Introductory Financial Accounting for Business 1st edition Edmonds Test Bank

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Introductory Financial Accounting for Business, 1e **(Edmonds)**
Chapter 2 Accounting for Accruals

1) Frank Company earned $15,000 of cash revenue. Which of the following accurately reflects how this event affects the company's horizontal financial statements model?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
A.	15,000	=	NA	+	15,000	NA	−	NA	=	NA	15,000 OA
B.	15,000	=	NA	+	15,000	15,000	−	NA	=	15,000	NA
C.	15,000	=	NA	+	15,000	15,000	−	NA	=	15,000	15,000 OA
D.	15,000	=	15,000	+	NA	15,000	−	NA	=	15,000	15,000 OA

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

2) Jackson Company paid $500 cash for salary expenses. Which of the following accurately reflects how this event affects the company's horizontal financial statements model?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
A.	NA	=	500	+	(500)	NA	−	500	=	(500)	NA
B.	(500)	=	NA	+	(500)	NA	−	500	=	(500)	(500) OA
C.	(500)	=	NA	+	(500)	NA	−	NA	=	NA	(500) OA
D.	(500)	=	NA	+	(500)	NA	−	500	=	(500)	(500) IA

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

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3) Perez Company paid a $300 cash dividend. Which of the following accurately reflects how this event affects the company's horizontal financial statements model?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
A.	NA	=	300	+	(300)	NA	−	300	=	(300)	NA
B.	(300)	=	NA	+	(300)	NA	−	300	=	(300)	(300) FA
C.	(300)	=	NA	+	(300)	NA	−	NA	=	NA	(300) FA
D.	(300)	=	NA	+	(300)	NA	−	NA	=	NA	(300) OA

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

4) Garrison Company acquired $23,000 by issuing common stock. Which of the following accurately reflects how this event affects the company's horizontal financial statements model?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
A.	23,000	=	NA	+	23,000	NA	−	NA	=	NA	23,000 FA
B.	23,000	=	NA	+	23,000	23,000	−	NA	=	23,000	23,000 FA
C.	23,000	=	23,000	+	NA	23,000	−	NA	=	NA	23,000 FA
D.	23,000	=	23,000	+	NA	23,000	−	NA	=	23,000	23,000 OA

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

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5) Tandem Company borrowed $32,000 of cash from a local bank. Which of the following accurately reflects how this event affects the company's horizontal financial statements model?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
A.	32,000	=	32,000	+	NA	32,000	−	NA	=	32,000	32,000 FA
B.	32,000	=	NA	+	32,000	NA	−	NA	=	NA	32,000 FA
C.	32,000	=	NA	+	32,000	32,000	−	NA	=	32,000	32,000 FA
D.	32,000	=	32,000	+	NA	NA	−	NA	=	NA	32,000 FA

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

6) Zimmerman Company sold land for $25,000 cash. The original cost of the land was $25,000. Which of the following accurately reflects how this event affects the company's horizontal financial statements model?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
A.	NA	=	NA	+	NA	NA	−	NA	=	NA	25,000 IA
B.	(25,000)	=	NA	+	(25,000)	NA	−	NA	=	NA	(25,000) IA
C.	25,000	=	25,000	+	NA	NA	−	NA	=	NA	25,000 FA
D.	None of these.										

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

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7) Reynolds 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	=	+	+OA

Which of the following accounting events could have caused these effects on the elements of Reynolds' statements?
A) Paid a cash dividend.
B) Earned cash revenue.
C) Borrowed money from a bank.
D) The information provided does not represent a completed event.

8) Chico 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	=	NA	+FA

Which of the following accounting events could have caused these effects on the elements of Chico's financial statements?
A) Issued common stock
B) Earned cash revenue
C) Borrowed money from a bank

9) Delta Company experienced an accounting event that affected its financial statements as indicated below:

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

Which of the following accounting events could have caused these effects on the elements of Delta's statements?
A) Paid a cash dividend
B) Incurred a cash expense
C) Borrowed money from a bank
D) Earned cash revenue

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10) 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.

11) 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.

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

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

14) 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

15) 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

16) 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.

17) 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 horizontal 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.

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18) 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

19) 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

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

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

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21) 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.

[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		

22) 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

23) 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

24) The amount of Carolina's retained earnings on December 31, Year 1 was:
A) $5,900
B) $7,200
C) $3,900
D) $4,900

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

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

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

25) 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

26) 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

27) 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

28) 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

29) 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

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30) 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

31) 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

32) 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

33) 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

34) 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.

35) 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.

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

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

38) 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

39) 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

40) 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

41) 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

42) Which of the following is an asset use transaction?
A) Purchased land for cash
B) Paid cash for salary expense
C) Invested cash in an interest earning account
D) Accrued salary expense at the end of the period

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43) 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) Earned cash revenue for services provided

44) 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

45) 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 land for cash.
C) Payments of cash dividends to the owners of the business.
D) Cash paid for interest on a note payable.

46) Chester Company began Year 2 with a note payable of $20,000 and interest payable of $800. During the year, the company accrued an additional $400 of interest expense, and paid off the note with interest. On the company's Year 2 statement of cash flows, cash flows for financing activities related to the note would be:
A) $1,200 outflow
B) $20,000 outflow
C) $20,400 outflow
D) $21,200 outflow

47) 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

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48) The Merry Maids provided cleaning services to Orange Company on account. Which of the following would describe the transaction's effect on Orange Company's financial statements?

