

## Chapter 2: The Balance Sheet

### TRUE/FALSE

#### [QUESTION]

1. A transaction is an exchange or event that directly affects the assets, liabilities, or stockholders' equity of a company.

Answer: True

Difficulty: 1 Easy

LO: 02-01

Topic: Transactions and Other Activities

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: A transaction is an event or activity that has a direct and measurable financial effect on the assets, liabilities, or stockholders' equity of a business.

#### [QUESTION]

2. General Motors (GM) signs a new labor agreement that its workers will receive a 5% wage increase next year. This transaction affects GM's financial statements in the current year.

Answer: False

Difficulty: 2 Medium

LO: 02-01

Topic: Transactions and Other Activities

Blooms: Understand

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Feedback: A promise to pay has been exchanged for a promise to work next year. This activity is not a transaction because no assets or services were exchanged at the time the new labor agreement is signed. This event does not GM's financial statements in the current year.

#### [QUESTION]

3. If total assets increase, then either total liabilities or total stockholders' equity must also increase.

Answer: True

Difficulty: 1 Easy

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

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AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: The accounting equation (Assets = Liabilities + Stockholders' Equity) must balance. If one side of the equation increases, the other side must increase.

[QUESTION]

4. A company signed an agreement to rent store space from another company. This is an example of a transaction that should be recorded.

Answer: False

Difficulty: 1 Easy

LO: 02-01

Topic: Transactions and Other Activities

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: This activity is not a transaction because no assets or services were exchanged at the time the agreement was signed. This is not a transaction.

[QUESTION]

5. A business is obliged to repay both debt and equity financing.

Answer: False

Difficulty: 2 Medium

LO: 02-01

Topic: Building a Balance Sheet from Business Activities

Blooms: Remember

AACSB: Analytic

AICPA BB: Legal

AICPA FN: Reporting

Feedback: There is no requirement to pay back equity contributions to stockholders. There is a legal requirement to pay back debt financing to creditors.

[QUESTION]

6. You are pleasantly surprised to discover that a popular actress appears on *The Tonight Show* wearing your company's jeans. Later, your company's sales increase by \$500,000 as a result. When the actress appeared on TV, you would have recorded an asset because the TV appearance was expected to bring future economic benefits to your company.

Answer: False

Difficulty: 3 Hard

LO: 02-01

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Topic: Building a Balance Sheet from Business Activities

Blooms: Evaluate

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Reporting

Feedback: This activity is not a transaction because no assets or services were exchanged at the time the actress appeared on television. No asset would be recorded. In addition, recall that an asset is an economic resource presently controlled by the company; it has measurable value and is expected to benefit the company by producing cash inflows or reducing cash outflows in the future. This situation does not meet the definition of an asset.

[QUESTION]

7. If a company uses \$100 million of its cash to pay off debt, its stockholders' equity will increase \$100 million.

Answer: False

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Assets and liabilities would each decrease by \$100 million; there is no impact on stockholders' equity.

[QUESTION]

8. Company X issues \$40 million in new stock for cash. This does not affect stockholders' equity because as new shares are sold, the value of existing shares falls.

Answer: False

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: When new stock is issued for cash, the company has more cash and common stock. Assets and stockholders' equity both increase.

[QUESTION]

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9. The analyze-record-summarize process is applied to daily transactions, to month-end adjustments, and as part of the year-end closing process.

Answer: True

Difficulty: Medium

LO: 02-02

Topic: Steps 2 and 3: Record and Summarize

Blooms: Remember

AACSB: Analytic

AICPA BB: Legal

AICPA FN: Reporting

Feedback: The three-step analyze-record-summarize process is applied to daily transactions, as well as adjustments at the end of each month, before preparing a trial balance and the financial statements.

[QUESTION]

10. The list of account names and reference numbers that the company will use when accounting for transactions is called the chart of accounts.

Answer: True

Difficulty: 1 Easy

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: The chart of accounts is a summary of all account names (and corresponding account numbers) used to record financial results in the accounting system.

[QUESTION]

11. A debit may increase or decrease an account, depending on the type of account.

Answer: True

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Whether a debit or credit increases or decreases an account depends upon the type of account. Debits increase assets, expenses, and dividends, but decrease liabilities, revenues,

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and equity. Credits increase liabilities, revenue, and equity, but decrease assets, expenses and dividends.

[QUESTION]

12. The normal balance of an account is on the same side that increases the account.

Answer: True

Difficulty: 1 Easy

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: The balance in an account is determined by the excess of increases over decreases. It is normal to have more increases in an account than decreases.

[QUESTION]

13. If the total dollar value of credits to an account exceeds the total dollar value of debits to that account, the ending balance of the account will be a debit balance.

Answer: False

Difficulty: 1 Easy

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: If credits exceed debits, the account will have a credit balance.

[QUESTION]

14. Every transaction increases at least one account and decreases at least one account.

Answer: False

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA B: Resource Management

AICPA FN: Reporting

Feedback: A transaction may have any combination of increases and decreases. For example,

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a purchase of equipment on account increases both equipment and accounts payable. What is true is that every transaction is recorded with at least one debit and at least one credit.

[QUESTION]

15. Accounts increase on the same side as they appear in the accounting equation:  $A = L + SE$ .

Answer: True

Difficulty: Easy

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Accounts on the left side of the accounting equation (that is, assets) increase on the left side and accounts on the right side of the equation (that is, liabilities and stockholders' equity) increase on the right side.

[QUESTION]

16. Journal entries show the effects of transactions on the elements of the accounting equation, as well as the account balances.

Answer: False

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Journal entries are entered into the journal using a debit/credit format. By themselves, journal entries show the effect of transactions, but they do not provide account balances. The entries are "posted" to the ledger accounts, which then show the balance of each of the accounts.

[QUESTION]

17. The general ledger is an internal report that lists all the accounts and their balances and is used to check that total debits equals total credits.

Answer: False

Difficulty: 2 Medium

LO: 02-04

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Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Reporting

Feedback: The trial balance is an internal report that lists all the accounts and their balances and is used to check that total debits equals total credits.

[QUESTION]

18. A classified balance sheet shows a subtotal for current assets and current liabilities.

Answer: True

Difficulty: 1 Easy

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Reporting

Feedback: A classified balance sheet contains subcategories and subtotals for current assets and current liabilities.

[QUESTION]

19. When a company prepares a classified balance sheet, stockholders' equity accounts must be shown in subcategories of current and noncurrent.

Answer: False

Difficulty: 2 Medium

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Reporting

Feedback: Assets and liabilities are classified as current and noncurrent. Stockholders' equity accounts are not classified as current or noncurrent.

[QUESTION]

20. The trial balance is a financial statement that reports the assets, liabilities, and equity of a business at a point in time.

Answer: False

Difficulty: 1 Easy

## Chapter 2: The Balance Sheet

LO: 02-03

LO: 02-04

Topic: The Debit/Credit Framework

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: The trial balance is an internal accounting report that lists the balances in all the ledger accounts at a point in time. It shows whether debit balance accounts equal the credit balance accounts. A balance sheet is a financial statement that reports the assets, liabilities, and equity of a business at a point in time.

### [QUESTION]

21. The acquisition of equipment in an exchange for a company's stock would increase the current ratio of the company.

Answer: False

Difficulty: 2 Medium

LO: 02-05

Topic: Assessing the Ability to Pay

Blooms: Analyze

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: The current ratio is current assets divided by current liabilities. Neither of the accounts in this transaction would be classified as current and, so, this transaction does not affect the current ratio.

### [QUESTION]

22. The current ratio can be used to evaluate a company's ability to pay liabilities in the short term, and in general, a lower ratio means better ability to pay.

Answer: False

Difficulty: 2 Medium

LO: 02-05

Topic: Assessing the Ability to Pay

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: The current ratio is current assets divided by current liabilities. A higher ratio means better ability to pay.



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### MULTIPLE CHOICE

#### [QUESTION]

23. Owners of a company:

- A) hold promissory notes as evidence of their ownership claim.
- B) are entitled to repayment of their investment.
- C) have a claim that is secondary to creditor's claims.
- D) have a claim equal to the amount of liabilities a company owes.

Answer: C

Difficulty: 3 Hard

LO: 02-01

Topic: Building a Balance Sheet from Business Activities

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Owners have a claim on company assets that is secondary to creditor's claims. Promissory notes are the legal documents that describe the details of a loan; stock certificates are evidence of ownership claims. A business is obligated to repay debt financing, but is not obligated to repay equity financing. Creditors have a claim on company assets equal to the amount of liabilities that the company owes.

#### [QUESTION]

24. If a company borrows money from a bank and signs an agreement to repay the loan several years from now, in which account would the company report the amount borrowed?

- A) Common Stock
- B) Accounts Payable
- C) Notes Payable (long-term)
- D) Retained Earnings

Answer: C

Difficulty: 2 Medium

LO: 02-01

Topic: Building a Balance Sheet from Business Activities

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Debt financing refers to money obtained through loans. A formal loan with the bank is reported as Notes Payable (long-term).

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### [QUESTION]

25. The Sweet Smell of Success Fragrance Company borrowed \$60,000 from the bank to be paid back in five years and used all of the money to purchase land for a new store. Sweet Smell's balance sheet would show this as:

- A) \$60,000 under Land and \$60,000 under Notes Payable (long-term).
- B) \$60,000 under Depreciation Expense and \$60,000 under Notes Payable (long-term).
- C) \$60,000 under Land and \$60,000 under Notes Receivable (long-term).
- D) \$60,000 under Other Assets and \$60,000 under Other Liabilities.

Answer: A

Difficulty: 2 Medium

LO: 02-01

Topic: Building a Balance Sheet from Business Activities

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: The purchase of land is recorded in the Land account and a noncurrent bank loan is recorded as Notes Payable (long-term).

### [QUESTION]

26. Transactions include which two types of events?

- A) Direct events, indirect events
- B) Monetary events, production events
- C) External exchanges, internal events
- D) Past events, future events

Answer: C

Difficulty: 1 Easy

LO: 02-01

Topic: Transactions and Other Activities

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Transactions include two types of events: external exchanges and internal events.

### [QUESTION]

27. Your company places an order with suppliers for inventory for delivery in two weeks.

- A) This is an internal event and it does not affect the balance sheet.
- B) This is an activity that does not affect the balance sheet.
- C) This is an internal event that affects the balance sheet.
- D) This is an external exchange and it affects the balance sheet.

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Answer: B

Difficulty: 2 Medium

LO: 02-01

Topic: Transactions and Other Activities

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: External exchanges are exchanges involving assets, liabilities, and/or stockholders' equity between the company and someone else. An order has been placed; but the promise to pay will not occur until the supplies are delivered. An exchange of only promises is not an accounting transaction. Since no exchange has occurred, this activity would not be recorded as a transaction.

[QUESTION]

28. The characteristic shared by all liabilities is that they:

- A) provide a future economic benefit.
- B) result in an inflow of resources to the company.
- C) always end in the word "payable."
- D) obligate the company to do something in the future.

Answer: D

Difficulty: 2 Medium

LO: 02-01

Topic: Building a Balance Sheet from Business Activities

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Liabilities are debts and other obligations that must be paid or settled in the future. Not all liabilities have the word "payable" in their names.

[QUESTION]

29. Which of the following is a financing activity?

- A) The business receives land and gives a check for \$1,000.
- B) The business receives \$1,000 cash and in exchange gives a promissory note.
- C) The business promises to hire an employee on the 15<sup>th</sup> of the month.
- D) The business orders supplies and promises to pay for them at the end of the month.

Answer: B

Difficulty: 2 Medium

LO: 02-01

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Topic: Building a Balance Sheet from Business Activities

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Financing activities involve debt transactions with lenders (e.g., Notes Payable) or equity transactions with investors (e.g., Common Stock). Receiving cash in exchange for a promissory note is a financing activity.

[QUESTION]

30. Which of the following would not be recorded as an accounting transaction?

- A) Putting a deposit down on a new vehicle
- B) Hiring a new employee
- C) Receiving cash upon signing a note
- D) Receiving a deposit from a customer

Answer: B

Difficulty: 2 Medium

LO: 02-01

Topic: Transactions and Other Activities

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: A transaction is an event or activity that has a direct and measurable financial effect on the assets, liabilities, or stockholders' equity of a business. Hiring a new employee is an activity that is not a transaction because no assets or services were exchanged at the time the employee was hired.

[QUESTION]

31. The Flynn Company started business by obtaining financing through debt financing and equity financing. Which of the following statements is not correct?

