

Chapter 16—Understanding Accounting and Financial Statements

MATCHING

Complete the following using the terms listed.

- a. certified public accountant
 - b. accounting process
 - c. Asset
 - d. Liability
 - e. owners' equity
 - f. basic accounting equation
 - g. balance sheet
 - h. income statement
 - i. statement of cash flows
 - j. accrual accounting
 - k. public accountant
 - l. management accountant
 - m. GAAP
 - n. FASB
 - o. profitability ratio
 - p. International Accounting Standards Committee
 - q. leverage ratio
 - r. Budget
1. The basic relationship that states assets equal liabilities plus owners' equity is called the _____.
 2. The _____ is a statement of a firm's financial position on a particular date.
 3. A financial record of a company's revenues, expenses, and profits over a period of time is called the _____.
 4. _____ represents the owners' initial investment in the business plus profits that were not paid out to owners over time in the form of cash dividends.
 5. A claim against a firm's assets by a creditor is a(n) _____.
 6. The _____ provides investors and creditors with relevant information about a firm's cash receipts and cash payments for its operations, investments, and financing during an accounting period.
 7. The accounting method that records revenues and expenses when they occur is called _____.
 8. A(n) _____ is anything of value owned or leased by a business.
 9. The procedure by which accountants convert data about individual transactions to financial statements is called the _____.
 10. A(n) _____ demonstrates his or her accounting knowledge by meeting state requirements for education and experience, as well as successfully completing a number of rigorous tests in accounting theory and practice, auditing, law, and taxes.
 11. A(n) _____ provides accounting services to individuals and businesses for a fee.
 12. A(n) _____ is employed by a business other than a public accounting firm.
 13. Financial statements are prepared according to _____, whose principles encompass the conventions, rules, and procedures for determining acceptable accounting practices at a particular time.
 14. _____ is primarily responsible for evaluating, setting, or modifying the generally accepted accounting principles.
 15. _____ measures the extent to which a firm relies on debt financing.
 16. An organization's overall financial performance is measured by its _____, which evaluates the ability to generate revenues in excess of operating costs and other expenses.
 17. A(n) _____ is a planning and controlling tool that reflects the firm's expected sales revenues, operating expenses, and cash receipts and outlays.

18. The _____ was established to promote worldwide consistency in financial reporting practices.

- | | | |
|---------------------|--------|--|
| 1. ANS: F | DIF: 2 | REF: The Accounting Cycle |
| NAT: AACSB Analytic | | MSC: KN |
| 2. ANS: G | DIF: 2 | REF: Financial Statements |
| NAT: AACSB Analytic | | MSC: KN |
| 3. ANS: H | DIF: 2 | REF: Financial Statements |
| NAT: AACSB Analytic | | MSC: KN |
| 4. ANS: E | DIF: 2 | REF: Financial Statements |
| NAT: AACSB Analytic | | MSC: KN |
| 5. ANS: D | DIF: 2 | REF: The Accounting Cycle |
| NAT: AACSB Analytic | | MSC: KN |
| 6. ANS: I | DIF: 2 | REF: Financial Statements |
| NAT: AACSB Analytic | | MSC: KN |
| 7. ANS: J | DIF: 2 | REF: Financial Statements |
| NAT: AACSB Analytic | | MSC: KN |
| 8. ANS: C | DIF: 2 | REF: The Accounting Cycle |
| NAT: AACSB Analytic | | MSC: KN |
| 9. ANS: B | DIF: 2 | REF: The Accounting Cycle |
| NAT: AACSB Analytic | | MSC: KN |
| 10. ANS: A | DIF: 2 | REF: Accounting Professionals |
| NAT: AACSB Analytic | | MSC: KN |
| 11. ANS: K | DIF: 2 | REF: Accounting Professionals |
| NAT: AACSB Analytic | | MSC: KN |
| 12. ANS: L | DIF: 2 | REF: Accounting Professionals |
| NAT: AACSB Analytic | | MSC: KN |
| 13. ANS: M | DIF: 2 | REF: The Foundation of the Accounting System |
| NAT: AACSB Analytic | | MSC: KN |
| 14. ANS: N | DIF: 2 | REF: The Foundation of the Accounting System |
| NAT: AACSB Analytic | | MSC: KN |
| 15. ANS: Q | DIF: 2 | REF: Financial Ratio Analysis |
| NAT: AACSB Analytic | | MSC: KN |
| 16. ANS: O | DIF: 2 | REF: Financial Ratio Analysis |
| NAT: AACSB Analytic | | MSC: KN |
| 17. ANS: R | DIF: 2 | REF: Budgeting |
| NAT: AACSB Analytic | | MSC: KN |
| 18. ANS: P | DIF: 2 | REF: International Accounting |
| NAT: AACSB Analytic | | MSC: KN |

ESSAY

1. What is accounting? What tasks do accountants perform?

ANS:

Accounting is the process of measuring, interpreting, and communicating financial information to enable people inside and outside the organization to make informed decisions. Accountants gather, record, report, and interpret financial information that describes the status and operation of an organization and aids in decision making.