	Accounts Receivable	=	Accounts Payable	+	Common Stock	+	Retained Earnings	Rev.	−	Exp.	=	Net Inc.
A.	NA	=	+	+	NA	+	−	NA	−	NA	=	NA
B.	+	=	NA	+	NA	+	+	+	−	NA	=	+
C.	NA	=	+	+	NA	+	−	NA	−	+	=	−
D.	+	=	NA	+	NA	+	+	NA	−	NA	=	NA

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

49) The Merry Maids provided cleaning services to Orange Company on account. Which of the following would describe the transaction's effect on the Merry Maids' financial statements?

	Accounts Receivable	=	Accounts Payable	+	Common Stock	+	Retained Earnings	Rev.	−	Exp.	=	Net Inc.
A.	NA	=	+	+	NA	+	−	NA	−	NA	=	NA
B.	+	=	NA	+	NA	+	+	+	−	NA	=	+
C.	NA	=	+	+	NA	+	−	NA	−	+	=	−
D.	+	=	NA	+	NA	+	+	NA	−	NA	=	NA

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

50) During Year 2, Fancy Foods Incorporated earned $104,000 of revenue on account. The beginning balance in accounts receivable was $26,000, and the ending balance was $4,000. Based solely on this information, what was the amount of cash collected from accounts receivable?
A) $74,000
B) $82,000
C) $126,000
D) $134,000

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51) Fancy Foods Incorporated had an ending balance in accounts payable of $6,000. The company incurred $72,000 of operating expenses on account and paid $90,000 cash to settle accounts payable. Determine the beginning balance in accounts payable.
A) $12,000
B) $24,000
C) $96,000
D) $156,000

52) During Year 3, Fancy Foods Incorporated earned $54,000 of revenue on account. The beginning balance in accounts receivable was $5,000, and the ending balance was $10,000. Also, Fancy Foods Incorporated started the year with a beginning balance in accounts payable of $5,000. Fancy Foods' ending balance in account payable was $4,000. The company incurred $12,000 of operating expenses on account. Determine the amount of cash paid to settle accounts payable.
A) $13,000
B) $24,000
C) $96,000
D) $156,000

53) Wheaton Co. performed services for a customer on account. Indicate whether each of the following statements about this transaction is true or false.

_____ a) Assets and equity both increase when the revenue is recognized.
_____ b) This transaction did not affect cash flows.
_____ c) The Company recorded an increase in revenue and a decrease in accounts receivable.
_____ d) Recognition of revenue would be delayed until cash was collected.
_____ e) This transaction is an example of an asset exchange transaction.

54) Wyatt Company paid $57,000 in January, Year 2 for salaries that had been earned by employees in December, Year 1. Indicate whether each of the following statements about financial statement effects of the January, Year 2 event is true or false.

_____ a) The income statement for Year 2 is not affected because the salaries expense had been recognized at the end of December, Year 1.
_____ b) Cash flows from operating activities decreased on the Year 2 statement of cash flows.
_____ c) Payment of the salaries in Year 2 increased a liability.
_____ d) The Year 2 statement of changes in stockholders' equity would not be affected because the salaries expense had been recognized at the end of December, Year 1.
_____ e) Both assets and equity decreased in Year 2 as a result of this transaction.

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55) Indicate whether each of the following statements regarding the four types of accounting events is true or false.

_____ a) Asset exchange transactions involve an increase in one asset and a decrease in another asset.
_____ b) An asset source transaction involves an increase in assets and an increase in a corresponding claims account.
_____ c) An asset use transaction cannot result in an increase in equity.
_____ d) Asset exchange transactions cannot affect cash flows.
_____ e) Some claims exchange transactions involve an increase in a liability account and a decrease in an equity account.

56) Indicate whether each of the following statements regarding preparing financial statements is true or false.

_____ a) Accounts receivable is a liability account.
_____ b) Salaries payable is on the income statement.
_____ c) Interest expense is on the income statement.
_____ d) Accounts payable is on the statement of cash flows.
_____ e) Notes payable is a liability account.
_____ f) Interest payable is an asset account.

57) Indicate whether each of the following statements about corporate governance is true or false.

_____ a) The Financial Accounting Standards Board issues a code of ethical behavior by which public accountants must abide.
_____ b) The Sarbanes Oxley Act created the Public Company Accounting Oversight Board (PCAOB).
_____ c) Because of the Sarbanes Oxley Act, audit firms are not permitted to provide many nonaudit services to audit clients.
_____ d) The fraud triangle identifies opportunity, pressure, and rationalization as the three elements that are typically present when fraud is committed.
_____ e) An executive found guilty of falsely certifying a company's financial statements faces up to a $100,000 fine and five years in prison.

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58) On January 1, Year 1, Wilson Company borrowed $70,000 from State Bank. The note stipulates a 3-year term with a 3 percent interest rate. On December 31, Year 1, Wilson recorded an adjusting entry to accrue interest expense. Based solely on these events, indicate whether each of the following statements is true or false.

_____ a) The Year 1 income statement is not affected because interest expense has been accrued but not paid.
_____ b) The Year 1 statement of cash flows will show a $70,000 cash inflow from investing activities.
_____ c) Accruing interest expense in Year 1 increased a liability.
_____ d) Accruing interest expense is a claims exchange transaction.
_____ e) Both assets and equity decreased in Year 1 as a result of this transaction.

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

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

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

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

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

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

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

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

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

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

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

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

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71) 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 nonaudit services to its audit clients.

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

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

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

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

76) Accrued interest expense is an asset use transaction.

77) Some claims exchange transactions increase liabilities and decrease stockholders' equity.

78) The primary difference between notes payable and accounts payable is that notes payable generally have longer terms and usually require interest charges.

