers for $10,000 on account.
The company borrowed $32,000 from the bank.
Operating expenses of $24,000 were incurred and paid in cash.
Salary expense of $1,600 was accrued.
A dividend of $8,000 was paid to the stockholders of Warren Enterprises.

After closing, what is the balance of the Retained Earnings account as of December 31, Year 1?
A) $10,000
B) $8,400
C) $16,400
D) $42,000

Answer: B
Explanation: Net income = Revenues of $42,000 – Operating expenses of $25,600 = $16,400
Ending retained earnings = Beginning retained earnings of $0 + Net income of $16,400 – Dividends of $8,000 = $8,400
Difficulty: 3 Hard
Topic: Accounting for Receivables; Steps in an Accounting Cycle; Preparing Financial Statements with Accruals; Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-01 Show how receivables affect financial statements.; 02-04 Identify the steps in the accounting cycle.; 02-02 Show how payables affect financial statements.; 02-03 Prepare financial statements that include accruals.
Bloom's: Apply
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23) Which of the following would cause net income on the accrual basis to be different from (either higher or lower than) "cash provided by operating activities" on the statement of cash flows?
A) Purchased land for cash
B) Purchased supplies for cash
C) Paid advertising expense
D) Paid dividends to stockholder

Answer: B
Explanation: Purchasing supplies for cash is a cash outflow for operating activities, but will not be reported as an expense until the supplies are used. Purchasing land is a cash outflow for investing activities and does not affect net income. Paying utilities expense causes equal decreases in net income and cash flows from operating activities. Paying dividends to stockholders is a cash outflow for financing activities and does not affect net income.
Difficulty: 3 Hard
Topic: Accounting for Supplies
Learning Objective: 02-05 Show how accounting for supplies affects financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

24) Rushmore Company provided services for $45,000 cash during Year 1. Rushmore incurred $36,000 of operating expenses on account during Year 1, and by the end of the year, $9,000 of that amount had been paid with cash. If these are the only accounting events that affected Rushmore during Year 1, which of the following statements is true?
A) The amount of net loss shown on the income statement is $9,000.
B) The amount of net income shown on the income statement is $27,000.
C) The amount of net income shown on the income statement is $9,000.
D) The amount of net cash flow from operating activities shown on the statement of cash flows is $18,000.

Answer: C
Explanation: Net income = Revenue of $45,000 – Operating expenses of $36,000 = $9,000
Net cash flow from operating activities = Cash collections of $45,000 – Cash payments for operating expenses of $9,000 = $36,000
Difficulty: 2 Medium
Topic: Preparing Financial Statements with Accruals; Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-02 Show how payables affect financial statements.; 02-03 Prepare financial statements that include accruals.
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[The following information applies to the questions displayed below.]

The following pre-closing accounts and balances were drawn from the records of Carolina Company on December 31, Year 1:

Cash	$ 4,000	Accounts receivable	$ 3,400
Dividends	2,000	Common stock	3,900
Land	3,200	Revenue	3,200
Accounts payable	1,800	Expense	2,200
Retained earnings	5,900		

25) What is the amount of total assets that will be reported on the balance sheet as of December 31, Year 1?
A) $12,600
B) $13,800
C) $7,200
D) $10,600

Answer: D
Explanation: Total assets = Cash of $4,000 + Land of $3,200 + Accounts Receivable of $3,400 = $10,600
Difficulty: 3 Hard
Topic: Preparing Financial Statements with Accruals
Learning Objective: 02-03 Prepare financial statements that include accruals.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

26) What is the amount of net income that will be reported on the Year 1 income statement?
A) $2,200
B) $3,200
C) $1,000
D) $200

Answer: C
Explanation: Net income = Revenue of $3,200 − Expenses of $2,200 = $1,000
Difficulty: 1 Easy
Topic: Preparing Financial Statements with Accruals
Learning Objective: 02-03 Prepare financial statements that include accruals.
Bloom's: Apply
AACSB: Knowledge Application
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27) After closing, what is the balance of the Retained Earnings account on December 31, Year 1?
A) $5,900
B) $7,200
C) $3,900
D) $4,900

Answer: D
Explanation: Net income = Revenue of $3,200 – Expenses of $2,200 = $1,000
Ending retained earnings = Beginning retained earnings of $5,900 + Net income of $1,000 – Dividends of $2,000 = $4,900
Difficulty: 3 Hard
Topic: Steps in an Accounting Cycle; Preparing Financial Statements with Accruals
Learning Objective: 02-04 Identify the steps in the accounting cycle.; 02-03 Prepare financial statements that include accruals.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

[The following information applies to the questions displayed below.]

Nelson Company experienced the following transactions during Year 1, its first year in operation.