DIF: 2 REF: Users of Accounting Information
NAT: AACSB Analytic MSC: KN

2. What is the relationship between accounting and business environments?

ANS:

Accountants play fundamental roles in not only business but also other aspects of society. Their work influences various business environments by contributing important information to help managers deal with competitive and economic situations. Less obvious contributions include helping others to understand, predict, and react to the technological, regulatory, social, and cultural environments.

DIF: 2

REF: Users of Accounting Information

NAT: AACSB Reflective Thinking

MSC: AP

3. All organizations perform three basic business activities. What are these activities?

ANS:

All businesses perform, in natural progression, financing, investing, and operating activities. Financing activities involve providing funds to start and expand the business. Investing activities provide valuable assets to run a business. Operating activities focus on the sale of goods and services, but also consider expense control as an important element of sound financial management.

DIF: 2

REF: Users of Accounting Information

NAT: AACSB Analytic

MSC: KN

4. Explain the differences between public accountants and management accountants.

ANS:

A public accountant is an independent professional who provides accounting services to businesses and individuals for a fee. These services include the preparation of tax statements, examinations of financial statements, management consulting, and the design of accounting systems. Management accountants are employed by businesses other than public accounting firms. They are responsible for collecting and recording financial transactions, preparing financial statements, and interpreting financial statements.

DIF: 2

REF: Accounting Professionals

NAT: AACSB Analytic

MSC: KN

5. Define GAAP and its purpose.

ANS:

GAAP stands for generally accepted accounting principals. The purpose of GAAP is to ensure reliable, consistent, and unbiased information to decision makers. GAAP encompasses the conventions, rules, and procedures for determining acceptable accounting practices at a particular time.

DIF: 2

REF: The Foundation of the Accounting System

NAT: AACSB Analytic

MSC: KN

6. Explain the basic accounting equation.

ANS:

The basic accounting equation states that assets equal liabilities plus owners' equity. Assets are anything of value owned by the firm, and include tangible as well as intangible assets. Liabilities and owners' equity are claims against the firm's assets. A liability is anything owed to creditors, while owners' equity represents the owners' initial investment in the business plus retained earnings that were not paid over time in dividends. The basic accounting equation states that an increase in assets must be accompanied by an increase in either liabilities or owners' equity. Likewise, a decrease in assets must be accompanied by a decrease in either liabilities or owners' equity.

DIF: 3 REF: The Accounting Cycle
NAT: AACSB Reflective Thinking MSC: AP

7. What is the purpose of the balance sheet? How is it organized?

ANS:

The balance sheet shows a firm's financial position at a particular date. It is similar to a photograph of what the firm owns (its assets), what it owes (its liabilities), and its owners' equity. The balance sheet follows the accounting equation. Assets are reported on the left side, while liabilities and owners' equity are reported on the right side. Assets are listed in descending order of liquidity -- their convertibility into cash. Liabilities and owners' equity indicate the sources of the firm's assets and are listed in the order in which they are due.

DIF: 2 REF: Financial Statements NAT: AACSB Analytic
MSC: KN

8. What is accrual accounting? How does depreciation affect net income and cash flow?

ANS:

Accrual accounting recognizes revenues and costs when they occur, not when actual cash changes hands. (If a company buys goods from a supplier in August, for example, but doesn't pay for the goods until September, the expense is still recorded in August.) Because of the widespread use of accrual accounting, there can be differences between what the firm reports as sales, expenses, and profits, and the amount of cash that actually flows in and out of the business during a period of time. Depreciation is the systematic reduction in the value of certain company assets, such as machinery and buildings over time. While it is reported as an expense on the firm's income statement, depreciation is not an actual cash expense. Therefore, a firm's after-tax cash flow for a specific period of time will actually exceed what it reports as net income for the same period.

