

FINANCIAL ACCOUNTING

SCORE BUILDER

**Bruce A.
Baldwin**

Boost your exam scores with self-test questions

- ✓ 700 actual pretested exam questions
- ✓ Cross-referenced to eight leading Financial Accounting texts
- ✓ Created by professionals and analyzed for clarity
- ✓ Annotated Solutions:
 - tell why solutions are correct
 - show percentage of students who answered correctly on actual tests
 - indicate level of difficulty

SCOREBUILDER

for

Financial Accounting

Bruce A. Baldwin
Portland State University

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PREFACE

SCOREBUILDER is a set of 700 actual examination questions previously used on introductory financial accounting examinations at colleges and universities all across the United States. The answer to each question is given and an annotated solution is provided that tells **why** the answer is correct.

Each question was originally written by faculty and staff trained in item-writing by the author. Also, each question has been psychometrically item-analyzed for difficulty and reliability. The difficulty index for each question is provided with the annotated solution and indicates what percentage of students answered the question correctly when it was used on a financial accounting exam.

THIS BOOK CAN HELP FACULTY AND STUDENTS IN SEVERAL WAYS.

Students often request faculty to provide copies of old exams or exam questions so that they can "sharpen their test-taking skills" or practice on "real questions" before an exam. Instead of having to reproduce old exams and distribute them, or instead of putting old exams on reserve in the library, faculty can save time by making *SCOREBUILDER* available in the bookstore. This procedure would allow faculty members to keep their actual exam materials confidential (allowing for reuse) while still giving students guidance in preparation for exams. All students then have equal access to exam preparation and review materials.

Second, faculty should recommend *SCOREBUILDER* to students wishing to challenge the introductory accounting course and want some guidelines as to what they should study or what type of problems they should be able to solve. A faculty member may state with confidence that *SCOREBUILDER* provides that information. This should be particularly helpful for students who studied accounting/bookkeeping in high school and wonder if they should challenge the first course.

Third, faculty could recommend *SCOREBUILDER* to students who took financial accounting some time ago, are now enrolled in managerial accounting, and need some "brushing up" on the basic mechanics of accounting.

A further use of *SCOREBUILDER* is by MBA students who might have taken their basic accounting courses some time ago. A faculty member might assign several "review" chapters from the text and recommend "self-testing" by the student in *SCOREBUILDER*.

There are many other situations in which *SCOREBUILDER* could be effectively used. The uses mentioned above are only examples of the ways that it has been productively used by faculty and students at my university.

THE DIFFERENCE BETWEEN *SCOREBUILDER* AND A STUDY GUIDE

A Study Guide and *SCOREBUILDER* are designed to help you in different stages of your learning. A Study Guide is most helpful in your day-by-day learning or in your chapter-by-chapter study. It is usually designed to "walk" you through each significant topic in each chapter. Chapter summaries, true-false questions, exercises, and fill in the blank items tend to be developmental in nature. That is, they are designed to prod your thinking and guide your learning.

SCOREBUILDER, on the other hand, is specifically designed to help you prepare for and maximize your score on exams. The multiple-choice questions are all actual questions used on prior elementary accounting exams. Test questions are often different from Study Guide questions since the objectives differ. Study Guide questions are usually designed to **help you learn**...test questions are designed to **measure** how much learning took place.

You will find, then, several different types of exam questions in *SCOREBUILDER*. Some measure your ability to recall facts; others measure your ability to apply concepts or procedures to given data. Still other questions measure the **depth** of your knowledge by rearranging facts into unfamiliar patterns and asking you to analyze, evaluate and integrate. Most Study Guide questions simply don't do this.

SPECIAL NOTE TO STUDENTS

The purpose of this book is to help you achieve better scores on your introductory Financial Accounting examinations. Careful study of the materials herein can contribute to that goal in two ways. First, by working through the questions and then reviewing the annotated solutions before an exam, you can find out which topics you have mastered and which topics still need a little work. (Most learning psychologists agree that studying old exam questions is an effective and efficient method of quickly identifying concepts or procedures that could use some further work.) When you find a weak area you should return to the relevant section of your textbook for more study. Sometimes, however, the annotated solution may be enough to establish the tested concept or procedure in your mind.