- A) Equity financing refers to the money obtained through owners' contributions and reinvestments of profit.
- B) Debt financing refers to the money obtained through loans.
- C) The business is obligated to repay debt financing.
- D) The business is obligated to repay equity financing.

Answer: D

Difficulty: 1 Easy

LO: 02-01

Topic: Building a Balance Sheet from Business Activities

Blooms: Remember

## Chapter 2: The Balance Sheet

AACSB: Analytic

AICPA BB: Legal

AICPA FN: Measurement

Feedback: Equity refers to financing a business through owners' contributions and reinvestments of profit. Debt refers to financing the business through loans. A business is obligated to repay debt financing, but it is not obligated to repay its equity financing.

[QUESTION]

32. Which of the following is not an asset?

- A) Cash
- B) Notes Receivable
- C) Common Stock
- D) Land

Answer: C

Difficulty: 1 Easy

LO: 02-01

Topic: Building a Balance Sheet from Business Activities

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Assets are resources presently owned by a business that generate future economic benefits.. Cash, Notes Receivable, and Land are all examples of assets.

[QUESTION]

33. Which of the following would be treated as an accounting transaction for a gardening supply store?

- A) The company signed an agreement to rent store space at \$200 month.
- B) The vice president of the company spoke at a luncheon that contributed to enhancing the company's reputation as a responsible company.
- C) The company ordered supplies for \$500.
- D) The company loaned \$500 to an employee.

Answer: D

Difficulty: 2 Medium

LO: 02-01

Topic: Transactions and Other Activities

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: A transaction is an event or activity that has a direct and measurable financial

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effect on the assets, liabilities, or stockholders' equity of a business. An asset (the employee's promise to pay) was exchanged for another asset (the cash given to the employee) and, so, loaning \$500 to an employee is a transaction. No exchange took place with regards to the rental agreement, the speech, or the supply order.

### [QUESTION]

34. \_\_\_\_\_ are of special importance because they are the only activities that enter the financial accounting system.

- A) External exchanges
- B) Internal events
- C) Documents
- D) Transactions

Answer: D

Difficulty: 2 Medium

LO: 02-01

Topic: Transactions and Other Activities

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Business activities that affect the basic accounting equation (A 5 L 1 SE) are called transactions. Transactions are of special importance because they are the only activities that enter the financial accounting system.

### [QUESTION]

35. A company has \$26,000 in its Land account, \$10,000 in its Inventory account, and \$6,000 in its Notes Payable (short-term) account. If its only other account is Common Stock, what is the balance of that account?

- A) \$10,000.
- B) \$42,000.
- C) \$30,000.
- D) \$22,000.

Answer: C

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback:

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Assets = Liabilities + Stockholders' Equity  
Stockholders' Equity = Assets – Liabilities  
= (\$26,000 + \$10,000) – \$6,000 = \$30,000

### [QUESTION]

36. Stockholders' equity in a corporation consists of:

- A) Amounts invested and reinvested by a company's owners.
- B) Resources presently owned by a business that generate future economic benefits.
- C) Amounts invested in assets that will be used for one or more years.
- D) Amounts presently owed by a business.

Answer: A

Difficulty: 1 Easy

LO: 02-01

Topic: Building a Balance Sheet from Business Activities

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Stockholders' equity is the amount invested and reinvested in a company by its stockholders.

### [QUESTION]

37. Typical cash flows from investing activities include:

- A) payments to purchase property and equipment.
- B) repayment of loans.
- C) proceeds from issuing notes payable.
- D) receipts from cash sales.

Answer: A

Difficulty: 2 Medium

LO: 02-01

Topic: Building a Balance Sheet from Business Activities

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Investing activities include buying or selling noncurrent assets, such as property and equipment.

### [QUESTION]

38. The requirement that transactions be recorded at their exchange price at the transaction date is called the:

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- A) conservatism exception.
- B) separate entity assumption.
- C) cost principle.
- D) monetary unit assumption.

Answer: C

Difficulty: 1 Easy

LO: 02-01

LO: 02-05

Topic: Building a Balance Sheet from Business Activities

Topic: Balance Sheet Concepts and Values

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: The cost principle states that assets and liabilities should be initially recorded at their original cost to the company. Following the cost principle, assets and liabilities are first recorded at cost, which is their cash-equivalent value on the date of the transaction.

### [QUESTION]

39. Which of the following is not an accounting transaction?

- A) Issued shares of stock to investors in exchange for cash contributions of \$4,000.
- B) Ordered inventory from suppliers for \$3,000.
- C) Sold equipment to another company for \$3,000 and accepted a note from the company promising payment in 6 months.
- D) Borrowed money from the bank by signing a promissory note for \$2,000.

Answer: B

Difficulty: 1 Easy

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource management

AICPA FN: Measurement

Feedback: External exchanges are exchanges involving assets, liabilities, and/or stockholders' equity between the company and someone else. An exchange of only promises is not an accounting transaction. Since no exchange has occurred when inventory is ordered from suppliers, this activity would not be recorded as a transaction.

### [QUESTION]

40. Account titles in the chart of accounts are:

- A) general purpose and do not indicate the nature of the account.



## Chapter 2: The Balance Sheet

- B) consistent with those used by other companies.
- C) linked to account numbers.
- D) the names mandated for use by the FASB.

Answer: C

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: As part of transaction analysis, a name is given to each item exchanged.

Accountants refer to these names as account titles (or names). To ensure account titles are used consistently, every company establishes a chart of accounts—a list that designates a name and reference number that the company will use when accounting for each item it exchanges. The chart of accounts is tailored to each company's business, so although some account titles are common across all companies, others may be unique to a particular company.

[QUESTION]

41. Every transaction:

- A) increases one account and decreases another account.
- B) has at least two effects on the basic accounting equation.
- C) affects only balance sheet accounts or only income statement accounts.
- D) is analyzed from the standpoint of the business owners.

Answer: B

Difficulty: 3 Hard

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Feedback: Every transaction has at least two effects on the basic accounting equation (at least one debit and one credit). A transaction can result in two accounts increasing, two accounts decreasing, or one account increasing and one account decreasing. A transaction may affect two balance sheet accounts, two income statement accounts, or one of each. Every transaction is analyzed from the standpoint of the business, not the owners.

[QUESTION]

42. The Buddy Burger Corporation owes \$1.5 million to the Texas Wholesale Meat Company

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from whom Buddy Burger buys its burger meat. Which account would Buddy Burger use to report the amount owed?

- A) Cash
- B) Accounts Payable
- C) Notes Payable
- D) Accounts Receivable

Answer: B

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Accounts Payable is used to report amounts owed to suppliers for goods or services bought on credit (or on account).

### [QUESTION]

43. If a company receives \$20,000 cash from its customers on account and uses the cash to pay \$20,000 to its suppliers on accounts, the net result is that:

- A) assets would increase by \$20,000 while liabilities would decrease by \$20,000.
- B) liabilities would decrease by \$20,000 while stockholders' equity would increase by \$20,000.
- C) assets would decrease by \$20,000 and liabilities would decrease by \$20,000.
- D) liabilities would decrease by \$20,000 and stockholders' equity would decrease by \$20,000.

Answer: C

Difficulty: 3 Hard

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Receiving cash of \$20,000 from customers in payment of their accounts will cause one asset (Cash) to increase and another asset (Accounts Receivable) to decrease. There is no change in the amount of total assets. Using the \$20,000 of cash received to pay off accounts payable will cause an asset (Cash) to decrease and a liability (Accounts Payable) to decrease. Considering both transactions, assets (Accounts Receivable) decrease by \$20,000 and liabilities (Accounts Payable) decrease by \$20,000.

### [QUESTION]

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44. What is the minimum number of accounts that must be involved in any transaction?

- A) One
- B) Two
- C) Three
- D) There is no minimum.

Answer: B

Difficulty: 1 Easy

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Every transaction has at least two effects on the basic accounting equation.

[QUESTION]

45. Which of the following applies to Accounts Payable?

- A) They can be outstanding for more than one year.
- B) They charge interest.
- C) It is an amount a business is obligated to repay.
- D) They are documented using formal documents.

Answer: C

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Accounts Payable is used to report amounts owed to suppliers for goods or services bought on credit (or on account).

[QUESTION]

46. In part, a transaction affects the accounting equation by decreasing an asset. There is no effect on liabilities. Which of the following statements is correct with regards to this transaction?

- A) If other assets are unchanged, stockholders' equity must be increasing.
- B) If other assets are unchanged, stockholders' equity must be decreasing.
- C) If stockholders' equity is unchanged, another asset must be decreasing.
- D) If stockholders' equity is unchanged, other assets must be unchanged.

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Answer: B

Difficulty: 1 Easy

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Change in assets = change in liabilities + change in stockholders' equity. If assets decrease and there is no change in liabilities, then either another asset must increase or stockholders' equity must decrease.

### [QUESTION]

47. Your company pays back \$2 million on a loan it had obtained earlier from a bank.

A) Assets decrease by \$2 million; liabilities and stockholders' equity are both unchanged.

B) Assets decrease by \$2 million, liabilities decrease by \$2 million, and stockholders' equity is unchanged.

C) Assets decrease by \$2 million and liabilities increase by \$2 million.

D) Assets decrease by \$2 million, liabilities are unchanged, and stockholders' equity decreases by \$2 million.

Answer: B

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: This transaction will cause assets (Cash) to decrease and liabilities (Notes Payable) to decrease.

### [QUESTION]

48. A company issues \$20 million in new stock. It later uses the cash received to pay off promissory notes. What accounts are affected by these two transactions?

A) Common Stock, Cash, and Notes Payable.

B) Common Stock, Cash, Investments, and Notes Payable.

C) Cash, Common Stock, and Accounts Payable.

D) Common Stock, Investments, and Notes Payable.

Answer: A

Difficulty: 2 Medium

LO: 02-02

## Chapter 2: The Balance Sheet

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Issuing stock for cash means that Cash and Common Stock are affected. Using the cash to pay off notes means that Cash and Notes Payable are affected.

### [QUESTION]

49. A company borrows \$2 million from its bank. It then uses this money to buy equipment. How do these two transactions affect the company's accounting equation?

- A) Assets and liabilities both increase by \$2 million.
- B) Assets increase by \$2 million and liabilities decrease by \$2 million.
- C) Assets increase by \$4 million, liabilities increase by \$2 million, and stockholders' equity increases by \$2 million.
- D) Assets remain unchanged and liabilities increase by \$2 million.

Answer: A

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: The first transaction increases assets (Cash) and liabilities (Notes Payable). The second transaction increases assets (Equipment) and decreases an asset (Cash). The Cash account is increased and decreased by equal amounts. As such, taken together, these two transactions increase assets (Equipment) and increase liabilities (Notes Payable).

### [QUESTION]

50. A company receives \$100,000 cash from investors in exchange for stock. Several weeks later, the company buys a \$250,000 machine using all of the cash from the stock issue and signing a promissory note for the remainder. The accounts involved in these two transactions are:

- A) Cash; Equipment; Noncurrent Investments; and Accounts Payable.
- B) Cash; Noncurrent Investments; Common Stock; and Notes Payable.
- C) Cash; Equipment; Common Stock; and Notes Payable.
- D) Equipment; Notes Payable; and Retained Earnings.

Answer: C

Difficulty: 2 Medium

LO: 02-02

## Chapter 2: The Balance Sheet

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Receiving cash in exchange for common stock affects the Cash and Common Stock accounts. Buying a machine using cash for part of the purchase amount and borrowing the rest affects the Equipment, Cash, and Notes Payable accounts.

[QUESTION]

51. If total liabilities decreased by \$25,000 and stockholders' equity increased by \$5,000 during a period of time, then total assets must change by what amount and direction during the same time period?

- A) \$20,000 increase
- B) \$20,000 decrease
- C) \$30,000 increase
- D) \$30,000 decrease

Answer: B

Difficulty: 1 Easy

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback:

Change in assets = Change in liabilities + Change in stockholders' equity  
= (\$25,000) + \$5,000 = (\$20,000)

[QUESTION]

52. A company issues \$20 million in new stock. The company later uses this money to acquire a building. What is the effect of these two transactions on the company's accounts?

- A) Buildings increases and Common Stock increases.
- B) Buildings increases and Common Stock decreases.
- C) Cash increases, Buildings increases, and Common Stock increases.
- D) Cash decreases, Buildings increases, and Common Stock decreases.

Answer: A

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

## Chapter 2: The Balance Sheet

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Receiving cash from the issuance of stock increases both Cash and Common Stock. Using the cash to acquire a building causes the Cash account to decrease and the Buildings account to increase. The Cash account is increased and decreased by equal amounts. As such, taken together, these two transactions increase the Buildings account and increase the Common Stock account.