79) Issuing a note is an asset use transaction.

80) The balance in accounts receivable represents the amount of cash the company is required to pay in the future.

81) Accounts receivable is an asset account on the balance sheet.

82) Accounts payable is reported on the income statement.

83) Sales on account decrease the balance in accounts receivable.

84) Expenses incurred on account increase the accounts receivable balance.

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Introductory Financial Accounting for Business, 1e **(Edmonds)**
Chapter 2 Accounting for Accruals

1) Frank Company earned $15,000 of cash revenue. Which of the following accurately reflects how this event affects the company's horizontal financial statements model?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
A.	15,000	=	NA	+	15,000	NA	−	NA	=	NA	15,000 OA
B.	15,000	=	NA	+	15,000	15,000	−	NA	=	15,000	NA
C.	15,000	=	NA	+	15,000	15,000	−	NA	=	15,000	15,000 OA
D.	15,000	=	15,000	+	NA	15,000	−	NA	=	15,000	15,000 OA

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

Answer: C
Explanation: Earning cash revenue increases assets (cash) and stockholders' equity (retained earnings) on the balance sheet. It increases both revenue and net income on the income statement and is reported as a cash inflow for operating activities on the statement of cash flows.
Difficulty: 2 Medium
Topic: The Horizontal Financial Statements Model
Learning Objective: 02-01 Use a horizontal financial statements model to show how accounting events affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

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2) Jackson Company paid $500 cash for salary expenses. Which of the following accurately reflects how this event affects the company's horizontal financial statements model?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
A.	NA	=	500	+	(500)	NA	−	500	=	(500)	NA
B.	(500)	=	NA	+	(500)	NA	−	500	=	(500)	(500) OA
C.	(500)	=	NA	+	(500)	NA	−	NA	=	NA	(500) OA
D.	(500)	=	NA	+	(500)	NA	−	500	=	(500)	(500) IA

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

Answer: B
Explanation: Paying cash for expenses decreases assets (cash) and decreases stockholders' equity (retained earnings) on the balance sheet. It increases expenses which decreases net income on the income statement, and is reported as a cash outflow for operating activities on the statement of cash flows.
Difficulty: 2 Medium
Topic: The Horizontal Financial Statements Model
Learning Objective: 02-01 Use a horizontal financial statements model to show how accounting events affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
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3) Perez Company paid a $300 cash dividend. Which of the following accurately reflects how this event affects the company's horizontal financial statements model?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
A.	NA	=	300	+	(300)	NA	−	300	=	(300)	NA
B.	(300)	=	NA	+	(300)	NA	−	300	=	(300)	(300) FA
C.	(300)	=	NA	+	(300)	NA	−	NA	=	NA	(300) FA
D.	(300)	=	NA	+	(300)	NA	−	NA	=	NA	(300) OA

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

Answer: C
Explanation: Paying cash dividends decreases assets (cash) and decreases stockholders' equity (retained earnings) on the balance sheet. It does not affect the income statement, but is reported as a cash outflow for financing activities on the statement of cash flows.
Difficulty: 2 Medium
Topic: The Horizontal Financial Statements Model
Learning Objective: 02-01 Use a horizontal financial statements model to show how accounting events affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
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4) Garrison Company acquired $23,000 by issuing common stock. Which of the following accurately reflects how this event affects the company's horizontal financial statements model?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
A.	23,000	=	NA	+	23,000	NA	−	NA	=	NA	23,000 FA
B.	23,000	=	NA	+	23,000	23,000	−	NA	=	23,000	23,000 FA
C.	23,000	=	23,000	+	NA	23,000	−	NA	=	NA	23,000 FA
D.	23,000	=	23,000	+	NA	23,000	−	NA	=	23,000	23,000 OA

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

Answer: B
Explanation: Issuing common stock increases assets (cash) and stockholders' equity (common stock). It does not affect the income statement, but is reported as a cash inflow for financing activities on the statement of cash flows.
Difficulty: 2 Medium
Topic: The Horizontal Financial Statements Model
Learning Objective: 02-01 Use a horizontal financial statements model to show how accounting events affect financial statements.
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5) Tandem Company borrowed $32,000 of cash from a local bank. Which of the following accurately reflects how this event affects the company's horizontal financial statements model?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
A.	32,000	=	32,000	+	NA	32,000	−	NA	=	32,000	32,000 FA
B.	32,000	=	NA	+	32,000	NA	−	NA	=	NA	32,000 FA
C.	32,000	=	NA	+	32,000	32,000	−	NA	=	32,000	32,000 FA
D.	32,000	=	32,000	+	NA	NA	−	NA	=	NA	32,000 FA

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

Answer: D
Explanation: Borrowing cash increases assets (cash) and increases liabilities (notes payable). It does not affect the income statement, but is reported as a cash inflow for financing activities on the statement of cash flows.
Difficulty: 2 Medium
Topic: The Horizontal Financial Statements Model
Learning Objective: 02-01 Use a horizontal financial statements model to show how accounting events affect financial statements.
Bloom's: Analyze
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6) Zimmerman Company sold land for $25,000 cash. The original cost of the land was $25,000. Which of the following accurately reflects how this event affects the company's horizontal financial statements model?

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
A.	NA	=	NA	+	NA	NA	−	NA	=	NA	25,000 IA
B.	(25,000)	=	NA	+	(25,000)	NA	−	NA	=	NA	(25,000) IA
C.	25,000	=	25,000	+	NA	NA	−	NA	=	NA	25,000 FA
D.	None of these.										