The second way this book can help you is by improving your test-taking skills. If your instructor gives examinations that are at least partially of the multiple-choice format, you can profit by practicing on these questions. Even if your instructor does not use multiple-choice questions, you will find *SCOREBUILDER* to be good exam preparation. Many of the problem-type questions contained herein could just as easily be presented on an exam in a "free-response" format. That is, the same question/problem could be asked without a set of possible answers being suggested. The skills necessary to master multiple-choice questions are often used to master "free-response" problems. These questions should give you insight into the level and complexity of questions that your instructor might ask on an introductory accounting exam.

The purpose of *SCOREBUILDER* is to help you maximize your exam score. It is **not** a substitute for other learning activities. Before trying to use it, you should have read the textbook chapters carefully (perhaps several times); worked and checked the homework assignments; maybe have worked through the Study Guide; and absolutely, positively attended **every** single class session. If you've done the necessary groundwork, *SCOREBUILDER* will help you maximize your test scores.

Good luck as you prepare for your accounting exams!

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CHAPTER ONE: PERSPECTIVES – ACCOUNTING OBJECTIVES AND COMMUNICATION

PART A: The Objectives and Environment of Accounting

1. Limited liability is a feature of what form(s) of business organization?
 - a. corporation
 - b. proprietorship
 - c. partnership
 - d. both a proprietorship and a partnership
2. One of the following is **not** an advantage of the corporate form of business organization. Identify it.
 - a. access to large amounts of capital
 - b. continuity of life
 - c. unlimited liability
 - d. ease in transferring ownership
3. Which of the following types of business entity have (has) the disadvantage of double taxation?
 - I. proprietorship
 - II. partnership
 - III. corporation
 - a. I only
 - b. II only
 - c. III only
 - d. both I and II
 - e. both II and III
4. The accounting rule that prohibits a corporation from including the president's personal automobile (that is not used for business purposes) as a corporate asset is the:
 - a. conservatism rule.
 - b. accounting cycle rule.
 - c. separate-entity rule.
 - d. operating cycle rule.
 - e. asset ownership rule.
5. The **primary** purpose of accounting is to:
 - a. measure and report financial information of economic entities.
 - b. facilitate decision making.
 - c. certify the accuracy of accounting records.
 - d. provide for internal control over financial transactions.
6. The foundations for the "basic accounting model" in use today were originally developed in what part of the world?
 - a. Europe
 - b. Africa
 - c. South America
 - d. Asia
 - e. North America
7. The term GAAP refers to:
 - a. generally accepted accounting principles.
 - b. generally accepted auditing procedures.
 - c. general auditing and accounting processes.
 - d. general accounting associates program.
8. The best protection currently available to the public to assure that financial statements present a fair representation of the company is:
 - a. have the president of the company sign a sworn statement that the financial statements are a fair representation of the company.
 - b. have an audit performed by an independent CPA.
 - c. have an audit performed by the company's internal auditors.
 - d. have the financial statements reviewed by the Board of Directors.
 - e. have the financial statements examined by the General Accounting Office of the United States.

