Chapter 14

Accounting and Financial Statements

True / False Questions

1. In the United States, the Bureau of Labor Statistics has been setting the principles standards of financial accounting and reporting in the private sector since 1973.
   True  False

2. Accounting is the recording, measurement, and interpretation of financial information.
   True  False

3. The terms accounting and bookkeeping are interchangeable because they mean almost the same thing.
   True  False

4. Bookkeeping is only one aspect of accounting and involves the recording of routine, day-to-day business transactions.
   True  False

5. Highly successful and rapidly growing companies can easily make payments to employees, suppliers, and lenders even if they have an inadequate cash flow.
   True  False

6. Budgets are valuable tools because they break down cash inflows and outflows to help individuals and organizations clearly see where financial problems may lie.
   True  False

7. Assets are a firm's economic resources.
   True  False

8. Liabilities are debts a firm owes to others.
   True  False

9. All business transactions can be classified as assets, liabilities, or owner's equity.
   True  False
10. The accounting cycle is a system of analyzing and interpreting business transactions in separate accounts in order to maintain the balance of the accounting equation.

   True   False

11. In accounting, a ledger is a time-ordered list of accounting transactions.

   True   False

12. When the financial statements are completed and an accountant has attested that the firm followed GAAP, a firm's books are said to be "closed," and the accounting cycle begins anew for the next accounting period.

   True   False

13. Nonbusiness organizations obtain revenue through the sale of its assets.

   True   False

14. Cost of goods sold is calculated by subtracting the ending inventory from the beginning inventory.

   True   False

15. Interest expenses include the indirect costs of borrowing money.

   True   False

16. Income statements show revenue, expenses, and income over a period of time.

   True   False

17. Net income is the profit (or sometimes loss) after all expenses, excluding taxes, have been deducted from revenue.

   True   False

18. At the end of each accounting period, the dollar amounts in all the revenue and expense accounts on the income statement are moved into an account called "Retained Earnings."

   True   False


   True   False

20. Liquidity is judged by how easily an asset can be turned into cash.

   True   False
21. Accounts receivable refers to money owed the company by its clients or customers who have promised to pay for the products at a later.

True  False

22. Current liabilities refers to a firm's financial obligations to short-term creditors, which must be repaid within one year.

True  False

23. Owners' equity includes owners' contributions to their business along with income retained to finance growth and development.

True  False

24. Statement of cash flows explains how the company's cash changed from the beginning of the accounting period to the end.

True  False

25. Cash from investing activities is calculated from changes in the long-term liability accounts and the contributed capital accounts in owners' equity.

True  False

Multiple Choice Questions

26. Accounting refers to a process of:

A. recording, measuring, and interpreting financial data.
B. producing goods and services.
C. reporting only to those within the organization.
D. reporting only to those outside the organization.
E. developing promotional plans.

27. If Evelyn Chang is a self-employed, state-certified accountant who provides various types of accounting services for different companies and organizations, she is probably a:

A. private accountant.
B. certified management accountant.
C. certified public accountant.
D. noncertified accountant.
E. forensic accountant.
28. CPA stands for:

A. Certified Private Accountant.
B. Credentialed Private Accountant.
C. Credentialed Public Accountant.
D. Certified Public Accountant.
E. Certified Professional Accountant.

29. A CPA has the right to:

A. officially express an unbiased opinion about the accuracy of a firm's financial statements.
B. publicly express a biased opinion about the accuracy of a firm's financial statements.
C. express their personal opinion in all financial matters.
D. handle every firm's reports by different rules.
E. prepare and analyze their employer's financial statements.

30. A forensic accountant:

A. investigates crime scenes.
B. works for a public corporation.
C. analyzes financial documents in search of fraudulent entries or financial misconduct.
D. investigates workplace accidents to determine fault.
E. analyzes annual reports to ensure that corporations have adequate corporate governance mechanisms.