### [QUESTION]

53. Park & Company was recently formed with a \$5,000 investment in the company by stockholders in exchange for common stock. The company then borrowed \$2,000 from a local bank, purchased \$1,000 of supplies on account, and also purchased \$5,000 of equipment by paying \$2,000 in cash and signing a promissory note for the balance. Based on these transactions, the company's total assets are:

- A) \$7,000.
- B) \$9,000.
- C) \$10,000.
- D) \$11,000.

Answer: D

Difficulty: 3 Hard

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback:

Cash of \$5,000 cash from stock issuance + Cash of \$2,000 borrowed from bank + Supplies purchased in the amount of \$1,000 + Equipment purchased in the amount of \$5,000 – Cash paid for equipment of \$2,000 = \$11,000

### [QUESTION]

54. A company purchased land costing \$27,000 by paying cash of \$6,750 and signing a 90-day note for the balance. The entry to record this transaction would:

- A) increase total assets.
- B) decrease total liabilities.
- C) decrease Common Stock.
- D) increase total assets and decrease total liabilities.

Answer: A

Difficulty: 2 Medium

## Chapter 2: The Balance Sheet

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: The entry to record this transaction would increase Land by \$27,000, decrease Cash by \$6,750, and increase Notes Payable by \$20,250 (or \$27,000 – \$6,750).

[QUESTION]

55. On January 1, Kirk Corporation had total assets of \$850,000. During the month, the following activities occurred:

- Kirk Corporation acquired equipment costing \$6,000, promising to pay cash for it in 60 days.
- Kirk Corporation purchased \$3,500 of supplies for cash.
- Kirk Corporation sold land which it had acquired 2 years ago. The land had cost \$15,000 and it was sold for \$15,000 cash.
- Kirk Corporation signed an agreement to rent additional storage space next month at a charge of \$1,000 per month.

What is the amount of total assets of Kirk Corporation at the end of the month?

- A) \$859,500.
- B) \$856,000.
- C) \$837,500.
- D) \$840,000.

Answer: B

Difficulty: 3 Hard

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Analyze

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback:

Beginning total assets of \$850,000 + Equipment purchased of \$6,000 + Supplies purchased of \$3,500 – Cash paid of \$3,500 + Cash received from sale of land of \$15,000 – Land sold of \$15,000 = \$856,000

Signing a rental agreement is not an accounting transaction since there was no exchange involving assets, liabilities, and/or stockholders' equity between the company and someone else.

[QUESTION]

56. When accounts receivable are collected:



## Chapter 2: The Balance Sheet

- A) stockholders' equity increases.
- B) total assets increase.
- C) total assets decrease.
- D) the amount of total assets is unchanged.

Answer: D

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Collecting from customers on account increases the asset, Cash, and decreases the asset, Accounts Receivable; as such, that transaction does not change total assets.

Use the following information to answer questions 57 and 58:

A company was formed with \$60,000 cash contributed by its owners in exchange for common stock. The company borrowed \$30,000 from a bank. The company purchased \$10,000 of inventory and paid cash for it. The company also purchased \$70,000 of equipment by paying \$10,000 in cash and issuing a note for the remainder.

[QUESTION]

57. Use the information above to answer the following question. What is the amount of the total assets to be reported on the balance sheet?

- A) \$150,000.
- B) \$160,000.
- C) \$90,000.
- D) \$80,000.

Answer: A

Difficulty: 3 Hard

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback:

Cash from owners of \$60,000 + Cash from bank of \$30,000 + Inventory purchased for \$10,000 – Cash paid for inventory of \$10,000 + Equipment purchased for \$70,000 – Cash

## Chapter 2: The Balance Sheet

paid for equipment of \$10,000 = \$150,000

[QUESTION]

58. Use the information above to answer the following question. What is the amount of the total liabilities to be reported on the balance sheet?

- A) \$60,000.
- B) \$0
- C) \$90,000.
- D) \$80,000.

Answer: C

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback:

Note issued to bank for \$30,000 borrowing + Note issued to purchase equipment of \$60,000  
(or  $\$100,000 - \$30,000 = \$160,000$ )

Use the following information to answer questions 59 and 60:

Assets totaled \$24,250 and liabilities totaled \$8,500 at the beginning of the year. During the year, assets decreased by \$3,500 and liabilities increased by \$2,800.

[QUESTION]

59. Use the information above to answer the following question. What is the amount of the change in stockholders' equity during the year?

- A) \$5,750 increase
- B) \$700 decrease
- C) \$6,300 decrease
- D) \$550 increase

Answer: C

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Analyze

AACSB: Analytic

AICPA BB: Resource Management

## Chapter 2: The Balance Sheet

AICPA FN: Measurement

Feedback:

Change in assets = Change in liabilities + Change in stockholders' equity

Change in stockholders' equity = Change in assets – Change in liabilities

= (\$3,500) – \$2,800 = (\$6,300)

[QUESTION]

60. Use the information above to answer the following question. What is the amount of stockholders' equity at the end of the year?

- A) \$9,450.
- B) \$15,750.
- C) \$15,050.
- D) \$14,450.

Answer: A

Difficulty: 3 Hard

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Analyze

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback:

Assets = Liabilities + Stockholders' Equity

Stockholders' Equity = Assets - Liabilities

Beginning of year:

= \$24,250 – \$8,500 = \$15,750

Change in assets = Change in liabilities + Change in stockholders' equity

Change in stockholders' equity = Change in assets – Change in liabilities

= (\$3,500) – \$2,800 = (\$6,300)

Ending stockholders' equity = \$15,750 - \$6,300 = \$9,450

Use the following information to answer questions 61 and 62:

During its first year of operations, a company entered into the following transactions:

- Borrowed \$5,000 from the bank by signing a promissory note.
- Issued stock to owners for \$10,000.
- Purchased \$1,000 of supplies on account.
- Paid \$400 to suppliers as payment on account for the supplies purchased.

[QUESTION]

61. Use the information above to answer the following question. What is the amount of total assets at the end of the year?

## Chapter 2: The Balance Sheet

- A) \$16,000.
- B) \$5,600.
- C) \$15,000.
- D) \$15,600.

Answer: D

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback:

Total assets = Cash from borrowing of \$5,000 + Cash from issuing stock of \$10,000 + Supplies purchased \$1,000 – Cash paid to suppliers of \$400 = \$15,600

[QUESTION]

62. Use the information above to answer the following question. What is the amount of total liabilities at the end of the year?

- A) \$6,000.
- B) \$15,600.
- C) \$16,000.
- D) \$5,600.

Answer: D

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback:

Liabilities = Notes payable to the bank of \$5,000 + Accounts payable to supplier of \$1,000 – \$400 paid to supplier = \$5,600

[QUESTION]

63. Which of the following statements regarding debits and credits is always correct?

- A) Debits decrease accounts while credits increase them.
- B) The total value of all debits recorded in the ledger must equal the total value of all credits recorded in the ledger.
- C) The total value of all debits to a particular account must equal the total value of all credits

## Chapter 2: The Balance Sheet

to that account.

D) The normal balance for an account is the side on which it decreases.

Answer: B

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: The total value of all debits recorded in the ledger must equal the total value of all credits recorded in the ledger. Debits may increase or decrease an account, depending on the type of account. If an account has equal amounts of debits and credits, the account would then have a zero balance. The normal balance for an account is the side on which it increases.

### [QUESTION]

64. Accounts Payable had a balance of \$18,200 at the beginning of the month. During the month, three debits in the amounts of \$4,700, \$11,300, and \$14,800 were posted to Accounts Payable, and three credits in the amounts of \$3,600, \$9,500, and \$12,700 were posted to Accounts Payable. What is the ending balance of the Accounts Payable account?

A) \$13,200.

B) \$5,000.

C) \$23,200.

D) \$49,000.

Answer: A

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback:

Accounts Payable, a liability account, has a normal credit balance. The beginning credit balance of \$18,200 – Debits of (\$4,700 + \$11,300 + \$14,800) + Credits of (\$3,600 + \$9,500 + \$12,700) = Ending credit balance of \$13,200.

### [QUESTION]

65. How do debits appear in a T-account?

A) They are listed on the left side for asset accounts, but listed on the right side for liabilities and stockholders' equity accounts.

## Chapter 2: The Balance Sheet

- B) They are always listed on the right side of the account.
- C) They are always listed on the left side of the account.
- D) They are listed on the right side for asset accounts, but listed on the left side for liabilities and stockholders' equity accounts.

Answer: C

Difficulty: 1 Easy

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: The terms (and abbreviations) debit (dr) and credit (cr) just mean left and right.

[QUESTION]

66. Within the debit/credit framework, the best interpretation of the word “credit” is:

- A) left side of an account.
- B) increase side of an account.
- C) right side of an account.
- D) decrease side of an account.

Answer: C

Difficulty: 1 Easy

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: The terms (and abbreviations) debit (dr) and credit (cr) just mean left and right.

[QUESTION]

67. The Accounts Payable account:

- A) has a normal credit balance.
- B) is increased by a debit.
- C) is an asset.
- D) is increased when a company receives cash from customers.

Answer: A

Difficulty: 1 Easy

LO: 02-03

Topic: The Debit/Credit Framework

## Chapter 2: The Balance Sheet

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Accounts Payable is a liability account. All liability accounts have a normal credit balance and are increased by credits.

### [QUESTION]

68. The Accounts Receivable account:

- A) has a normal credit balance.
- B) is increased by a debit.
- C) is a liability.
- D) is increased when a company receives cash from its customers.

Answer: B

Difficulty: 1 Easy

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Accounts Receivable is an asset account. All asset accounts have a normal debit balance and are increased by debits.

Use the following T-account to answer questions 69-70:

Cash			
Beg. Bal.	123,900		
(a)	14,700	6,000	(c)
(b)	38,300	5,800	(d)
		7,400	(e)
		12,000	(f)
		11,200	(g)

### [QUESTION]

69. Use the information above to answer the following question. What is the ending balance of the Cash account?

- A) \$219,300
- B) \$113,300
- C) \$28,500
- D) \$134,500

## Chapter 2: The Balance Sheet

Answer: D

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback:

Beginning debit balance of \$123,900 + \$14,700 + \$38,300 – \$6,000 – \$5,800 – \$7,400 – \$12,000 – \$11,200 = Ending balance of \$134,500

[QUESTION]

70. Use the information above to answer the following question. In the T-account above:

A) (a) and (b) are credits.

B) (c) through (g) are debits.

C) if the sum of (a) and (b) is less than the sum of (c) through (g), the Cash account balance will increase.

D) (a) and (b) are increases.

Answer: D

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Cash is an asset account and assets are increased by debits (on the left-side of the account) and decreased by credits (on the right-side of the account). Entries (a) and (b) are debits; the rest are credits. If the sum of (a) and (b) is more than the sum of (c) through (g), the Cash account balance will increase.

[QUESTION]

71. A credit would make which of the following accounts decrease?

A) Common Stock

B) Inventory

C) Notes Payable

D) Retained Earnings

Answer: B

Difficulty: 2 Medium

LO: 02-03



## Chapter 2: The Balance Sheet

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Use debits for increases in assets (and for decreases in liabilities and stockholders' equity accounts). Use credits for increases in liabilities and stockholders' equity accounts (and for decreases in assets). Inventory is an asset account and, as such, it decreases with a credit. The other accounts are on the right-side of the accounting equation and increase with credits.

### [QUESTION]

72. Cash had a beginning balance of \$68,900. During the month, Cash was credited for \$16,000 and debited for \$18,300. At the end of the month, the balance is:

- A) \$71,200 credit.
- B) \$71,200 debit.
- C) \$66,600 debit.
- D) \$66,600 credit.

Answer: B

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Cash, an asset account, has a normal debit balance.

Beginning debit balance of \$68,900 + Debit of \$18,300 – Credit of \$16,000 = Ending debit balance of \$71,200

### [QUESTION]

73. Which of the following statements about normal account balances is correct?

- A) Assets have debit balances and liabilities have credit balances.
- B) Assets and liabilities have credit balances.
- C) Assets have credit balances and liabilities have debit balances.
- D) Assets and liabilities have debit balances.

Answer: A

Difficulty: 1 Easy

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Remember

AACSB: Analytic

## Chapter 2: The Balance Sheet

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Assets normally end with a debit balance (because debits to assets normally exceed credits) and liabilities and stockholders' equity accounts normally end with credit balances (credits exceed debits).