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

Answer: A
Explanation: Selling land for cash increases one asset (cash) and decreases another asset (land), so it does not affect overall assets, liabilities or equity. It does not affect the income statement, but is reported as a cash inflow for investing activities on the statement of cash flows.
Difficulty: 2 Medium
Topic: The Horizontal Financial Statements Model
Learning Objective: 02-01 Use a horizontal financial statements model to show how accounting events affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
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7) Reynolds 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	=	+	+OA

Which of the following accounting events could have caused these effects on the elements of Reynolds' statements?
A) Paid a cash dividend.
B) Earned cash revenue.
C) Borrowed money from a bank.
D) The information provided does not represent a completed event.

Answer: B
Explanation: Earning cash revenue is an event that affected the financial statements as indicated because it increased revenue and net income on the income statement and was reported as a cash inflow for operating activities on the statement of cash flows. Also, this event affected the Balance Sheet by increasing Assets (Cash) and Equity (Retained Earnings).
Difficulty: 2 Medium
Topic: The Horizontal Financial Statements Model
Learning Objective: 02-01 Use a horizontal financial statements model to show how accounting events affect financial statements.
Bloom's: Analyze
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8) Chico 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	=	NA	+FA

Which of the following accounting events could have caused these effects on the elements of Chico's financial statements?
A) Issued common stock
B) Earned cash revenue
C) Borrowed money from a bank

Answer: A
Explanation: Issuing common stock would increase assets (cash) and increase stockholders' equity (common stock). It would not affect net income, but would be reported as a cash inflow from financing activities on the statement of cash flows.
Difficulty: 2 Medium
Topic: The Horizontal Financial Statements Model
Learning Objective: 02-01 Use a horizontal financial statements model to show how accounting events affect financial statements.
Bloom's: Analyze
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9) Delta Company experienced an accounting event that affected its financial statements as indicated below:

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

Which of the following accounting events could have caused these effects on the elements of Delta's statements?
A) Paid a cash dividend
B) Incurred a cash expense
C) Borrowed money from a bank
D) Earned cash revenue

Answer: B
Explanation: Incurring a cash expense would decrease assets (cash) and decrease stockholders' equity (retained earnings). It would increase expenses and decrease net income, and would be reported as a cash outflow for operating activities on the statement of cash flows.
Difficulty: 2 Medium
Topic: The Horizontal Financial Statements Model
Learning Objective: 02-01 Use a horizontal financial statements model to show how accounting events affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

10) 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: 02-02 Show how receivables affect financial statements.
Bloom's: Apply
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

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11) 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 stockholders' equity (retained earnings). It does not affect cash flows.
Difficulty: 2 Medium
Topic: Accounting for Receivables
Learning Objective: 02-02 Show how receivables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
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12) 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 stockholders' equity (retained earnings). It does not affect cash flows.
Difficulty: 2 Medium
Topic: Accounting for Payables
Learning Objective: 02-03 Show how payables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

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

	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Stmt of Cash Flows
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 stockholders' equity (retained earnings). It does not affect cash flows.
Difficulty: 2 Medium
Topic: Accounting for Payables
Learning Objective: 02-03 Show how payables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

14) 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: 02-02 Show how receivables affect financial statements.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

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15) 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).
Difficulty: 2 Medium
Topic: Accounting for Payables
Learning Objective: 02-03 Show how payables affect financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

16) 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: Preparing Financial Statements
Learning Objective: 02-04 Prepare financial statements that include accruals.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

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17) 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 horizontal 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 $38,000 + Increase in Cash because of Collection on Account receivable of $38,000 − Decrease in Cash because of payments 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 stockholders' 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
Learning Objective: 02-02 Show how receivables affect financial statements.; 02-03 Show how payables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

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18) 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 − $14,500)
$25,300 = Common Stock + $9,900
Common Stock = $15,400
Difficulty: 3 Hard
Topic: Preparing Financial Statements
Learning Objective: 02-04 Prepare financial statements that include accruals.
Bloom's: Apply
AACSB: Knowledge Application
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19) 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
Learning Objective: 02-02 Show how receivables affect financial statements.; 02-03 Show how payables affect financial statements.
Bloom's: Apply
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20) Warren Enterprises began operations during Year 1. The company had the following events during Year 1:

1) The business issued $40,000 of common stock to its stockholders.
2) The business purchased land for $24,000 cash.
3) Services were provided to customers for $32,000 cash.
4) Services were provided to customers for $10,000 on account.
5) The company borrowed $32,000 from the bank.
6) Operating expenses of $24,000 were incurred and paid in cash.
7) Salary expense of $1,600 was accrued.
8) 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; Accounting for Payables; Preparing Financial Statements
Learning Objective: 02-04 Prepare financial statements that include accruals.; 02-02 Show how receivables affect financial statements.; 02-03 Show how payables affect financial statements.
Bloom's: Apply
AACSB: Knowledge Application
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21) 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: Accounting for Payables; Preparing Financial Statements
Learning Objective: 02-04 Prepare financial statements that include accruals.; 02-03 Show how payables affect financial statements.
Bloom's: Apply
AACSB: Knowledge Application
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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		

22) 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
Learning Objective: 02-04 Prepare financial statements that include accruals.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

23) 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
Learning Objective: 02-04 Prepare financial statements that include accruals.
Bloom's: Apply
AACSB: Knowledge Application
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24) The amount of Carolina's retained earnings on December 31, Year 1 was:
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: Preparing Financial Statements
Learning Objective: 02-04 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.

