Financial Accounting For Decision Makers 1st edition Tietz Test Bank

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***Financial Accounting for Decision Makers, 1e* (Tietz/Larson)**
Chapter 1 Fundamentals of Accounting and Financial Statements

Learning Objective 1-1

1) Accounting is primarily concerned with preparing tax returns rather than providing information for decision making.
Answer: FALSE
Explanation: Accounting focuses on measuring, processing, and communicating business information to decision makers, not just tax preparation.
Diff: 1
LO: 1-1

2) Accounting is often referred to as the "language of business."
Answer: TRUE
Explanation: Accounting communicates financial information much like a language communicates ideas, helping users understand business performance.
Diff: 1
LO: 1-1

3) Bookkeeping and accounting mean the same thing.
Answer: FALSE
Explanation: Bookkeeping is the mechanical part of recording transactions, while accounting includes analyzing and communicating financial results.
Diff: 1
LO: 1-1

4) Accounting information helps both managers and external users make informed business decisions.
Answer: TRUE
Explanation: Accounting provides information used by internal decision makers like managers and external users such as investors and creditors.
Diff: 1
LO: 1-1

5) In accounting, a proprietorship is not considered separate from its owner for financial reporting purposes.
Answer: FALSE
Explanation: Although legally the same, for accounting purposes a proprietorship is treated as a separate entity from its owner.
Diff: 2
LO: 1-1

6) One advantage of forming a corporation is limited liability for its owners.
Answer: TRUE
Explanation: Corporate stockholders' personal assets are protected from the company's debts, limiting their liability.
Diff: 1
LO: 1-1

7) In a general partnership, each partner's liability is limited to the amount invested in the business.
Answer: FALSE
Explanation: General partners have unlimited liability; only limited partners in an LLP or LLC have liability protection.
Diff: 2
LO: 1-1

8) Limited-liability companies (LLCs) combine features of partnerships and corporations.
Answer: TRUE
Explanation: LLCs offer pass-through taxation like partnerships and limited liability like corporations.
Diff: 2
LO: 1-1

9) Corporations avoid double taxation because profits are only taxed once at the shareholder level.
Answer: FALSE
Explanation: Corporations face double taxation–once on corporate income and again when profits are distributed as dividends.
Diff: 2
LO: 1-1

10) Accounting is important for businesses of all sizes and types because it provides information for planning, controlling, and evaluating operations.
Answer: TRUE
Explanation: Accounting supports decision making across all organizational forms and sizes by providing relevant financial data.
Diff: 1
LO: 1-1

11) Which statement best describes accounting?
A) It is a system for recording and communicating business information.
B) It is a method used only for calculating business taxes.
C) It is limited to preparing payroll and inventory reports.
D) It is a process focused mainly on government compliance.
Answer: A
Explanation: Accounting measures and communicates business information to assist decision makers.
Diff: 1
LO: 1-1

12) Why is accounting often referred to as the "language of business"?
A) It records only transactions that involve cash payments or receipts.
B) It explains financial results through a standardized system of communication.
C) It focuses on describing marketing and management strategies.
D) It is used only by accountants and auditors for reporting.
Answer: B
Explanation: Accounting is called the language of business because it communicates financial information consistently.
Diff: 1
LO: 1-1

13) What is the main purpose of accounting information?
A) To ensure that businesses avoid all types of financial risk
B) To eliminate the need for professional financial management
C) To help users make informed financial and business decisions
D) To provide entertainment value to readers of financial reports
Answer: C
Explanation: The goal of accounting information is to provide useful data for decision making.
Diff: 1
LO: 1-1

14) Which of the following best differentiates bookkeeping from accounting?
A) Bookkeeping involves analysis; accounting focuses on simple recording.
B) Bookkeeping records transactions; accounting analyzes and reports them.
C) Bookkeeping manages employees; accounting manages customers.
D) Bookkeeping and accounting perform identical business functions.
Answer: B
Explanation: Bookkeeping is mechanical recording, while accounting interprets and communicates the results.
Diff: 1
LO: 1-1

15) What is one reason understanding accounting is important for all professionals?
A) It enhances decision-making ability through financial understanding.
B) It focuses solely on tax preparation and auditing compliance.
C) It eliminates the need for teamwork and collaboration skills.
D) It ensures that every person can create detailed engineering reports.
Answer: A
Explanation: Knowledge of accounting improves financial literacy and supports better decisions.
Diff: 1
LO: 1-1

16) Which of the following statements about accounting is correct?
A) It focuses exclusively on tax-related financial records.
B) It provides information to internal and external decision makers.
C) It is not relevant to individuals outside of the accounting field.
D) It is used only by managers within large organizations.
Answer: B
Explanation: Accounting serves both internal users, such as managers, and external users, such as investors.
Diff: 1
LO: 1-1

17) Why should someone in business study accounting?
A) It helps them avoid all legal and ethical responsibilities.
B) It ensures they can operate without understanding data systems.
C) It allows them to understand how financial decisions affect operations.
D) It guarantees that all companies will be equally profitable.
Answer: C
Explanation: Studying accounting helps individuals understand how financial results reflect business performance.
Diff: 1
LO: 1-1

18) Which of the following best defines the role of accounting in business?
A) Estimating potential profits through marketing research only
B) Managing nonfinancial assets and unrelated investments
C) Measuring, processing, and communicating financial information
D) Regulating all aspects of human resource management
Answer: C
Explanation: Accounting measures, processes, and communicates business activities for decision makers.
Diff: 1
LO: 1-1

19) Why is accounting considered essential to effective business management?
A) It replaces the need for strategic planning and forecasting.
B) It provides a framework for evaluating performance and planning.
C) It guarantees that all business investments will be successful.
D) It eliminates the importance of leadership and communication.
Answer: B
Explanation: Accounting provides the financial data needed for evaluating and managing operations.
Diff: 1
LO: 1-1

20) Which of the following best represents the relationship between accounting and decision making?
A) Accounting decisions are unrelated to financial performance.
B) Accounting replaces managerial judgment in all decisions.
C) Accounting information is used only after decisions are made.
D) Accounting provides data that supports informed decisions.
Answer: D
Explanation: Accounting information supports decisions by providing relevant and reliable data about performance.
Diff: 1
LO: 1-1

21) A student claims that since computers perform all calculations, there is no need for humans to understand accounting. Which statement most effectively weakens this argument?
A) Computers can calculate but cannot interpret financial results.
B) Accounting involves no calculations or analysis.
C) Most companies still use paper-based systems.
D) Computers are not used in modern accounting systems.
Answer: A
Diff: 2
LO: 1-1

22) A manager argues that accounting is unnecessary because business decisions depend only on customer feedback. Which point most directly challenges this claim?
A) Managers prefer verbal communication to written reports.
B) Customer feedback is generally accurate.
C) Accounting provides objective data for decision making.
D) Businesses cannot operate without customer support.
Answer: C
Diff: 2
LO: 1-1

23) Which of the following, if true, would most strengthen the claim that accounting is the "language of business"?
A) Each business prepares its reports using different systems and terms.
B) Managers and investors both rely on accounting reports to understand performance.
C) Accounting information is usually kept confidential.
D) Accounting statements are rarely used in business communication.
Answer: B
Diff: 2
LO: 1-1

24) A company claims that bookkeeping and accounting are identical. Which statement provides the strongest counterargument?
A) Accounting includes analysis and communication, not just recordkeeping.
B) Both processes involve using computers for documentation.
C) Bookkeeping is performed only by accountants.
D) Both terms refer to the same professional tasks.
Answer: A
Diff: 1
LO: 1-1

25) A friend argues that studying accounting is valuable only for those who plan to become accountants. What information most directly refutes this claim?
A) Accounting has no relevance to personal financial management.
B) Accounting is unrelated to most business fields.
C) Only accountants need to analyze financial data.
D) Accounting knowledge helps all professionals make financial decisions.
Answer: D
Diff: 1
LO: 1-1

26) A policymaker asserts that external users of accounting information have no influence on business decisions. Which statement most weakens this claim?
A) External users seldom read financial statements.
B) Most accounting systems are designed for internal reports only.
C) Accounting information is too technical for most users to understand.
D) Investors and creditors rely on accounting data to decide where to allocate funds.
Answer: D
Diff: 2
LO: 1-1

27) A student argues that partnerships and corporations are the same type of business organization because both involve more than one person. Which statement best challenges this reasoning?
A) In corporations, owners have limited liability, unlike in partnerships.
B) Both organizations issue stock to raise funds.
C) Both structures are treated identically under tax law.
D) In both, profits are always retained rather than distributed.
Answer: A
Diff: 2
LO: 1-1

