

Chapter 14 Accounting and Financial Statements

True False Questions

1) The terms accounting and bookkeeping are interchangeable.

True False

2) When the FBI is analyzing a company's financial documents to see if it broke some laws, it would likely use a forensic accountant.

True False

3) Harvey put together a financial plan so he could forecast income and expenses for his company for the year. This is called an annual report.

True False

4) A company's assets include its liabilities.

True False

5) In double-entry bookkeeping, assets and liabilities are on different sides of the accounting equation.

True False

6) In accounting, a ledger is a time-ordered list of account transactions.

True False

7) An income statement is the same thing as a profit and loss statement.

True False

8) Net income is the amount on which a firm will pay taxes.

True False

9) Non-business entities typically obtain revenues through the sale of their assets.

True False

10) The balance sheet presents a "snapshot" of an organization's financial position at a given moment.

True False

11) In a balance sheet, assets may exceed liabilities plus owners' equity.

True False

12) The tangible evidence of ownership is a security called common stock.

True False

13) In ratio analysis, ratios by themselves are not very useful.

True False

14) A profitability ratio is computed by dividing net income by sales and shows the overall percentage of profits earned by the company.

True False

15) For every \$1 Jim Woo invested in his company, he earned \$2. Jim Woo's return on equity was 200%.

True False

16) Generally, the more shares of stock a company issues, the less income is available for each share.

Multiple Choice Questions

17) Accounting refers to the process of

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

18) Which of the following is a function of the Public Company Accounting Oversight Board?

- A) It provides relief to banks during financial crisis.
- B) It ensures that accounting firms do not separate their consulting and auditing businesses.
- C) It makes rules and policies for accounting firms and businesses.
- D) It overlooks the accounts department of the federal government.
- E) It certifies individuals to provide accounting services.

19) Ebony is a self-employed, state-certified accountant who files tax returns, prepares financial records, and audits corporate financial records. She is most likely a _____ accountant.

- A) private
- B) certified management
- C) certified public

- D) noncertified
- E) forensic

20) Matt is a carpenter who runs his own small shop. When tax season comes, he hires an accountant from one of "the Big Four" accounting firms to help him file his business's tax return. In this scenario, Matt has most likely hired a _____ accountant.

- A) certified private
- B) forensic
- C) certified public
- D) private
- E) noncertified

21) All of the following are part of "the Big Four" EXCEPT

- A) Ernst & Young.
- B) Deloitte.
- C) PricewaterhouseCoopers.
- D) Plante Moran.
- E) KPMG.

22) Garrett wants to become a certified public accountant. To accomplish this, he must be certified by the _____ in which he plans to provide accounting services.

- A) country
- B) state
- C) town
- D) company
- E) municipality

23) Amanda is a certified public accountant who provides accounting services to individuals and businesses. Which of the following rights does her certification give her?

- A) the right to express, officially, an unbiased opinion regarding the accuracy of a client's financial statements
- B) the right to publicly express a biased opinion about the accuracy of a firm's financial statements
- C) the right to express her personal opinion in all financial matters
- D) the right to handle every firm's reports by different rules
- E) the right to limit the types of assets commercial banks can buy

24) The _____ Act required firms to be more rigorous in their accounting and reporting practices and to separate their consulting and auditing businesses.

- A) Sarbanes-Oxley
- B) Celler-Kefauver
- C) Williams
- D) Glass-Steagall
- E) Gramm-Leach-Bliley

25) Which of the following is a requirement stated by the Sarbanes-Oxley Act?

- A) This act requires that the Federal Reserve Board take up the task of certifying public accountants.
- B) This act requires firms to separate their consulting and auditing businesses.
- C) This act limits the types of assets commercial banks can buy.
- D) This act limits the use of derivative instruments.
- E) This act requires that firms employ their own private accountants.
- 26) Yakov is an executive of Fit Corp., a chain of fitness clubs. For years, he successfully hid illegal and misleading accounting practices, but eventually, he was exposed and punished with a jail sentence under the _____ Act.
- A) Gramm-Leach-Bliley
- B) Glass-Steagall
- C) Dodd-Frank
- D) Sarbanes-Oxley
- E) Celler-Kefauver
- 27) All of the following contributed to the financial crisis in 2008 EXCEPT
- A) government bailouts.
- B) questionable lending practices.
- C) excessive risk taking.
- D) investments based on subprime mortgages.
- E) declining housing prices.
- 28) The _____ Act limits the types of assets commercial banks can buy, the amount of capital they must maintain, and the use of derivative instruments, such as options, futures, and structured investment products.
- A) Sarbanes-Oxley
- B) Dodd-Frank
- C) Glass-Steagall
- D) Gramm-Leach-Bliley
- E) Celler-Kefauver
- 29) _____ accounting involves analyzing financial documents in search of fraudulent entries or financial misconduct.
- A) Financial
- B) Management
- C) Operational
- D) Forensic
- E) Tax
- 30) Kevin works for the Internal Revenue Service. His main responsibility is rooting out evidence of cooked books at major companies. Kevin is a _____ accountant.
- A) criminal
- B) private
- C) forensic
- D) certified public