31. Vikram Patel is an accountant who is employed by a large department store chain in the tax department. He is probably a(n):

A. public accountant.
B. private accountant.
C. legal accountant.
D. junior accountant.
E. senior accountant.

Source: M Business 5th edition
32. Which of the following is NOT true of private accountants?

A. They work for a corporation, government, or other organization to prepare and analyze its financial information.
B. They have titles such as controller or internal auditor.
C. They prepare and interpret a firm's financial statements.
D. They express an official unbiased opinion regarding the accuracy of a client's financial statements.
E. They take part in internal planning and decision making of the organization for which they work.

33. Which of the following is true of bookkeeping?

A. Bookkeeping involves understanding and interpreting sophisticated accounting systems to classify financial information.
B. Bookkeeping involves developing sophisticated accounting systems.
C. Bookkeeping is a process that requires extensive training.
D. Bookkeeping is a broader term than accounting.
E. Bookkeeping involves recording information that accountants require to analyze a firm's financial position.

34. All of the following are outsiders who rely on information from an organization's financial statements EXCEPT:

A. lenders.
B. the Internal Revenue Service.
C. potential stockholders.
D. creditors.
E. managers.

35. Billy Banker has to decide whether to lend the Safe Toy Company $10,000 to pay suppliers. He will:

A. approve the loan application without checking the company's credibility.
B. review the company's financial statements.
C. prepare an organizational budget.
D. report the organization's financial performance to outsiders.
E. turn down the loan application.
36. What is meant by the term owners' equity?

A. A firm's economic resources
B. A firm's 'goodwill' or reputation
C. Debts the firm owes to others
D. Outstanding loans and credit
E. All the money that the firm has that does not need to be paid back

37. What are the fundamentals of the accounting process?

A. Journals and ledgers
B. The accounting equation and the double-entry bookkeeping system
C. The accounting equation and the accounting cycle
D. Double-entry bookkeeping and the accounting cycle
E. Ledgers and financial statements

38. All of the following represent assets EXCEPT:

A. cash.
B. inventory.
C. land.
D. equipment.
E. a bank loan.

39. According to the scenario presented in the text, the debts Anna's Flowers owes to the Small Business Administration and her company's suppliers represent _____.

A. owners' equity
B. assets
C. liabilities
D. stock
E. bonds

40. Which of the following equations is equivalent to the accounting equation?

A. Equity = liabilities - assets
B. Owners' equity = assets - liabilities
C. Revenues - expenses = net income
D. Net income = expenses - revenues + taxes
E. Profit = sales - revenues
41. Double-entry bookkeeping is a system of recording and classifying business transactions:

A. by the amount of the transaction.
B. in separate accounts in order to maintain the accounting equation.
C. in all accounts including those that do not maintain the accounting equation.
D. in general ledgers.
E. in the same account.

42. Which of the following is the first step in the accounting cycle?

A. Record transactions.
B. Examine source documents.
C. Post transactions.
D. Prepare financial statements.
E. Generate annual reports.

43. What is the last step that must be done before a firm's books can be closed for an accounting cycle?

A. The annual reports must be prepared.
B. The journal must be filled out.
C. The information from the journal must be transferred to the ledger.
D. A CPA must attest that good principles were used in the preparation of the document.
E. The trial balance must be verified.

44. The accounting cycle includes all of the following, EXCEPT:

A. examining source documents.
B. recording transactions.
C. posting transactions.
D. preparing financial statements.
E. generating annual reports.

45. In double-entry bookkeeping, after gathering together and analyzing source documents and recording each financial transaction in a journal, a financial manager, bookkeeper, or accountant next:

A. closes out the books.
B. posts transactions in a journal.
C. posts transactions in a ledger.
D. prepares a trial balance.
E. balances the accounting equation.
46. An income statement shows:

A. assets, liabilities, and equity.
B. revenues, expenses, and net income over a period of time.
C. the company's variable costs at a particular point in time.
D. how much income each employee earned.
E. how much income the CEO earns per year.