DIF: 3 REF: Financial Statements NAT: AACSB Reflective Thinking
MSC: AP

9. Identify and briefly describe the four categories of financial ratios.

ANS:

The four categories of ratios are liquidity ratios, profitability ratios, leverage ratios, and activity ratios. Liquidity ratios measure the firm's abilities to meet its short-term obligations as they come due. Profitability ratios measure the overall performance of the firm by comparing earnings to sales, assets, or the owner's investment. Leverage ratios give an indication of the extent to which a firm is relying on borrowed money. Finally, activity ratios measure how effectively the firm uses its inventory and other assets.

DIF: 2 REF: Financial Ratio Analysis
NAT: AACSB Analytic MSC: KN

10. Describe the role of budgets in a business.

NAT: AACSB Reflective Thinking

MSC: AP

4. Olga owns a business and is reviewing her company's current financial statements. As a user of accounting information, Olga is most interested in using this information to _____.
a. evaluate credit risk
b. approve new issues of stocks and bonds
c. evaluate tax liabilities
d. plan and control

ANS: D

DIF: 2

REF: Users of Accounting Information

NAT: AACSB Reflective Thinking

MSC: AP

5. The natural progression of a business begins with _____.
a. Financing
b. Investing
c. Operating
d. Selling

ANS: A

DIF: 2

REF: Users of Accounting Information

NAT: AACSB Analytic

MSC: KN

6. _____ activities provide the necessary funds to start a business and to expand it after it begins operations.
a. Investing
b. Financing
c. Operating
d. Selling

ANS: B

DIF: 2

REF: Users of Accounting Information

NAT: AACSB Analytic

MSC: KN

7. _____ activities focus on selling goods and services.
a. Investing
b. Financing
c. Operating
d. Marketing

ANS: C

DIF: 2

REF: Users of Accounting Information

NAT: AACSB Analytic

MSC: KN

8. _____ activities focus on providing valuable assets to a business.
a. Investing
b. Marketing
c. Selling
d. Operating

ANS: A

DIF: 2

REF: Users of Accounting Information

NAT: AACSB Analytic

MSC: KN

9. Sri manages the sales force for his company. He is engaged in the _____ activity.
a. Accounting
b. Operating
c. Financing
d. Investing

ANS: B

DIF: 2

REF: Users of Accounting Information

NAT: AACSB Reflective Thinking

MSC: AP

10. Julie is evaluating which state her company will expand into next. She is engaged in the _____ activity.
- Accounting
 - Operating
 - Investing
 - Marketing

ANS: C

DIF: 2

REF: Users of Accounting Information

NAT: AACSB Reflective Thinking

MSC: AP

11. Public accountants typically perform all of the following tasks for a business client EXCEPT _____.
- developing the firm's marketing strategy
 - reviewing a firm's financial statements
 - tax planning
 - management consulting

ANS: A

DIF: 1

REF: Accounting Professionals

NAT: AACSB Reflective Thinking

MSC: KN

12. Emilio is not an employee of the Modesto Corporation, but was hired as a management consultant to provide unbiased advice about Modesto's financial condition. Emilio is a(n) _____.
- management accountant
 - government accountant
 - public accountant
 - internal auditor

ANS: C

DIF: 2

REF: Accounting Professionals

NAT: AACSB Reflective Thinking

MSC: AP

13. Raphael works as a tax accountant at a mid-sized manufacturing company. Raphael would be considered a _____.
- management consultant
 - management accountant
 - public accountant
 - government accountant

ANS: B

DIF: 2

REF: Accounting Professionals

NAT: AACSB Reflective Thinking

MSC: AP

14. Samantha works for a mid-sized manufacturing company. Her responsibility is to examine the firm's financial practices to ensure that records include accurate data and that the firm's operations are in compliance with federal, state, and local laws and regulations. Samantha is a _____.
- government accountant
 - cost accountant
 - certified internal auditor
 - tax accountant

ANS: C

DIF: 3

REF: Accounting Professionals

NAT: AACSB Reflective Thinking

MSC: AP

15. Faye works as an accountant for the city of Portland. Faye can best be described as a _____.
- management accountant

- b. government accountant
- c. public accountant
- d. cost accountant

ANS: B DIF: 2 REF: Accounting Professionals
NAT: AACSB Reflective Thinking MSC: AP

16. What is the primary role of a government accountant?
- a. Determining how efficiently the organization accomplishes its objectives
 - b. Determining how much money the organization is taking in
 - c. Determining the cost of goods and services provided by the organization
 - d. Preparing the organization's tax return