Acquired $12,000 cash by issuing common stock
Provided $4,600 of services on account
Paid $3,200 cash for operating expenses
Collected $3,800 of cash from customers in partial settlement of its accounts receivable
Paid a $200 cash dividend to stockholders

28) What is the amount of net income that will be reported on the Year 1 income statement?
A) $1,400
B) $800
C) $1,000
D) $1,200

Answer: A
Explanation: Net income = Revenue of $4,600 − Expenses of $3,200 = $1,400
Difficulty: 3 Hard
Topic: Preparing Financial Statements with Accruals
Learning Objective: 02-03 Prepare financial statements that include accruals.
Bloom's: Apply
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29) What is the amount of net cash flows from operating activities that will be reported on the Year 1 statement of cash flows?
A) $400
B) $600
C) $1,400
D) $1,200

Answer: B
Explanation: Net cash flow from operating activities = Cash collections of $3,800 – Cash payments for expenses of $3,200 = $600
The cash paid for dividends would be reported as a financing activity.
Difficulty: 3 Hard
Topic: Preparing Financial Statements with Accruals
Learning Objective: 02-03 Prepare financial statements that include accruals.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

30) What is the amount of total assets that will be reported on the balance sheet as of December 31, Year 1?
A) $12,400
B) $12,600
C) $13,400
D) $13,200

Answer: D
Explanation: Total assets = Cash of $12,400 (calculated as $12,000 + $3,800 – $3,200 – $200) + Accounts Receivable of $800 (calculated as $4,600 – $3,800) = $13,200
Difficulty: 3 Hard
Topic: Preparing Financial Statements with Accruals
Learning Objective: 02-03 Prepare financial statements that include accruals.
Bloom's: Apply
AACSB: Knowledge Application
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31) What is the balance of the retained earnings that will be reported on the balance sheet as of December 31, Year 1?
A) $1,200
B) $1,000
C) $1,400
D) $13,200

Answer: A
Explanation: Ending retained earnings = Beginning retained earnings of $0 + Net income of $1,400 − Dividends of $200 = $1,200
Alternatively:
Assets of $13,200 = Liabilities of $0 + Common stock of $12,000 + Retained earnings
Retained earnings = $1,200
Difficulty: 3 Hard
Topic: Preparing Financial Statements with Accruals; Statement of changes in stockholders' equity
Learning Objective: 02-03 Prepare financial statements that include accruals.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

32) On December 31, Year 1, Gaskins Co. owed $4,500 in salaries to employees who had worked during December but will not be paid until January, Year 2. If the year-end adjustment is properly recorded on December 31, Year 1, what will be the effect of this accrual on net income and cash flows from operating activities reported for Year 1?
A) No effect on net income; no effect on cash flow from operating activities
B) Decrease in net income; no effect on cash flow from operating activities
C) Increase in net income; decrease in cash flow from operating activities
D) No effect on net income; decrease in cash flow from operating activities

Answer: B
Explanation: Recording the adjusting entry will increase salaries expense, which will reduce net income and it will increase salaries payable, a liability. It will not affect cash flows.
Difficulty: 2 Medium
Topic: Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-02 Show how payables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

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33) Duluth Co. collected a $6,000 cash advance from a customer on November 1, Year 1 for services to be provided over a six-month period beginning on that date. If the year-end adjustment is properly recorded, what will be the effect of the adjusting entry on Duluth's Year 1 financial statements?
A) Increase assets and decrease liabilities
B) Increase assets and increase revenues
C) Decrease liabilities and increase revenues
D) No effect

Answer: C
Explanation: The adjusting entry to recognize revenue earned on the contract will increase revenues and decrease liabilities (unearned revenue).
Difficulty: 2 Medium
Topic: Accounting for Unearned Revenue
Learning Objective: 02-07 Show how accounting for unearned revenues affects financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

34) On September 1, Year 1, Gomez Company collected $9,000 in advance from a customer for services to be provided over a one-year period beginning on that date. How much revenue would Gomez Company report related to this contract on its income statement for the year ended December 31, Year 1? How much would the company report as net cash flows from operating activities for Year 1?
A) $3,000; $3,000
B) $9,000; $9,000
C) $3,000; $9,000
D) $0; $9,000

Answer: C
Explanation: Monthly revenue = Receipt of $9,000 ÷ 12 months = $750 per month
Revenue (on the income statement) = $750 per month × 4 months (September through December) = $3,000
The company will recognize the $9,000 received as a cash inflow for operating activities in Year 1.
Difficulty: 2 Medium
Topic: Accounting for Unearned Revenue
Learning Objective: 02-07 Show how accounting for unearned revenues affects financial statements.
Bloom's: Analyze
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35) Which of the following are "matched" under the matching concept?
A) Expenses and revenues
B) Expenses and liabilities
C) Assets and equity
D) Assets and liabilities

Answer: A
Explanation: The matching concept refers to the matching of expenses to the revenues that those expenses produce.
Difficulty: 1 Easy
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