CHAPTER ONE QUESTIONS

9. Accountants perform many different kinds of services. The activities that have as their primary purpose the verification of financial statement information is called:
 - a. cost accounting.
 - b. consulting.
 - c. management advisory services.
 - d. auditing.
 10. As part of the audit function, an independent CPA must:
 - a. examine all business transactions of the entity.
 - b. report any illegal activities of the entity to the proper legal authorities.
 - c. express an opinion on the financial statements.
 - d. prepare the required state and federal tax returns.
 11. Which of the following is **not** included in management advisory services performed by an independent CPA?
 - a. Design and installation of control systems.
 - b. Preparation of tax returns.
 - c. Preparation of business forecasts.
 - d. Preparation of cost effectiveness studies.
 12. The audit or attest function performed by the CPA in public practice:
 - a. lends credibility to financial reports.
 - b. assists management in designing and installing accounting systems.
 - c. involves submitting periodic reports to the Securities and Exchange Commission and accepting responsibility for the reports.
 - d. involves the accumulation of data concerning the cost of manufacturing products.
 13. The private-sector organization that took over the APB's function of establishing and improving accounting standards and principles in 1973 is the:
 - a. FASB.
 - b. AICPA.
 - c. AAA.
 - d. SEC.
 14. The Financial Accounting Standards Board (FASB):
 - a. is a government regulatory agency.
 - b. sponsors and encourages the improvement of accounting teaching and research.
 - c. deals primarily with tax reporting problems with the Internal Revenue Service (IRS).
 - d. is a private sector organization that develops accounting standards.
 15. There are five important groups in the United States predominating the development of financial accounting concepts and practice. Which of the following is **not** considered to be one of those groups?
 - a. The Government Accounting Office
 - b. The Securities and Exchange Commission
 - c. The American Institute of Certified Public Accountants
 - d. The Financial Accounting Standards Board
 - e. The Financial Executives Institute
 16. Which of the following organizations was founded around 1900, has a membership limited to certified public accountants, and has as two of its major interests professional development of its members and the development of accounting standards?
 - a. SEC
 - b. AICPA
 - c. FASB
 - d. AAA
- PART B: Communication of Accounting Information**
17. Which financial statements cover a period of time?
 - a. Income Statement and Balance Sheet
 - b. Balance Sheet and Statement of Changes in Financial Position
 - c. Income Statement and Statement of Changes in Financial Position
 - d. Statement of Changes in Financial Position and Statement of Assets, Liabilities and Owners' Equity.

18. A business had the following transactions, among others, during January. Which transaction represented an expense for January?
- Purchased a typewriter for \$300 cash.
 - Paid \$2,000 in settlement of a loan obtained three months earlier.
 - Paid a garage \$200 for automobile repair work performed in November.
 - Purchased \$60 of gasoline on account for the delivery truck. Account will be paid during February.
19. Assume you are examining a financial statement which indicates it is "At December 31, 19X2." That heading tells you the statement is the:
- balance sheet.
 - income statement.
 - statement of changes in financial position.
 - ledger.
20. Under generally accepted accounting principles (GAAP), revenue is most commonly recognized when:
- a sale is made.
 - the product is manufactured.
 - cash is collected from the sale.
 - the goods are delivered to the customer.
21. Assume that each of the following events occurs on January 1, 19A. Which **one** would result in revenue being recognized at that date?
- MK Apartments receives \$500 for rent covering the months of February, March, and April.
 - Billy B. Company receives a promise from Bulk Corp. that it will be paid \$100 for repair work just completed that day.
 - EG Corp. sells 100 shares of capital stock on the open market for \$1,000 cash.
 - RXG Company receives a loan from the State Bank in the amount of \$5,000.
22. Earnings per share (EPS) is determined by which of the following computations?
- Total revenues divided by the number of shares of common stock outstanding
 - Net income divided by the number of shares of common stock outstanding
 - Pretax income divided by the number of shares of common stock outstanding
 - Total revenues divided by Owners' Equity
23. AFG reported earnings per share of \$15.50 and the number of shares of capital stock outstanding is 8,000. The income tax rate is 45%. Net income must have been:
- \$ 516
 - \$ 3,600
 - \$ 17,778
 - \$ 55,800
 - \$ 124,000
24. During June, the Maple Restaurant had revenues of \$3,000 and expenses of \$1,800. The owner withdrew \$600 cash from the business during the month. If owners' equity on June 30 was \$8,600, owners' equity on June 1 must have been:
- \$10,400.
 - \$ 9,800.
 - \$ 9,200.
 - \$ 8,000.
 - some other answer.
25. Ten years ago the X Company bought a tract of land for \$100,000 and built a factory on it. This past year a land appraiser determined that the value of the land was now \$200,000 because of increasing land values. On X Company's balance sheet the land should be listed at:
- \$100,000.
 - \$150,000.
 - \$200,000.
 - an amount not determinable from the information given.