ANS: A DIF: 2 REF: Accounting Professionals
NAT: AACSB Analytic MSC: KN

17. The procedure used by accountants to convert transactions into financial statements is called _____.
- a. the accounting process
 - b. processing financial information
 - c. recording financial information
 - d. summarizing financial information

ANS: A DIF: 1 REF: The Foundation of the Accounting System
NAT: AACSB Analytic MSC: KN

18. The rules followed by accountants when preparing financial statements are referred to as _____.
- a. Generally Accepted Accounting Practices (GAAP)
 - b. Financial Accounting Standards Board (FASB)
 - c. the accounting process
 - d. the accounting system

ANS: A DIF: 1 REF: The Foundation of the Accounting System
NAT: AACSB Analytic MSC: KN

19. The _____ was created by the Sarbanes-Oxley Act of 2002.
- a. Public Company Accounting Oversight Board
 - b. Securities & Exchange Commission
 - c. GAAP
 - d. FASB

ANS: A DIF: 2 REF: The Foundation of the Accounting System
NAT: AACSB Analytic MSC: KN

20. Who appoints the members of the Public Company Accounting Oversight Board?
- a. FASB
 - b. American Association of CPAs
 - c. Securities and Exchange Commission
 - d. Federal Trade Commission

ANS: C DIF: 2 REF: The Foundation of the Accounting System
NAT: AACSB Analytic MSC: KN

21. All of the following are assets EXCEPT _____.
- a. Inventory
 - b. bank loans

- c. Patents
- d. Cash

ANS: B DIF: 1 REF: The Accounting Cycle
NAT: AACSB Analytic MSC: KN

22. All of the following are tangible assets EXCEPT _____.
- a. Cash
 - b. Inventory
 - c. Building
 - d. Patents

ANS: D DIF: 2 REF: The Accounting Cycle
NAT: AACSB Analytic MSC: KN

23. Which of the following represents the basic accounting equation?
- a. Assets + Liabilities = Owners' Equity
 - b. Liabilities = Assets + Owners' Equity
 - c. Assets = Liabilities + Owners' Equity
 - d. Owners' Equity - Liabilities = Assets

ANS: C DIF: 2 REF: The Accounting Cycle
NAT: AACSB Analytic MSC: KN

24. Milwaukee Fabrication has \$50 million in assets and \$30 million in owners' equity. How much does the firm have in liabilities?
- a. \$20 million
 - b. \$30 million
 - c. \$50 million
 - d. \$80 million

ANS: A DIF: 2 REF: The Accounting Cycle
NAT: AACSB Reflective Thinking MSC: AP

25. All of the following are liabilities EXCEPT _____.
- a. accounts payable
 - b. accumulated profits not paid in dividends
 - c. bank loans
 - d. wages payable

ANS: B DIF: 2 REF: The Accounting Cycle
NAT: AACSB Analytic MSC: KN

26. Makayla is a corporate CPA working on a new budget. When she lists the company's liabilities, which of the following will she include?
- a. Employees' wages and salaries
 - b. Owners' equity
 - c. Marketable securities
 - d. Computer software

ANS: A DIF: 2 REF: The Accounting Cycle
NAT: AACSB Reflective Thinking MSC: AP

27. Camden Products buys a \$500,000 machine by taking out a bank loan. The company's assets will _____ by \$500,000 while its liabilities will _____ by \$500,000.
- a. rise; fall

- b. fall; rise
- c. rise; rise
- d. fall; fall

ANS: C DIF: 3 REF: The Accounting Cycle
 NAT: AACSB Reflective Thinking MSC: AP

28. Which of the following financial statements shows a firm's financial position at a particular date?
- a. Balance sheet
 - b. Income statement
 - c. Statement of cash flows
 - d. Statement of changes in retained earnings

ANS: A DIF: 1 REF: Financial Statements
 NAT: AACSB Analytic MSC: KN

29. A(n) _____ is a financial statement that is directly based on the accounting equation.
- a. income statement
 - b. balance sheet
 - c. statement of cash flows
 - d. statement of changes in retained earnings

ANS: B DIF: 1 REF: Financial Statements
 NAT: AACSB Analytic MSC: KN

30. Which of the following assets would be listed first on the assets side of a balance sheet?
- a. Fixed assets
 - b. Goodwill
 - c. Accounts receivable
 - d. Inventory