36) Which of the following financial statements is impacted most significantly by the matching concept?
A) Balance sheet
B) Income statement
C) Statement of changes in stockholders' equity
D) Statement of cash flows

Answer: B
Explanation: The matching concept is an accounting principle of recognizing expenses in the same accounting period as the revenues they produce. Revenues and expenses are reported on the income statement.
Difficulty: 2 Medium
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

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37) Which of the following is frequently used to describe the expenses that are matched in the same accounting period in which they are incurred?
A) Market expenses
B) Matching expenses
C) Period costs
D) Working costs

Answer: C
Explanation: When the connection between and expense and the corresponding revenue is vague, accountants commonly match the expense with the period in which it is incurred. Those expenses are frequently called period costs.
Difficulty: 1 Easy
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

38) If retained earnings decreased during the year, and no dividends were paid, which of the following statements must be **true**?
A) Expenses for the year exceeded revenues.
B) The company did not have enough cash to pay its expenses.
C) Total equity decreased.
D) Liabilities increased during the year.

Answer: A
Explanation: If retained earnings decreased and no dividends were paid, the company must have reported a net loss. A net loss would have been the result if expenses for the year exceeded revenues.
Difficulty: 2 Medium
Topic: Preparing Financial Statements with Accruals
Learning Objective: 02-03 Prepare financial statements that include accruals.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

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39) Which of the following correctly states the proper order of the steps in the accounting cycle?
A) Record transactions, adjust accounts, close temporary accounts, prepare statements.
B) Adjust accounts, record transactions, close temporary accounts, prepare statements.
C) Record transactions, adjust accounts, prepare statements, close temporary accounts.
D) Adjust accounts, prepare statements, record transactions, close temporary accounts.

Answer: C
Explanation: In the accounting cycle, a company records transactions throughout the accounting period, then adjusts accounts at the end of the period. Next, the company prepares financial statements, and finally, it closes temporary accounts in order to begin the next accounting period. If accounts were closed prior to preparing statements, the income statement accounts would have zero balances on the income statement.
Difficulty: 2 Medium
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

40) What is the purpose of the accrual basis of accounting?
A) Recognize revenue when it is collected from customers.
B) Match assets with liabilities during the proper accounting period.
C) Recognize expenses when cash disbursements are made.
D) Recognizing revenue when it is earned and expenses when they are incurred, regardless of when cash changes hands.

Answer: D
Explanation: Recognizing revenue when it is earned and expenses when they are incurred, regardless of when cash changes hands, is commonly called accrual accounting.
Difficulty: 2 Medium
Topic: Accounting for Receivables
Learning Objective: 02-01 Show how receivables affect financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

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41) Which of the following types of accounts is closed at the end of an accounting cycle?
A) Dividends
B) Common stock
C) Assets
D) Liabilities

Answer: A
Explanation: Revenues, expenses and dividends are closed to retained earnings at the end of an accounting cycle.
Difficulty: 1 Easy
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

42) Which of the following types of accounts is **not** closed at the end of an accounting cycle?
A) Revenues
B) Retained earnings
C) Dividends
D) Expenses

Answer: B
Explanation: Revenues, expenses and dividends are closed to retained earnings at the end of an accounting cycle. Retained earnings is a permanent account that is reported on the balance sheet.
Difficulty: 2 Medium
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

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43) Which of the following statements best describes the balance in a revenue account at the beginning of an accounting period?
A) Zero
B) Last period's ending balance
C) Higher than the previous period's beginning balance
D) Equal to the amount of retained earnings for the previous period

Answer: A
Explanation: The temporary accounts (that is, revenue, expense, and dividends) are closed prior to the start of the next accounting cycle. After closing, these accounts have zero balances and are ready to capture the revenue, expense, and dividend information for the next annual accounting period.
Difficulty: 2 Medium
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

44) What should an accountant do when there is no traceable connection between expenses and revenue?
A) Apply the matching concept
B) Design a system of internal control
C) Exercise judgment
D) Be as uniform as possible

Answer: C
Explanation: Although it would be more accurate to match expenses with revenues than with periods, there is sometimes no traceable connection between expenses and revenue. Accountants must exercise judgment to select the accounting period in which to recognize revenues and expenses.
Difficulty: 2 Medium
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

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45) Which of the following is **not** an element of the fraud triangle?
A) Reliance
B) Rationalization
C) Opportunity
D) Pressure

Answer: A
Explanation: The auditing profession has identified three elements that are typically present when fraud occurs. These three elements are often shown in the form of a triangle. The first of these elements is the availability of opportunity without which fraud could not exist. The second element recognizes pressure as a key ingredient of misconduct. The third element is the rationalization.
Difficulty: 1 Easy
Topic: Corporate Governance
Learning Objective: 02-10 Discuss the primary components of corporate governance.
Bloom's: Remember
AACSB: Ethics
AICPA: BB Critical Thinking; FN Risk Analysis; FN Decision Making