E) noncertified

31) Jordan has been an accountant for many years. Since the accounting scandals in 2000, his firm added fraud-detection services, and Jordan now focuses on these services. Which of the following organizations could certify Jordan, so he can focus on detecting fraud?

- A) the Internal Revenue Service
- B) the Federal Bureau of Investigation
- C) the Association of Certified Fraud Examiners
- D) the Federal Reserve Board
- E) the Association of Fighting Fraud

32) Vikram is an accountant employed by a large corporation. He works for the billing and taxation department, preparing and analyzing the company's financial statements. He is most likely to be a _____ accountant.

- A) public
- B) private
- C) legal
- D) junior
- E) senior

33) Which of the following types of accountants is likely to have a title such as controller, tax accountant, and internal auditor?

- A) private accountant
- B) certified public accountant
- C) forensic accountant
- D) certified fraud examiner
- E) noncertified accountant

34) Carleigh is a private accountant who passed an examination by the Institute of Management Accountants. After passing this examination, Carleigh is a

- A) forensic accountant.
- B) certified private accountant.
- C) certified public accountant.
- D) noncertified management accountant.
- E) certified management accountant.

35) Dexter works for a publishing company, recording its routine, day-to-day business transactions. His main responsibility is obtaining and recording the information his company needs to analyze its financial position. Based on this description, Dexter is most likely

- A) an accountant.
- B) a financial manager.
- C) a certified fraud examiner.
- D) a bookkeeper.
- E) a federal agent.

36) Which of the following statements 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 is much more mechanical than accounting.

37) Carol is an accountant who completed course work beyond a basic four- or five-year college accounting degree. Which of the following is something Carol's additional training allows her to do?

- A) complete the complex mechanical tasks associated with recording a company's day-to-day business transactions
- B) classify and analyze complex financial information
- C) simply to obtain and record financial information
- D) become a certified management accountant
- E) specialize in forensic accounting

38) Harold owns a chain of coffee shops. He hires accountants to summarize the information from his company's business transactions into a financial statement. Which of the following is a reason Harold would use a financial statement?

- A) to pinpoint areas of employee weakness
- B) to pinpoint individual employee successes
- C) to determine who to promote
- D) to aid in internal planning and control
- E) to determine the types of customers the company has

39) _____ is the movement of money through an organization over a daily, weekly, monthly, or yearly basis.

- A) Expenses trajectory
- B) Income trajectory
- C) Assets flow
- D) Liabilities flow
- E) Cash flow

40) The principal value of a budget lies in its

- A) breakdown of cash inflows and outflows.
- B) forecast of income and expenses over a period of time.
- C) purpose of control over expenditures.
- D) evaluation of the firm's performance.
- E) development of a strategic financial plan.

41) Deviations between expected operating expenses and _____ serve as a "feedback loop" to launch more detailed financial analyses in an effort to pinpoint trouble spots and opportunities.

- A) fixed operating costs
- B) variable operating costs
- C) operating revenues

- D) basic operating costs
- E) overhead operating expenses

42) Gary's Pets hired a managerial accountant to help forecast the company's expenses and income for its first year in business. This financial plan for how Gary's Pets plans to move from Point A to Point B over the course of the year is its

- A) budget.
- B) schedule.
- C) agenda.
- D) mission.
- E) annual report.

43) The single most important component of an annual report is the

- A) balance sheet.
- B) income statement.
- C) cash flow statement.
- D) signature of a certified public accountant.
- E) signature of the firm's owners or stakeholders.

44) Potential investors typically study the _____ in a firm's annual report to determine whether the company meets their investment requirements.