ANS: C DIF: 2 REF: Financial Statements
 NAT: AACSB Analytic MSC: KN

31. Jackson, chief financial officer for a company, is interested in a summary of all the costs related to producing revenues for the most recent quarter. He can best find this information by consulting the _____ section of the _____.
- a. current asset; balance sheet
 - b. operating; cash flow statement
 - c. expense; income statement
 - d. current liability; balance sheet

ANS: C DIF: 2 REF: Financial Statements
 NAT: AACSB Reflective Thinking MSC: AP

32. Kate is the Executive Director of a local food bank and is assessing the financial situation of her not-for-profit organization. Kate uses a(n) _____ to determine whether revenues from contributions and other sources will cover operating costs.
- a. income statement
 - b. statement of cash flows
 - c. balance sheet
 - d. accrual accounting

ANS: A DIF: 2 REF: Financial Statements
 NAT: AACSB Reflective Thinking MSC: AP

33. Expenses that have been incurred (such as wages) but have yet to be paid, are reported on the balance sheet as _____.
a. accounts payable
b. accounts receivable
c. accruals
d. notes payable

ANS: C DIF: 2 REF: Financial Statements
NAT: AACSB Analytic MSC: KN

34. The Ming Company sells \$1,000 worth of goods on July 25 on credit. The customer sends the company a check on August 15. The customer receives the goods on September 1. Assuming the company uses accrual accounting, the sale will be recorded in _____.
a. August
b. July
c. September
d. either July, August, or September

ANS: B DIF: 3 REF: Financial Statements
NAT: AACSB Reflective Thinking MSC: AP

35. Jenna asked her accountant to prepare a summary of the company's "bottom line." What specific information is Jenna interested in?
a. The company's financial position for that week
b. Net income after taxes
c. Comparison of assets and liabilities
d. Statement of owners' equity

ANS: B DIF: 3 REF: Financial Statements
NAT: AACSB Reflective Thinking MSC: AP

36. Which of the following is a non-cash expense?
a. Depreciation
b. Cost of goods sold
c. Income taxes
d. Operating costs

ANS: A DIF: 2 REF: Financial Statements
NAT: AACSB Analytic MSC: KN

37. Kwane wants to assess his firm's ability to meet its short-term obligations. Which of the following ratios are the most relevant?
a. Profitability ratios
b. Liquidity ratios
c. Debt ratios
d. Activity ratios

ANS: B DIF: 1 REF: Financial Ratio Analysis
NAT: AACSB Reflective Thinking MSC: AP

38. Which of the following current assets is NOT included when calculating the acid-test ratio?
a. Cash
b. Marketable securities
c. Inventory
d. Accounts receivable

ANS: C DIF: 2
NAT: AACSB Analytic

REF: Financial Ratio Analysis
MSC: KN

39. If a firm has a current ratio of 2.00, it means that for every \$2 in _____ it has \$1 in _____.
a. total assets; total liabilities
b. total assets; current liabilities
c. current assets; current liabilities
d. current assets; total liabilities

ANS: C DIF: 2
NAT: AACSB Analytic

REF: Financial Ratio Analysis
MSC: KN

40. Using the following balance sheet information, find the firm's acid-test ratio.

Cash and marketable securities	\$15 million
Accounts receivable	\$10 million
Inventory	\$25 million
Current liabilities	\$25 million

- a. 0.60
b. 1.00
c. 1.40
d. 2.00

ANS: B DIF: 3
NAT: AACSB Reflective Thinking

REF: Financial Ratio Analysis
MSC: AP

41. If a company has an acid test ratio of 1.00, \$5 million in inventory, and \$10 million in current liabilities, what are its total current assets?
a. \$5 million
b. \$10 million
c. \$15 million
d. \$20 million

ANS: C DIF: 3
NAT: AACSB Reflective Thinking

REF: Financial Ratio Analysis
MSC: AP

42. Last year, a firm had a current ratio of 1.50 and an acid-test ratio of 0.75. This year the firm's current ratio is 2.00 and its acid-test ratio is 1.00. This firm's _____ has _____.
a. liquidity; improved
b. liquidity; deteriorated
c. profitability; improved
d. profitability; deteriorated

ANS: A DIF: 2
NAT: AACSB Reflective Thinking

REF: Financial Ratio Analysis
MSC: AP

43. An activity turnover ratio of 2.00 means that for every \$1 in assets, the firm generates _____ in sales.
a. \$2.00
b. \$2.50
c. \$3.00
d. \$0.50

ANS: A DIF: 3

REF: Financial Ratio Analysis

NAT: AACSB Analytic

MSC: KN

44. All of the following are profitability ratios EXCEPT _____.
- a. return on equity
 - b. inventory turnover
 - c. return on assets
 - d. gross profit margin