### [QUESTION]

74. For both accounts and amounts, the standard formatting for a journal entry lists:

- A) credits first and then debits, both aligned to the left.
- B) credits first and then debits, indented underneath.
- C) debits first and then credits, both aligned to the right.
- D) debits first and then credits, indented to the right underneath.

Answer: D

Difficulty: 1 Easy

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Debits appear first (on top). Credits are shown below the debits and are indented to the right (both the words and the amounts).

### [QUESTION]

75. The standard formatting for a journal entry lists the dollar amounts for:

- A) credits underneath and to the right of the dollar amounts for debits.
- B) debits and credits aligned equally to the right.
- C) debits underneath and to the right of the dollar amounts for credits.
- D) debits and credits aligned equally to the left.

Answer: A

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Debits appear first (on top). Credits are shown below the debits and are indented to the right (both the words and the amounts).

### [QUESTION]

## Chapter 2: The Balance Sheet

76. Which of the following statements about the debit/credit framework is correct?

- A) Stockholders' Equity = Assets + Liabilities.
- B) The total value of credits in all accounts must always equal the total value of debits in all accounts.
- C) The normal balance for an account is the side on which it decreases.
- D) A decrease in Common Stock would be recorded with a credit.

Answer: B

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: The double-entry system requires that debits = credits. The accounting equation is: Assets = Liabilities + Stockholders' Equity (or Stockholders' Equity = Assets – Liabilities). Assets normally end with a debit balance (because debits to assets normally exceed credits) and liabilities and stockholders' equity accounts normally end with credit balances (credits exceed debits). An increase (rather than a decrease) in Common Stock would be recorded with a credit.

[QUESTION]

77. The normal balance of any account is the:

- A) left side.
- B) right side.
- C) side which increases that account.
- D) side which decreases that account.

Answer: C

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: The side that increases an account is the normal balance of the account.

[QUESTION]

78. A company started the year with a normal balance of \$68,000 in the Inventory account. During the year, debits totaling \$45,000 and credits totaling \$55,000 were posted to the Inventory account. Which of the following statements about the Inventory account is correct?

## Chapter 2: The Balance Sheet

- A) The normal balance of the Inventory account is a credit balance.
- B) After these amounts are posted, the balance in the Inventory account is a credit balance of \$58,000.
- C) The Inventory account is decreased by debits.
- D) The debits and credits posted to the Inventory account caused it to decrease by \$10,000.

Answer: D

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Inventory is an asset account and, as such, it has a normal debit balance. The Inventory account is increased with debits and decreased with credits. Beginning debit balance of \$68,000 + Debits totaling \$45,000 – Credits totaling \$55,000 = Ending debit balance of \$58,000. As a result, the Inventory account balance decreased by \$10,000 during the year.

### [QUESTION]

79. Which of the following statements about the debit/credit framework is correct?

- A) All asset accounts have a normal debit balance with the exception of cash which has a normal credit balance.
- B) The Common Stock account is increased by debits.
- C) When payment is made on a liability such as accounts payable, the liability account is decreased with a debit.
- D) The total amount of asset accounts must equal the total amount of liability accounts minus the total amount of stockholders' equity accounts.

Answer: C

Difficulty: 1 Easy

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Comprehension

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Accounts Payable, a liability account, is decreased with a debit. All asset accounts, including cash, have a normal debit balance. Common Stock is a stockholders' equity account and, as such, is increased by credits. The accounting equation is assets equal liabilities plus (rather than minus) stockholders' equity.

## Chapter 2: The Balance Sheet

### [QUESTION]

80. A company purchased equipment for use in the business at a cost of \$12,000, one-fourth was paid in cash, and the company signed a note for the balance. The journal entry to record this transaction will include a:

- A) debit to Notes Payable of \$9,000.
- B) debit to Cash of \$12,000.
- C) credit to Notes Payable of \$9,000.
- D) debit to Equipment of \$3,000.

Answer: C

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: The journal entry will debit Equipment for \$12,000, credit Cash for \$3,000, and credit Notes Payable for \$9,000.

### [QUESTION]

81. Which account would be increased with a debit?

- A) Retained Earnings
- B) Accounts Receivable
- C) Common Stock
- D) Notes Payable

Answer: B

Difficulty: 1 Easy

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Use debits for increases in assets (and for decreases in liabilities and stockholders' equity accounts). Use credits for increases in liabilities and stockholders' equity accounts (and for decreases in assets). Accounts Receivable is an asset and, as such, would be increased with a debit. Retained Earnings and Common Stock are stockholders' equity accounts and Notes Payable is a liability account. Liabilities and stockholders' equity accounts are increased with credits.

### [QUESTION]

## Chapter 2: The Balance Sheet

82. Which account would be decreased with a credit?

- A) Cash
- B) Accounts Payable
- C) Common Stock
- D) Retained Earnings

Answer: A

Difficulty: 1 Easy

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Use debits for increases in assets (and for decreases in liabilities and stockholders' equity accounts). Use credits for increases in liabilities and stockholders' equity accounts (and for decreases in assets). Cash is an asset and, as such, would be decreased with a credit.

Retained Earnings and Common Stock are stockholders' equity accounts and Accounts Payable is a liability account. Liabilities and stockholders' equity accounts are decreased with debits.

[QUESTION]

83. Which of the following statements about the debit/credit framework is correct?

- A) Asset and liability accounts have a normal debit balance.
- B) To debit an account means to increase it.
- C) Common Stock has a normal credit balance.
- D) To credit an account means to decrease it.

Answer: C

Difficulty: 1 Easy

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Use debits for increases in assets (and for decreases in liabilities and stockholders' equity accounts). Use credits for increases in liabilities and stockholders' equity accounts (and for decreases in assets). The normal balance for an account is the side on which it increases.

Common Stock is a stockholders' equity account and has a normal credit balance.

[QUESTION]

84. Which of the following statements about transaction analysis is correct?

## Chapter 2: The Balance Sheet

- A) Transactions are analyzed from the standpoint of the owners.
- B) All business activities are considered to be accounting transactions.
- C) The transaction amount is determined for each exchange based on the cost of the items given and received.
- D) A business needs journal entries only to show how transactions affect the balance sheet.

Answer: C

Difficulty: 1 Easy

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Each exchange is analyzed to determine a dollar amount that represents the value of items given and received. Transactions are analyzed from the standpoint of the business (rather than its owners). Business activities that do not include the exchange of assets or services at the time of the activity are not considered transactions. Journal entries indicate the effects of each day's transactions in a debits-equal-credits format on all of the accounts affected (not just the balance sheet accounts).

### [QUESTION]

85. Which of the following statements about liabilities is not correct?

- A) Liabilities are amounts owed by a business.
- B) Liability accounts have a normal credit balances.
- C) Financing activities may affect the amount of liabilities.
- D) Examples of liabilities include Notes Payable, Common Stock, and Income Tax Payable.

Answer: D

Difficulty: 1 Easy

LO: 02-01

Topic: Building a Balance Sheet from Business Activities

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Notes Payable and Income Tax Payable are liability accounts; however, Common Stock is a component of stockholders' equity; it is not a liability account.

### [QUESTION]

86. Each account is assigned a number; this listing of all accounts is called a:

- A) trial balance.
- B) journal.

## Chapter 2: The Balance Sheet

- C) ledger.
- D) chart of accounts.

Answer: D

Difficulty: 1 Easy

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: A chart of accounts is a summary of all account names (and corresponding account numbers) used to record financial results in the accounting system.

### [QUESTION]

87. Darin Company purchased land at a cost of \$15,000 and planned to use it to construct a new storage facility on the property. A short time later, the company changed its plans and sold the property to Dee Company for \$15,000. Dee Company signed a note for \$15,000 that is due in 60 days. The journal entry prepared by Darin Company to record the sale of the property would include which of the following?

- A) Credit to Note Receivable
- B) Debit to Cash
- C) Credit to Land
- D) Debit to Accounts Payable

Answer: C

Difficulty: 2 Medium

LO: 02-03

Topic: Transaction Analysis

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: The journal entry to record the sale of the land would include a debit to Notes Receivable and a credit to Land for \$15,000.

### [QUESTION]

88. B. Darin Company issued common stock to investors and received \$50,000. Which of the following statements about this transaction is correct?

- A) This is an example of a cash inflow from an investing activity.
- B) The journal entry to record this transaction will include a credit to Cash.
- C) This is an example of a cash outflow from a financing activity.



## Chapter 2: The Balance Sheet

D) The journal entry to record this transaction will include a credit to Common Stock.

Answer: D

Difficulty: 2 Medium

LO: 02-01

Topic: Building a Balance Sheet from Business Activities

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: The journal entry to record this transaction would include a debit to Cash and a credit to Common Stock. This transaction is an example of a cash inflow from a financing activity.

### [QUESTION]

89. On January 5, Arlington Inc. purchases \$23,000 of supplies; payment is not required until February 4. What action should be taken by Arlington Inc. on January 5?

- A) No journal entry is required; this transaction should not be recorded until the payment is made.
- B) A journal entry that includes a credit to Accounts Payable should be prepared.
- C) A journal entry that includes a debit to Accounts Payable should be prepared.
- D) A journal entry that includes a debit to Prepaid Expenses should be prepared.

Answer: B

Difficulty: 2 Medium

LO: 02-02

LO: 02-03

Topic: Step 1: Analyze Transactions

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: A transaction has taken place; supplies were received in exchange for a promise to pay. On January 5, the date of the transaction, a journal entry should be prepared that includes a debit to Supplies and a credit to Accounts Payable for \$23,000.

### [QUESTION]

90. A company uses \$100,000 in cash to pay off \$100,000 in notes payable. This would result in a:

- A) \$100,000 debit to Notes Payable and a \$100,000 credit to Cash.
- B) \$100,000 credit to Cash and a \$100,000 credit to Notes Payable.
- C) \$100,000 debit to Cash and a \$100,000 credit to Notes Payable.

## Chapter 2: The Balance Sheet

D) \$100,000 debit to Cash and a \$100,000 debit to Notes Payable.

Answer: A

Difficulty: 2 Medium

LO: 02-02

LO: 02-03

Topic: Step 1: Analyze Transactions

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Both accounts decrease. Cash is an asset account and Notes Payable is a liability account. The journal entry would include a debit to Notes Payable and a credit to Cash and for \$100,000.

### [QUESTION]

91. Purrfect Pets, Inc. makes a \$10,000 payment on account. This would result in a:

- A) \$10,000 credit to Cash and a \$10,000 credit to Accounts Payable.
- B) \$10,000 debit to Cash and a \$10,000 debit to Accounts Payable.
- C) \$10,000 debit to Accounts Payable and a \$10,000 credit to Cash.
- D) \$10,000 debit to Cash and a \$10,000 credit to Accounts Payable.

Answer: C

Difficulty: 2 Medium

LO: 02-02

LO: 02-03

Topic Ares: Analyze Transactions

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Both accounts decrease. Cash is an asset account and Accounts Payable is a liability account. The journal entry would include a debit to Accounts Payable and a credit to Cash and for \$10,000.

### [QUESTION]

92. Your company purchases equipment for \$2 million paying \$300,000 in cash and issuing \$1.7 million in promissory notes. When the journal entry is posted to the related accounts:

- A) \$2 million will be credited and \$300,000 will be debited to asset accounts; \$1.7 million will be debited to liability accounts.
- B) \$2 million will be debited to asset accounts; \$2 million will be credited to liability

## Chapter 2: The Balance Sheet

accounts.

C) \$2 million will be debited and \$300,000 will be credited to asset accounts; \$1.7 million will be credited to liability accounts.

D) \$2 million will be credited to asset accounts; \$2 million will be debited to liability accounts.

Answer: C

Difficulty: 3 Hard

LO: 02-02

LO: 02-03

Topic: Step 1: Analyze Transactions

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback:

Equipment, an asset, will increase with a debit for \$2 million. Cash, an asset, will decrease with a credit for \$300,000. Notes Payable, a liability, will increase with a credit for \$1.7 million.

[QUESTION]

93. Consider the following journal entry:

Equipment	10,000	
Cash		4,000
Note Payable		6,000

Which of the following explanations best describes this journal entry?

A) The company buys \$10,000 of equipment, pays cash of \$4,000, and signs a note for \$6,000.

B) The company receives \$4,000 in cash and \$6,000 in notes payable in exchange for selling \$10,000 of equipment.

C) The company buys \$10,000 of equipment, pays \$4,000 cash, and promises to cancel a debt owed to the company in the amount of \$6,000.

D) The company sells \$10,000 of equipment, receives \$4,000 in cash, and pays off \$6,000 it owes on the equipment.