47. An accounting term that is synonymous with revenue is:

A. profit.
B. expenses.
C. net income.
D. sales.
E. price.

48. Do-It-Yourself Home Repair Shop started the accounting period with $10,000 worth of shovels in inventory. During the accounting period, it purchased $5,000 worth of shovels and sold $7,500 worth. What is its cost of goods sold in this scenario?

A. $15,000
B. $2,500
C. $5,000
D. $7,500
E. $10,000

49. All of the following could be expense accounts EXCEPT:

A. interest expense.
B. retained expense.
C. general and administrative expense.
D. research and development expense.
E. depreciation expense.

50. The process of spreading the costs of long-lived assets such as buildings and equipment over the total number of accounting periods in which they are expected to use is called _____.

A. depreciation
B. gross profit
C. budget
D. net income
E. revenue
51. Derek, an accountant, allocates the cost of a piece of earth-moving equipment over a specific period of time. According to this information, it can be concluded that Derek is implementing the process of:

A. discounting.
B. appreciation.
C. cost plus pricing.
D. expense designation.
E. depreciation.

52. When a company wants to place a value on a physical asset for its balance sheet, it must:

A. reduce the value by the amount the asset has depreciated.
B. auction the asset off.
C. ask its competitors what the asset is worth.
D. price a new one.
E. increase the value by the amount the asset has appreciated.

53. Net income is:

A. earnings after all taxes and other expenses are paid.
B. valuation of assets after all taxes are paid.
C. liabilities after taxes.
D. expenses after taxes.
E. cash disbursements after taxes.

54. The net income of a company is equal to the total revenue minus:

A. assets and liabilities.
B. equity.
C. sales.
D. expenses and taxes.
E. income and profits.

55. The information presented in an income statement could be described using the following equations:

A. equity = liabilities - assets
B. equity = assets - liabilities
C. net income = expenses - revenues + taxes
D. revenues - expenses = net income
E. Costs of goods sold = beginning inventory + interim purchases - ending inventory
56. _____ is an account showing money owed to a company by its clients or customers.

A. Accounts payable  
B. Accounts receivable  
C. Current assets  
D. Current liabilities  
E. Balance sheet

57. The financial document that has been likened to a snapshot of how the company’s finances are doing at that moment is called a(n):

A. income statement.  
B. balance sheet.  
C. annual report.  
D. budget.  
E. statement of cash flow.

58. Unlike an income statement, the _____ represents an accumulation of all of a company’s transactions.

A. statement of retained earnings  
B. balance sheet  
C. profit and loss statement  
D. statement of cash flow  
E. income tax form

59. A company’s assets that can be easily converted into cash are called:

A. fixed assets.  
B. long-term assets.  
C. equity.  
D. current assets.  
E. current liabilities.

60. Which of the following is an asset in the balance sheet?

A. accrued expenses.  
B. accounts payable.  
C. accounts receivable.  
D. taxes payable.  
E. wages payable.
61. A company's short-term financial obligations are called its:

A. current assets.
B. equity.
C. net profit.
D. current liabilities.
E. accounts payable.

62. Which of the following is a liability in a balance sheet?

A. accounts receivable.
B. cash.
C. inventory.
D. current assets.
E. accounts payable.

63. All of a firm's unpaid financial obligations are occasionally consolidated into an account called:

A. current assets.
B. accounts payable.
C. cost of goods sold.
D. accrued expenses.
E. long-term liabilities.

64. The owners' contributions to a company and all earnings retained to finance continued growth and product development are

A. owners' equity.
B. owners' assets.
C. owners' liabilities.
D. revenue.
E. profits.

65. Which of the following is considered as an owners' equity account?

A. deferred revenue.
B. preferred stock.
C. insurance revenue.
D. accounts payable.
E. accrued taxes.
66. The financial statement that explains how a firm's cash changed from the beginning of the accounting period to the end is called the:

A. statement of cash flows.
B. balance sheet.
C. income statement.
D. master budget.
E. profit-loss statement.

67. Information found on the company's income statement and balance sheet is extracted from these documents and examined more closely through the use of:

A. general analysis.
B. specific analysis.
C. cash-flow analysis.
D. feedback analysis.
E. ratio analysis.

68. One of the best ways to analyze a company's financial performance is to compare its ratios with those of:

A. the suppliers of the raw materials.
B. the manufacturers producing their products.
C. the companies in the same industry.
D. the U.S. government.
E. the foreign governments.