ANS: B

DIF: 1

REF: Financial Ratio Analysis

NAT: AACSB Analytic

MSC: KN

45. _____ ratios are designed to indicate how successful a firm is in terms of its earnings as compared with its assets or owners' equity.
- a. Profitability
 - b. Liquidity
 - c. Activity
 - d. Debt

ANS: A

DIF: 1

REF: Financial Ratio Analysis

NAT: AACSB Analytic

MSC: KN

46. A firm has total assets of \$50 million and owner's equity of \$35 million. What is the firm's leverage ratio?
- a. 25 percent
 - b. 30 percent
 - c. 50 percent
 - d. 70 percent

ANS: B

DIF: 2

REF: Financial Ratio Analysis

NAT: AACSB Reflective Thinking

MSC: AP

47. If Topeka Enterprises has a leverage ratio of 40 percent, it means that for every \$1 in _____, the firm has 40 cents in _____.
- a. owners' equity; liabilities
 - b. owners' equity; assets
 - c. assets; owners' equity
 - d. assets; liabilities

ANS: D

DIF: 3

REF: Financial Ratio Analysis

NAT: AACSB Reflective Thinking

MSC: AP

48. Daniel wishes to create a financial blueprint for a future period that reflects such items as expected sales revenues, operating expenses, and cash receipts and disbursements. Daniel wants to create a(n) _____.
- a. sales forecast
 - b. statement of cash flows
 - c. budget
 - d. income statement

ANS: C

DIF: 1

REF: Budgeting

NAT: AACSB Reflective Thinking

MSC: AP

49. Which of the following statements is correct?
- a. Budgets serve as a planning and control tool.
 - b. Budgets are limited to projecting cash inflows and outflows.

- c. GAAP standards are used in budget development.
- d. Budgets serve as the standard by which estimated performance is compared.

ANS: A DIF: 1 REF: Budgeting
NAT: AACSB Analytic MSC: KN

50. Cash budgets are usually prepared _____.
- a. yearly
 - b. weekly
 - c. quarterly
 - d. monthly

ANS: D DIF: 1 REF: Budgeting
NAT: AACSB Analytic MSC: KN

51. Cash budgets include all of the following EXCEPT _____.
- a. a statement of the company's cash inflows and outflows
 - b. an analysis of interest on cash earned from company profits
 - c. an indication when the company can invest excess funds in securities
 - d. a tangible standard against which to compare actual cash inflows and outflows

ANS: B DIF: 2 REF: Budgeting
NAT: AACSB Analytic MSC: KN

52. Companies such as Coca-Cola generate more than half their annual revenues from sales outside the United States, including Europe. If the dollar gets stronger relative to the euro, what will be the financial impact on the company?
- a. Overall earnings will decrease
 - b. Earnings will decrease in euros, but increase in dollars
 - c. Overall earnings will increase
 - d. Earnings will increase in euros, but decrease in dollars

ANS: A PTS: 1 DIF: 2 REF: International Accounting
NAT: AACSB Reflective Thinking MSC: AP

53. Who is recognized worldwide as the body with sole responsibility and authority to issue pronouncements on international accounting standards?
- a. FASB
 - b. The World Bank
 - c. IASC
 - d. GAAP

ANS: C PTS: 1 DIF: 2 REF: International Accounting
NAT: AACSB Analytic MSC: KN

TRUE/FALSE

1. Accounting is the language of business.

ANS: T DIF: 1 REF: Users of Accounting Information
NAT: AACSB Analytic MSC: KN

2. Daily business decisions are generally unaffected by accounting information; long-term decisions, however, are affected by accounting information and the interpretation of financial reports.

ANS: F DIF: 2 REF: Users of Accounting Information
NAT: AACSB Reflective Thinking MSC: AP

3. Accounting information can be as important to those outside the organization as it is to those inside the organization.

ANS: T DIF: 1 REF: Users of Accounting Information
NAT: AACSB Analytic MSC: KN

4. Most companies refuse to share any financial information with employees.

ANS: F DIF: 1 REF: Users of Accounting Information
NAT: AACSB Analytic MSC: KN

5. Accountants play fundamental roles in not only business but also other aspects of society.

ANS: T DIF: 1 REF: Users of Accounting Information
NAT: AACSB Analytic MSC: KN

6. Since publicly traded companies are required to report their financial information, anyone can find out how much Target made during the past three months.