CHAPTER ONE QUESTIONS

26. The accounting records of Cactus Farms show the following balances at 6-31-19E:

Cash	\$100
Equipment	1,000
Accounts Receivable	300
Accounts Payable	200
Notes Payable	200
Retained Earnings	600
Capital Stock	700
Net Income	400
Expenses	1,100

Total assets as of 6-31-19E are:

- \$1,000.
 - \$1,400.
 - \$1,800.
 - \$2,000.
27. Which of the following best describes the purpose of the balance sheet?
- summarize revenues and expenses for the accounting period
 - report the inflows and outflows of cash
 - balance current period revenues with those of the previous period
 - report assets, liabilities and owners' equity as of a specific date
28. What effect do revenues and expenses eventually have on Owners' Equity?
- | | <i>Revenues</i> | <i>Expenses</i> |
|----|-----------------|-----------------|
| a. | increase | increase |
| b. | increase | decrease |
| c. | decrease | decrease |
| d. | decrease | increase |
29. Which of the following is **not** an asset?
- Inventory
 - Accounts Receivable
 - Revenue
 - Cash
30. The balance sheet differs from the other financial statements in that:
- it is the most important statement to the investor.
 - it is prepared more frequently.
 - it is dated as of a specific point in time.
 - its purpose is to show where cash came from during the period, and how the cash was used.

31. The ABC Company recently purchased a warehouse for cash in which it intends to store inventory. On ABC's financial statements this warehouse should be reported as:

- an expense.
- an asset.
- a revenue.
- contributed capital.

32. Sub Company reported revenues of \$10,000, expenses of \$3,000, and dividends paid of \$2,000 for the most recent accounting period. If Sub Company has 1,000 shares of stock outstanding, what is Sub's earnings per share for the period?

- \$10
- \$7
- \$5
- \$2

33. Which financial statement(s) report(s) the financial position of the firm at a specific point in time?

- the balance sheet, income statement, and statement of changes in financial position
- the balance sheet and income statement
- the income statement only
- the balance sheet only

34. Wasteful Corporation is preparing the income statement for the month ending December 31, 19B. The following transactions occurred during December.

Dec. 10 Paid off an account payable arising the purchase of supplies used in Nov. 19B.....\$1,200.

Dec. 22 Paid rent of \$400 for January of 19C.

Dec. 31 Purchased goods to be held in inventory for future sale.....\$50

What are total expenses for the month ended December 31, 19B?

- \$ -0-
- \$1,200
- \$1,600
- \$1,650

CHAPTER ONE: ANNOTATED SOLUTIONS

1. a	7. a	13. a	19. a	25. a	31. b
2. c	8. b	14. d	20. a	26. b	32. b
3. c	9. d	15. a	21. b	27. d	33. d
4. c	10. c	16. b	22. b	28. b	34. a
5. b	11. b	17. c	23. e	29. c	
6. a	12. a	18. d	24. d	30. c	

The correct answer and the percentage of students answering the question correctly (when it was used on an introductory accounting examination) are shown in parentheses at the beginning of each annotated solution that follows.