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

25) 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
Learning Objective: 02-04 Prepare financial statements that include accruals.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

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26) 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
Learning Objective: 02-04 Prepare financial statements that include accruals.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

27) 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
Learning Objective: 02-04 Prepare financial statements that include accruals.
Bloom's: Apply
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28) 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
Learning Objective: 02-04 Prepare financial statements that include accruals.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

29) 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 adjustment 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
Learning Objective: 02-03 Show how payables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

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30) 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: 02-02 Show how receivables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

31) 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: Preparing Financial Statements
Learning Objective: 02-04 Prepare financial statements that include accruals.
Bloom's: Remember
AACSB: Reflective Thinking
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32) 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: Preparing Financial Statements
Learning Objective: 02-04 Prepare financial statements that include accruals.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

33) 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: Preparing Financial Statements
Learning Objective: 02-04 Prepare financial statements that include accruals.
Bloom's: Remember
AACSB: Reflective Thinking
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34) 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
Learning Objective: 02-04 Prepare financial statements that include accruals.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

35) 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: 02-02 Show how receivables affect financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

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36) 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: The Financial Analyst
Learning Objective: 02-07 Identify the primary components of corporate governance.
Bloom's: Remember
AACSB: Ethics
AICPA: BB Critical Thinking; FN Risk Analysis; FN Decision Making

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

Answer: C
Explanation: The AICPA Code of Professional Conduct includes the following six principles: Responsibilities, Public Interest, Integrity, Objectivity and Independence, Due Care, and Scope and Nature of Services.
Difficulty: 2 Medium
Topic: The Financial Analyst
Learning Objective: 02-07 Identify the primary components of corporate governance.
Bloom's: Remember
AACSB: Ethics
AICPA: BB Critical Thinking; FN Decision Making

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38) 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: The Financial Analyst
Learning Objective: 02-07 Identify the primary components of corporate governance.
Bloom's: Understand
AACSB: Ethics
AICPA: BB Critical Thinking; FN Risk Analysis; FN Decision Making

39) 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: The Financial Analyst
Learning Objective: 02-07 Identify the primary components of corporate governance.
Bloom's: Remember
AACSB: Ethics
AICPA: BB Critical Thinking; FN Risk Analysis

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40) 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: The Financial Analyst
Learning Objective: 02-07 Identify the primary components of corporate governance.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Legal; FN Risk Analysis

41) 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 stockholders' 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: Accounting for Receivables; Accounting for Payables
Learning Objective: 02-02 Show how receivables affect financial statements.; 02-03 Show how payables affect financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

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42) Which of the following is an asset use transaction?
A) Purchased land for cash
B) Paid cash for salary expense
C) Invested cash in an interest earning account
D) Accrued salary expense at the end of the period

Answer: B
Explanation: Paid cash for salary expense is an asset use transaction that decreases assets (cash) and decreases stockholders' equity (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
Learning Objective: 02-03 Show how payables affect financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

43) 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) Earned cash revenue for services provided

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 is a claims exchange transaction. Earning cash revenue is an asset source transaction.
Difficulty: 2 Medium
Topic: Accounting for Receivables; Accounting for Payables
Learning Objective: 02-02 Show how receivables affect financial statements.; 02-03 Show how payables affect financial statements.
Bloom's: Understand
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44) 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 stockholders' equity (retained earnings), and is therefore classified as an asset source transaction.
Difficulty: 2 Medium
Topic: Accounting for Receivables
Learning Objective: 02-02 Show how receivables affect financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

45) 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 land 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 Payables; Accounting for Notes Payable
Learning Objective: 02-05 Show how notes payable and interest expense affect financial statements.; 02-03 Show how payables affect financial statements.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

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46) Chester Company began Year 2 with a note payable of $20,000 and interest payable of $800. During the year, the company accrued an additional $400 of interest expense, and paid off the note with interest. On the company's Year 2 statement of cash flows, cash flows for financing activities related to the note would be:
A) $1,200 outflow
B) $20,000 outflow
C) $20,400 outflow
D) $21,200 outflow

Answer: B
Explanation: Only the $20,000 principle would be considered an outflow for financing activities. The $1,200 interest paid is considered an operating activity.
Difficulty: 2 Medium
Topic: Accounting for Notes Payable
Learning Objective: 02-05 Show how notes payable and interest expense affect financial statements.
Bloom's: Apply
AACSB: Knowledge Application
AICPA: BB Critical Thinking; FN Measurement

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47) 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: Recognizing accrued salary expense is a claims exchange transaction. The claims of creditors increase and the claims of stockholders decrease. Total claims remain unchanged. Specifically, the liabilities account, Salaries Payable, increases. The balance in the Salaries Payable account represents the amount of cash the company is required to pay the employee in the future. Recognizing salary expense decreases net income. There is no effect on the statement of cash flows because cash was not paid.
Difficulty: 2 Medium
Topic: Accounting for Payables
Learning Objective: 02-03 Show how payables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
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48) The Merry Maids provided cleaning services to Orange Company on account. Which of the following would describe the transaction's effect on Orange Company's financial statements?

	Accounts Receivable	=	Accounts Payable	+	Common Stock	+	Retained Earnings	Rev.	−	Exp.	=	Net Inc.
A.	NA	=	+	+	NA	+	−	NA	−	NA	=	NA
B.	+	=	NA	+	NA	+	+	+	−	NA	=	+
C.	NA	=	+	+	NA	+	−	NA	−	+	=	−
D.	+	=	NA	+	NA	+	+	NA	−	NA	=	NA

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

Answer: C
Explanation: The Merry Maids provided cleaning services to Orange Company on account. From the perspective of Orange, the company has received services but has not paid cash for the services. Orange must record a liability to represent how much money it owes the Merry Maids. On Orange's balance sheet, the liability account, Accounts Payable, will increase and the stockholders' equity account, Retained Earnings, will decrease. On Orange's income statement, expenses will increase and net income will decrease.
Difficulty: 2 Medium
Topic: Accounting for Payables
Learning Objective: 02-03 Show how payables affect financial statements.
Bloom's: Analyze
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49) The Merry Maids provided cleaning services to Orange Company on account. Which of the following would describe the transaction's effect on the Merry Maids' financial statements?