28) A company claims that financial reports are useful only to managers. Which of the following best identifies the flaw in that reasoning?
A) Managers rarely read accounting statements.
B) Investors and creditors also use financial reports for decisions.
C) Financial reports are private internal documents.
D) Accounting information is not relevant to outside users.
Answer: B
Diff: 1
LO: 1-1

29) Which statement, if true, would most weaken the argument that accounting information benefits only large corporations?
A) Larger businesses generally produce more detailed reports.
B) Large corporations have dedicated accounting departments.
C) Many small businesses have fewer reporting requirements.
D) Small businesses also rely on accounting to track performance and make decisions.
Answer: D
Diff: 1
LO: 1-1

30) A student concludes that since accounting is called the "language of business," it must involve communication skills rather than numerical skills. Which reasoning flaw does this conclusion illustrate?
A) It misinterprets the purpose of accounting regulation.
B) It correctly identifies accounting as unrelated to mathematics.
C) It assumes that communication and numerical skills cannot coexist.
D) It confuses accounting with written business correspondence.
Answer: C
Diff: 2
LO: 1-1

31) Which of the following, if true, most strengthens the argument that understanding accounting improves financial decision-making?
A) Accounting provides consistent and verified data about performance.
B) Financial decisions are primarily emotional rather than logical.
C) Accounting requires little interpretation once data are recorded.
D) Managers base decisions only on intuition and experience.
Answer: A
Diff: 2
LO: 1-1

32) A business owner believes that since their company is small, they do not need to keep accounting records. Which of the following points most directly challenges this belief?
A) Accounting principles are applied only to complex organizations.
B) Large corporations are required to submit annual reports.
C) Even small businesses must measure results to make informed decisions.
D) Small businesses can operate entirely without written data.
Answer: C
Diff: 1
LO: 1-1

33) Which of the following would most weaken the claim that the form of business organization has no effect on accounting practices?
A) Different forms have different liability and tax implications that must be recorded.
B) All business forms use the same financial statements.
C) The accounting cycle is identical for all entities.
D) Businesses of all types prepare financial reports.
Answer: A
Diff: 2
LO: 1-1

34) Which of the following is an inference that can reasonably be drawn from the information about accounting's role in business?
A) Reliable accounting information supports better business planning.
B) Accounting eliminates the need for professional judgment.
C) Only external users benefit from financial statements.
D) Accounting ensures that all businesses are equally successful.
Answer: A
Diff: 2
LO: 1-1

35) All *except* which of the following statements help explain why accounting is critical to businesses?
A) It assists decision makers in evaluating performance.
B) It allows communication through standardized financial reports.
C) It guarantees that a company will earn profits each year.
D) It measures and summarizes business activities.
Answer: C
Diff: 1
LO: 1-1

36) Explain why accounting is considered the language of business and discuss how understanding this language benefits both internal and external decision makers.
Answer: Accounting communicates financial information that describes a company's activities and performance.
It provides a standardized method for reporting business transactions and results.
Internal decision makers, such as managers, use accounting to plan, control, and evaluate operations.
External decision makers, such as investors and creditors, use accounting reports to assess profitability, financial stability, and creditworthiness.
Understanding accounting helps individuals interpret financial data and make better personal and business decisions.
Without this shared "language," communication about financial performance would be inconsistent and unreliable.
Diff: 2
LO: 1-1

37) Compare and contrast the four basic forms of business organization in terms of ownership, liability, and taxation, and explain how accounting applies to each.
Answer: Proprietorship: owned by one individual; the owner has unlimited liability; income is reported on the owner's personal tax return; accounting treats the business as separate from the owner for recordkeeping.
Partnership: owned by two or more individuals or entities; partners share profits and losses; general partners have unlimited liability; income flows through to partners' tax returns; accounting must track each partner's ownership interest.
Limited-liability company (LLC): owned by members; members have limited liability; profits pass through to members' personal tax returns; accounting reflects both partnership-like flexibility and corporate protections.
Corporation: owned by shareholders; shareholders have limited liability; profits are taxed at the corporate level and again when distributed as dividends (double taxation); accounting must comply with formal reporting and regulatory requirements.
Accounting is essential for all forms because it measures financial performance and communicates results to users, regardless of the organization's legal structure.
Diff: 3
LO: 1-1

Learning Objective 1-2

1) The income statement communicates a company's revenues, expenses, and resulting net income or net loss for a specific period of time.
Answer: TRUE
Explanation: The income statement, also called the statement of operations, reports revenues, expenses, and the resulting profit or loss for a defined period.
Diff: 1
LO: 1-2

2) The income statement reports a company's financial position as of a specific date.
Answer: FALSE
Explanation: The income statement covers a period of time, while the balance sheet reports financial position at a specific date.
Diff: 1
LO: 1-2

3) A fiscal year must always correspond to the calendar year ending on December 31.
Answer: FALSE
Explanation: A fiscal year is a 52-week reporting period that may or may not align with the calendar year.
Diff: 2
LO: 1-2

4) Revenues are outflows of resources that occur when a company pays its bills.
Answer: FALSE
Explanation: Revenues are inflows of resources earned by providing goods or services; outflows are expenses.
Diff: 1
LO: 1-2

5) Expenses represent the cost of resources used to generate revenue.
Answer: TRUE
Explanation: Expenses are the costs of doing business that reduce the company's profit for the period.
Diff: 1
LO: 1-2

6) Gains and losses are identical to revenues and expenses because they arise from normal business operations.
Answer: FALSE
Explanation: Gains and losses are similar in effect but result from activities outside the company's normal operations.
Diff: 2
LO: 1-2

7) Net income occurs when total revenues and gains exceed total expenses and losses.
Answer: TRUE
Explanation: Net income represents the excess of revenues and gains over expenses and losses for the period.
Diff: 2
LO: 1-2

8) Net income, often called the "bottom line," is the most important measure of a company's profitability.
Answer: TRUE
Explanation: The bottom line on the income statement shows the company's overall profit or loss, a key indicator of performance.
Diff: 2
LO: 1-2

9) A complete income statement typically presents only one year of data to ensure clarity.
Answer: FALSE
Explanation: Full income statements often present three years of data to show trends in profitability over time.
Diff: 2
LO: 1-2

10) Large corporations sometimes round financial statement amounts to the nearest thousand or million dollars for readability.
Answer: TRUE
Explanation: To simplify presentation, companies often report figures in thousands or millions, clearly indicating this on the statement.
Diff: 1
LO: 1-2

11) Which statement best describes the purpose of an income statement?
A) It communicates revenues, expenses, and the resulting profit or loss.
B) It shows the financial position of a company on a specific date.
C) It records changes in owners' equity accounts during the year.
D) It reports the inflows and outflows of cash during a period.
Answer: A
Explanation: The income statement summarizes revenues, expenses, and the resulting net income or loss for a specific time period.
Diff: 2
LO: 1-2

12) The income statement covers which type of time frame?
A) A specific date such as December 31
B) A single day that represents a company's operations
C) A continuous period such as one fiscal year
D) The entire life span of the business
Answer: C
Explanation: The income statement reports performance for a defined time period, such as a month, quarter, or fiscal year.
Diff: 2
LO: 1-2

13) Which of the following best describes a fiscal year?
A) A reporting period that must end on December 31
B) A reporting period that may differ from the calendar year
C) A period that covers more than one full year of operations
D) A temporary time frame used for interim reporting only
Answer: B
Explanation: A fiscal year may or may not correspond to the calendar year, depending on a company's operations.
Diff: 2
LO: 1-2

14) What is the relationship between revenues and expenses on the income statement?
A) Revenues and expenses are unrelated categories.
B) Revenues and expenses appear only on the balance sheet.
C) Revenues and expenses both reduce profitability equally.
D) Revenues increase profitability, while expenses decrease it.
Answer: D
Explanation: Revenues represent inflows that increase profitability, and expenses are outflows that reduce it.
Diff: 2
LO: 1-2

15) Which of the following best describes gains and losses?
A) They have no impact on profitability.
B) They arise from normal operating activities.
C) They are transactions outside the company's regular operations.
D) They always result in a decrease in cash balance.
Answer: C
Explanation: Gains and losses occur from events outside day-to-day operations but still affect overall profitability.
Diff: 2
LO: 1-2

16) Which statement best defines net income?
A) The total amount of cash received from customers during the year
B) The excess of revenues and gains over expenses and losses
C) The total of all owner contributions to the company
D) The difference between assets and liabilities at year-end
Answer: B
Explanation: Net income results when revenues and gains exceed expenses and losses for a specific period.
Diff: 2
LO: 1-2