- A) product list
- B) growth plans
- C) mission statement
- D) corporate information
- E) financial statements

45) The City Bank, a short-term lender, examines Frank's Kitchen Fixtures' _____ to assess its ability to repay a loan quickly with cash generated from sales.

- A) indebtedness
- B) profitability
- C) cash flow
- D) assets
- E) cash equity

46) Liam is a manager at a bank. He has to decide whether to lend \$10,000 to Safe Toys, a company that produces toys that don't have a choking hazard. He should

- 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 auditors.
- E) turn down the loan application.

47) Carl works for a large technology company as an engineer. As an employee, why should he look at his company's financial statements?

- A) to ensure that his job is secure
- B) to see what his co-workers are making

- C) to get a sense of how competitive companies pay their employees
- D) to determine if his company needs his help to succeed
- E) to establish reasonable expectations for salary and other benefit requests

48) A crafts store displays various types of paper, stickers, glue sticks, yarn, canvases, paints, and other craft supplies on shelves. These items are examples of the company's

- A) equity.
- B) liabilities.
- C) assets.
- D) profits.
- E) features.

49) What is meant by owners' equity?

- A) It refers to a firm's economic resources.
- B) It refers to a firm's "goodwill" or reputation.
- C) It refers to debts a firm owes to others.
- D) It refers to outstanding loans and credit that a firm has to return.
- E) It refers to the money contributed to a firm that never has to be paid back.

50) 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) the double-entry bookkeeping system and the accounting cycle
- E) ledgers and financial statements

51) Ian got a loan from the Small Business Administration to start his own house contracting business. For Ian, this loan is

- A) an asset.
- B) a benefit.
- C) an expense.
- D) a transaction.
- E) a liability.

52) When Harvey opened his store, he convinced his family and friends to invest in the store. They invested money and assets to help him start and grow his business. The money and assets these investors contributed to Harvey's store comprise his

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

53) Connor is using the double-entry bookkeeping system to account for all the transactions during his first month in business as an electrician. All of the following could be specific asset categories for Connor EXCEPT

- A) supplier credit.

- B) cash.
- C) tools.
- D) inventory.
- E) equipment.

54) 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

55) What is the last step that must be taken before a public corporation'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) The information is certified.
- E) The trial balance must be verified.

56) In the accounting cycle, after examining source documents and recording transactions in an accounting journal, what is the next step taken by a financial manager?

- A) closing the books
- B) posting recorded transactions
- C) gathering credit card receipts
- D) preparing a trial balance
- E) balancing the accounting equation

57) Maya owns a bakery. She has already gathered and examined the checks, credit card receipts, sales slips, and other related evidence concerning specific transactions. She has also recorded each financial transaction in a journal and transferred that information into a ledger. What must Maya do before preparing the financial statements?

- A) She must check her journal for mistakes.
- B) She must prepare a trial balance.
- C) She must recheck all her source documents.
- D) She must attest that she used generally accepted accounting principles.
- E) She must throw away her ledger and start over.

58) An accounting term that is interchangeable with revenue is

- A) services.
- B) expenses.
- C) net income.
- D) sales.
- E) price.

59) An income statement shows

- A) a company's assets, liabilities, and equity.
- B) an organization's profitability over a period of time.
- C) a 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.

60) Cole owns a large chain of grocery stores. A significant part of his job is determining the amount of income left after taxes and whether the company will retain this income or pay it out in dividends to its stockholders. The income in this scenario is _____ income.

- A) gross
- B) profit
- C) service
- D) net
- E) operating

61) _____ is the total amount of money received from the sale of goods or services, as well as from other business activities, such as the rental of property and investments.

- A) Profit
- B) Expense
- C) Net income
- D) Revenue
- E) Price

62) Nonbusiness entities typically obtain revenue through

- A) the sale of goods.
- B) the sale of services.
- C) the rental of property.
- D) investments.
- E) donations.

63) A home repair shop started the accounting period with \$10,000 worth of tools in inventory. During the accounting period, it purchased \$5,000 worth of tools and sold \$7,500 worth. In this scenario, what is the cost of goods sold?

- A) \$2,500
- B) \$5,000
- C) \$7,500
- D) \$10,000
- E) \$15,000

64) Leiko owns a childcare company. Since this market is competitive, she has hired an advertising and sales manager to make sure potential customers know about her company. As a result, she must pay for advertising materials and her advertising and sales manager's salary. These expenses would be classified as _____ expenses.

