

LO.a: Describe how business activities are classified for financial reporting purposes.

1. AIM Inc. recently issued common stock. This transaction should *most likely* be classified as:
 - A. financing.
 - B. investing.
 - C. operating.
2. XYZ Inc. is planning to sell its surplus equipment. This transaction should *most likely* be classified as:
 - A. financing.
 - B. investing.
 - C. operating.

LO.b: Explain the relationship of financial statement elements and accounts, and classify accounts into the financial statement elements.

3. Which of the following is a residual claim on a company's resources?
 - A. Assets.
 - B. Liabilities.
 - C. Owner's equity.
4. Unearned fees are *most likely* to be categorized as:
 - A. an asset.
 - B. a liability.
 - C. owner's equity.
5. Which of the following is *least likely* to provide information regarding an activity during a period of time?
 - A. Balance sheet.
 - B. Income statement.
 - C. Statement of cash flow.
6. Which of the following is *not* classified as a financial statement element?
 - A. Net income.
 - B. Asset.
 - C. Revenue.

LO.c: Explain the accounting equation in its basic and expanded forms.

7.

Beginning retained earnings	\$40,000
Ending retained earnings	\$58,000
Dividends paid	\$16,000

 Based on the information given above, the estimated net income is *closest* to:
 - A. \$2,000.
 - B. \$24,000.
 - C. \$34,000.

8. Given below is an excerpt from a company's financial statements:

Assets, December 31, 2014	\$6,750,000
Liabilities, December 31, 2014	\$3,250,000
Contributed capital, December 31, 2014	\$1,300,000
Retained earnings, January 1, 2014	\$700,000
Dividends during 2014	\$200,000

The net income for 2014 would be *closest* to:

- A. \$400,000.
- B. \$800,000.
- C. \$1,700,000.

9. The table below presents information on a company (in '000s):

Revenues for the year	15,000
Total expenses for the year	12,500
Total current assets at year-end	8,500
Total non-current assets at year-end	13,750
Contributed capital at the beginning of the year	2,000
Proceeds from shares issued during the year	500
Retained earnings at the beginning of the year	7,750
Total liabilities at year-end	11,400

The amount of dividends declared (£ '000s) during the year is *closest* to

- A. 1,400.
- B. 1,450.
- C. 1,900.

10. At the beginning of the year, a company had total shareholders' equity consisting of ¥500,000 in common share capital and ¥100,000 in retained earnings. Following details are given for the year:

Net income reported	¥35,000
Dividends paid	3,500
Repurchase of company stock, to be held as treasury stock	5,000

The total shareholders' equity at the end of the year is *closest* to:

- A. ¥636,500.
- B. ¥626,500.
- C. ¥631,500.

11. The following information is available about a company:

Contributed capital, beginning of the year	\$ 60,000
Retained earnings, beginning of the year	250,000

Sales revenues earned during the year	400,000
Investment income earned during the year	9,000
Total expenses paid during the year	300,000
Dividends paid during the year	10,000
Total assets, end of the year	700,000

Total liabilities at the end of the year are *closest* to:

- A. \$290,000.
- B. \$291,000.
- C. \$300,000.

12. Which of the following relationships is most accurate?

- A. Ending retained earnings = Beginning retained earnings – Expenses – Dividends.
- B. Owners' equity = Contributed capital – Retained Earnings.
- C. Assets = Liabilities + Contributed capital + Beginning retained earnings + Revenue – Expenses – Dividends.

13. Which of the following relationships is most accurate?

- A. Owners' equity = Assets + Liabilities.
- B. Owners' equity = Contributed capital – Retained earnings.
- C. Liabilities = Assets - Owners' equity.

LO.d: Describe the process of recording business transactions using an accounting system based on the accounting equation.

14. At the start of a month, an auto retailer paid \$50,000 in cash for different types of cars. He sold cars costing \$25,000 for \$35,000 during the month. The *most likely* effect of these transactions on the auto retailer's accounting equation for the month is that assets will:

- A. be unchanged.
- B. increase by \$10,000.
- C. decrease by \$20,000.

15. A finance manager wants to look at the company's transactions by the order in which they occur. The accounting document that she would *most likely* refer to is the:

- A. general journal.
- B. general ledger.
- C. trial balance.

16. A company purchases inventory with cash. What is the *most likely* effect of this transaction on the accounting equation?

- A. Assets increase, and liabilities increase.
- B. There is no effect on the accounting equation.
- C. Assets decrease, and owners' equity decreases.

17. Jennifer Jones owns a bakery. On June 1 2013, Jones delivered 50 loaves of bread at a rate of \$10 per loaf. The cost of each loaf is \$8. The invoice attached with the delivery has the terms

that payment is due within 20 days. Which of the following accounting entries would Jones make in her books?