Answer: A

Difficulty: 2 Medium

LO: 02-02

LO: 02-03

Topic: Step 1: Analyze Transactions

Topic: The Debit/Credit Framework

## Chapter 2: The Balance Sheet

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: The debit to the Equipment account increases that asset account, so \$10,000 of equipment was purchased. The credit to the Cash account decreases that asset account, so \$4,000 cash was paid. The credit to Notes Payable increases that liability account, so a note for \$6,000 was signed.

### [QUESTION]

94. A trial balance:

- A) ensures that all journal entries have been posted.
- B) is a way to check that no mistakes have been made during the accounting cycle.
- C) is a report for internal use only.
- D) is a way to check that all journal entries have been posted and that no mistakes have been made during the accounting cycle.

Answer: C

Difficulty: 2 Medium

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: A trial balance is an internal report only. A trial balance checks on the equality of debits and credits. It is not a way to ensure that all journal entries have been posted since if a journal entry is not posted, debits could still equal credits. It is also not a way to ensure that no mistakes have been made. If a mistake was made, but was posted using equal debits and credits, the trial balance would still be in balance.

### [QUESTION]

95. Which of the following would cause a trial balance to be out of balance?

- A) A transaction was recorded twice.
- B) A transaction was not recorded.
- C) A transaction was posted to the wrong accounts.
- D) Only the credit of a transaction was recorded.

Answer: D

Difficulty: 1 Easy

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

## Chapter 2: The Balance Sheet

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: A trial balance is an internal report that lists all accounts and their balances to check on the equality of total recorded debits and total recorded credits. If only the credit of a transaction was recorded, the trial balance would not be in balance. The other errors listed (recording a transaction twice, not recording a transaction, or posting the transaction to the wrong accounts) would result in a trial balance that would still be in balance even though various account balances would be misstated.

### [QUESTION]

96. Assume a company only entered into financing and investing activities and has prepared its journal entries and posted them to T-accounts. How would the related account balances be listed on its trial balance?

- A) Credits first, followed by debits
- B) Debits first, followed by credits
- C) Alphabetically
- D) In descending order by dollar amount

Answer: B

Difficulty: 1 Easy

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: This company's trial balance would list its asset accounts, which have debit balances, and then its liability and stockholders' equity accounts, which have credit balances.

### [QUESTION]

97. All of the following would be classified as current on a classified balance sheet except:

- A) Common Stock
- B) Cash
- C) Accounts Payable
- D) Supplies

Answer: A

Difficulty: 1 Easy

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

AACSB: Analytic

## Chapter 2: The Balance Sheet

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Common Stock is a stockholders' equity account and is not classified as current or noncurrent. Cash and Supplies are current assets. Accounts Payable is a current liability.

[QUESTION]

98. Daisy Company's trial balance was in balance at the end of the period and showed the following accounts:

<u>Account</u>	<u>Balance</u>
Accounts Payable	\$20,400
Cash	41,400
Common Stock	20,000
Equipment	9,000
Land	30,000
Notes Payable	40,000

What is the balance of the credit column on Daisy Company's trial balance?

- A) \$160,800.
- B) \$80,400.
- C) \$60,400.
- D) \$60,000.

Answer: B

Difficulty: 2 Medium

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Application

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback:

Total credits = Accounts Payable \$20,400 + Common Stock \$20,000 + Notes Payable \$40,000 = \$80,400

[QUESTION]

99. The following account balances were listed on the trial balance of Edgar Company at the end of the period:

<u>Account</u>	<u>Balance</u>
Accounts Payable	\$30,600
Cash	48,900
Common Stock	30,000

## Chapter 2: The Balance Sheet

Equipment	13,500
Land	45,000
Notes Payable	60,000

The company's trial balance is not in balance and the company's accountant has determined that the error is in the cash account. What is the correct balance in the cash account?

- A) \$57,900.
- B) \$31,500.
- C) \$2,100.
- D) \$62,100.

Answer: D

Difficulty: 3 Hard

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Application

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback:

Total credits = Accounts Payable \$30,600 + Common Stock \$30,000 + Notes Payable \$60,000 = \$120,600

Total debits = Cash (unknown) + Equipment \$13,500 + Land \$45,000

Total debits must also equal \$120,600

\$120,600 = Cash (unknown) + Equipment \$13,500 + Land \$45,000

Cash = \$120,600 – Equipment \$13,500 – Land \$45,000 = \$62,100

[QUESTION]

100. Which one of the following is not a current asset?

- A) Cash
- B) Supplies
- C) Equipment
- D) Prepaid Insurance

Answer: C

Difficulty: 1 Easy

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Cash, Supplies, and Prepaid Insurance are current assets because they will be used

## Chapter 2: The Balance Sheet

up or converted to cash within 12 months of the date of the balance sheet. Equipment is classified as a noncurrent asset because it will be used over a number of years.

### [QUESTION]

101. Which of the following would be listed as a current liability?

- A) Cash
- B) Notes Payable (due in two years)
- C) Supplies
- D) Accounts Payable

Answer: D

Difficulty: 1 Easy

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Current liabilities are debts and other obligations that will be paid or fulfilled within 12 months of the balance sheet date. Accounts Payable is the only current liability. Cash and Supplies are assets. Since the Notes Payable are due in two years, they are a noncurrent liability.

### [QUESTION]

102. A noncurrent liability is one that the company:

- A) has owed for over one year.
- B) has owed for over five years.
- C) will not pay within 12 months.
- D) will not pay within five years.

Answer: C

Difficulty: 1 Easy

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Knowledge

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Current liabilities are debts and obligations that will be paid, settled, or fulfilled within 12 months of the balance sheet date. Noncurrent (or long-term) liabilities are those that do not meet the definition of current.

### [QUESTION]



## Chapter 2: The Balance Sheet

103. A current asset is one that the company:

- A) has owned for over one year.
- B) has owned for over five years.
- C) will use up or converted into cash in less than 12 months.
- D) has updated to reflect its current value.

Answer: C

Difficulty: 1 Easy

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Current assets are assets that will be used up or converted into cash within 12 months of the balance sheet date.

[QUESTION]

104. At the start of the first year of operations, Retained Earnings would be:

- A) equal to zero.
- B) equal to Common Stock.
- C) equal to stockholders' equity.
- D) equal to the Net Income.

Answer: A

Difficulty: 2 Medium

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Knowledge

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Retained Earnings is the amount of earnings accumulated from prior years that have not been distributed as dividends. At the start of the first year of operations, there would be no Retained Earnings.

[QUESTION]

105. Current liabilities are expected to be:

- A) converted to cash within one year.
- B) settled within one year.
- C) used in the business within one year.
- D) acquired within one year.

## Chapter 2: The Balance Sheet

Answer: B

Difficulty: 1 Easy

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource management

AICPA FN: Reporting

Feedback: Current liabilities are debts and obligations that will be paid, settled, or fulfilled within 12 months of the balance sheet date.

### [QUESTION]

106. Assets are listed on a classified balance sheet:

- A) in alphabetical order.
- B) from the largest dollar amount to the lowest dollar amount.
- C) beginning with noncurrent assets and ending with current assets.
- D) beginning with current assets and starting with Cash.

Answer: D

Difficulty: 1 Easy

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Companies list assets in order of liquidity (how soon they will be used up or turned into cash) and liabilities in order of maturity (how soon they will be paid in cash or fulfilled by providing a service). A classified balance sheet lists current assets first starting with Cash.

### [QUESTION]

107. Which of the following would not be classified as a current asset?

- A) Cash
- B) Accounts Payable
- C) Supplies
- D) Inventory

Answer: B

Difficulty: 1 Easy

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

AACSB: Analytic

## Chapter 2: The Balance Sheet

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Current assets are assets that will be used up or converted into cash within 12 months of the balance sheet date. Examples include Cash, Supplies and Inventory.

Accounts Payable is a current liability.

[QUESTION]

108. Which of the following would be classified as a noncurrent liability on the balance sheet at December 31, Year 1?

- A) An accounts payable due on January 30, Year 2
- B) A notes payable due November 30, Year 2
- C) A note receivable that matures on April 30, Year 3
- D) A notes payable due January 15, Year 3

Answer: D

Difficulty: 1 Easy

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

E) Feedback: Current liabilities are debts and obligations that will be paid, settled, or fulfilled within 12 months of the balance sheet date. Noncurrent (or long-term) liabilities that do not meet the definition of current liabilities. A notes payable that is due January 15, Year 3 would be classified as a noncurrent liability on the balance sheet at December 31, Year 1 since it is due after 12 months of the balance sheet date.

Use the following information to answer questions 109 through 111:

A company reported the following information at December 31, Year 1:

Accounts Payable	\$ 4,500
Accounts Receivable	9,350
Cash	23,490
Common Stock	90,000
Equipment	49,500
Inventory	31,200
Notes Payable due December 31, Year 3	2,500
Retained Earnings, December 31, Year 1	14,090
Wages Payable	2,450

[QUESTION]

## Chapter 2: The Balance Sheet

109. Use the information above to answer the following question. What is the amount of current assets on the classified balance sheet?

- A) \$113,540.
- B) \$64,040.
- C) \$32,840.
- D) \$82,170.

Answer: B

Difficulty: 2 Medium

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback:

Current assets = Cash + Accounts Receivable + Inventory  
= \$23,490 + \$9,350 + \$31,200 = \$64,040

[QUESTION]

110. Use the information above to answer the following question. What is the amount of current liabilities on the classified balance sheet?

- A) \$9,450.
- B) \$6,950.
- C) \$113,540.
- D) \$4,500.

Answer: B

Difficulty: 2 Medium

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback:

Current liabilities = Accounts Payable + Wages Payable  
= \$4,500 + \$2,450 = \$6,950

[QUESTION]

111. Use the information above to answer the following question. What is the total of the credit balance accounts?

- A) \$111,040.

## Chapter 2: The Balance Sheet

- B) \$104,090.
- C) \$113,540.
- D) \$108,590.

Answer: C

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: Liabilities and stockholders' equity are the credit balance accounts.

Liabilities = Accounts Payable + Wages Payable + Notes Payable

= \$4,500 + \$2,450 + \$2,500 = \$9,450

Stockholders' equity = Common Stock + Retained Earnings

= \$90,000 + 14,090 = \$104,090

Liabilities + Stockholders' equity = \$9,450 + \$104,090 = \$113,540

### [QUESTION]

112. Which of the following statements about the balance sheet is correct?

- A) A classified balance sheet is one that contains privileged information.
- B) Current liabilities are debts and other obligations that will be paid or fulfilled within 12 months of the balance sheet date.
- C) All companies use the chart of account names defined by the Financial Accounting Standards Board (FASB).
- D) A balance sheet is prepared for a period of time.

Answer: B

Difficulty: 2 Medium

LO: 02-02

LO: 02-04

Topic: Step 1: Analyze Transactions

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: A classified balance sheet is a balance sheet that shows a subtotal for current assets and current liabilities. Current liabilities are debts and obligations that will be paid, settled, or fulfilled within 12 months of the balance sheet date. Although some account titles are common across all companies, each chart of accounts is tailored to each company's business. A balance sheet is prepared as of a specific date (rather than for a period of time).

## Chapter 2: The Balance Sheet

### [QUESTION]

113. Which of the following statements about the balance sheet is correct?

- A) An item on a balance sheet that is labeled as “payable” is a liability of that company.
- B) Assets are listed on the balance sheet in alphabetical order.
- C) The balance sheet balances when assets plus liabilities equal stockholders’ equity.
- D) The balance sheet proves that asset debits = liability credits.

Answer: A

Difficulty: 2 Medium

LO: 02-04

Topic: Transaction Analysis

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Payables are liabilities or obligations of the company. Companies list assets in order of liquidity (how soon they will be used up or turned into cash). The balance sheet balances when assets equal liabilities plus stockholders’ equity (rather than assets plus liabilities equal stockholders’ equity or asset debits equal liability credits).

### [QUESTION]

114. Which of the following statements regarding posting and classification is correct?

- A) Posting journal entries involves copying the dollar amounts from the ledger into the journal.
- B) If a \$100 debit is erroneously posted to an account as a \$100 credit, the accounts will be out of balance by \$100.
- C) If a \$5,000 credit to a stockholders’ equity account is misclassified as a \$5,000 credit to a liability, the accounting equation will still balance.
- D) If a purchase of supplies on account for \$100 is recorded with a debit to Supplies of \$10 and a credit to Accounts Payable for \$10, the accounting equation will not balance.