	Accounts Receivable	=	Accounts Payable	+	Common Stock	+	Retained Earnings	Rev.	−	Exp.	=	Net Inc.
A.	NA	=	+	+	NA	+	−	NA	−	NA	=	NA
B.	+	=	NA	+	NA	+	+	+	−	NA	=	+
C.	NA	=	+	+	NA	+	−	NA	−	+	=	−
D.	+	=	NA	+	NA	+	+	NA	−	NA	=	NA

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

Answer: B
Explanation: The Merry Maids provided services to Orange Company on account. From the perspective of the Merry Maids, it has earned revenue but not been paid for the services. The Merry Maids must record an asset to represent the amount of money it is waiting to receive from Orange Company. On the Merry Maids' balance sheet, the asset account, Accounts Receivable, will increase and the stockholders' equity account, Retained Earnings, will increase. On the Merry Maids' income statement, revenue will increase and net income will increase.
Difficulty: 2 Medium
Topic: Accounting for Receivables
Learning Objective: 02-02 Show how receivables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
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50) During Year 2, Fancy Foods Incorporated earned $104,000 of revenue on account. The beginning balance in accounts receivable was $26,000, and the ending balance was $4,000. Based solely on this information, what was the amount of cash collected from accounts receivable?
A) $74,000
B) $82,000
C) $126,000
D) $134,000

Answer: C
Explanation: Year 2 Changes in Accounts Receivable: Beginning accounts receivable balance + Increases due to sales on account - Decreases due to receivables collections = Ending accounts receivable balance. $26,000 + $104,000 – X = $4,000. X= $126,000.
Difficulty: 2 Medium
Topic: Accounting for Receivables
Learning Objective: 02-02 Show how receivables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

51) Fancy Foods Incorporated had an ending balance in accounts payable of $6,000. The company incurred $72,000 of operating expenses on account and paid $90,000 cash to settle accounts payable. Determine the beginning balance in accounts payable.
A) $12,000
B) $24,000
C) $96,000
D) $156,000

Answer: B
Explanation: Year 2 Changes in Accounts Payable: Beginning accounts payable balance + Increases due to expenses incurred on account - Decreases due to payment of accounts payable = Ending accounts payable balance. X +$72,000 – $90,000 = $6,000. X= $24,000.
Difficulty: 2 Medium
Topic: Accounting for Payables
Learning Objective: 02-03 Show how payables affect financial statements.
Bloom's: Analyze
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52) During Year 3, Fancy Foods Incorporated earned $54,000 of revenue on account. The beginning balance in accounts receivable was $5,000, and the ending balance was $10,000. Also, Fancy Foods Incorporated started the year with a beginning balance in accounts payable of $5,000. Fancy Foods' ending balance in account payable was $4,000. The company incurred $12,000 of operating expenses on account. Determine the amount of cash paid to settle accounts payable.
A) $13,000
B) $24,000
C) $96,000
D) $156,000

Answer: A
Explanation: Year 2 Changes in Accounts Payable: Beginning accounts payable balance + Increases due to expenses incurred on account - Decreases due to payment of accounts payable = Ending accounts payable balance. $5,000 +$12,000 – X= $4,000. X= $13,000.
Difficulty: 2 Medium
Topic: Accounting for Payables
Learning Objective: 02-03 Show how payables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

53) Wheaton Co. performed services for a customer on account. Indicate whether each of the following statements about this transaction is true or false.

_____ a) Assets and equity both increase when the revenue is recognized.
_____ b) This transaction did not affect cash flows.
_____ c) The Company recorded an increase in revenue and a decrease in accounts receivable.
_____ d) Recognition of revenue would be delayed until cash was collected.
_____ e) This transaction is an example of an asset exchange transaction.

Answer: a) T b) T c) F d) F e) F
Explanation: a) This is true. Assets (accounts receivable) and equity (revenue increases retained earnings) both increase.
b) This is true. Because cash is not affected, cash flows are not affected.
c) This is false. The event resulted in an increase in revenue and an increase in accounts receivable.
d) This is false. Kenyon would recognize revenue when the services are performed, not when cash is received.
e) This is false. Because assets (accounts receivable) increase, it is an asset source transaction.
Difficulty: 2 Medium
Topic: Accounting for Receivables
Learning Objective: 02-02 Show how receivables affect financial statements.
Bloom's: Analyze
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54) Wyatt Company paid $57,000 in January, Year 2 for salaries that had been earned by employees in December, Year 1. Indicate whether each of the following statements about financial statement effects of the January, Year 2 event is true or false.

_____ a) The income statement for Year 2 is not affected because the salaries expense had been recognized at the end of December, Year 1.
_____ b) Cash flows from operating activities decreased on the Year 2 statement of cash flows.
_____ c) Payment of the salaries in Year 2 increased a liability.
_____ d) The Year 2 statement of changes in stockholders' equity would not be affected because the salaries expense had been recognized at the end of December, Year 1.
_____ e) Both assets and equity decreased in Year 2 as a result of this transaction.