- A. Increase in accounts receivable by \$500, increase in revenue by \$500.
- B. Increase in cost of goods sold by \$400, and decrease in inventory by \$400.
- C. Both A and B.

18. Data is sorted out by account rather than by date in the:

- A. general ledger.
- B. general journal.
- C. adjusted trial balance.

19. Jonathan Trott is a manager at UFLP Ltd. He receives \$1000 in cash for services which are to be delivered in the next period. In order to balance the accounting equation, which of the following is Trott *most likely* to do?

- A. Record an asset.
- B. Record a liability.
- C. Record revenue.

LO.e: Describe the need for accruals and other adjustments in preparing financial statements.

20. Which of the following statements is *least accurate*?

- A. Accrued revenue arises when revenue has been earned but not yet received.
- B. A valuation adjustment for an asset converts its historical cost to its depreciated value.
- C. Accrued expenses arise when a company incurs expenses that have not yet been paid at the end of accounting period.

21. In accrual accounting, an adjusting entry is made that resulted in the reduction of an asset and a recording of an expense. The originating entry was *most likely* a(n):

- A. accrued expense.
- B. deferred revenue.
- C. prepaid expense.

22. David Retta is an accountant at G&P Ltd. The originating entry he makes is the establishment of a liability and record of an expense. Which of the following is *most likely* to be the nature of the activity for which Retta has made the entry?

- A. Accrued expense.
- B. Prepaid expense.
- C. Unbilled revenue.

23. Which of the following entries *most likely* involves a valuation adjustment?

- A. Record cash receipt and establish a liability for deferred revenue.
- B. Increase an asset and record the gain on the income statement or increase in other comprehensive income.
- C. Sell an asset; record cash receipt and revenue.

LO.f: Describe the relationships among the income statement, balance sheet, statement of cash flows, and statement of owners' equity.

24. The following information is available about XYX Company:

Contributed Capital, beginning of the year	£ 100,000
Retained earnings, beginning of the year	450,000
Sales revenues earned during the year	900,000
Investment income earned during the year	10,000
Total expenses paid during the year	804,000
Dividends paid during the year	20,000
Total assets, end of the year	1,600,000

Total liabilities at the end of the year *closest* to:

- A. £974,000.
- B. £944,000.
- C. £964,000.

25. Nina Nasser wants to estimate the worth of Lily Flowers Corporation's liabilities. She has the following information available.

Income Statement Extract		Additional information	
Net Revenue	\$5,000	Assets at year end:	\$12,000
Net Expenses	\$4,200	Capital at year beginning:	\$5,000
Dividends Paid Out	\$0	Retained earnings at year beginning:	\$1,200

Which of the following is *most likely* to be Nasser's estimate of Lily Flowers Corporation's liabilities?

- A. 5,000.
- B. 7,000.
- C. 19,000.

LO.g: Describe the flow of information in an accounting system.

26. A trial balance is *best* described as a document that:

- A. contains business transactions recorded in the order in which they occur.
- B. lists account balances at a particular point in time.
- C. shows all business transactions by account.

LO.h: Describe the use of the results of the accounting process in security analysis.

27. In security valuation, analysts *least likely* use the financial statements to:

- A. identify the type of accruals and valuation entry.
- B. detect fraudulent accounting.
- C. assess the performance of economy.

28. The use of estimates in financial reporting:
- A. is a limitation in the accounting model as they provide an opportunity for deliberate earnings manipulation.
 - B. can be avoided by using complex accounting models.
 - C. is an effort to misrepresent the economic performance of a company.

Solutions

1. A is correct. Issuing common stock is a form of financing activity as it is related to obtaining capital.
2. B is correct. Investing activities are those activities associated with acquisition and disposal of long-term assets.
3. C is correct. The owner's equity is a residual claim on a company's resources. Assets are the economic resources of a company. Liabilities are the creditors' claims on the resources.
4. B is correct. Unearned fees are a liability because the business has yet to earn it, while it has already received cash in advance.
5. A is correct. The balance sheet (statement of financial position) provides information at a point in time, whereas other statements provide information regarding the activity during a period of time.
6. A is correct. Financial statement elements are revenue, expenses, assets, liabilities, and owner's equity.
7. C is correct.

$$\text{Ending retained earnings} = \text{Beginning retained earnings} + \text{Net income} - \text{Dividends paid out}$$

$$58,000 = 40,000 + \text{Net income} - 16,000$$

$$\text{Net income} = \$34,000$$
8. C is correct.