17) What is typically found at the bottom of an income statement?
A) The total change in cash from operations
B) The company's retained earnings balance
C) The total liabilities and equity balance
D) The net income or net loss for the period
Answer: D
Explanation: The "bottom line" of the income statement reports the company's net income or net loss.
Diff: 1
LO: 1-2

18) Why might a company present figures in thousands or millions on its income statement?
A) To simplify and improve the readability of large amounts
B) To hide sensitive financial data from competitors
C) To satisfy government-imposed rounding requirements
D) To ensure all reports match those of competitors
Answer: A
Explanation: Companies round figures to thousands or millions to make statements easier to read and interpret.
Diff: 1
LO: 1-2

19) What does a net loss indicate for a business?
A) Revenues and gains exceeded expenses and losses.
B) Cash inflows were greater than cash outflows.
C) Expenses and losses exceeded revenues and gains.
D) The company had no taxable income for the year.
Answer: C
Explanation: A net loss occurs when total expenses and losses are greater than total revenues and gains.
Diff: 2
LO: 1-2

20) Which of the following best describes the main purpose of the income statement?
A) To present a detailed list of assets and liabilities
B) To summarize operational performance over a defined period
C) To show changes in stockholders' equity during the year
D) To display cash receipts and payments for the reporting period
Answer: B
Explanation: The income statement communicates operational results–revenues, expenses, and profit or loss–over a set time period.
Diff: 1
LO: 1-2

21) For the year ended December 31, 20x1, a company reports total revenues of $480,000 and total expenses of $350,000. What is the company's net income?
A) $120,000
B) $130,000
C) $140,000
D) $150,000
Answer: B
Explanation: Net income = Revenues − Expenses = $480,000 − $350,000 = $130,000.
Diff: 2
LO: 1-2

22) During the fiscal year ended June 30, 20x1, a company earns $725,000 in revenues and incurs $775,000 in expenses. What is the net loss for the period?
A) $45,000
B) $50,000
C) $55,000
D) $60,000
Answer: B
Explanation: Net loss = Expenses − Revenues = $775,000 − $725,000 = $50,000.
Diff: 2
LO: 1-2

23) For the fiscal year ended September 30, 20x1, revenues total $395,000 and expenses total $285,000. What is the net income?
A) $100,000
B) $105,000
C) $110,000
D) $115,000
Answer: C
Explanation: Net income = Revenues − Expenses = $395,000 − $285,000 = $110,000.
Diff: 2
LO: 1-2

24) A company has revenues of $650,000, expenses of $600,000, gains of $20,000, and losses of $15,000 for the year ended December 31, 20x1. What is its net income?
A) $55,000
B) $60,000
C) $65,000
D) $70,000
Answer: B
Explanation: Net income = (Revenues + Gains) − (Expenses + Losses) = ($650,000 + $20,000) − ($600,000 + $15,000) = $55,000.
Diff: 2
LO: 1-2

25) A company reports revenues of $820,000 and expenses of $910,000 during the year ended December 31, 20x1. What is the net loss?
A) $80,000
B) $85,000
C) $90,000
D) $95,000
Answer: C
Explanation: Net loss = Expenses − Revenues = $910,000 − $820,000 = $90,000.
Diff: 2
LO: 1-2

26) For the year ended May 31, 20x1, a company reports total revenues of $500,000, total expenses of $475,000, and total gains of $15,000. What is the company's net income?
A) $35,000
B) $40,000
C) $45,000
D) $50,000
Answer: B
Explanation: Net income = (Revenues + Gains) − Expenses = ($500,000 + $15,000) − $475,000 = $40,000.
Diff: 2
LO: 1-2

27) During the fiscal year ended August 31, 20x1, total revenues were $380,000, total expenses were $410,000, and total losses were $20,000. What is the net loss?
A) $45,000
B) $50,000
C) $55,000
D) $60,000
Answer: B
Explanation: Net loss = (Expenses + Losses) − Revenues = ($410,000 + $20,000) − $380,000 = $50,000.
Diff: 2
LO: 1-2

28) For the year ended December 31, 20x1, revenues are $275,000, expenses are $195,000, and gains are $20,000. What is the company's net income?
A) $85,000
B) $90,000
C) $95,000
D) $100,000
Answer: D
Explanation: Net income = (Revenues + Gains) − Expenses = ($275,000 + $20,000) − $195,000 = $100,000.
Diff: 2
LO: 1-2

29) A company reports $720,000 in revenues, $630,000 in expenses, and $25,000 in losses for the fiscal year ended September 30, 20x1. What is its net income?
A) $55,000
B) $60,000
C) $65,000
D) $70,000
Answer: C
Explanation: Net income = Revenues − (Expenses + Losses) = $720,000 − ($630,000 + $25,000) = $65,000.
Diff: 2
LO: 1-2

30) During the year ended December 31, 20x1, a business had total revenues of $900,000, total expenses of $825,000, and total gains of $15,000. What is the net income?
A) $80,000
B) $85,000
C) $90,000
D) $95,000
Answer: C
Explanation: Net income = (Revenues + Gains) − Expenses = ($900,000 + $15,000) − $825,000 = $90,000.
Diff: 2
LO: 1-2

31) A student argues that because the income statement shows revenues and expenses, it also measures a company's financial position. Which statement best identifies the flaw in this reasoning?
A) The income statement includes only cash-based transactions.
B) The income statement does not measure financial position but reports performance over time.
C) The income statement contains the same data as the balance sheet.
D) The income statement shows only information on owners' equity.
Answer: B
Diff: 2
LO: 1-2

32) A manager claims that since revenues appear first on the income statement, they are always more important than expenses. Which of the following weakens this argument?
A) Revenues appear first only to follow standard reporting format.
B) Expenses are usually smaller than revenues in all cases.
C) Expenses must be compared with revenues to determine net income or loss.
D) Revenues are the only factor that determines company performance.
Answer: C
Diff: 2
LO: 1-2

33) Which of the following, if true, would most strengthen the claim that the income statement helps decision makers?
A) The income statement provides no link to other financial reports.
B) Managers rarely use the income statement for planning or analysis.
C) The income statement focuses solely on one day's performance.
D) Managers rely on the income statement to evaluate profitability and performance trends.
Answer: D
Diff: 2
LO: 1-2

34) A student concludes that a fiscal year must end on December 31. Which of the following most directly challenges this conclusion?
A) Fiscal years are required to align with tax payment schedules.
B) Fiscal years always begin on January 1.
C) Companies can choose fiscal years that differ from the calendar year.
D) All companies must use the same year-end date for reporting purposes.
Answer: C
Diff: 2
LO: 1-2

35) Which statement, if true, would most weaken the claim that gains and losses are part of a company's ordinary operations?
A) Gains and losses increase a company's total income.
B) Gains and losses appear on the income statement with revenues and expenses.
C) Gains and losses result from transactions outside normal operations.
D) Gains and losses reduce net income when expenses rise.
Answer: C
Diff: 2
LO: 1-2

36) A supervisor argues that a company showing a net loss for one year has failed completely. Which reasoning best identifies the flaw in this argument?
A) A single period's loss does not necessarily indicate long-term failure.
B) A net loss eliminates all equity within the business.
C) Net losses are common only for large corporations.
D) A company can operate only if it earns profits every year.
Answer: A
Diff: 2
LO: 1-2

37) A student claims that net income and cash inflow must always be equal. Which statement most effectively weakens this argument?
A) Cash inflow and net income often differ due to timing of revenue and expense recognition.
B) Net income and cash inflow are always identical measures of performance.
C) Cash inflow includes only revenue-related transactions.
D) Net income is unrelated to profitability.
Answer: A
Diff: 2
LO: 1-2

38) Which of the following, if true, would most strengthen the idea that reporting net income is vital to investors?
A) Investors ignore financial statements when evaluating company value.
B) Investors rely on net income to assess profitability and performance.
C) Investors are primarily concerned with cash balances and not income.
D) Investors consider net income unimportant to valuation.
Answer: B
Diff: 3
LO: 1-2

39) A critic argues that an income statement showing profit guarantees future success. Which point most directly challenges this reasoning?
A) Profitability in one period does not ensure future profitability.
B) Profitability is the only measure of business success.
C) Future results must always match past performance.
D) Once a company is profitable, its risks disappear.
Answer: A
Diff: 2
LO: 1-2

40) Which of the following would most weaken the argument that a company with high revenues is automatically profitable?
A) Revenues do not account for expenses that reduce overall profit.
B) Companies with high revenues always earn higher profits.
C) Expenses usually increase along with revenues.
D) The income statement reports only total sales and not profit.
Answer: A
Diff: 2
LO: 1-2