46) Which of the following is **not** a principle of the AICPA Code of Professional Conduct?
A) Due Care
B) Objectivity and Independence
C) Integrity
D) Internal Controls

Answer: D
Explanation: The AICPA Code of Professional Conduct includes the following six principles: Responsibilities, Public Interest, Integrity, Objectivity and Independence, Due Care, and Score and Nature of Services.
Difficulty: 2 Medium
Topic: Corporate Governance
Learning Objective: 02-10 Discuss the primary components of corporate governance.
Bloom's: Remember
AACSB: Ethics
AICPA: BB Critical Thinking; FN Decision Making

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47) Which of the following is **not** one of the common elements that are typically present when fraud occurs?
A) The capacity to rationalize
B) The existence of pressure leading to an incentive
C) The assistance of others
D) The presence of an opportunity

Answer: C
Explanation: The auditing profession has identified three elements that are typically present when fraud occurs: opportunity, pressure, and rationalization.
Difficulty: 1 Easy
Topic: Corporate Governance
Learning Objective: 02-10 Discuss the primary components of corporate governance.
Bloom's: Understand
AACSB: Ethics
AICPA: BB Critical Thinking; FN Risk Analysis; FN Decision Making

48) What is the term used to describe the policies and procedures that are designed to reduce the opportunities for fraud?
A) Internal controls
B) Asset source transactions
C) Accounting standards
D) Financial systems

Answer: A
Explanation: Internal controls are policies and procedures designed to reduce the opportunities for fraud.
Difficulty: 1 Easy
Topic: Corporate Governance
Learning Objective: 02-10 Discuss the primary components of corporate governance.
Bloom's: Remember
AACSB: Ethics
AICPA: BB Critical Thinking; FN Risk Analysis

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49) What action did the U.S. Congress take because of the audit failures at Enron, WorldCom and other companies?
A) Required publicly-traded companies to be audited by a government agency
B) Passed the Sarbanes-Oxley Act
C) Required companies to begin preparing an additional financial statement
D) Passed an amendment to the Securities and Exchange Act

Answer: B
Explanation: Congress passed the Sarbanes-Oxley Act in 2002 in response to audit failures at Enron and WorldCom, among others.
Difficulty: 1 Easy
Topic: Corporate Governance
Learning Objective: 02-10 Discuss the primary components of corporate governance.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Legal; FN Risk Analysis

50) Which of the following describes the effects of a claims exchange transaction on a company's financial statements?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
A.	NA	=	NA	+	NA	NA	−	NA	=	NA	+OA
B.	+	=	+	+	NA	NA	−	NA	=	NA	+OA
C.	NA	=	+	+	−	NA	−	+	=	−	NA
D.	All of these could represent the effects of a claims exchange transaction.										

A) Option A
B) Option B
C) Option C
D) Option D

Answer: C
Explanation: A claims exchange transaction will result in either an increase in liabilities and a decrease in equity or a decrease in liabilities and an increase in equity. It may or may not affect the income statement, but it will never affect the statement of cash flows, as it does not affect any asset, including cash.
Difficulty: 2 Medium
Topic: Transaction Classification
Learning Objective: 02-09 Classify accounting events into one of four categories.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

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51) Which of the following is an asset source transaction?
A) Issued common stock
B) Paid a cash dividend to stockholders
C) Collected cash from customers in settlement of accounts receivable
D) Accrued salary expense

Answer: A
Explanation: Issuing common stock is an asset source transaction that increases assets (cash) and increases equity (common stock). Paying a cash dividend is an asset use transaction, receiving a payment on accounts receivable is an asset exchange transaction, and accruing salary expense is a claims exchange transaction.
Difficulty: 2 Medium
Topic: Transaction Classification; Accounting for Receivables; Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-01 Show how receivables affect financial statements.; 02-02 Show how payables affect financial statements.; 02-09 Classify accounting events into one of four categories.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

52) Which of the following is an asset use transaction?
A) Purchased machine for cash.
B) Recorded insurance expense at the end of the period.
C) Invested cash in an interest earning account.
D) Accrued salary expense at the end of the period.

Answer: B
Explanation: Recording insurance expense at the end of the period is an asset use transaction that decreases assets (prepaid insurance) and decreases equity (insurance expense decreases retained earnings). Purchasing a machine for cash and investing cash in an interest earning account are asset exchange transactions. Accruing salary expense is a claims exchange transaction.
Difficulty: 2 Medium
Topic: Transaction Classification; Accounting for Prepaid Items; Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-02 Show how payables affect financial statements.; 02-06 Show how accounting for prepaid items affects financial statements.; 02-09 Classify accounting events into one of four categories.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

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53) Which of the following is a claims exchange transaction?
A) Recognized revenue earned on a contract where the cash had been collected at an earlier date.
B) Issued common stock.
C) Invested cash in an interest earning account.
D) Purchased machine for cash.