- A) selling
- B) general
- C) development

- D) interest
- E) administrative

65) Salaries of executives and their staff are included under the category of _____ expenses.

- A) interest
- B) retained
- C) general and administrative
- D) research and development
- E) depreciation

66) Hannah borrowed money from a bank to start her new company. Her direct cost of borrowing this money is known as her _____ expenses.

- A) interest
- B) selling
- C) general and administrative
- D) research and development
- E) depreciation

67) 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 be used is called

- A) depreciation.
- B) gross profit.
- C) budget.
- D) net income.
- E) revenue.

68) Depreciation, a type of expense, is included in the _____ category.

- A) interest
- B) selling
- C) general and administrative
- D) research and development
- E) retained

69) Derek, an accountant, allocates the cost of a piece of earth-moving equipment over a specific period of time. Based on the given information, it can be concluded that Derek is implementing the process of

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

70) Which of the following is true of a piece of equipment when it is fully depreciated?

- A) It has a zero value on the firm's balance sheet.
- B) It needs to be auctioned off.
- C) It can no longer be used.

- D) It is economically worthless.
- E) It will still appear on the firm's balance sheet at the full purchase price.

71) A pet store is trying to determine its net income. To figure out this value, the company should equate the total profit or loss minus

- A) assets and liabilities.
- B) equity.
- C) sales.
- D) expenses, including taxes.
- E) income and profits.

72) Which of the following are the results of calculations made from the revenues and expenses accounts?

- A) interest and taxes
- B) assets and liabilities
- C) earnings and equity
- D) gross profit and net income
- E) inventory and profits

73) At the end of each accounting period, the dollar amounts in all the revenue and expense accounts are moved into an account called

- A) net earnings.
- B) net expense.
- C) interest expense.
- D) retained expense.
- E) retained earnings.

74) A video game company has decided to pay dividends to its shareholders. "Doing so will decrease which of the following accounts?"

- A) its revenue and expense accounts
- B) its checking and savings accounts
- C) its cash and capital accounts
- D) its liabilities and equity accounts
- E) its assets and stock accounts

75) The _____ presents a snapshot of an organization's financial position at a given moment.

- A) profit margin
- B) statement of cash flows
- C) net income
- D) per-share data
- E) balance sheet

76) Molly is preparing a balance sheet for her pet grooming company. Following long-established traditions, she lists items on her balance sheet on the basis of their

- A) competitive value.
- B) perceived market value.

- C) present values minus accumulated depreciation.
- D) present values.
- E) original cost minus accumulated depreciation.

77) Which of the following is one of the most common formats for balance sheets?

- A) horizontal
- B) vertical
- C) diagonal
- D) revised
- E) modern

78) All asset accounts are listed in descending order of

- A) investments.
- B) inventory.
- C) revenues.
- D) liquidity.
- E) accounts receivable.

79) _____ refers to money owed to a company by its clients or customers who have promised to pay for the products at a later date.

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

80) _____ represent a commitment of organizational funds of at least one year.

- A) Current assets
- B) Fixed assets
- C) Temporary investments
- D) Inventory
- E) Accounts receivable

81) All of the following are items that are classified as fixed assets EXCEPT

- A) temporary investments.
- B) equipment.
- C) reputation.
- D) trademarks.
- E) corporate "goodwill."

82) A company's assets that are used or converted into cash within the course of a calendar year are

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

83) 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

84) A company's financial obligations to short-term creditors, which must be repaid within one year, are

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

85) Tom is completing a balance sheet for his home improvement company. He must include the amounts he owes to suppliers for lumber, tools, equipment, and other materials that he purchased with credit. These liabilities are called

- A) accounts receivable.
- B) current liabilities.
- C) inventory.
- D) accrued expenses.
- E) accounts payable.

86) An account that represents all unpaid financial obligations incurred by an organization is called

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

87) _____ includes the owners' contributions to a company along with income earned by the company and retained to finance continued growth and product development.

- A) Owners' equity
- B) Owners' assets
- C) Owners' liabilities
- D) Revenue
- E) Profits

88) Each type of stock issued by a company represents a different claim on the organization, thus, each must be represented by a separate owners' equity account called

- A) deferred revenue.
- B) contributed capital.
- C) insurance revenue.
- D) accounts payable.

E) accrued taxes.

89) 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.