Answer: a) T b) T c) F d) T e) F
Explanation: a) This is true. The expense is recognized in the period in which the salaries were earned, in Year 1.
b) This is true. The January, Year 2 payment decreases cash flows from operating activities in Year 2.
c) This is false. When the payment is made, salaries payable, a liability, is decreased, not increased.
d) This is true. Because the expense was recognized in Year 1, the Year 2 statement of changes in stockholders' equity is unaffected.
e) This is false. The January, Year 2 payment decreases assets (cash) and liabilities (salaries payable), but not equity.
Difficulty: 3 Hard
Topic: Accounting for Payables
Learning Objective: 02-03 Show how payables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
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55) Indicate whether each of the following statements regarding the four types of accounting events is true or false.

_____ a) Asset exchange transactions involve an increase in one asset and a decrease in another asset.
_____ b) An asset source transaction involves an increase in assets and an increase in a corresponding claims account.
_____ c) An asset use transaction cannot result in an increase in equity.
_____ d) Asset exchange transactions cannot affect cash flows.
_____ e) Some claims exchange transactions involve an increase in a liability account and a decrease in an equity account.

Answer: a) T b) T c) T d) F e) T
Explanation: a) This is true. An asset exchange transaction involves an increase in one asset and a decrease in another asset.
b) This is true. An asset source transaction involves an increase in assets and an increase in liabilities or equity.
c) This is true. An asset use transaction involves a decrease in assets and either a decrease in liabilities or equity. Therefore, it cannot result in an increase in equity.
d) This is false. Because an asset exchange transaction involves an increase in one asset and a decrease in another, it often affects cash.
e) This is true. Some claims exchange transactions, including accruing salaries, involve an increase in a liability and a decrease in equity.
Difficulty: 2 Medium
Topic: Accounting for Receivables; Accounting for Payables
Learning Objective: 02-02 Show how receivables affect financial statements.; 02-03 Show how payables affect financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

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56) Indicate whether each of the following statements regarding preparing financial statements is true or false.

_____ a) Accounts receivable is a liability account.
_____ b) Salaries payable is on the income statement.
_____ c) Interest expense is on the income statement.
_____ d) Accounts payable is on the statement of cash flows.
_____ e) Notes payable is a liability account.
_____ f) Interest payable is an asset account.

Answer: a) F b) F c) T d) F e) T f) F
Explanation: a) This is false. Accounts receivable is an asset account.
b) This is false. Salaries payable is a liability account on the balance sheet.
c) This is true. Interest expense is reported on the income statement.
d) This is false. Accounts payable is a liability account on the balance sheet. It represents the amount of cash a company is required to pay in the future.
e) This is true. Notes payable is a liability account on the balance sheet.
f) This is false. Interest payable is a liability account on the balance sheet.
Difficulty: 2 Medium
Topic: Accounting for Receivables; Accounting for Payables; Accounting for Notes Payable
Learning Objective: 02-02 Show how receivables affect financial statements.; 02-05 Show how notes payable and interest expense affect financial statements.; 02-03 Show how payables affect financial statements.
Bloom's: Remember
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57) Indicate whether each of the following statements about corporate governance is true or false.

_____ a) The Financial Accounting Standards Board issues a code of ethical behavior by which public accountants must abide.
_____ b) The Sarbanes Oxley Act created the Public Company Accounting Oversight Board (PCAOB).
_____ c) Because of the Sarbanes Oxley Act, audit firms are not permitted to provide many nonaudit services to audit clients.
_____ d) The fraud triangle identifies opportunity, pressure, and rationalization as the three elements that are typically present when fraud is committed.
_____ e) An executive found guilty of falsely certifying a company's financial statements faces up to a $100,000 fine and five years in prison.

Answer: a) F b) T c) T d) T e) F
Explanation: a) This is false. The AICPA, not FASB, issues a code of professional behavior for CPAs.
b) This is true. The PCAOB is a result of the Sarbanes-Oxley Act.
c) This is true. The Sarbanes-Oxley Act restricts nonaudit services that audit firms can provide to audit clients.
d) This is true. Opportunity, pressure, and rationalization make up the fraud triangle.
e) This is false. A $5 million fine and 20-year prison sentence are possible penalties for executives who falsely certify a company's financial statements.
Difficulty: 2 Medium
Topic: The Financial Analyst
Learning Objective: 02-07 Identify the primary components of corporate governance.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Legal; FN Risk Analysis

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58) On January 1, Year 1, Wilson Company borrowed $70,000 from State Bank. The note stipulates a 3-year term with a 3 percent interest rate. On December 31, Year 1, Wilson recorded an adjusting entry to accrue interest expense. Based solely on these events, indicate whether each of the following statements is true or false.

_____ a) The Year 1 income statement is not affected because interest expense has been accrued but not paid.
_____ b) The Year 1 statement of cash flows will show a $70,000 cash inflow from investing activities.
_____ c) Accruing interest expense in Year 1 increased a liability.
_____ d) Accruing interest expense is a claims exchange transaction.
_____ e) Both assets and equity decreased in Year 1 as a result of this transaction.