$$\text{Total assets} = \text{liabilities} + \text{owner's equity}$$

$$\text{Owner's equity} = 6,750,000 - 3,250,000 = 3,500,000$$

$$\text{Owner's equity} = \text{contributed capital} + \text{ending retained earnings}$$

$$\text{Ending retained earnings} = 3,500,000 - 1,300,000 = 2,200,000$$

$$\text{Ending retained earnings} = \text{beginning retained earnings} + \text{net income} - \text{dividends}$$

$$2,200,000 = 700,000 + \text{NI} - 200,000$$

$$\text{NI} = 1,700,000.$$
9. C is correct.

$$\text{Equity} = \text{Current assets} + \text{Non-current assets} - \text{Total liabilities}$$

$$\text{Year-End Equity} = 8,500 + 13,750 - 11,400 = 10,850.$$

$$\text{Retained earnings} = \text{Equity} - \text{Contributed capital}$$

$$\text{Ending retained earnings} = 10,850 - (2,000 + 500) = 8,350.$$

$$\text{Dividends} = \text{Beginning retained earnings} + \text{Net income} - \text{Ending retained earnings}$$

$$\text{Dividends} = 7,750 + (15,000 - 12,500) - 8,350 = 1,900.$$
10. B is correct.

Shareholders' equity at the end of year = beginning shareholders' equity + net income + retained earnings – dividends – repurchase of stock = 500,000 + 100,000 + 35,000 – 3,500 – 5,000 = 626,500.

11. B is correct. Increase in retained earnings = Sales – total expenses + investment income – dividends paid.
 Increase in retained earnings = 400 – 300 + 9 – 10 = 99,000
 Ending owner's equity = contributed capital + initial retained earnings + increase in retained earnings
 Ending owner's equity = 60 + 250 + 99 = 409
 Total liabilities = 700 – 409 = 291,000.
12. C is correct. A is incorrect because revenue is not added.
13. C is correct. This based on the fundamental accounting relationship: Assets = Liabilities + Equity
14. B is correct. Buying \$50,000 of cars will decrease cash by \$50,000 and increase inventory by \$50,000. Selling \$25,000 of cars for \$35,000 will decrease inventory by \$25,000, and increase either cash (if cash collected in the same accounting period) or accounts receivable (if sold on credit) by \$35,000. The combined effect is an increase of \$10,000 in assets.
15. A is correct. The general journal records transactions in the order in which they occur (chronological order) and is, therefore, sorted by date.
16. B is correct. There would be no effect on the accounting equation because the company has exchanged one asset for another. Cash has decreased, and office equipment, a capital asset, has increased.
17. C is correct. The delivery results in a decrease in inventory, an increase in cost of goods sold, an increase in accounts receivable, and an increase in revenue. Therefore, Jennifer will record all four entries in her books.
18. A is correct. The general ledger sorts the data and shows all business transactions by account. The general journal has the same transactions recorded in chronological order rather than by account. The adjusted trial balance simply lists the balances of accounts.
19. B is correct. In order to balance the accounting transaction, Trott will record a liability (unearned revenue) so as to match against an increase in asset in the form of cash received.
20. B is correct. A valuation adjustment for an asset converts its historical cost to current market value.
21. C is correct. The adjusting entry to record the expiry of a prepaid expense is the reduction of an asset (the prepaid) and the recognition of the expense.

22. A is correct. This is the originating entry for an accrued expense. The expense has been incurred and is recorded. Because the payment is still due, a liability arises.

23. B is correct. Valuation adjustments are made to a company's assets or liabilities. When an asset's value increases, the gain is recorded as a gain on the income statement or other comprehensive income. When an asset's value decreases, the decrease is recorded as a loss on the income statement or decrease in other comprehensive income.

24. C is correct.

Assets = Liabilities + Equity.

First calculate ending equity (£636,000, see calculation below)

£1,600,000 = liabilities + £636,000, Total liabilities = **£964,000**

Contributed capital	100,000
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Initial retained earnings	450,000
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Sales revenues	900,000
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Investment income	10,000
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Total expenses	(804,000)
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Net income for the year	106,000
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Dividends paid	<u>(20,000)</u>
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Increase in retained earnings	86,000
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Ending owners' equity	= Contributed Capital + Initial retained earnings + Increase in retained earnings = \$636,000
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25. A is correct.

Liabilities = Assets – Capital at year end

Capital at year end = Capital at year beginning + Ending retained earnings

Ending retained earnings = Beginning retained earnings + Net income – Dividends paid out

Ending retained earnings = 1200 + (5000 – 4200) = 2,000

Capital at year end = 5,000 + 2,000 = 7,000

Liabilities = 12,000 – 7000 = 5,000

26. B is correct. A trial balance is a document that lists account balances at a particular point in time.

27. C is correct.

28. A is correct.