90) Which of the following categories of cash flow is calculated from changes in the long-term or fixed asset accounts?

- A) cash from investing activities
- B) cash from operating activities
- C) cash from marketing activities
- D) cash from financing activities
- E) cash from profiteering activities

91) A company is paying off its long-term debt from the bank loan it secured to open the business several years ago. What does this scenario indicate?

- A) It has a positive amount of cash from financing activities.
- B) It has a negative amount of cash from financing activities.
- C) It is going out of business.
- D) It has a negative amount of cash from operating activities.
- E) It has a positive amount of cash from investing activities.

92) _____ analysis refers to calculations that measure an organization's financial health.

- A) General
- B) Specific
- C) Ratio
- D) Feedback
- E) Cash-flow

93) Which of the following calculations helps managers compare an organization's productivity, profitability, and financing mix with other similar entities?

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

94) One of the ways to analyze a company's financial performance is to compare its performance with those of

- A) foreign governments.
- B) manufacturers producing their products.
- C) its competitors.
- D) the U.S. government.

E) suppliers of the raw materials.

95) Profitability ratios measure

A) how efficiently a firm uses its assets to generate sales.

B) how much debt the firm is using relative to other sources of financing.

C) how much operating income or net income a firm is able to generate relative to its assets, equity, and sales.

D) the speed with which a company can turn its short-term assets into cash to pay off its short-term debts.

E) the performance of the firm relative to others on a per-share basis.

96) A company with a low return on assets

A) is making profits.

B) does not have debts.

C) is not using its assets very productively.

D) is lending its assets to other companies.

E) invests money in its assets.

97) Return on assets and return on equity are examples of _____ ratios.

A) asset utilization

B) liquidity

C) debt

D) profitability

E) current

98) Which of the following equations is used to calculate return on equity?

A) $\text{return on equity} = \text{net income}/\text{sales}$

B) $\text{return on equity} = \text{revenue} - \text{expenses}$

C) $\text{return on equity} = \text{net income}/\text{stockholder's equity}$

D) $\text{return on equity} = \text{assets} + \text{liabilities}$

E) $\text{return on equity} = \text{net income}/\text{total assets}$

99) Asset utilization ratios measure

A) the performance of the firm relative to others on a per-share basis.

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 speed with which a company can turn its short-term assets into cash to pay off its short-term debts.

E) how well a firm uses its assets to generate each \$1 of sales.

100) 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.

101) The _____, an asset utilization ratio, indicates how many times a firm collects its accounts receivable in one year.

- A) inventory turnover
- B) return on equity
- C) accounts payable
- D) receivables turnover
- E) asset turnover

102) Total asset turnover

- A) determines the speed with which a company can turn its assets into cash to meet debts.
- B) compares current (short-term) assets to current liabilities.
- C) measures the most valuable asset of a company.
- D) measures the amount of inventory that is required by a company at any point of time.
- E) measures how well an organization uses all of its assets in creating sales.

103) _____ ratios compare current assets to current liabilities to indicate the speed with which a company can turn its assets into cash to meet debts as they fall due.

- A) Asset utilization
- B) Liquidity
- C) Debt
- D) Profitability
- E) Current

104) The measure of liquidity that reflects a company's liquidity ratio after excluding its inventory is the _____ ratio.

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

105) Chloe's Cosmetics doesn't have a lot of inventory. As a result, its _____ ratio is almost exactly the same as its current ratio.

- A) liquidity
- B) total asset turnover
- C) quick
- D) receivables turnover
- E) debt utilization

106) _____ ratios provide information about how much debt an organization is using relative to other sources of capital, such as owners' equity.

- A) Debt utilization
- B) Quick
- C) Asset utilization
- D) Receivables turnover

E) Current

107) Alma is an investor who wants to compare the performance of one publishing company with another on an equal, or per share, basis. What is a general finding associated with this practice?

- A) The less shares of stock a company issues, the less income is available for each share.
- B) When two companies issue the same amount of stock, one will still generate more income than the other.
- C) The more shares of stock a company issues, the more income is available for each share.
- D) The amount of shares of stock a company issues has no impact on its income.
- E) The more shares of stock a company issues, the less income is available for each share.

Essay Type Questions

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

109) 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.

110) Describe an income statement. What is its purpose?

111) What is a balance sheet? Explain the concepts of assets and liabilities in the context of the balance sheet. How are balance sheets typically presented?

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