Answer: a) F b) F c) T d) T e) F
Explanation: a) This is false. Accrued interest expense is recognized as an expense on the income statement even though there has not been a cash payment for the interest.
b) This is false. Borrowing money is a financing activity. There will be a cash inflow of $70,000 reported as a financing activity on the statement of cash flows.
c) This is true. Accruing interest expense increases the liability account, Interest Payable.
d) This is true. Accruing interest expense is a claims exchange transaction. Liabilities increase and stockholders' equity decreases. There is no net effect on total claims.
e) This is false. Liabilities and assets increase and equity decreases in Year 1.
Difficulty: 2 Medium
Topic: Accounting for Notes Payable
Learning Objective: 02-05 Show how notes payable and interest expense affect financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

59) 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: 02-02 Show how receivables affect financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
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60) 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: 02-02 Show how receivables affect financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

61) 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: 02-02 Show how receivables affect financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

62) 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: 02-02 Show how receivables affect financial statements.
Bloom's: Remember
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63) 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
Learning Objective: 02-03 Show how payables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

64) 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
Learning Objective: 02-03 Show how payables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

65) 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: Preparing Financial Statements
Learning Objective: 02-04 Prepare financial statements that include accruals.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

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66) 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: Preparing Financial Statements
Learning Objective: 02-04 Prepare financial statements that include accruals.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

67) 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: The Financial Analyst
Learning Objective: 02-07 Identify the primary components of corporate governance.
Bloom's: Understand
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Risk Analysis

68) 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: The Financial Analyst
Learning Objective: 02-07 Identify 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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69) 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: The Financial Analyst
Learning Objective: 02-07 Identify the primary components of corporate governance.
Bloom's: Remember
AACSB: Reflective Thinking; Ethics
AICPA: BB Critical Thinking; FN Decision Making

70) 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: The Financial Analyst
Learning Objective: 02-07 Identify the primary components of corporate governance.
Bloom's: Understand
AACSB: Reflective Thinking; Ethics
AICPA: BB Critical Thinking; BB Legal; FN Risk Analysis

71) 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 nonaudit 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: The Financial Analyst
Learning Objective: 02-07 Identify the primary components of corporate governance.
Bloom's: Understand
AACSB: Ethics
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72) 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: The Financial Analyst
Learning Objective: 02-07 Identify the primary components of corporate governance.
Bloom's: Understand
AACSB: Reflective Thinking; Ethics
AICPA: BB Critical Thinking; FN Risk Analysis

73) 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: Accounting for Receivables
Learning Objective: 02-02 Show how receivables affect financial statements.
Bloom's: Analyze
AACSB: Analytical Thinking
AICPA: BB Critical Thinking; FN Measurement

74) 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 Use a horizontal financial statements model to show how accounting events affect financial statements.; 02-02 Show how receivables affect financial statements.
Bloom's: Analyze
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75) 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: 02-05 Show how notes payable and interest expense affect financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

76) Accrued interest expense is an asset use transaction.

Answer: FALSE
Explanation: Accruing interest expense is a claims exchange transaction. The liability account, Interest Payable, increases and the stockholders' equity account, Retained Earnings, decreases. Total claims are not affected.
Difficulty: 2 Medium
Topic: Accounting for Notes Payable
Learning Objective: 02-05 Show how notes payable and interest expense affect financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

77) Some claims exchange transactions increase liabilities and decrease stockholders' equity.

Answer: TRUE
Explanation: Recognizing accrued expense is a claims exchange transaction. The claims of creditors (liability) increase and the claims of stockholders (equity) decrease.
Difficulty: 2 Medium
Topic: Accounting for Notes Payable
Learning Objective: 02-05 Show how notes payable and interest expense affect financial statements.
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78) The primary difference between notes payable and accounts payable is that notes payable generally have longer terms and usually require interest charges.

Answer: TRUE
Explanation: Notes payable and Accounts payable are both liability accounts. The primary difference between notes payable and accounts payable is that notes payable generally have longer terms and usually require interest charges.
Difficulty: 2 Medium
Topic: Accounting for Notes Payable
Learning Objective: 02-05 Show how notes payable and interest expense affect financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

79) Issuing a note is an asset use transaction.

Answer: FALSE
Explanation: Issuing a note is an asset source transaction. The asset account, Cash, increases and the liability account, Notes Payable, increases.
Difficulty: 2 Medium
Topic: Accounting for Notes Payable
Learning Objective: 02-05 Show how notes payable and interest expense affect financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

80) The balance in accounts receivable represents the amount of cash the company is required to pay in the future.

Answer: FALSE
Explanation: The balance in accounts receivable represents the amount of cash the company expects to collect in the future.
Difficulty: 2 Medium
Topic: Accounting for Receivables
Learning Objective: 02-02 Show how receivables affect financial statements.
Bloom's: Remember
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81) Accounts receivable is an asset account on the balance sheet.

Answer: TRUE
Explanation: Accounts receivable is an asset account on the balance sheet.
Difficulty: 2 Medium
Topic: Accounting for Receivables
Learning Objective: 02-02 Show how receivables affect financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

82) Accounts payable is reported on the income statement.

Answer: FALSE
Explanation: Accounts payable is a liability account on the balance sheet. It is not reported on the income statement.
Difficulty: 2 Medium
Topic: Accounting for Payables
Learning Objective: 02-03 Show how payables affect financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

83) Sales on account decrease the balance in accounts receivable.

Answer: FALSE
Explanation: Sales on account increase the balance in accounts receivable.
Difficulty: 2 Medium
Topic: Accounting for Receivables
Learning Objective: 02-02 Show how receivables affect financial statements.
Bloom's: Remember
AACSB: Reflective Thinking
AICPA: BB Critical Thinking; FN Measurement

84) Expenses incurred on account increase the accounts receivable balance.

Answer: FALSE
Explanation: Expenses incurred on account increase the accounts payable balance not the accounts receivable balance.
Difficulty: 2 Medium
Topic: Accounting for Payables
Learning Objective: 02-03 Show how payables affect financial statements.
Bloom's: Remember
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