41) An analyst claims that a company's income statement can predict cash flows precisely. Which statement most effectively weakens this claim?
A) Income statements include depreciation as a cash inflow.
B) Cash flows are identical to profits in most companies.
C) The income statement omits all noncash transactions.
D) The income statement reports performance, not direct cash flow.
Answer: D
Diff: 2
LO: 1-2

42) Which of the following, if true, would most strengthen the reliability of income statement information?
A) The company consistently applies accounting principles across periods.
B) The company changes reporting formats each quarter.
C) The company omits gains and losses from its statement.
D) The company records transactions only in cash form.
Answer: A
Diff: 2
LO: 1-2

43) A student argues that gains and revenues are interchangeable terms. Which of the following most directly refutes this argument?
A) Gains are recorded only when a company has a net loss.
B) Gains and revenues are always reported together without distinction.
C) Both represent decreases in total profitability.
D) Revenues come from normal operations, while gains come from non-recurring events.
Answer: D
Diff: 2
LO: 1-2

44) A manager claims that the income statement alone provides a complete picture of a company's financial condition. Which statement most directly challenges this claim?
A) The income statement reports profitability, but not the company's financial position.
B) The income statement includes information about total assets and liabilities.
C) The income statement is required to match the balance sheet exactly.
D) The income statement provides a complete view without limitations.
Answer: A
Diff: 2
LO: 1-2

45) All *except* which of the following statements accurately describe the income statement?
A) It covers a specific period of time.
B) It reports revenues and expenses.
C) It lists the company's assets and liabilities.
D) It indicates net income or net loss.
Answer: C
Diff: 1
LO: 1-2

46) Explain the purpose of an income statement and discuss how it helps users evaluate a company's financial performance.
Answer: The income statement communicates a company's revenues, expenses, gains, and losses over a specific time period.
It shows whether a company earned a profit (net income) or incurred a loss (net loss).
The report helps users understand how effectively management generated income from operations.
By comparing income statements over several years, users can identify trends in profitability and growth.
Investors, creditors, and managers use the income statement to make informed decisions about investing, lending, and internal operations.
Diff: 2
LO: 1-2

47) Describe the main components of an income statement and explain why each is important for understanding business performance.
Answer: Revenues: represent inflows from providing goods or services and show the company's ability to generate sales.
Expenses: represent outflows of resources used to earn revenues and help assess cost control and efficiency.
Gains and losses: reflect results from activities outside normal operations and reveal other factors affecting profitability.
Net income or net loss: indicates the overall financial outcome of operations during the period, summarizing all revenues, expenses, gains, and losses.
Each component contributes to understanding not only how much the company earned but also how and where those results were achieved.
Diff: 2
LO: 1-2

48) A company reports the following for the year ended December 31, 20x1: Sales Revenues $840,000; Service Revenues $160,000; Gains From Sale of Equipment $12,000; Cost of Goods Sold $620,000; Salaries Expense $170,000; Rent Expense $48,000; Utilities Expense $9,000; Loss on Inventory Write-down $6,000.
Required:
A) Calculate net income (or net loss) for the year.
B) If the company presents the income statement in thousands with a note "Amounts in $000s," what is the bottom-line amount it would display?
C) Briefly categorize which items are Revenues, Expenses, Gains, and Losses.
Answer:
A) Net income = (Sales + Services + Gains) − (All Expenses + Losses)
= ($840,000 +$160,000 + $12,000) − ($620,000 + $170,000 + $48,000 + $9,000 + $6,000)
= $1,012,000 − $853,000 = $159,000
B) Bottom line in $000s = $159,000 ÷ 1,000 = $159
C) Categories: Revenues = sales, services; Expenses = cost of goods sold, salaries, rent, utilities; Gain = sale of equipment; Loss = inventory write-down
Diff: 2
LO: 1-2

49) The following condensed data relate to a company's income statements:
For the fiscal year ended May 31, 20x1: Revenues $590,000; expenses $552,000; gains $8,000; losses $5,000
For the fiscal year ended May 31, 20x2: Revenues $605,000; expenses $579,000; gains $3,000; losses $11,000
Required:
A) Calculate net income (or net loss) for each year.
B) Determine the year-over-year change in net income from 20x1 to 20x2.
C) Identify which single line item change most reduced profitability in 20x2 relative to 20x1 based on these totals.
Answer:
A) Net Income 20x1 = (Revenues + Gains) − (Expenses + Losses)
= ($590,000 + $8,000) − ($552,000 + $5,000) = $598,000 − $557,000 = $41,000
Net Income 20x2 = ($605,000 + $3,000) − ($579,000 + $11,000) = $608,000 − $590,000 = $18,000
B) Change in Net Income = $18,000 - -$41,000 = −$23,000 (decrease)
C) Largest negative effect came from losses increasing (from $5,000 to $11,000), which reduced profitability compared with the prior year.
Diff: 3
LO: 1-2

Learning Objective 1-3

1) The statement of stockholders' equity connects the income statement and the balance sheet.
Answer: TRUE
Explanation: The statement of stockholders' equity links net income from the income statement with the equity section of the balance sheet.
Diff: 1
LO: 1-3

2) The statement of stockholders' equity shows changes in total assets during a specific accounting period.
Answer: FALSE
Explanation: The statement summarizes changes in stockholders' equity, not total assets.
Diff: 1
LO: 1-3

3) Retained earnings represent the cumulative net income a company has kept, less any dividends declared.
Answer: TRUE
Explanation: Retained earnings accumulate profits not distributed as dividends to shareholders.
Diff: 1
LO: 1-3

4) Dividends are considered expenses that reduce net income on the income statement.
Answer: FALSE
Explanation: Dividends are not expenses; they are distributions of profits to shareholders and appear after net income is calculated.
Diff: 2
LO: 1-3

5) The ending balance of retained earnings is reported on the balance sheet.
Answer: TRUE
Explanation: The ending retained earnings figure from the statement of stockholders' equity is carried over to the balance sheet's equity section.
Diff: 1
LO: 1-3

6) Dividends increase retained earnings because they are paid from company profits.
Answer: FALSE
Explanation: Dividends decrease retained earnings since they reduce the amount of profit kept in the company.
Diff: 2
LO: 1-3

7) A company with an accumulated deficit in retained earnings has historically incurred more losses than profits.
Answer: TRUE
Explanation: An accumulated deficit occurs when total expenses and losses exceed total revenues and gains over time.
Diff: 2
LO: 1-3

8) Retained earnings are included in the calculation of net income on the income statement.
Answer: FALSE
Explanation: Retained earnings are not part of net income; they are affected by it after net income is determined.
Diff: 1
LO: 1-3

9) Companies in a growth phase typically retain earnings instead of paying dividends.
Answer: TRUE
Explanation: Growing companies often keep profits to reinvest in operations rather than distribute them as dividends.
Diff: 2
LO: 1-3

10) The statement of stockholders' equity provides information about investments by shareholders, net income, and dividends declared.
Answer: TRUE
Explanation: These are the main components shown in the statement of stockholders' equity, summarizing changes in the owners' equity accounts.
Diff: 2
LO: 1-3

11) What does the statement of stockholders' equity primarily report?
A) Changes in equity accounts, including investments, dividends, and net income
B) The company's revenues, expenses, and profit for the current period
C) The company's total cash inflows and outflows during the year
D) The company's total assets, liabilities, and equity at a point in time
Answer: A
Explanation: The statement of stockholders' equity summarizes changes in the ownership section of the balance sheet, showing how net income, investments, and dividends affect total equity.
Diff: 2
LO: 1-3

12) Retained Earnings are best described as which of the following?
A) The company's total cash remaining after all debts are paid
B) The cumulative profits a company has kept after distributing dividends
C) The total stock issued to shareholders during the fiscal year
D) The revenues earned from ongoing business operations
Answer: B
Explanation: Retained Earnings represent the accumulated profits that have not been distributed to shareholders as dividends.
Diff: 2
LO: 1-3

13) Which of the following actions would most likely decrease Retained Earnings?
A) Issuing additional shares of common stock
B) Earning revenues that exceed expenses for the year
C) Declaring and paying dividends to shareholders
D) Retiring outstanding bonds payable
Answer: C
Explanation: Paying off or retiring bonds does not directly affect retained earnings; however, dividends declared reduce retained earnings, showing a decrease in accumulated profit.
Diff: 3
LO: 1-3

14) How does the income statement connect to the statement of stockholders' equity?
A) Net income from the income statement increases Retained Earnings.
B) Retained Earnings determine the company's total revenue for the year.
C) Dividends declared appear as expenses on the income statement.
D) The income statement reports equity changes for the fiscal period.
Answer: A
Explanation: Net income from the income statement flows into retained earnings on the statement of stockholders' equity, increasing total equity.
Diff: 1
LO: 1-3