Answer: C

Difficulty: 3 Hard

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: If a \$5,000 credit to a stockholders’ equity account is misclassified as a \$5,000 credit to a liability, the accounting equation will still balance because liabilities and

## Chapter 2: The Balance Sheet

stockholders' equity are on the same side of the accounting equation. After journal entries have been recorded, their dollar amounts are copied ("posted") to each ledger account affected by the transaction (rather than from the ledger to the journal). If an error in posting is made so that a \$100 debit is entered as a credit to an account, the accounts will be out of balance by \$200 (rather than \$100). If a transaction is recorded with a debit to Supplies of \$10 and a credit to Accounts Payable for \$10, the accounting equation will still balance.

Use the following to answer questions 115-116:

**PURRFECT PETS, INC.**  
Balance Sheet  
at June 30, Year 1

Assets		Liabilities	
Cash	\$ 732,600	Accounts Payable	\$ 349,200
Accounts Receivable	419,200	Notes Payable due June 30, Year 3	<u>268,900</u>
Supplies	58,400	Total Liabilities	<u>618,100</u>
Equipment	118,500	Stockholders' Equity	
Other Assets	<u>69,400</u>	Common Stock	662,100
		Retained Earnings	<u>117,900</u>
		Total Stockholders' Equity	<u>780,000</u>
Total Assets	<u>\$1,398,100</u>	Total Liabilities & Stockholders' Equity	<u>\$1,398,100</u>

**[QUESTION]**

115. Use the information above to answer the following question. Which line items would be classified as noncurrent on a classified balance sheet?

- A) Cash; Supplies; Accounts Payable
- B) Equipment; Other Assets; Notes Payable
- C) Supplies; Equipment; Notes Payable
- D) Accounts Receivable; Equipment; Other Assets

Answer: B

Difficulty: 2 Medium

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Current assets are assets that will be used up or converted into cash within 12 months of the balance sheet date. Current liabilities are debts and obligations that will be paid,

## Chapter 2: The Balance Sheet

settled, or fulfilled within 12 months of the balance sheet date. Noncurrent (or long-term) assets and liabilities do not meet the definition of current. Noncurrent assets include Equipment and Other Assets. Noncurrent liabilities include Notes Payable due in two years.

### [QUESTION]

116. Use the information above to answer the following question. How much financing did the stockholders of Purrfect Pets, Inc. directly contribute to the company?

- A) \$117,900.
- B) \$662,100.
- C) \$780,000.
- D) \$1,398,100.

Answer: B

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Stockholders' equity includes Common Stock, which is the amount contributed by owners of \$662,100.

### [QUESTION]

117. Which of the following sequences indicates the correct order of steps in the accounting cycle?

- A) Post to T-accounts, prepare journal entries, prepare trial balance, and prepare financial statements.
- B) Post to T-accounts, prepare journal entries, prepare financial statements, and prepare trial balance.
- C) Prepare Journal entries, post to T-accounts, prepare trial balance, and prepare financial statements.
- D) Prepare Journal entries, post to T-accounts, prepare financial statements, and prepare trial balance.

Answer: C

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting



## Chapter 2: The Balance Sheet

Feedback: After transactions are analyzed, journal entries are prepared to record those transactions in the journal. Then, they are posted to the T-accounts. After a trial balance is prepared using the T-account balances, the financial statements are prepared.

Use the following T-account and partial listing of account balances to answer questions 118 and 119:

T-account:

Accounts Receivable	
Beg. Bal.	187,500
	104,900
	63,900
	18,000
	5,400
	14,700
	19,200

Partial list of account balances at the end of the year:

Cash	\$28,000
Accounts Receivable	Unknown
Equipment	35,600
Accounts Payable	5,900

[QUESTION]

118. Use the information above to answer the following question. The amount of total current assets that will be reported on the company's balance sheet at the end of the year is:

- A) \$362,600.
- B) \$368,500.
- C) \$139,500.
- D) \$327,000.

Answer: D

Difficulty: 3 Hard

LO: 02-03

LO: 02-04

Topic: The Debit/Credit Framework

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback:

Total current assets = Cash + Accounts Receivable

## Chapter 2: The Balance Sheet

Accounts Receivable is an asset; it is increased with debits (right-side of T-account) and decreased with credits (right-side of T-account)

Ending Accounts Receivable balance = Beginning debit balance of \$187,500 + \$104,900 + \$63,900 – \$18,000 – \$5,400 – \$14,700 – \$19,200 = \$299,000

Total Current Assets = \$28,000 + \$299,000 = \$327,000.

### [QUESTION]

119. Use the information above to answer the following question. Which of the following is an accurate description of the economic events involving Accounts Receivable as documented in the T-account above?

- A) Sales to customers on account exceeded the payments received from customers on account.
- B) Payments received from customers on account exceeded the sales made to customers on account.
- C) The company paid off its debt more than it incurred new debt.
- D) The company incurred more debt than it paid off.

Answer: A

Difficulty: 2 Medium

LO: 02-03

Topic: Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback:

Accounts Receivable is an asset; it is increased with debits (right-side of T-account) and decreased with credits (right-side of T-account)

Ending Accounts Receivable balance = Beginning debit balance of \$187,500 + \$104,900 + \$63,900 – \$18,000 – \$5,400 – \$14,700 – \$19,200 = \$299,000

The debits represent increases as a result of sales to customers on account. The credits represent decreases as a result of customer payments on account. The account balance increased from \$187,500 to \$299,000, which means the debits exceeded the credits. Sales to customers on account (the debits) exceeded the payments received from customers on account (the credits).

### [QUESTION]

120. Which of the following statements about transaction analysis is not correct?

- A) A transaction is an exchange or event that has a direct and measurable financial effect.
- B) Every transaction has at least two effects.
- C) Cash is the account credited when a bank loan is repaid.
- D) Notes Payable is the account debited when money is borrowed from a bank using a

## Chapter 2: The Balance Sheet

promissory note.

Answer: D

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: When money is borrowed from a bank using a promissory note, the related journal entry includes a debit to Cash and a credit to Notes Payable.

### [QUESTION]

121. Which of the following statements about the concepts underlying the balance sheet is correct?

- A) A company bought land for \$5 million dollars 10 years ago. The land is now worth \$15 million. The company should increase the book value of this asset on its balance sheet to reflect its current value.
- B) All events affecting the current value of a company are reported on the balance sheet.
- C) According to the cost principle, assets are valued at their replacement cost.
- D) If an asset's value increases, the increase in value is generally not recorded under GAAP.

Answer: D

Difficulty: 2 Medium

LO: 02-05

Topic: Balance Sheet Concepts and Values

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Following the cost principle, assets and liabilities are first recorded at cost, which is their cash-equivalent value on the date of the transaction. Later, if an asset's value increases, the increase is generally not recorded under GAAP (unless it is a particular type of financial investment).

### [QUESTION]

122. In Year 2, the Denim Company bought an acre of land that cost \$15,000. In Year 5, another company purchased a nearby acre of land for \$28,000 and a different company purchased another nearby acre of land for \$26,000. As a result, an appraiser estimated that the acre owned by Denim had increased in value to \$27,000. If Denim prepares a balance sheet at the end of Year 5, the acre of land that it owns should be reported at:

- A) \$15,000.

## Chapter 2: The Balance Sheet

- B) \$28,000.
- C) \$18,000.
- D) the average of all of the amounts.

Answer: A

Difficulty: 2 Medium

LO: 02-05

Topic: Balance Sheet Concepts and Values

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: Following the cost principle, assets and liabilities are first recorded at cost, which is their cash-equivalent value on the date of the transaction. Later, if an asset's value increases, the increase is generally not recorded under GAAP (unless it is a particular type of financial investment). Denim's balance sheet should report its land at the original cost of \$15,000.

### [QUESTION]

123. How will a company's current ratio be affected by the purchase of equipment for cash?

- A) The current ratio will increase because current assets increase.
- B) The current ratio will decrease because current liabilities increase.
- C) The current ratio will decrease because current assets decrease.
- D) The current ratio will remain unchanged.

Answer: C

Difficulty: 2 Medium

LO: 02-05

Topic: Assessing the Ability to Pay

Blooms: Analyze

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: The transaction will increase Equipment, a noncurrent asset, and decrease Cash, a current asset. The current ratio is computed by dividing current assets by current liabilities. Since the numerator will decrease, the current ratio will decrease.

### [QUESTION]

124. How will a company's current ratio be affected when the company receives \$20,000 from owners and issues common stock to them?

- A) The current ratio will increase because current assets increase.
- B) The current ratio will increase because current liabilities decrease.
- C) There will be no change in the company's current ratio.

## Chapter 2: The Balance Sheet

D) The current ratio will decrease because current liabilities increase.

Answer: A

Difficulty: 2 Medium

LO: 02-05

Topic: Assessing the Ability to Pay

Blooms: Analyze

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback: The transaction will increase Cash, a current asset, and increase, Common Stock, a stockholders' equity account. The current ratio is computed by dividing current assets by current liabilities. Since the numerator will increase, the current ratio will increase.

### [QUESTION]

125. Your company's president donates a large amount of her own money to charity and receives significant publicity that includes the company's name. How would the benefits of this publicity appear on the balance sheet?

- A) It would appear as a current asset.
- B) It would appear as Common Stock.
- C) It would appear as a noncurrent asset.
- D) It would not appear on the balance sheet.

Answer: D

Difficulty: 2 Medium

LO: 02-05

Topic: Balance Sheet Concepts and Values

Blooms: Understand

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Feedback: This activity is not a transaction because no assets or services were exchanged by the business. No asset would be recorded. In addition, recall that an asset is an economic resource presently controlled by the company; it has measurable value and is expected to benefit the company by producing cash inflows or reducing cash outflows in the future. This situation does not meet the definition of an asset.

### [QUESTION]

126. Which of the following would a company be most likely to overstate if the company was trying to mislead potential creditors as to its ability to pay debts as they become due?

- A) Accounts Receivable
- B) Notes Payable

## Chapter 2: The Balance Sheet

- C) Salaries Expense
- D) Accounts Payable

Answer: A

Difficulty: 3 Hard

LO: 02-05

Topic: Assessing the Ability to Pay

Blooms: Evaluate

AACSB: Ethics

AACSB: Analytic

AICPA BB: Resource management

AICPA FN: Reporting

Feedback: If the company is trying to mislead creditors, it would want to overstate its current ratio. A higher current ratio means better ability to pay. The current ratio is computed by dividing current assets by current liabilities. A higher current ratio would result if the company overstated its current assets, which include Accounts Receivable.

### [QUESTION]

127. Which concept should be applied when reporting a piece of land that was bought for \$50,000 five years ago, and which would probably now sell for \$80,000?

- A) The cost principle
- B) The accounting equation
- C) The separate entity concept
- D) The monetary concept

Answer: A

Difficulty: 2 Medium

LO: 02-05

Topic: Balance Sheet Concepts and Values

Blooms: Understand

AACSB: Analytic

AICPA BB: Legal

AICPA FN: Reporting

Feedback: Following the cost principle, assets and liabilities are first recorded at cost, which is their cash-equivalent value on the date of the transaction. Later, if an asset's value increases, the increase is generally not recorded under GAAP (unless it is a particular type of financial investment).

Use the following information to answer questions 128 through 130:

The classified balance sheet for a company reported current assets of \$1,623,850, total liabilities of \$799,540, Common Stock of \$1,000,000, and Retained Earnings of \$130,260. The current ratio was 2.5.

## Chapter 2: The Balance Sheet

### [QUESTION]

128. Use the information above to answer the following question. What is the total amount of noncurrent assets?

- A) \$493,590.
- B) \$824,310.
- C) \$649,540.
- D) \$305,950.

Answer: D

Difficulty: 3 Hard

LO: 02-04

Topic: Classified Balance Sheet

Blooms: Analyze

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback:

Total Assets = Total Liabilities + Total Stockholders' Equity

= \$799,540 + (\$1,000,000 + \$130,260) = \$1,929,800

Total Assets = Total current assets + Total noncurrent assets

Total noncurrent assets = Total Assets – Total current assets

= \$1,929,800 – \$1,623,850 = \$305,950

### [QUESTION]

129. Use the information above to answer the following question. What is the total amount of current liabilities?

- A) \$649,540.
- B) \$4,059,625.
- C) \$771,920.
- D) \$799,540.