1. (a,90) Only the owners of a corporation enjoy the privilege of limited liability. Limited liability means that the maximum amount an owner can lose is the amount of his/her investment. Under both the proprietorship and partnership forms of organization, the owners have unlimited liability. That is, their personal assets may be attached in order to pay off the debts of the business.
2. (c,79) Unlimited liability is **not** an advantage (and relates only to partnerships and proprietorships anyway).
3. (c,71) Corporate profits are first taxed when earned by the corporation, and then a second time when stockholders receive them as dividends.
4. (c,82) This question is a straightforward application of the entity concept.
5. (b,26) The primary purpose of accounting is to provide information that is useful in making economic decisions. Responses a, c and d are all activities that contribute to the primary goal of making information useful for decision-making.
6. (a,77) In 1494, Paciolo wrote the first book regarding the basic accounting model that is still used today. It described a system developed by Italian merchants.
7. (a,88) GAAP means Generally Accepted Accounting Principles. The other suggested answers are nonsense.
8. (b,75) While responses a, c, d, and e may be good ideas, there is currently no procedure in place to implement them. Assurance to users that financial statements are fairly presented currently comes as a result of an audit performed by an independent CPA.
9. (d,80) The process of verifying financial information and expressing an opinion as to the fairness of the resulting financial statements is called auditing.
10. (c,82) The basic goal of an audit is to determine if the financial statements present fairly the firm's financial position. Usually, only a sample of transactions are examined. The auditor should report illegal activities to management but need not contact legal authorities. Preparation of tax returns is not part of auditing.

11. (b,44) CPA services fall into three broad categories: (1) auditing, (2) tax assistance, and (3) management advisory services (MAS). Preparation of tax returns, then, is part of the tax assistance category and not part of MAS. Responses a,c, and d are common MAS activities.
12. (a,76) The primary purpose of the audit (attest) function is to assure the dependability of the financial statements. This process lends credibility to the financial statements. Response b describes an MAS function and response d describes cost accounting. Response c is incorrect because management submits (and takes responsibility for) any required reports to the SEC.
13. (a,73) The FASB took over the APB's standard-setting function in 1973 and continues to do it currently.
14. (d,76) The Financial Accounting Standards Board (FASB) is currently the private sector organization that develops accounting standards and principles. Prior to the FASB, this function was provided by the Accounting Principles Board (APB).
15. (a,64) The five important groups predominating the development of financial accounting concepts and practices are the (1) AICPA, (2) FASB, (3) SEC, (4) the American Accounting Association, and (5) the FEI. The Government Accounting Office, then, is not one of those five.
16. (b,69) The description in this question is of the American Institute of Certified Public Accountants. The SEC is a government regulatory agency; the FASB is the standard setting body established in 1973; and the AAA is the national organization of accounting educators.
17. (c,79) The balance sheet is dated as of a specific day which causes responses a and b to be incorrect. Response d is incorrect because a statement of assets, liabilities, and owners' equity would be a balance sheet.
18. (d,44) An expense occurs when goods or services are consumed or used up. That is, no expense occurs upon purchase of an asset (item a); repaying a loan decreases liabilities (item b); and item c is an expense of the month of November. In item d we must be making the reasonable assumption that the gasoline was used up shortly after purchase.
19. (a,85) The only financial statement that is dated as of a specific point in time is the balance sheet. (Also, a ledger is not a financial statement.)
20. (a,73) Under the revenue principle, revenue should be recognized when it is earned. Usually this is deemed to have occurred when the sale is made. Under rare circumstances, revenue may be recognized at the other points listed as alternative answers. The question asked, though, for the point at which revenue is **commonly** recognized.
21. (b,57) Revenue is to be recognized in the period it is earned. Only response b meets this test. The revenue in response a will be earned during the months of February, March and April. Responses c and d do not involve revenue at all since goods have not been sold nor have services been rendered.
22. (b,94) By definition.