15) Which of the following statements correctly describes dividends?
A) Dividends are recorded as a business expense that reduces profit.
B) Dividends have no impact on the retained earnings account.
C) Dividends reduce retained earnings after net income has been calculated.
D) Dividends are subtracted from total assets to determine net income.
Answer: C
Explanation: Dividends are not expenses; they are distributions of profit that reduce retained earnings after the calculation of net income.
Diff: 2
LO: 1-3

16) When a company is in a rapid growth stage, it most likely will:
A) increase the amount of dividends paid to shareholders each quarter.
B) repurchase shares of its own stock to increase Retained Earnings.
C) borrow additional funds to replace Retained Earnings.
D) retain profits to reinvest in expansion rather than pay dividends.
Answer: D
Explanation: Companies focused on growth typically keep their earnings to reinvest in operations instead of distributing them as dividends.
Diff: 3
LO: 1-3

17) An accumulated deficit in Retained Earnings means that:
A) the company's total assets are less than its total liabilities.
B) the company's cumulative losses have exceeded its cumulative profits.
C) the company has issued more stock than it has repurchased.
D) the company's retained earnings balance is higher than total equity.
Answer: B
Explanation: An accumulated deficit occurs when a company has experienced more losses than profits over time, resulting in negative retained earnings.
Diff: 2
LO: 1-3

18) Why are dividends not considered expenses?
A) They are subtracted from revenue before profit is determined.
B) They are treated as a liability owed to shareholders before taxes.
C) They are distributions of profit, not costs incurred to earn revenue.
D) They are included as a part of cost of goods sold.
Answer: C
Explanation: Dividends are distributions to shareholders and not operating expenses used to generate revenue.
Diff: 3
LO: 1-3

19) The ending balance of Retained Earnings represents:
A) the cumulative profit retained after deducting dividends to date.
B) the company's total income earned during the most recent quarter.
C) the total amount of capital contributed by shareholders.
D) the company's total net cash position for the year.
Answer: A
Explanation: Ending retained earnings reflect the cumulative profits that have been kept in the company after paying dividends.
Diff: 2
LO: 1-3

20) Where is the ending balance of Retained Earnings reported?
A) On the income statement as part of total revenue
B) On the statement of cash flows under financing activities
C) On the trial balance as an asset account
D) On the balance sheet in the stockholders' equity section
Answer: D
Explanation: The ending retained earnings balance from the statement of stockholders' equity appears in the stockholders' equity section of the balance sheet.
Diff: 2
LO: 1-3

21) On January 1, 20x1, a company's Retained Earnings were $420,000. During the year, it earned net income of $95,000 and declared Dividends of $25,000. What is Retained Earnings at December 31, 20x1?
A) $480,000
B) $540,000
C) $490,000
D) $500,000
Answer: C
Explanation: Retained Earnings = $420,000 + $95,000 − $25,000 = $490,000.
Diff: 2
LO: 1-3

22) At the beginning of 20x1, Retained Earnings were $360,000. During the year ended December 31, 20x1, the company earned $110,000 in net income and paid $40,000 in Dividends. What is the ending Retained Earnings balance?
A) $430,000
B) $420,000
C) $410,000
D) $400,000
Answer: A
Explanation: Retained Earnings = $360,000 + $110,000 − $40,000 = $430,000.
Diff: 2
LO: 1-3

23) A company began 20x1 with Retained Earnings of $520,000. It reported net income of $140,000 and declared Dividends of $30,000. What is the Retained Earnings balance at December 31, 20x1?
A) $620,000
B) $640,000
C) $610,000
D) $630,000
Answer: D
Explanation: Retained Earnings = $520,000 + $140,000 − $30,000 = $630,000.
Diff: 2
LO: 1-3

24) A company has beginning Retained Earnings of $275,000 on January 1, 20x1. If it earns $125,000 in net income and pays Dividends of $35,000, what will be the Retained Earnings on December 31, 20x1?
A) $365,000
B) $370,000
C) $375,000
D) $380,000
Answer: A
Explanation: Retained Earnings = $275,000 + $125,000 − $35,000 = $365,000.
Diff: 2
LO: 1-3

25) On January 1, 20x1, a company's Retained Earnings were $800,000. During 20x1, it reported net income of $120,000 and declared Dividends totaling $50,000. What is the Retained Earnings balance at year-end?
A) $850,000
B) $870,000
C) $860,000
D) $880,000
Answer: B
Explanation: Retained Earnings = $800,000 + $120,000 − $50,000 = $870,000.
Diff: 2
LO: 1-3

26) A company had beginning Retained Earnings of $310,000 at January 1, 20x1. During the year, it reported a net income of $75,000 and declared dividends of $25,000. What is the ending Retained Earnings?
A) $355,000
B) $410,000
C) $365,000
D) $360,000
Answer: D
Explanation: Retained Earnings = $310,000 + $75,000 − $25,000 = $360,000.
Diff: 2
LO: 1-3

27) Retained Earnings at the start of 20x1 were $600,000. The company earned net income of $90,000 during 20x1 and declared Dividends of $40,000. What is the ending Retained Earnings balance at December 31, 20x1?
A) $650,000
B) $640,000
C) $630,000
D) $620,000
Answer: A
Explanation: Retained Earnings = $600,000 + $90,000 − $40,000 = $650,000.
Diff: 2
LO: 1-3

28) A company begins the year 20x1 with Retained Earnings of $900,000. During the year, the company earns $80,000 in net income and declares Dividends of $60,000. What is the retained earnings balance at December 31, 20x1?
A) $910,000
B) $940,000
C) $920,000
D) $930,000
Answer: C
Explanation: Retained Earnings = $900,000 + $80,000 − $60,000 = $920,000.
Diff: 2
LO: 1-3

29) A corporation reports beginning Retained Earnings of $450,000 at January 1, 20x1. Net income during the year is $120,000, and Dividends declared total $70,000. What is Retained Earnings on December 31, 20x1?
A) $490,000
B) $520,000
C) $510,000
D) $500,000
Answer: D
Explanation: Retained Earnings = $450,000 + $120,000 − $70,000 = $500,000.
Diff: 2
LO: 1-3

30) A company reports Retained Earnings of $320,000 at January 1, 20x1. During the year, the company incurs a net income of $85,000 and declares Dividends of $30,000. What is the Retained Earnings balance at December 31, 20x1?
A) $370,000
B) $375,000
C) $380,000
D) $385,000
Answer: B
Explanation: Retained Earnings = $320,000 + $85,000 − $30,000 = $375,000.
Diff: 2
LO: 1-3

31) A manager argues that dividends should be treated as an expense because they reduce the company's profit. Which statement most effectively weakens this argument?
A) Dividends are part of operating costs associated with generating revenue.
B) Dividends are distributions of profit, not expenses incurred in operations.
C) Dividends reduce profit before net income is calculated.
D) Dividends are paid only when the company experiences a loss.
Answer: B
Diff: 2
LO: 1-3

32) A student claims that the statement of stockholders' equity is unnecessary because the balance sheet already shows total equity. Which of the following best challenges this reasoning?
A) The balance sheet and the statement of stockholders' equity report identical information.
B) The balance sheet explains only ending balances, not the changes that occurred during the period.
C) The income statement fully replaces the statement of stockholders' equity.
D) The statement of stockholders' equity explains the changes in equity during the period.
Answer: D
Diff: 2
LO: 1-3

33) An analyst concludes that a company with a positive Retained Earnings balance has never had a net loss. Which of the following best identifies the flaw in this reasoning?
A) A company may have had losses in some years but profits large enough in others to offset them.
B) A company with positive Retained Earnings cannot report Dividends.
C) Retained Earnings cannot change once a loss is recorded.
D) The statement of stockholders' equity does not include net losses.
Answer: A
Diff: 2
LO: 1-3

34) A manager asserts that dividends automatically decrease a company's total equity by the full amount declared. Which statement most directly supports this claim?
A) Dividends are declared by management and only decrease retained earnings, not contributed capital.
B) Dividends are recorded as liabilities until paid, not as equity reductions.
C) Dividends affect retained earnings directly, which is a part of total equity and thus reduces total equity by the same amount.
D) Dividends reduce net income directly on the income statement.
Answer: C
Diff: 3
LO: 1-3

35) A student claims that Retained Earnings equal the company's total cash balance. Which statement best refutes this claim?
A) Retained Earnings appear in the asset section of the balance sheet.
B) Cash is reduced by dividends, while Retained Earnings are not.
C) Cash always matches the amount of accumulated profit reported.
D) Retained Earnings include noncash profits accumulated over time.
Answer: D
Diff: 3
LO: 1-3