ANS: T DIF: 2 REF: Users of Accounting Information
NAT: AACSB Reflective Thinking MSC: KN

7. The natural progression of a business begins with operating the business.

ANS: F DIF: 1 REF: Users of Accounting Information
NAT: AACSB Reflective Thinking MSC: KN

8. Accountants play a role in all three business activities: financing, investing, and operating.

ANS: T DIF: 1 REF: Users of Accounting Information
NAT: AACSB Reflective Thinking MSC: KN

9. Monica is deciding which new markets look the most promising. She is engaged in an investing activity.

ANS: T DIF: 2 REF: Users of Accounting Information
NAT: AACSB Reflective Thinking MSC: AP

10. Financing activities focus on providing valuable assets required to run a business.

ANS: F DIF: 2 REF: Users of Accounting Information
NAT: AACSB Analytic MSC: KN

11. Investing activities focus on selling goods and services, but they also consider cost control as an important element of sound financial management.

ANS: F DIF: 2 REF: Users of Accounting Information
NAT: AACSB Analytic MSC: KN

12. Camille is an accountant who works for a firm providing auditing services to other businesses. Camille is a public accountant.

ANS: T DIF: 2 REF: Accounting Professionals
NAT: AACSB Reflective Thinking MSC: AP

13. Public accountants are typically employees of the firm for which they are providing services.

ANS: F DIF: 1 REF: Accounting Professionals
NAT: AACSB Analytic MSC: KN

14. A public accounting firm is prohibited from providing both consulting services and audit services to the same firm.

ANS: F PDIF: 2 REF: Accounting Professionals
NAT: AACSB Analytic MSC: KN

15. An accountant employed by a business other than an accounting firm is called a management accountant.

ANS: T DIF: 1 REF: Accounting Professionals
NAT: AACSB Analytic MSC: KN

16. Only public accountants can become CPAs.

ANS: F DIF: 2 REF: Accounting Professionals
NAT: AACSB Analytic MSC: KN

17. Miles is an accountant and works for a firm that provides tax planning and preparation services to other businesses. Miles is a management accountant.

ANS: F DIF: 2 REF: Accounting Professionals
NAT: AACSB Reflective Thinking MSC: AP

18. Government accounting reports show the profit or loss of an organization.

ANS: F DIF: 2 REF: Accounting Professionals
NAT: AACSB Analytic MSC: KN

19. The primary role of government accountants is to determine how efficiently their organizations have accomplished their objectives.

ANS: T DIF: 1 REF: Accounting Professionals
NAT: AACSB Analytic MSC: KN

20. Government accountants frequently specialize in different aspects of accounting, such as cost accounting, tax accounting, and auditing.

ANS: F DIF: 2 REF: Accounting Professionals
NAT: AACSB Analytic MSC: KN

21. The not-for-profit sector is one of the fastest growing segments of accounting practice.

ANS: T DIF: 1 REF: Accounting Professionals
NAT: AACSB Analytic MSC: KN

22. The accounting process converts individual transactions into financial statements.

ANS: T DIF: 1 REF: The Foundation of the Accounting System
NAT: AACSB Analytic MSC: KN

23. GAAP principles are established by a federal government agency to ensure consistency.

ANS: F DIF: 2 REF: The Foundation of the Accounting System
NAT: AACSB Analytic MSC: KN

24. Assets can include intangible possessions such as patents and trademarks.

ANS: F DIF: 2 REF: The Accounting Cycle
NAT: AACSB Analytic MSC: KN

25. A firm has \$10 million in assets and \$5 million in owner's equity. Therefore, the firm must also have \$5 million in liabilities.

ANS: T DIF: 2 REF: The Accounting Cycle
NAT: AACSB Reflective Thinking MSC: AP

26. Assume a company buys a machine worth \$1 million and pays for it by borrowing the funds from a bank. The firm's assets will rise by \$1 million and its liabilities will also rise by \$1 million. Owners' equity will not change.

ANS: T DIF: 2 REF: The Accounting Cycle
NAT: AACSB Reflective Thinking MSC: AP

27. Double-entry bookkeeping refers to the process by which accounting transactions are recorded.

ANS: T DIF: 2 REF: The Accounting Cycle
NAT: AACSB Analytic MSC: KN

28. A firm's balance sheet shows its financial position over a period of time.

ANS: F DIF: 1 REF: Financial Statements
NAT: AACSB Analytic MSC: KN

29. The balance sheet is based on the accounting equation.

ANS: T DIF: 1 REF: Financial Statements
NAT: AACSB Analytic MSC: KN

30. The three principal financial statements are the balance sheet, income statement, and the statement of retained earnings.