Answer: A
Explanation: Recognizing revenue earned on a contract where the cash had been collected at an earlier date is a claims exchange transaction that decreases liabilities (unearned revenue) and increases equity (revenue increases retained earnings). Purchasing a machine for cash and investing in an interest earning account are asset exchange transactions. Issuing common stock is an asset source transaction.
Difficulty: 2 Medium
Topic: Transaction Classification; Accounting for Unearned Revenue
Learning Objective: 02-07 Show how accounting for unearned revenues affects financial statements.; 02-09 Classify accounting events into one of four categories.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

54) Which of the following is an asset exchange transaction?
A) Issued common stock.
B) Accrued salary expense at the end of the accounting period.
C) Collected cash on accounts receivable.
D) Recognized revenue earned on a contract where the cash had been collected at an earlier date.

Answer: C
Explanation: Collecting cash on accounts receivable is an asset exchange transaction that increases one asset (cash) and decreases another asset (accounts receivable). Issuing common stock is an asset source transaction. Accruing salary expense and recognizing revenue earned on a contract where the cash had been collected at an earlier date are both claims exchange transactions.
Difficulty: 2 Medium
Topic: Transaction Classification; Accounting for Unearned Revenue; Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-02 Show how payables affect financial statements.; 02-07 Show how accounting for unearned revenues affects financial statements.; 02-09 Classify accounting events into one of four categories.
Bloom's: Understand
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AICPA: BB Critical Thinking; FN Measurement

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55) If a company provides services to clients but has not yet collected any cash, how should that transaction be classified?
A) Claims exchange transaction
B) Asset use transaction
C) Asset source transaction
D) Asset exchange transaction

Answer: C
Explanation: This transaction increases assets (accounts receivable) and increases equity (revenue increases retained earnings), and is therefore classified as an asset source transaction.
Difficulty: 2 Medium
Topic: Transaction Classification; Accounting for Receivables
Learning Objective: 02-01 Show how receivables affect financial statements.; 02-09 Classify accounting events into one of four categories.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

56) The term "recognition" means to report an economic event in the financial statements.

Answer: TRUE
Explanation: Recognition means recording revenue or expense, which results in reporting the event in the financial statements.
Difficulty: 1 Easy
Topic: Accounting for Receivables
Learning Objective: 02-01 Show how receivables affect financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

57) Companies that use accrual accounting recognize revenues and expenses at the time that cash is received or paid, respectively.

Answer: FALSE
Explanation: Accrual basis companies recognize revenue when earned and expense when incurred, regardless of when cash is received or paid.
Difficulty: 1 Easy
Topic: Accounting for Receivables
Learning Objective: 02-01 Show how receivables affect financial statements.
Bloom's: Remember
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AICPA: BB Critical Thinking; FN Measurement

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58) The term "accrual" describes an earnings event that is recognized before cash is received or paid.

Answer: TRUE
Explanation: Accruals involve events such as earning revenue on account and incurring expense on account, in which earnings is affected before cash is received or paid.
Difficulty: 1 Easy
Topic: Accounting for Receivables
Learning Objective: 02-01 Show how receivables affect financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

59) A company may recognize a revenue or expense without a corresponding cash collection or payment in the same accounting period.

Answer: TRUE
Explanation: Accrual basis companies recognize revenue when earned and expense when incurred, regardless of when cash is received or paid.
Difficulty: 1 Easy
Topic: Accounting for Receivables
Learning Objective: 02-01 Show how receivables affect financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

60) A payment to an employee in settlement of salaries payable decreases an asset and decreases equity.

Answer: FALSE
Explanation: The event decreases assets (cash) and decreases liabilities (salaries payable).
Difficulty: 2 Medium
Topic: Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-02 Show how payables affect financial statements.
Bloom's: Analyze
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61) An increase in an expense may be accompanied by a decrease in a liability.

Answer: FALSE
Explanation: An increase in an expense, such as salaries expense, may be accompanied by an increase in a liability, such as salaries payable, but it may not be accompanied by a decrease in a liability.
Difficulty: 1 Easy
Topic: Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-02 Show how payables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

62) Revenues and expenses are temporary accounts.

Answer: TRUE
Explanation: Revenues and expenses, along with dividends, are temporary accounts.
Difficulty: 1 Easy
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

63) The balances of the temporary accounts are transferred to Net Income, a permanent account, during the closing process.

Answer: FALSE
Explanation: All temporary account balances are transferred to the Retained Earnings account during the closing process. Net income is not an account; it is a total calculated on the income statement.
Difficulty: 1 Easy
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Remember
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64) Accounts that are closed include expenses, dividends, and unearned revenues.

Answer: FALSE
Explanation: The temporary accounts (that is, revenue, expense, and dividends) are closed prior to the start of the next accounting cycle. Unearned Revenue, which is a liability account, is a permanent account; as such, it is not closed.
Difficulty: 2 Medium
Topic: Accounting for Unearned Revenue; Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.; 02-07 Show how accounting for unearned revenues affects financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

65) After the closing process, all income statement accounts have balances that carry forward into the next accounting period.