69. Profitability ratios are used to measure:

A. how efficiently a firm uses its assets to generate sales.
B. the speed with which a company can turn its short-term assets into cash to pay off its short-term debts.
C. how much income (net or operating) a firm generates relative to its assets, equity, and sales.
D. how much debt the firm is using relative to other sources of financing.
E. the performance of the firm relative to others on a per-share basis.

70. Which of the following equations is correct?

A. Profit margin = net income/sales.
B. Profit margin = assets + liabilities.
C. Profit margin = revenue - expenses.
D. Profit margin = net income/total assets.
E. Profit margin = net income/stockholder's equity.
71. Return on assets and return on equity are examples of _____ ratio.

A. asset utilization  
B. liquidity  
C. debt  
D. profitability  
E. current

72. Asset utilization ratios are used to measure:

A. the speed with which a company can turn its short-term assets into cash to pay off its short-term debts.  
B. how much income a firm generates relative to its assets, equity, and sales.  
C. how much debt the firm is using relative to other sources of financing.  
D. the performance of the firm relative to others on a per-share basis.  
E. how efficiently the firm uses its assets to generate $1 in sales.

73. Maurice was asked to extend trade credit to a restaurant she hadn’t serviced before. She asked to see its balance sheet to determine if it could pay its bills. She divided its current assets by current liabilities to get its:

A. current ratio.  
B. receivable turnover.  
C. inventory turnover.  
D. earnings per share.  
E. book value per share.

74. The ratio that reflects a company’s liquidity after excluding inventory is _____ ratio.

A. debt utilization  
B. current  
C. asset utilization  
D. receivables turnover  
E. quick

75. If a company is relying on borrowing and credit too extensively, this will probably be reflected in _____ ratio.

A. current usage  
B. past utilization  
C. debt utilization  
D. liquid utilization  
E. fixed asset usage
Essay Questions

76. What is the difference between a certified public accountant (CPA) and a private accountant?

77. How do managers and owners use financial statements?

78. Define managerial accounting. Discuss the roles of a managerial accountant in an organization.

79. Discuss the external uses of accounting information by managers.
80. Discuss the components of the accounting equation.

81. Define double-entry bookkeeping. Explain its implication in keeping the accounting equation in balance.

82. Megan is the managerial accountant of Shield Corp. and has to prepare the financial statements for the current year. Discuss the steps that Megan should take prior to the preparation of the requisite financial statements of the company.

83. Define "cost of goods sold" on an income statement. State the equation.
84. Discuss the three common expense accounts shown on an income statement.

85. Why are income statements temporary in nature?

86. Discuss why the financial statement called the "balance sheet" was given the name. Explain the two different formats of the balance sheet.

87. Distinguish current assets from current liabilities with suitable examples.
88. Distinguish between the terms, accounts payable and accounts receivable in a balance sheet.

89. What is meant by the term fixed assets?

90. What is meant by owners' equity? How can stock issues complicate the manner in which owners' equity account is recorded?

91. Discuss the concept of cash from operating activities.
92. Discuss the concept of cash from financing activities.

93. Discuss how analysts can use ratio analysis to evaluate a company's financial performance.

94. Harold, the manager of Neptune Inc., intends to examine the utilization of the inventory in this company during the course of this year. As a managerial accountant, which ratio should be calculated by George in order to fulfill the manager's purpose?

95. Fred, the manager of Pluto Inc., intends to examine the utilization of the assets in the company to generate revenue. As a managerial accountant, which ratio should be calculated by Nathan in order to fulfill the manager's purpose?