23. (e,73) Earnings per share = net income/number of shares outstanding. $\$15.50 = X / 8000$ shares; $X = \$124,000$. The tax rate is irrelevant to this question since EPS is computed on **after-tax** income.
24. (d,55) Revenue minus expense = net income ($\$3,000 - \$1,800 = \$1,200$). Net income increases owners' equity while owner withdrawals ($\$600$) decrease it. Let $X =$ June 1 owners' equity. ($X + \text{net income} - \text{withdrawals} = \text{June 30 owners' equity}$.) So, $X + \$1,200 - \$600 = \$8,600$; and $X = \$8,000$.
25. (a,78) According to the cost principle, the land will continue to be recorded at $\$100,000$ until sold. (Land is not depreciated because we assume it does not "wear out" like machinery does.)
26. (b,80) The asset accounts here are cash ($\$100$), accounts receivable ($\300), and equipment ($\$1,000$) for a total of $\$1,400$.
27. (d,94) By definition.
28. (b,90) By definition, revenues increase equity and expenses decrease it.
29. (c,62) Inventory, accounts receivable, and cash are all assets. Revenue is **not** an asset, but is earned when there has been an inflow of assets as a result of goods sold or services rendered.
30. (c,86) Only response c has any truth to it.
31. (b,77) The warehouse is a resource owned by the entity which means it is an asset.
32. (b,48) Earnings per share is equal to net income divided by the number of shares of stock outstanding. In this problem, net income is $\$7,000$ (revenues of $\$10,000$ minus expenses of $\$3,000$) and the number of shares outstanding is 1,000. Therefore, $\$7,000$ divided by 1,000 shares equals earnings per share of $\$7$.
33. (d,86) By definition, only the balance sheet reports the financial position of a firm at a specific point in time. Both the income statement and the statement of changes in financial position report information for a **period** of time.
34. (a,54) Expenses are recognized when goods or services are consumed (or used up) during the period. In this problem, no goods or services were consumed during December of 19B. The supplies were consumed in November; the rental services will be consumed during January of 19C; and the goods held in inventory have not been consumed (or used up) either.

CHAPTER TWO: THE FUNDAMENTAL ACCOUNTING MODEL AND TRANSACTION ANALYSIS

- "Oil Can Charlie" mortgaged his gas station to obtain operating capital for the business. The bank loaned the gas station \$20,000. Concerning the gas station, which of the following increased as a result of this loan?
 - revenues
 - expenses
 - equity
 - liabilities
- During an accounting period total assets decreased by \$4 while stockholders' equity increased by \$7. The change in total liabilities during this period was a(n):
 - \$ 3 increase.
 - \$ 3 decrease.
 - \$11 increase.
 - \$11 decrease.
- During the year, the Jameson Co. had revenues of \$75 and expenses of \$40. Total liabilities at year end amounted to \$105 and at the start of the year total stockholders' equity was \$45. What are the total assets at year end?
 - \$225
 - \$185
 - \$150
 - \$145
 - \$140
- The Fillmore Co. purchased a new delivery truck by making a cash down payment and signing a note for the balance. How will assets, liabilities, and stockholder's equity be affected by this transaction?

<i>Assets</i>	<i>Liabilities</i>	<i>Equity</i>
a. decreased	increased	no change
b. increased	increased	no change
c. increased	decreased	increased
d. no change	increased	decreased
e. no change	decreased	increased

- Guido started a business by contributing \$3,000 cash and a truck valued at \$5,000. The company then purchased equipment by making a \$3,000 down payment (which accounted for half its purchase price) and financed the other half by signing a note with the bank. After the above transactions, Guido's company balance sheet is composed of:

	<i>Assets</i>	<i>Liabilities</i>	<i>Equity</i>
a.	\$ 8,000	\$ 0	\$ 8,000
b.	\$ 8,000	\$3,000	\$ 5,000
c.	\$11,000	\$ 0	\$11,000
d.	\$11,000	\$3,000	\$ 8,000

- Doe Corporation had the following transactions during the month of January.

- Owners started the company by investing \$100,000 in cash in exchange for capital stock.
- Purchased \$50,000 of equipment by making a \$20,000 cash down payment and signed a 90-day note payable for the balance.
- Purchased land for \$5,000, signing a note payable for full amount.
- Earned \$15,000 of revenue, (of which \$10,000 was received in cash with the balance on accounts receivable).

What are total assets for the Doe Corporation at the end of January?

- \$140,000
 - \$145,000
 - \$150,000
 - \$170,000
- A debit is used to record:
 - decreases in liabilities, increases in assets and decreases in owners' equity.
 - increases in liabilities, increases in assets, and decreases in owners' equity.
 - decreases in assets, decreases in liabilities and decreases in owners' equity.
 - increases in assets, increases in revenues, and decreases in liabilities.