Answer: FALSE
Explanation: Revenues and expenses are income statement accounts. The temporary accounts (that is, revenue, expense, and dividends) are closed prior to the start of the next accounting cycle. After closing, these accounts have zero balances and are ready to capture the revenue, expense, and dividend information for the next accounting period.
Difficulty: 1 Easy
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

66) Two of the steps in the accounting cycle are adjusting the accounts and closing the accounts.

Answer: TRUE
Explanation: The accounting cycle includes recording transactions, adjusting the accounts, preparing statements, and closing the accounts.
Difficulty: 1 Easy
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Remember
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67) Accrual accounting usually fails to match expenses with revenues.

Answer: FALSE
Explanation: A primary goal of accrual accounting is to appropriately match expenses with revenues, the matching concept. Appropriately matching expenses with revenues can be difficult even when using accrual accounting.
Difficulty: 1 Easy
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

68) The matching concept leads accountants to select the recognition alternative that produces the lowest amount of net income.

Answer: FALSE
Explanation: The matching concept does not lead accountants to select the recognition alternative that produces the lowest amount of net income. Instead, it is an accounting principle of recognizing expenses in the same accounting period as the revenues they produce.
Difficulty: 2 Medium
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

69) Adjusting entries never affect a business's cash account.

Answer: TRUE
Explanation: Transactions affecting the Cash account are recorded during the first step (recording transactions) of the accounting cycle. Adjusting entries are made at the end of the accounting period so that all revenue and expense account balances and related asset and liability account balances are updated prior to their use in preparing the financial statements. These entries are recorded during the second step (Adjusting the accounts) of the accounting cycle. Adjusting entries never affect the Cash account.
Difficulty: 2 Medium
Topic: Steps in an Accounting Cycle
Learning Objective: 02-04 Identify the steps in the accounting cycle.
Bloom's: Understand
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70) Asset use transactions always involve the payment of cash.

Answer: FALSE
Explanation: Asset use transactions can also involve a decrease in another asset account, such as supplies or prepaid rent.
Difficulty: 2 Medium
Topic: Transaction Classification
Learning Objective: 02-09 Classify accounting events into one of four categories.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

71) The governance of a corporation includes the roles and responsibilities of the board of directors, managers, shareholders, and auditor.

Answer: TRUE
Explanation: All of these stakeholders determine how a company is operated.
Difficulty: 1 Easy
Topic: Corporate Governance
Learning Objective: 02-10 Discuss the primary components of corporate governance.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Risk Analysis

72) The ethical standards for certified public accountants only require that such accountants comply with applicable laws and regulations.

Answer: FALSE
Explanation: The high ethical standards required by the profession state "a certified public accountant assumes an obligation of self-discipline above and beyond requirements of laws and regulations."
Difficulty: 1 Easy
Topic: Corporate Governance
Learning Objective: 02-10 Discuss the primary components of corporate governance.
Bloom's: Understand
AACSB: Reflective Thinking; Ethics
AICPA: BB Critical Thinking; BB Legal; FN Decision Making

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73) Certified public accountants are obligated to act in a way that serves the public interest.

Answer: TRUE
Explanation: The Public Interest Principle of the AICPA Code of Professional Conduct states: "Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism."
Difficulty: 1 Easy
Topic: Corporate Governance
Learning Objective: 02-10 Discuss the primary components of corporate governance.
Bloom's: Remember
AACSB: Reflective Thinking; Ethics
AICPA: BB Critical Thinking; FN Decision Making

74) The bankruptcies of Enron and WorldCom both indicated the occurrence of major audit failures.

Answer: TRUE
Explanation: The massive surprise bankruptcies of Enron in late 2001 and WorldCom several months later suggested major audit failures on the part of the independent auditors. An audit failure means a company's auditor does not detect, or fails to report, that the company's financial reports are not in compliance with GAAP.
Difficulty: 1 Easy
Topic: Corporate Governance
Learning Objective: 02-10 Discuss the primary components of corporate governance.
Bloom's: Understand
AACSB: Reflective Thinking; Ethics
AICPA: BB Critical Thinking; BB Legal; FN Risk Analysis

75) The Sarbanes-Oxley Act includes several significant reforms that affect the auditing profession, but it did not reduce an audit firm's ability to provide non-audit services to its audit clients.

Answer: FALSE
Explanation: Prior to the Sarbanes-Oxley Act (SOX), independent auditors often provided nonaudit services, such as installing computer systems, for their audit clients. To reduce the likelihood of conflicts of interest, SOX prohibits all registered public accounting firms from providing audit clients, contemporaneously with the audit, certain nonaudit services, including internal audit outsourcing, financial-information-system design and implementation services, and expert services.
Difficulty: 2 Medium
Topic: Corporate Governance
Learning Objective: 02-10 Discuss the primary components of corporate governance.
Bloom's: Understand
AACSB: Ethics
AICPA: BB Critical Thinking; BB Legal; FN Risk Analysis

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76) The internal controls of a business are designed to reduce the probability of occurrence of fraud.