36) An investor argues that companies with an accumulated deficit cannot recover financially. Which point most effectively weakens this conclusion?
A) A deficit means the company's assets exceed its liabilities.
B) A company cannot earn income once a deficit has occurred.
C) Future profits can offset past losses, eliminating a deficit over time.
D) A deficit means the company is legally required to liquidate.
Answer: C
Diff: 2
LO: 1-3

37) A student claims that dividends must always be paid if the company earns a profit. Which reasoning best challenges this claim?
A) Management may choose to retain profits for growth rather than distribute dividends.
B) Dividends are required only when there is a large amount of cash available.
C) Profits can only be distributed as dividends when the board is dissolved.
D) Dividends are always paid before the calculation of Retained Earnings.
Answer: A
Diff: 2
LO: 1-3

38) An analyst concludes that a company's statement of stockholders' equity can be prepared without using data from the income statement. Which of the following most directly weakens this claim?
A) The income statement reports the dividends paid each year.
B) The statement of stockholders' equity records only stockholder contributions.
C) The statement of stockholders' equity requires the balance of cash accounts.
D) Net income from the income statement flows into Retained Earnings on the statement of stockholders' equity.
Answer: D
Diff: 2
LO: 1-3

39) Which of the following, if true, would most strengthen the argument that Retained Earnings reflect long-term profitability?
A) Retained Earnings accumulate profits and losses over multiple years.
B) Retained Earnings are recalculated each month.
C) Retained Earnings include only revenues from the current year.
D) Retained Earnings are affected only by stockholder investments.
Answer: A
Diff: 2
LO: 1-3

40) A student asserts that paying dividends increases a company's stockholders' equity because shareholders receive cash. Which of the following best refutes this argument?
A) Dividends are not recorded as expenses but still decrease total equity.
B) Dividends reduce Retained Earnings, decreasing total stockholders' equity.
C) Dividends are paid before Retained Earnings are calculated.
D) Dividends are included in net income and increase profitability.
Answer: B
Diff: 2
LO: 1-3

41) An accountant claims that Retained Earnings can never be negative. Which statement most directly challenges this reasoning?
A) Retained Earnings are always positive when dividends are paid.
B) Companies may choose to transfer losses directly to contributed capital.
C) Retained Earnings must be reset to zero every fiscal year.
D) If a company's cumulative losses exceed cumulative profits, Retained Earnings become negative.
Answer: D
Diff: 2
LO: 1-3

42) A manager concludes that dividends should always be declared because they motivate shareholders. Which point best identifies the weakness in this reasoning?
A) Companies must balance dividend payments with their need to retain funds for future investment.
B) Dividends are unrelated to shareholder satisfaction or expectations.
C) Dividends must be declared regardless of profitability.
D) Companies can only declare dividends when revenues are declining.
Answer: A
Diff: 2
LO: 1-3

43) A student believes that the statement of stockholders' equity and the income statement report identical information. Which of the following best refutes this belief?
A) The income statement reports net income, while the statement of stockholders' equity shows changes in equity accounts.
B) Both statements report the same results using different formats.
C) The statement of stockholders' equity reports the company's assets, while the income statement reports liabilities.
D) Both statements report changes in cash balances over time.
Answer: A
Diff: 2
LO: 1-3

44) A company's board decides not to declare dividends despite earning a high profit. Which statement best explains this decision?
A) The company is legally required to retain all profits.
B) Retained Earnings can only be used to repay debts.
C) The company intends to reduce total equity through future dividends.
D) The company plans to reinvest profits into future growth or expansion.
Answer: D
Diff: 2
LO: 1-3

45) A student concludes that Retained Earnings will always equal total stockholders' equity. Which reasoning most effectively challenges this conclusion?
A) Retained Earnings are unrelated to the equity section of the balance sheet.
B) Stockholders' equity includes other components, such as contributed capital.
C) Retained Earnings are reduced only by losses and not by dividends.
D) Total stockholders' equity consists only of Retained Earnings from prior years.
Answer: B
Diff: 2
LO: 1-3

46) Explain how the statement of stockholders' equity connects the income statement and the balance sheet, and discuss why this connection is important for understanding a company's financial performance.
Answer: The statement of stockholders' equity shows how equity changes during an accounting period due to net income, dividends, and stockholder investments.
Net income from the income statement increases retained earnings, while dividends declared decrease Retained Earnings.
The ending Retained Earnings balance from this statement is carried over to the stockholders' equity section of the balance sheet.
This connection ensures that financial statements are interrelated and provide a complete picture of a company's financial health.
By linking profitability with ownership equity, users can evaluate how earnings are used–either to reinvest in the company or to distribute to shareholders.
Diff: 3
LO: 1-3

47) Discuss the concept of Retained Earnings and describe the factors that cause Retained Earnings to increase or decrease over time.
Answer: Retained Earnings represent the cumulative amount of profits a company has kept after paying dividends to shareholders.
Retained Earnings increase when a company earns net income and chooses to reinvest profits instead of distributing them.
Retained Earnings decrease when a company experiences net losses or declares dividends to shareholders.
An accumulated deficit occurs when total losses and dividends exceed total profits, resulting in negative Retained Earnings.
Retained earnings reveal how much profit has been reinvested into the business, providing insight into management's long-term growth strategy.
Diff: 3
LO: 1-3

48) A company began the year on January 1, 20x1, with Retained Earnings of $950,000. During the year, it earned revenues of $1,200,000 and incurred expenses of $975,000. The company declared and paid dividends of $100,000 to its shareholders. At the end of the year, the company also issued new stock for $150,000.
Required:
A) Compute the company's net income for the year.
B) Determine the ending Retained Earnings on December 31, 20x1.
C) Explain how the results would appear on the statement of stockholders' equity.
Answer:
A) Net income = Revenues − Expenses = $1,200,000 − $975,000 = $225,000
B) Ending Retained Earnings = Beginning Retained Earnings + Net income − Dividends
= $950,000 + $225,000 − $100,000 = $1,075,000
C) On the statement of stockholders' equity:
— The $225,000 net income increases Retained Earnings.
— The $100,000 dividends reduce Retained Earnings.
— The $150,000 stock issuance increases common stock and total equity.
Diff: 2
LO: 1-3

49) A corporation reports the following information for the fiscal year ended December 31, 20x1:
Beginning Retained Earnings: $600,000
Net income: $180,000
Dividends declared: $75,000
Stock issued during the year: $90,000
At the end of the year, the company's total stockholders' equity equals $1,200,000.
Required:
A) Calculate the ending Retained Earnings.
B) Determine how much of total equity is contributed capital (stock issued) and how much is Retained Earnings.
C) Explain how dividends and net income affected Retained Earnings.
Answer:
A) Ending Retained Earnings = Beginning Retained Earnings + Net income − Dividends
= $600,000 + $180,000 − $75,000 = $705,000
B) Contributed capital (from stock issued) = $90,000
Total equity = Contributed capital + Retained Earnings = $90,000 + $705,000 = $795,000
(Other components of equity not provided make up the remaining $405,000 to reach total equity.)
C) Net income increases Retained Earnings by $180,000.
Dividends decrease Retained Earnings by $75,000.
Stock issuance affects contributed capital but does not change Retained Earnings.
Diff: 3
LO: 1-3

Learning Objective 1-4

1) The balance sheet reports a company's financial position as of a specific date.
Answer: TRUE
Explanation: The balance sheet provides a snapshot of a company's assets, liabilities, and equity at a specific point in time.
Diff: 1
LO: 1-4

2) The balance sheet reports information covering a period of time, such as one fiscal year.
Answer: FALSE
Explanation: Unlike the income statement, the balance sheet reports balances at a single point in time, not over a period.
Diff: 1
LO: 1-4

3) Assets are the resources a company owns that are expected to provide future benefits.
Answer: TRUE
Explanation: Assets represent economic resources such as cash, inventory, and property that will generate future value.
Diff: 1
LO: 1-4

4) Liabilities represent the owners' claims on the business.
Answer: FALSE
Explanation: Liabilities are outsider claims–debts owed to creditors and others outside the business.
Diff: 1
LO: 1-4

5) Stockholders' equity represents the residual interest in the company after liabilities are subtracted from assets.
Answer: TRUE
Explanation: Stockholders' equity shows the portion of assets remaining for owners once debts have been paid.
Diff: 1
LO: 1-4

6) The accounting equation is expressed as Assets = Liabilities + Equity.
Answer: TRUE
Explanation: This equation forms the foundation of the balance sheet and must always remain in balance.
Diff: 1
LO: 1-4

7) Stockholders' equity includes both Retained Earnings and common stock.
Answer: TRUE
Explanation: Equity consists of owners' contributions (common stock) and cumulative retained earnings or losses.
Diff: 1
LO: 1-4