ANS: F DIF: 1 REF: Financial Statements
NAT: AACSB Analytic MSC: KN

31. Assets are shown in descending order of liquidity.

ANS: T DIF: 2 REF: Financial Statements
NAT: AACSB Analytic MSC: KN

32. The left side of the balance sheet lists claims against assets.

ANS: F DIF: 2 REF: Financial Statements
NAT: AACSB Analytic MSC: KN

33. On a balance sheet, total assets must always equal the sum of liabilities and owners' equity.

ANS: T DIF: 2 REF: Financial Statements
NAT: AACSB Analytic MSC: KN

34. When examining a statement of cash flows, investors obtain relevant information about a firm's cash receipts and payments for its operations, investments, and financing during an accounting period.

ANS: T DIF: 1 REF: Financial Statements
NAT: AACSB Analytic MSC: KN

35. Accrual accounting recognizes revenues and expenses when cash changes hands.

ANS: F DIF: 1 REF: Financial Statements
NAT: AACSB Analytic MSC: KN

36. Depreciation is reported as an expense on the firm's income statement, but does not involve any actual cash.

ANS: T DIF: 2 REF: Financial Statements
NAT: AACSB Analytic MSC: KN

37. Ratios assist managers by interpreting actual performance and making comparisons with what should have happened.

ANS: T DIF: 1 REF: Financial Ratio Analysis
NAT: AACSB Analytic MSC: KN

38. The current ratio is a leverage ratio.

ANS: F DIF: 1 REF: Financial Ratio Analysis
NAT: AACSB Analytic MSC: KN

39. Two commonly used liquidity ratios are the acid-test ratio and the leverage ratio.

ANS: F DIF: 1 REF: Financial Ratio Analysis
NAT: AACSB Analytic MSC: KN

40. A firm's acid-test ratio can never be higher than its current ratio.

ANS: T DIF: 2 REF: Financial Ratio Analysis
NAT: AACSB Analytic MSC: KN

41. A firm has \$10 million in current assets, of which \$5 million is inventory. If the company has \$5 million in current liabilities, then its current ratio equals 1.0.

ANS: F DIF: 2 REF: Financial Ratio Analysis
NAT: AACSB Reflective Thinking MSC: AP

42. Return on assets is a profitability ratio.

ANS: T DIF: 1 REF: Financial Ratio Analysis
NAT: AACSB Analytic MSC: KN

43. Profitability ratios measure a firm's ability to meet its short-term obligations.

ANS: F DIF: 1 REF: Financial Ratio Analysis
NAT: AACSB Analytic MSC: KN

44. A leverage ratio of 20 percent means that the firm is relying more on borrowed money than owners' equity.

ANS: F DIF: 2 REF: Financial Ratio Analysis
NAT: AACSB Analytic MSC: KN

45. If a firm has an asset turnover ratio of 2.00, it means that it needs \$2 in assets to generate a \$1 in sales.

ANS: F DIF: 2 REF: Financial Ratio Analysis
NAT: AACSB Reflective Thinking MSC: AP

46. The budget establishes the standards with which actual performance may be compared.

ANS: T DIF: 1 REF: Budgeting
NAT: AACSB Analytic MSC: KN

47. A budget is essentially a long-term financial plan.

ANS: F DIF: 1 REF: Budgeting
NAT: AACSB Analytic MSC: KN

48. Cash budgets are typically prepared on a weekly basis.

ANS: F DIF: 1 REF: Budgeting
NAT: AACSB Analytic MSC: KN

49. A company's overall operating budget is a composite of many individual budgets for separate units of the firm.

ANS: T DIF: 2 REF: Budgeting
NAT: AACSB Analytic MSC: KN

50. A U.S. company with a subsidiary in France will restate the U.S. operations from U.S. dollars to euros.

ANS: F DIF: 1 REF: International Accounting
NAT: AACSB Analytic MSC: KN

51. If a U.S. company has substantial operations in Europe, and the value of the euro falls relative to the U.S. dollar, the company's profits, stated in U.S. dollars, will also fall.

ANS: F DIF: 2 REF: International Accounting
NAT: AACSB Analytic MSC: KN

52. An international firm's consolidated financial statements must reflect any gains or losses due to changes in exchange rates during specific periods of time.

ANS: T DIF: 2
NAT: AACSB Analytic

REF: International Accounting
MSC: KN