Answer: TRUE
Explanation: Internal controls are policies and procedures that a business implements to reduce opportunities for fraud and to assure that its objectives will be accomplished.
Difficulty: 1 Easy
Topic: Corporate Governance
Learning Objective: 02-10 Discuss the primary components of corporate governance.
Bloom's: Understand
AACSB: Reflective Thinking; Ethics
AICPA: BB Critical Thinking; FN Risk Analysis

77) Providing services to customers on account is an asset exchange transaction.

Answer: FALSE
Explanation: Providing services to customers on account is an asset source transaction that increases the asset accounts receivable.
Difficulty: 1 Easy
Topic: Transaction Classification; Accounting for Receivables
Learning Objective: 02-01 Show how receivables affect financial statements.; 02-09 Classify accounting events into one of four categories.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

78) An adjusting entry that decreases unearned revenue and increases service revenue is a claims exchange transaction.

Answer: TRUE
Explanation: Unearned revenue, a liability, decreases and service revenue increases the equity account retained earnings, making this a claims exchange transaction.
Difficulty: 2 Medium
Topic: Transaction Classification; Accounting for Unearned Revenue
Learning Objective: 02-07 Show how accounting for unearned revenues affects financial statements.; 02-09 Classify accounting events into one of four categories.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

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79) Sometimes the recognition of revenue is accompanied by an increase in liabilities.

Answer: FALSE
Explanation: Recognition of revenue increases equity, which cannot be accompanied by an increase in liabilities. It could, however, be accompanied by a decrease in liabilities as in a claims exchange transaction.
Difficulty: 2 Medium
Topic: Accounting for Unearned Revenue
Learning Objective: 02-07 Show how accounting for unearned revenues affects financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

80) The collection of an account receivable is a claims exchange transaction.

Answer: FALSE
Explanation: The collection of an account receivable is an asset exchange transaction.
Difficulty: 2 Medium
Topic: Transaction Classification; Accounting for Receivables
Learning Objective: 02-01 Show how receivables affect financial statements.; 02-09 Classify accounting events into one of four categories.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

81) Joseph Company purchased a delivery van on January 1, Year 1 for $35,000. The van is estimated to have a 5-year useful life and a $5,000 salvage value. How much expense should Joseph recognize in Year 1 related to the use of the van?
A) $6,000
B) $7,000
C) $30,000
D) $5,000

Answer: A
Explanation: Depreciation expense = (Cost of $35,000 − Salvage value of $5,000) ÷ Useful life of five years = $6,000
Difficulty: 1 Easy
Topic: Accounting for Depreciation Expense
Learning Objective: 02-11 Compute depreciation expense and show how it affects financial statements.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

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82) Which of the following events involves a deferral?
A) Recording interest that has been earned but not received.
B) Recording revenue that has been earned but not yet collected in cash.
C) Recording supplies that have been purchased with cash but not yet used.
D) Recording salaries owed to employees at the end of the year that will be paid during the following year.

Answer: C
Explanation: Recording the purchase of supplies constitutes a deferral because it involves the payment of cash before an expense (in this case, supplies expense) is recognized.
Difficulty: 2 Medium
Topic: Accounting for Supplies; Accounting for Interest Expense; Accounting for Receivables; Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-01 Show how receivables affect financial statements.; 02-02 Show how payables affect financial statements.; 02-05 Show how accounting for supplies affects financial statements.; 02-12 Compute interest expense and show how it affects financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

83) The entry to recognize depreciation expense incurred on equipment involves which of the following?
A) A decrease in assets
B) An increase in liabilities
C) An increase in assets
D) A decrease in liabilities

Answer: A
Explanation: Recognizing depreciation expense involves a decrease in assets due to an increase in the contra-asset accumulated depreciation and a decrease in equity due to recognizing depreciation expense.
Difficulty: 2 Medium
Topic: Accounting for Depreciation Expense
Learning Objective: 02-11 Compute depreciation expense and show how it affects financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

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84) The following accounts and balances were drawn from the records of Barnes Company:

Cash	$ 4,500
Accounts receivable	$ 2,700
Equipment	$ 10,000
Accumulated depreciation	$ 3,200
Accounts payable	$ 2,800
Common stock	$ 6,000

Based on this information alone the amount of Barnes's retained earnings is:
A) $11,600.
B) $17,200.
C) $5,200.
D) None of these answers is correct.