8) The balance sheet is also known as the statement of cash flows.
Answer: FALSE
Explanation: The balance sheet is called the statement of financial position, not the statement of cash flows.
Diff: 1
LO: 1-4

9) The balance sheet and the accounting equation must always balance, meaning total assets equal total liabilities and equity.
Answer: TRUE
Explanation: The balance sheet reflects the accounting equation, which ensures both sides are equal.
Diff: 1
LO: 1-4

10) Retained Earnings on the balance sheet represent cash available for distribution to shareholders.
Answer: FALSE
Explanation: Retained Earnings show cumulative profits kept in the business, not necessarily the cash available for dividends.
Diff: 2
LO: 1-4

11) Which of the following best describes the purpose of the balance sheet?
A) To show revenues and expenses for a period of time
B) To report cash inflows and outflows during a year
C) To present assets, liabilities, and equity as of a specific date
D) To summarize Retained Earnings changes during a period
Answer: C
Explanation: The balance sheet presents a company's financial position–its assets, liabilities, and equity–on a particular date.
Diff: 2
LO: 1-4

12) The balance sheet is also referred to as which of the following?
A) The statement of Retained earnings
B) The statement of cash flows
C) The statement of operations
D) The statement of financial position
Answer: D
Explanation: The balance sheet is known as the statement of financial position because it shows the company's financial standing at a point in time.
Diff: 2
LO: 1-4

13) What does stockholders' equity represent?
A) Total debts owed to outsiders of the company
B) The total value of assets owned by creditors
C) The total resources of a company available to creditors
D) The residual interest of owners after liabilities are deducted
Answer: D
Explanation: Stockholders' equity represents the portion of assets that remain after all liabilities have been paid.
Diff: 2
LO: 1-4

14) Which of the following best defines assets?
A) Resources a company owns that are expected to provide future benefits
B) Claims of outsiders and owners against a business
C) Costs incurred during normal business operations
D) Distributions made to shareholders from profits
Answer: A
Explanation: Assets are resources that a business owns and expects to yield future economic benefits.
Diff: 2
LO: 1-4

15) Which of the following is included in stockholders' equity?
A) Long-term debts and obligations to outsiders
B) Notes payable and accrued liabilities
C) Common stock and retained earnings
D) Prepaid expenses and intangible assets
Answer: C
Explanation: Stockholders' equity includes the owners' initial investments (common stock) and accumulated Retained Earnings.
Diff: 2
LO: 1-4

16) What fundamental relationship does the balance sheet represent?
A) Assets = Liabilities + Stockholders' Equity
B) Assets − Liabilities = Revenue + Expenses
C) Cash = Stockholders' Equity − Liabilities
D) Assets = Liabilities − Stockholders' Equity
Answer: A
Explanation: The accounting equation forms the structure of the balance sheet: assets equal liabilities plus stockholders' equity.
Diff: 1
LO: 1-4

17) Which of the following describes liabilities?
A) Resources a company owns that generate income
B) Debts or obligations owed to outsiders or creditors
C) Residual interests held by stockholders in a company
D) Future benefits expected from company-owned property
Answer: B
Explanation: Liabilities are debts owed to external parties, representing creditors' claims on company assets.
Diff: 2
LO: 1-4

18) What ensures that the balance sheet is always balanced?
A) The matching of revenues and expenses each period
B) The inclusion of dividends in Retained Earnings
C) The accounting equation must always remain in equilibrium
D) The calculation of total income from operations
Answer: C
Explanation: The balance sheet must balance because total assets always equal total liabilities plus stockholders' equity.
Diff: 2
LO: 1-4

19) Which statement correctly describes the timing of the balance sheet?
A) It reports financial information as of a specific date, not over a time period.
B) It covers the same time frame as the income statement.
C) It summarizes a company's cash activity during a fiscal year.
D) It presents equity changes for a defined accounting period.
Answer: A
Explanation: The balance sheet reports balances on a particular date, unlike other financial statements that cover a period.
Diff: 2
LO: 1-4

20) What is another name for stockholders' equity in a sole proprietorship?
A) Common capital or partnership equity
B) Owners' equity or capital account
C) Retained income or residual balance
D) Contributed profit or net asset value
Answer: B
Explanation: In a sole proprietorship, stockholders' equity is referred to as owners' equity or capital.
Diff: 2
LO: 1-4

21) On December 31, 20x1, a company reports total assets of $920,000 and total liabilities of $550,000. What is total stockholders' equity as of that date?
A) $360,000
B) $1,470,000
C) $380,000
D) $370,000
Answer: D
Explanation: Assets = Liabilities + Equity, so Equity = $920,000 − $550,000 = $370,000.
Diff: 1
LO: 1-4

22) A company's balance sheet on December 31, 20x1, shows total liabilities of $460,000 and total stockholders' equity of $290,000. What is the total amount of assets?
A) $730,000
B) $740,000
C) $750,000
D) $760,000
Answer: C
Explanation: Assets = Liabilities + Equity = $460,000 + $290,000 = $750,000.
Diff: 1
LO: 1-4

23) On December 31, 20x1, total assets are $880,000 and total stockholders' equity is $340,000. What are total liabilities?
A) $540,000
B) $550,000
C) $560,000
D) $570,000
Answer: A
Explanation: Liabilities = Assets − Equity = $880,000 − $340,000 = $540,000.
Diff: 1
LO: 1-4

24) At December 31, 20x1, a company's total liabilities are $620,000 and total equity is $230,000. What is the total amount of assets?
A) $850,000
B) $840,000
C) $830,000
D) $820,000
Answer: A
Explanation: Assets = Liabilities + Equity = $620,000 + $230,000 = $850,000.
Diff: 1
LO: 1-4

25) A business reports total assets of $700,000 and total stockholders' equity of $280,000 on December 31, 20x1. What are total liabilities?
A) $410,000
B) $420,000
C) $430,000
D) $440,000
Answer: B
Explanation: Liabilities = Assets − Equity = $700,000 − $280,000 = $420,000.
Diff: 1
LO: 1-4

26) On December 31, 20x1, a company has assets of $960,000 and liabilities of $650,000. What is the amount of stockholders' equity?
A) $300,000
B) $1,610,000
C) $320,000
D) $310,000
Answer: D
Explanation: Equity = Assets − Liabilities = $960,000 − $650,000 = $310,000.
Diff: 1
LO: 1-4

27) At year-end 20x1, total assets are $550,000 and total liabilities are $330,000. What is total stockholders' equity?
A) $220,000
B) $230,000
C) $240,000
D) $250,000
Answer: A
Explanation: Equity = Assets − Liabilities = $550,000 − $330,000 = $220,000.
Diff: 1
LO: 1-4

28) On December 31, 20x1, total stockholders' equity is $310,000 and total liabilities are $590,000. What is total assets?
A) $880,000
B) $890,000
C) $900,000
D) $910,000
Answer: C
Explanation: Assets = Liabilities + Equity = $590,000 + $310,000 = $900,000.
Diff: 1
LO: 1-4

29) A company reports total assets of $875,000 and total liabilities of $455,000 at December 31, 20x1. What is total stockholders' equity?
A) $1,330,000
B) $430,000
C) $440,000
D) $420,000
Answer: D
Explanation: Equity = Assets − Liabilities = $875,000 − $455,000 = $420,000.
Diff: 1
LO: 1-4

30) As of December 31, 20x1, a company reports total liabilities of $300,000 and total stockholders' equity of $180,000. What is total assets?
A) $470,000
B) $480,000
C) $490,000
D) $500,000
Answer: B
Explanation: Assets = Liabilities + Equity = $300,000 + $180,000 = $480,000.
Diff: 1
LO: 1-4

31) A student claims that because the balance sheet lists revenues and expenses, it measures company performance over time. Which statement best identifies the flaw in this reasoning?
A) The balance sheet reports cash activity, not performance.
B) The balance sheet records data from the income statement.
C) The balance sheet reports financial position at a single point in time, not over a period.
D) The balance sheet summarizes changes in Retained Earnings.
Answer: C
Diff: 2
LO: 1-4

32) A manager argues that liabilities represent the owners' claims on company assets. Which statement most directly challenges this argument?
A) Liabilities are assets that the company plans to sell in the future.
B) Liabilities are resources owned by the company's investors.
C) Liabilities represent profits retained by the business.
D) Liabilities are obligations to outsiders that must be repaid.
Answer: D
Diff: 2
LO: 1-4