Answer: A

Difficulty: 3 Hard

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Analyze

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback:

Current ratio = Current assets ÷ Current liabilities

Current liabilities = Current assets ÷ Current ratio

## Chapter 2: The Balance Sheet

$$= \$1,623,850 \div 2.5 = \$649,540$$

### [QUESTION]

130. Use the information above to answer the following question. Which of the following statements is not correct?

- A) Total Assets are \$1,929,800.
- B) Total Stockholders' equity is \$1,130,260.
- C) Noncurrent liabilities are \$130,260.
- D) The amount of current assets is 2.5 times the amount of current liabilities.

Answer: C

Difficulty: 2 Medium

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Analyze

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback:

Total assets = Total liabilities + Total stockholders' equity

= \$799,540 + \$1,000,000 + \$130,260 = \$1,929,800 (correct)

Total stockholders' equity = Common Stock + Retained Earnings

= \$1,000,000 + \$130,260 = \$1,130,260 (correct)

Noncurrent liabilities = Total liabilities – Current liabilities

= \$799,540 - \$649,540 = \$150,000

Current ratio = Current assets ÷ Current liabilities

Current liabilities = Current assets ÷ Current ratio

= \$1,623,850 ÷ 2.5 = \$649,540 (correct)

Total liabilities = Current liabilities + Noncurrent liabilities

Total liabilities – Current liabilities = Noncurrent liabilities

\$799,540 - \$649,540 = \$150,000

### [QUESTION]

131. Which of the following statements about the current ratio is not correct?

- A) When making comparisons across companies, it's far easier to express the relationship as a ratio.
- B) The current ratio is used to evaluate a company's ability to pay current obligations.
- C) Having more current assets than current liabilities will yield a current ratio less than 1.0.
- D) A high current ratio suggests good liquidity.

Answer: C

Difficulty: 2 Medium

LO: 02-05



## Chapter 2: The Balance Sheet

Topic: Assessing the Ability to Pay

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: The current ratio is calculated by dividing current assets by current liabilities. If current assets exceed current liabilities, the ratio will be greater than (rather than less) than 1.0.

Use the following information to answer questions 132 through 134:

A company's trial balance included the following account balances:

Accounts Payable	\$ 19,207
Accounts Receivable	81,336
Cash	73,324
Income Tax Payable	3,512
Inventory	25,816
Note Payable, due in two years	1,709
Equipment	54,128
Stockholders' Equity	202,808
Supplies	5,512
Wages Payable	12,880

[QUESTION]

132. Use the information above to answer the following question. What is the amount of Total Assets on the balance sheet?

- A) \$240,116.
- B) \$214,300.
- C) \$442,924.
- D) \$480,232.

Answer: A

Difficulty: 2 Medium

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback:

Total Assets = Cash + Accounts Receivable + Inventory + Supplies + Equipment  
= \$73,324 + \$81,336 + \$25,816 + \$5,512 + \$54,128 = \$240,116

## Chapter 2: The Balance Sheet

### [QUESTION]

133. Use the information above to answer the following question. What is the amount of Total Liabilities on the Balance Sheet?

- A) \$240,116.
- B) \$37,308.
- C) \$35,599.
- D) \$20,916.

Answer: B

Difficulty: 2 Medium

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Feedback:

Total Liabilities = Accounts Payable + Wages Payable + Income Tax Payable + Note Payable, due in two years  
 $= \$19,207 + \$12,880 + \$3,512 + \$1,709 = \$37,308$

### [QUESTION]

134. Use the information above to answer the following question. What is the amount of the current ratio (round to two decimal places)?

- A) 8.05
- B) 6.44
- C) 5.22
- D) 1.00

Answer: C

Difficulty: 3 Hard

LO: 02-05

Topic: Assessing the Ability to Pay

Blooms: Analyze

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback:

Current Assets = Cash + Accounts Receivable + Inventory + Supplies  
 $= \$73,324 = \$81,336 + \$25,816 + \$5,512 = \$185,988$

Current Liabilities = Accounts Payable + Wages Payable + Income Tax Payable  
 $= \$19,207 + \$12,880 + \$3,512 = \$35,559$

Current ratio = Current Assets ÷ Current Liabilities

## Chapter 2: The Balance Sheet

$$= \$185,988 \div \$35,599 = 5.22$$

### [QUESTION]

135. Oats, Inc. has \$14,000 in Cash, \$37,000 in Accounts Receivable, \$2,500 in Supplies, \$52,000 in Accounts Payable and \$12,400 in Wages Payable. If Oats uses Cash to pay off \$8,000 of the Wages Payable, which of the following statements is correct?

- A) The company's current ratio will not change since current assets decreased by the same amount that current liabilities increased.
- B) The company will look more favorable to creditors.
- C) The company has a greater ability to pay current liabilities.
- D) The company's current ratio will decrease.

Answer: D

Difficulty: 2 Medium

LO: 02-05

Topic: Assessing the Ability to Pay

Blooms: Analyze

AACSB: Analytical

AICPA BB: Critical Thinking

AICPA FN: Risk analysis

Feedback:

Current ratio = Current assets  $\div$  Current liabilities

Before the transaction:

$$(\$14,000 + \$37,000 + \$2,500) \div (\$52,000 + \$12,400) = \$53,500 \div \$64,400 = 0.83$$

After the transaction:

$$(\$6,000 + \$37,000 + \$2,500) \div (\$52,000 + \$4,400) = 0.81$$

The current ratio decreased. A higher ratio means better ability to pay; a lower ratio means lesser ability to pay. The company would look less (rather than more) favorable to creditors.

### [QUESTION]

136. Which of the following statements is correct?

- A) A current ratio of 1.60 means the company's current assets are probably not sufficient to pay its current liabilities.
- B) The separate entity assumption requires that the financial activities of the owners of a company be reported on the company's balance sheet.
- C) The cost principle states that recording activities at cost will result in the balance sheet representing the true value of the company.
- D) A transaction is recorded if it has a measurable financial effect on the assets, liabilities or stockholders' equity of a business.

Answer: D

Difficulty: 2 Medium

LO: 02-01

## Chapter 2: The Balance Sheet

LO: 02-05

Topic: Transactions and Other Activities

Topic: Assessing the Ability to Pay

Blooms: Remember

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Feedback: A transaction is recorded if it has a measurable financial effect on the assets, liabilities or stockholders' equity of a business. A current ratio of 1.60 means the company has \$1.60 in current assets for every \$1.00 of current liabilities; therefore, current assets are (rather than are not) probably sufficient to pay current liabilities. The separate entity assumption (from Chapter 1) states that transactions of the owners are separate from transactions of the business; as such, the financial activities of the owners of a company would not be reported on the company's balance sheet. Following the cost principle, assets and liabilities are first recorded at cost, which is their cash-equivalent value on the date of the transaction; cost does not approximate true value.

### PROBLEMS

[QUESTION]

137. Consider the following account balances of Purrfect Pets, Inc., as of June 30, Year 3:

Accounts Payable	\$119,400	Retained Earnings	\$ 54,700
Equipment	421,600	Notes Payable, due Year 5	343,200
Common Stock	200,000	Accounts Receivable	202,500
Income Tax Payable	3,900	Cash	97,100

Required:

Prepare a classified balance sheet at June 30, Year 3.

Answer:

**PURRFECT PETS, INC.**  
**Balance Sheet**  
**at June 30, Year 3**

#### **Assets**

##### **Current Assets**

Cash	\$ 97,100
Accounts Receivable	<u>202,500</u>
Total Current Assets	299,600
Equipment	<u>421,600</u>
Total Assets	<u>\$721,200</u>

## Chapter 2: The Balance Sheet

### Liabilities and Stockholders' Equity

Current Liabilities	
Accounts Payable	\$119,400
Income Tax Payable	<u>3,900</u>
Total Current Liabilities	123,300
Notes Payable	<u>343,200</u>
Total Liabilities	<u>466,500</u>
Stockholders' Equity	
Common Stock	200,000
Retained Earnings	<u>54,700</u>
Total Stockholders' Equity	<u>254,700</u>
Total Liabilities and Stockholders' Equity	<u>\$721,200</u>

Difficulty: 2 Medium

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Create

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

### [QUESTION]

138. Selected accounts for Moonbills Corporation appear below.

Required:

For each account, indicate the following:

Part a. In the first column at the right, indicate the nature of each account, using the following abbreviations: Asset — A, Liability — L, Stockholders' Equity — SE.

Part b. In the second column, indicate the normal balance by inserting *dr* (for debit) or *cr* (for credit).

	(Part a) Type of Account	(Part b) Normal Balance
1. Supplies.....	_____	_____
2. Notes Payable .....	_____	_____
3. Income Tax Payable.....	_____	_____
4. Equipment.....	_____	_____
5. Accounts Payable.....	_____	_____
6. Accounts Receivable.....	_____	_____
7. Common Stock .....	_____	_____
8. Cash .....	_____	_____

## Chapter 2: The Balance Sheet

9. Retained Earnings .....	<u>                    </u>	<u>                    </u>
10. Land .....	<u>                    </u>	<u>                    </u>

Answer:

	(Part a) Type of Account	(Part b) Normal Balance
1. Supplies .....	<u>A</u>	<u>dr</u>
2. Notes Payable .....	<u>L</u>	<u>cr</u>
3. Income Tax Payable.....	<u>L</u>	<u>cr</u>
4. Equipment .....	<u>A</u>	<u>dr</u>
5. Accounts Payable.....	<u>L</u>	<u>cr</u>
6. Accounts Receivable.....	<u>A</u>	<u>dr</u>
7. Common Stock .....	<u>SE</u>	<u>cr</u>
8. Cash .....	<u>A</u>	<u>dr</u>
9. Retained Earnings .....	<u>SE</u>	<u>cr</u>
10. Land .....	<u>A</u>	<u>dr</u>

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

### [QUESTION]

139. Soar Inc. enters into the following transactions:

- Stockholders contribute \$10,000 cash to a company in exchange for common stock.
- The company purchases \$5,000 to buy new equipment by paying cash.
- The company pays \$3,000 to suppliers on account.

Required:

Part a. Show the effect of these transactions on the basic accounting equation.

Part b. Prepare the journal entries that would be used to record the transactions.

Answer:

Part a

Transaction Analysis				
Assets	=	Liabilities	+	Stockholders' Equity
Cash	+10,000			Common Stock
				+ 10,000

## Chapter 2: The Balance Sheet

Equipment	-5,000			
Cash	+5,000			
Cash	-3,000	Accounts Payable	-3,000	

### Part b

Cash	10,000	
Common Stock		10,000
Equipment	5,000	
Cash		5,000
Accounts Payable	3,000	
Cash		3,000

Difficulty: 2 Medium

LO: 02-02

LO: 02-03

Topic: Step 1: Analyze Transactions

Topic: Debit/Credit Framework

Blooms: Analyze

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

### [QUESTION]

140. The following is a list of account balances for Pick-A-Pet, Inc., as of June 30, Year 3:

Accounts Payable	\$349,200
Accounts Receivable	419,200
Cash	732,600
Common Stock	662,100
Equipment	58,400
Logo and Trademarks	421,600
Notes Payable	268,900
Retained Earnings	117,900
Software	118,500

The company entered into the following transactions during July Year 3. Stockholders contribute \$300,000 cash for additional ownership shares and the company pays \$550,000 in cash and borrows \$150,000 from a bank to buy new equipment. No other transactions took place during July, Year 3.

## Chapter 2: The Balance Sheet

Required:

- Part a. Prepare a classified balance sheet for the company at June 30, Year 3.  
 Part b. Show the effects of the July transactions on the basic accounting equation.  
 Part c. Prepare the journal entries that would be used to record the transactions.

Answer:

Part a

**PURRFECT PETS, INC.**  
**Balance Sheet**  
**at June 30, Year 3**

**Assets**

**Current Assets**

Cash	\$ 732,600
Accounts Receivable	<u>419,200</u>
Total Current Assets	299,600
Equipment	58,400
Software	118,500
Logo and Trademarks	<u>421,600</u>
Total Assets	<u><u>\$1,398,100</u></u>

**Liabilities and Stockholders' Equity**

**Current Liabilities**

Accounts Payable	\$ 349,200
Total Current Liabilities	349,200
Notes Payable	<u>343,200</u>
Total Liabilities	<u>618,100</u>

**Stockholders' Equity**

Common Stock	662,100
Retained Earnings	<u>117,900</u>
Total Stockholders' Equity	<u>780,000</u>
Total Liabilities and Stockholders' Equity	<u><u>\$1,398,100</u></u>

Part b

Transaction Analysis					
Assets		=	Liabilities		+ Stockholders' Equity
Cash	+300,000				Common Stock + 300,000
Cash	+150,000		Note Payable	+150,000	



## Chapter 2: The Balance Sheet

Part c

Cash	300,000	
Common Stock		300,000
Cash	150,000	
Note Payable		150,000

Difficulty: 3 Hard

LO: 02-03

LO: 02-04

Topic: The Debit/Credit Framework

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Analyze

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

AICPA FN: Measurement

### [QUESTION]

141. During the month, a company enters into the following transactions:

- Buys \$4,000 of supplies on account.
- Pays \$5,000 cash for new equipment.
- Pays off \$3,000 of accounts payable.
- Pays off \$1,500 of notes payable.