Answer: C
Explanation: Assets = $4,500 + $2,700 + $10,000 − $3,200 = $14,000
Assets of $14,000 = Liabilities of $2,800 + Equity
Equity = $11,200
Equity = Common stock of $6,000 + Retained earnings
$11,200 = $6,000 + Retained earnings
Retained Earnings = $5,200
Difficulty: 2 Medium
Topic: Accounting for Depreciation Expense
Learning Objective: 02-11 Compute depreciation expense and show how it affects financial statements.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

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85) Which of the following would be included in the cash flow from operating activities section of the statement of cash flows?
A) Accrual of salary expense at year-end.
B) Purchase of equipment for cash.
C) Payments of cash dividends to the owners of the business.
D) Cash paid for interest on a note payable.

Answer: D
Explanation: Paying or receiving interest is considered an operating activity. Accruing salary expense is not a cash flow. Paying dividends is a financing activity, and purchasing equipment is an investing activity.
Difficulty: 2 Medium
Topic: Accounting for Interest Expense; Accounting for Payables (Year-End Adjusting Entry)
Learning Objective: 02-02 Show how payables affect financial statements.; 02-12 Compute interest expense and show how it affects financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

86) Chester Company began Year 2 with a note payable of $20,000 and an interest payable of $800. During the year, the company accrued an additional $400 of interest expense, and paid off the note with interest. What is the amount of cash flows for financing activities that will be reported on the statement of cash flows as a result of these transactions?
A) $1,200 outflow
B) $20,000 outflow
C) $20,400 outflow
D) $21,200 outflow

Answer: B
Explanation: Only the $20,000 outflow relating to the payment of the note is considered an outflow for financing activities. The $1,200 cash outflow for interest is considered an operating activity.
Difficulty: 3 Hard
Topic: Accounting for Interest Expense
Learning Objective: 02-12 Compute interest expense and show how it affects financial statements.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

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87) Consider how each of the transactions listed below affect net income reported on the income statement and the net cash flows from operating activities reported on the statement of cash flows. Which transaction(s) would affect the income statement in a different period from the statement of cash flows?
A) Recognized depreciation expense on equipment.
B) Incurred operating expenses on account.
C) Paid interest that was accrued in a prior year.
D) All of these answer choices would affect the income statement in a different period from the statement of cash flows.

Answer: D
Explanation: Recognizing depreciation expense reduces net income, but does not affect cash flows from operating activities. Incurring operating expenses on account also reduces net income, but does not affect cash flows from operating activities. Paying interest that was accrued in a prior year will reduce cash flows from operating activities, but will not affect net income.
Difficulty: 2 Medium
Topic: Accounting for Interest Expense; Accounting for Depreciation Expense
Learning Objective: 02-12 Compute interest expense and show how it affects financial statements.; 02-11 Compute depreciation expense and show how it affects financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

88) On January 1, Year 1, Alabama Company purchased a machine for $26,000. The machine has an estimated useful life of 4 years and an estimated salvage value of $6,000. What is the book value of the machine reported on Alabama's balance sheet as of December 31, Year 1?
A) $26,000
B) $19,500
C) $21,000
D) $15,000

Answer: C
Explanation: Accumulated depreciation at end of Year 1 = (Cost of $26,000 − Salvage value of $6,000) ÷ 4 years = $5,000
Book value = Cost of $26,000 cost − Accumulated depreciation of $5,000 = $21,000
Difficulty: 2 Medium
Topic: Computing Depreciation Expense
Learning Objective: 02-11 Compute depreciation expense and show how it affects financial statements.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

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89) Recognition of depreciation expense is an asset use transaction.

Answer: TRUE
Explanation: Recognition of depreciation expense is an asset use transaction that decreases the book (carrying) value of the depreciated asset and decreases equity.
Difficulty: 2 Medium
Topic: Accounting for Depreciation Expense
Learning Objective: 02-11 Compute depreciation expense and show how it affects financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

90) Recognition of depreciation expense on equipment decreases the equipment account.

Answer: FALSE
Explanation: Recognition of depreciation expense increases the contra-asset accumulated depreciation which decreases the book (carrying) value of the asset on the balance sheet. It does not decrease the equipment account itself.
Difficulty: 2 Medium
Topic: Accounting for Depreciation Expense
Learning Objective: 02-11 Compute depreciation expense and show how it affects financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

91) When a company purchases a depreciable asset, it must estimate the asset's useful life and salvage value.

Answer: TRUE
Explanation: It is necessary to estimate an asset's useful life and salvage value in order to calculate depreciation expense associated with the use of that asset.
Difficulty: 1 Easy
Topic: Accounting for Depreciation Expense
Learning Objective: 02-11 Compute depreciation expense and show how it affects financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

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92) The cash payment of interest is classified as a financing activity on the statement of cash flows.

Answer: FALSE
Explanation: The cash payment of interest is classified as an operating activity on the statement of cash flows.
Difficulty: 2 Medium
Topic: Accounting for Interest Expense
Learning Objective: 02-12 Compute interest expense and show how it affects financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

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