Required:

Part a. Show the effect of these transactions on the basic accounting equation.

Part b. Prepare the journal entries that would be used to record the transactions.

Answer:

Part a

Transaction Analysis						
Assets		=	Liabilities		+	Stockholders' Equity
Supplies	+4,000		Accounts Payable	+4,000		
Equipment	+5,000					
Cash	−5,000					
Cash	−3,000		Accounts Payable	−3,000		
Cash	−1,500		Notes Payable	−1,500		

## Chapter 2: The Balance Sheet

Part b

Supplies	4,000	
Accounts Payable		4,000
Equipment	5,000	
Cash		5,000
Accounts Payable	3,000	
Cash		3,000
Notes Payable	1,500	
Cash		1,500

Difficulty: 2 Medium

LO: 02-02

LO: 02-03

Topic: Step 1: Analyze Transactions

Topic: The Debit/Credit Framework

Blooms: Analyze

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

### [QUESTION]

142. CheapBooks Incorporated (CBI) had the following business activities:

1. Stockholders invest \$25,000 cash in the corporation.
2. CBI purchased \$400 of office supplies on credit.
3. CBI purchased office equipment for \$7,000, paying \$2,500 in cash and signing a 30-day note payable for the remainder.
4. CBI paid \$200 cash on account for office supplies purchased in transaction 2.
5. CBI purchased two acres of land for \$10,000, signing a 2-year note payable.
6. CBI sold one acre of land at one-half of the total cost of the two acres, receiving the full amount or \$5,000 in cash.
7. CBI made a payment of \$5,000 on its 2-year note.

Required:

Prepare the journal entries that would be used to record the transactions. (*Reference each journal entry to the transaction number, shown above*).

Answer:

1. Cash	25,000	
Common Stock		25,000

## Chapter 2: The Balance Sheet

2.	Supplies	400	
	Accounts Payable		400
3.	Equipment	7,000	
	Cash		2,500
	Notes Payable		4,500
4.	Accounts Payable	200	
	Cash		200
5.	Land	10,000	
	Notes Payable		10,000
6.	Cash	5,000	
	Land		5,000
7.	Notes Payable	5,000	
	Cash		5,000

Difficulty: 2 Medium

LO: 02-02

LO: 02-03

Topic: Step 1: Analyze Transactions

Topic: The Debit/Credit Framework

Blooms: Application

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

### Short Answer

#### [QUESTION]

143. The company's total assets are \$36,000. The following is a listing of the company's accounts and account balances as of December 31, Year 3. This company doesn't have any other accounts.

Accounts Payable	\$ 7,000
Accounts Receivable	8,000
Supplies	1,000
Equipment	22,000
Common Stock	10,000
Cash	Unknown

## Chapter 2: The Balance Sheet

Retained Earnings

Unknown

Required:

Part a. Determine the balance of the Cash account.

Part b. Determine the balance of the Retained Earnings account.

Answer:

Part a

Total Assets = Accounts Receivable + Supplies + Equipment + Cash

Cash = Total Assets – Accounts Receivable – Supplies – Equipment

= \$36,000 – \$8,000 – \$1,000 – \$22,000 = \$5,000

Part b

Assets = Liabilities + Stockholders' Equity

\$36,000 = \$7,000 + (\$10,000 + Retained Earnings)

Retained Earnings = \$36,000 – \$7,000 – \$10,000 = \$19,000

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Analyze

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

[QUESTION]

144. On January 1, Year 3, New Works, Inc.'s assets were \$300,000 and its stockholders' equity was \$140,000. During the year, assets increased \$15,000 and liabilities decreased \$10,000.

Required:

Determine the amount of stockholders' equity at December 31, Year 3.

Answer:

Beginning of the year:

Assets = Liabilities + Stockholders' Equity

Liabilities = Assets – Stockholders' Equity

= \$300,000 – \$140,000 = \$160,000

End of year:

Assets = Liabilities + Stockholders' Equity

Liabilities = Assets – Stockholders' Equity

= (\$300,000 + \$15,000) – (\$160,000 – \$10,000) = \$165,000

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

## Chapter 2: The Balance Sheet

Blooms: Analyze

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

### [QUESTION]

145. On March 3, Year 3, your company purchases supplies on account for \$4,000. Payment is due on April 2, Year 3.

Required:

Part a. Is this an accounting transaction on March 3, Year 3? Why or why not?

Part b. When this transaction is recorded, what accounts are affected and by how much each?

Answer:

Part a

A transaction is an event or activity that has a direct and measurable financial effect on the assets, liabilities, or stockholders' equity of a business. The purchase of supplies on account is a transaction because a promise to pay has been exchanged for supplies.

Part b

Supplies, an asset account, increases by \$4,000. Accounts payable, a liability account, increases by \$4,000.

Difficulty: Easy

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Apply

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

### [QUESTION]

146. A journal entry to record the purchase of supplies for \$400 cash was properly prepared. The debit in the entry was properly posted to the related account. However, the credit in the entry was mistakenly recorded as a credit to the Supplies account.

Required:

Determine the impact of this error on the accounting equation.

Answer:

The accounting equation is  $\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$ . The journal entry that was prepared included a debit to Supplies and a credit to Cash for \$400. Since both accounts are assets, total assets would have been unchanged if the journal entry was properly posted. Instead, since both accounts were credited, the posting of this transaction will cause the

## Chapter 2: The Balance Sheet

accounting equation to be out of balance by \$800 as shown below.

Transaction Analysis							
Assets		=	Liabilities		+	Stockholders' Equity	
Cash	−400						
Supplies	−400						
Totals	−800	=	0		+	0	

Difficulty: 2 Medium

LO: 02-02

LO: 02-03

Topic: Step 1: Analyze Transactions

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

### MATCHING

[QUESTION]

147. Listed below are components of several transactions. In the blank to the left indicate whether a debit (dr) or credit (cr) would be required to record the component of the transaction.

- \_\_\_\_\_ (1) Increase in Cash.
- \_\_\_\_\_ (2) Increase in Accounts Payable.
- \_\_\_\_\_ (3) Decrease in Notes Payable.
- \_\_\_\_\_ (4) Increase in Inventory.
- \_\_\_\_\_ (5) Increase in Common Stock.
- \_\_\_\_\_ (6) Decrease in Equipment.

Answer:

- (1) dr
- (2) cr
- (3) dr
- (4) dr
- (5) cr
- (6) cr

Difficulty: 2 Medium

LO: 02-03

Topic: The Debit/Credit Framework

Blooms: Understand

Test Bank—*Fundamentals of Financial Accounting*, 5e

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## Chapter 2: The Balance Sheet

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

[QUESTION]

148. Match each account name with the category that it would be included under in classified balance sheet.

### ACCOUNT

\_\_\_\_\_ (1) Equipment

\_\_\_\_\_ (2) Common Stock

\_\_\_\_\_ (3) Supplies

\_\_\_\_\_ (4) Retained Earnings

\_\_\_\_\_ (5) Accounts Receivable

\_\_\_\_\_ (6) Accounts Payable

### CATEGORY

CA – Current Asset

NCA – Noncurrent Asset

CL – Current Liability

NCL – Noncurrent Liability

SE – Stockholders' Equity

Answer:

(1) NCA

(2) SE

(3) CA

(4) SE

(5) CA

(6) CL

Difficulty: 2 Medium

LO: 02-04

Topic: Preparing a Trial Balance and Balance Sheet

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

[QUESTION]

149. For each of the following, indicate how the event would most likely be categorized.

### EVENT

\_\_\_\_\_ (1) A company sells \$2 million in goods for immediate payment.

## Chapter 2: The Balance Sheet

- \_\_\_\_\_ (2) The company uses up office supplies.  
\_\_\_\_\_ (3) The stock market rises 10% and the value of a company's stock increases.  
\_\_\_\_\_ (4) A company pays cash to an inventor for the legal rights to produce a new product.  
\_\_\_\_\_ (5) Management promises to pay workers an overtime bonus as required by their union contract.  
\_\_\_\_\_ (6) A company uses up supplies to manufacture a product.  
\_\_\_\_\_ (7) A company receives \$1 million in orders but no down payments.

### CATEGORY

EE – External Exchange

IE – Internal Event

NT – No Transaction

Answer:

(1) EE

(2) IE,

(3) NT

(4) EE

(5) NT

(6) IE

(7) NT

Difficulty: 2 Medium

LO: 02-02

Topic: Step 1: Analyze Transactions

Blooms: Understand

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

[QUESTION]

150. Match the term with its definition. (There are more definitions than terms.)

### TERM

\_\_\_\_\_ (1) dr

\_\_\_\_\_ (2) cr

\_\_\_\_\_ (3) Classified Balance Sheet

\_\_\_\_\_ (4) Common Stock

\_\_\_\_\_ (5) Accounting Equation

\_\_\_\_\_ (6) Transaction

\_\_\_\_\_ (7) Accounts Payable

\_\_\_\_\_ (8) Journal Entry

### DEFINITION



## Chapter 2: The Balance Sheet

- A. The account credited when cash is received in exchange for stock issued.
- B. Another name for stockholders' equity or shareholders' equity.
- C. An exchange or event that has a direct impact on a company's financial statements.
- D. A balance sheet that has not yet been publicly released.
- E. When a company becomes included in the Fortune 500.
- F. A method of recording a transaction in debit/credit format.
- G. A transaction that is triggered automatically merely by the passage of time.
- H. The abbreviation for an item posted on the left side of a T-account.
- I. The expression that assets must equal liabilities plus stockholders' equity.
- J. The value of a company's public relations campaign.
- K. Amounts owed to suppliers for goods or services bought on credit.
- L. An event that has no effect on the balance sheet and is not recorded in the financial statements.
- M. Liabilities divided by assets.
- N. A balance sheet that has assets and liabilities categorized as current vs. noncurrent.
- O. The abbreviation for an item posted on the right side of a T-account.

Answer:

- (1) H
- (2) O
- (3) N
- (4) A
- (5) I
- (6) C
- (7) K
- (8) F

Difficulty: 2 Medium

LO: 02-02

LO: 02-03

Topic: Step 1: Analyze Transactions

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Analysis

AICPA BB: Resource Management

AICPA FN: Reporting

[QUESTION]

151. Match the term with its definition. (There are more definitions than terms.)

### TERM

- \_\_\_\_\_ (1) Duality Of Effects
- \_\_\_\_\_ (2) Journal Entry
- \_\_\_\_\_ (3) Posting

## Chapter 2: The Balance Sheet

- \_\_\_\_\_ (4) Debit
- \_\_\_\_\_ (5) Chart Of Accounts
- \_\_\_\_\_ (6) T-Account
- \_\_\_\_\_ (7) Credit
- \_\_\_\_\_ (8) Cost Principle

### DEFINITION

- A. A journal entry that lowers the balance of the account.
- B. When journal entries are recorded in the appropriate T-account.
- C. The concept that a company must keep separate accounts by time period.
- D. A simplified version of an account in the General Ledger.
- E. The mechanism used to record each transaction in the General Journal.
- F. When a company's balance sheet has been verified by an outside auditor.
- G. The concept that any transaction must have at least two effects on the accounting equation.
- H. When a dollar value is assigned to an item recorded in the accounting system.
- I. Compares balance sheet items from two different time periods.
- J. An amount that is posted on the left side of a T-account or ledger.
- K. The principle that a company should use the least optimistic measure, when uncertainty exists.
- L. Assets are initially recorded at the amount paid to acquire them.
- M. A journal entry that raises the balance of the account.
- N. A balance sheet where assets appear on the top, liabilities in the middle and stockholders' equity appears on the bottom.
- O. An amount that is posted on the right side of a T-account.
- P. A summary of account names and numbers.

Answer: (1) G, (2) E, (3) B, (4) J, (5) P, (6) D, (7) O and (8) L

Difficulty: 2 Medium

LO: 02-02

LO: 02-03

Topic: Step 1: Analyze Transactions

Topic: The Debit/Credit Framework

Blooms: Understand

AACSB: Communications

AICPA BB: Resource Management

AICPA FN: Reporting