33) An accountant concludes that stockholders' equity represents what a company owes to its creditors. Which statement best challenges this reasoning?
A) Stockholders' equity represents the residual interest of owners after liabilities are deducted from assets.
B) Stockholders' equity includes liabilities such as long-term debts.
C) Stockholders' equity measures total revenues minus total expenses.
D) Stockholders' equity includes accounts payable and accrued expenses.
Answer: A
Diff: 2
LO: 1-4

34) A student claims that assets are equal to liabilities minus stockholders' equity. Which statement most effectively refutes this claim?
A) The accounting equation actually states that assets equal liabilities minus equity.
B) Assets are unrelated to liabilities and equity.
C) Assets equal liabilities plus stockholders' equity, not liabilities minus equity.
D) The balance sheet records assets as separate from both liabilities and equity.
Answer: C
Diff: 2
LO: 1-4

35) An investor concludes that because a company has large assets, it must also have large equity. Which statement best challenges this conclusion?
A) The accounting equation ensures assets always exceed liabilities.
B) Assets are not influenced by borrowing.
C) Large assets can result from financing with high liabilities, not necessarily from high equity.
D) The balance sheet cannot show equity when liabilities are high.
Answer: C
Diff: 3
LO: 1-4

36) A student argues that Common Stock and Retained Earnings are both types of liabilities. Which statement most directly weakens this argument?
A) Retained Earnings are temporary accounts.
B) Common Stock and Retained Earnings are components of stockholders' equity, not liabilities.
C) Liabilities represent owners' residual claims on the business.
D) Retained Earnings reduce the amount of total equity reported.
Answer: B
Diff: 2
LO: 1-4

37) A manager claims that the balance sheet is less important than the income statement because it does not show company profitability. Which statement most effectively weakens this argument?
A) The balance sheet provides crucial information about resources and obligations at a specific date.
B) The balance sheet replaces the statement of cash flows for internal reporting.
C) The balance sheet provides profitability data over several years.
D) The balance sheet reports only short-term transactions.
Answer: A
Diff: 2
LO: 1-4

38) A student claims that the balance sheet and the income statement report the same type of information. Which statement most directly refutes this claim?
A) The balance sheet shows cash inflows and outflows for a period.
B) The income statement measures net income, while the balance sheet lists only expenses.
C) Both statements use the same accounts for revenue and expenses.
D) The balance sheet reports assets, liabilities, and equity at a point in time, while the income statement measures net income over a period.
Answer: D
Diff: 3
LO: 1-4

39) Which of the following, if true, would most strengthen the argument that the balance sheet is fundamental to understanding a company's financial health?
A) It provides information about what the company owns and owes at a specific point in time.
B) It reports only the company's revenues and expenses over a fiscal year.
C) It shows net income but not dividends declared.
D) It eliminates the need to prepare an income statement.
Answer: A
Diff: 2
LO: 1-4

40) A student concludes that equity will remain unchanged if a company repays part of its liabilities using its assets. Which statement most effectively supports this reasoning?
A) The accounting equation changes when liabilities are repaid.
B) Using assets to pay liabilities decreases both equally, leaving equity unchanged.
C) Paying liabilities always increases retained earnings.
D) Using assets to pay liabilities decreases equity by the same amount.
Answer: B
Diff: 2
LO: 1-4

41) A manager argues that assets always increase when liabilities increase. Which statement most directly challenges this claim?
A) Assets and liabilities cannot change simultaneously.
B) Assets and liabilities move independently and may not always increase together.
C) The accounting equation ensures liabilities and equity remain constant.
D) Assets may decrease or remain unchanged even if liabilities increase.
Answer: D
Diff: 3
LO: 1-4

42) A student asserts that Retained Earnings are listed among a company's liabilities. Which statement most directly refutes this reasoning?
A) Retained Earnings are included in stockholders' equity, not in liabilities.
B) Retained Earnings appear as part of current liabilities on the balance sheet.
C) Retained Earnings are only reported on the income statement.
D) Retained Earnings are subtracted from total assets to determine total equity.
Answer: A
Diff: 2
LO: 1-4

43) Which of the following would most weaken the claim that assets and liabilities are unrelated?
A) The accounting equation shows that assets are financed through liabilities and equity.
B) Assets and liabilities are separate accounts that do not interact.
C) Liabilities are recorded only when assets are sold.
D) Liabilities are calculated by subtracting assets from equity.
Answer: A
Diff: 2
LO: 1-4

44) A company's accountant argues that the balance sheet can be accurate even if total assets are not equal to total liabilities and stockholders' equity. Which statement best challenges this claim?
A) The accounting equation requires total assets to equal total liabilities and equity.
B) A company can present the balance sheet without equity amounts.
C) Equity can remain constant even if assets and liabilities change.
D) The balance sheet can vary depending on reporting practices.
Answer: A
Diff: 2
LO: 1-4

45) Which of the following statements best explains why the balance sheet is called the statement of financial position?
A) It reports cash flow activities for a given period.
B) It summarizes revenues and expenses for the fiscal year.
C) It presents a company's assets, liabilities, and equity at a specific date.
D) It measures financial performance over time.
Answer: C
Diff: 2
LO: 1-4

46) Explain the purpose of the balance sheet and discuss how it differs from other financial statements in what it communicates to users.
Answer: The balance sheet, also called the statement of financial position, reports a company's assets, liabilities, and equity as of a specific date.
It provides a snapshot of the company's financial position at one point in time rather than over a period.
Assets show the resources a company controls that are expected to generate future benefits.
Liabilities represent debts or obligations to creditors–outsider claims on the company's assets.
Stockholders' equity reflects the residual or insider claims after liabilities have been paid.
The balance sheet differs from other statements because it does not show performance or cash flow activity, but rather the cumulative results of all prior activities.
This information helps users evaluate a company's financial strength and its ability to meet obligations and support future operations.
Diff: 3
LO: 1-4

47) Describe the accounting equation and explain how it ensures the balance sheet remains balanced.
Answer: The accounting equation is Assets = Liabilities + Stockholders' Equity.
It expresses the relationship between a company's resources and the claims to those resources.
Assets represent what the company owns or controls; liabilities are creditor claims; and equity represents owners' residual claims.
Every transaction affects at least two elements of the equation, maintaining balance between both sides.
For example, when a company borrows money, both assets (cash) and liabilities (debt) increase by the same amount.
The equality of this equation ensures that the balance sheet always balances and provides a logical framework for recording financial information accurately.
By maintaining this relationship, the accounting equation forms the foundation of the double-entry accounting system.
Diff: 2
LO: 1-4

48) A company reports the following balances as of December 31, 20x1: cash $150,000; Accounts Receivable $120,000; Inventory $90,000; Equipment $240,000; Accounts Payable $80,000; Notes Payable $100,000; and Common Stock $200,000.
Required:
A) Compute total assets, total liabilities, and total stockholders' equity.
B) Verify that the accounting equation is in balance.
Answer:
A) Total assets = Cash + Accounts receivable + Inventory + Equipment
= $150,000 + $120,000 + $90,000 + $240,000 = $600,000
Total liabilities = Accounts payable + Notes payable
= $80,000 + $100,000 = $180,000
Stockholders' equity = Assets − Liabilities
= $600,000 − $180,000 = $420,000
B) Verification: Assets ($600,000) = Liabilities ($180,000) + Equity ($420,000) → $600,000 = $600,000. The accounting equation balances.
Diff: 2
LO: 1-4

49) As of December 31, 20x2, a company's balance sheet shows total assets of $980,000 and total liabilities of $630,000. During the year, the company issued $150,000 of new common stock and retained $50,000 of its net income in the business after paying dividends.
Required:
A) Calculate stockholders' equity at December 31, 20x1 (the beginning of the year).
B) Determine total stockholders' equity at December 31, 20x2.
Answer:
Step 1: Compute stockholders' equity at December 31, 20x2
Stockholders' equity = Assets − Liabilities = $980,000 − $630,000 = $350,000.
Step 2: Determine beginning stockholders' equity (before current-year changes)
Beginning equity = Ending equity − New stock issued − Increase from retained income
= $350,000 − $150,000 − $50,000 = $150,000.
Therefore, stockholders' equity increased from $150,000 at the beginning of 20x2 to $350,000 at year-end due to new stock issued and retained income.
Diff: 3
LO: 1-4

Learning Objective 1-5

1) The statement of cash flows summarizes how a company's cash resources were generated and used during a period.
Answer: TRUE
Explanation: The statement of cash flows shows cash inflows and outflows from operating, investing, and financing activities during the reporting period.
Diff: 1
LO: 1-5

2) The statement of cash flows reports financial position as of a specific date.
Answer: FALSE
Explanation: Unlike the balance sheet, the statement of cash flows reports activities over a period of time.
Diff: 1
LO: 1-5

3) Cash receipts and payments are classified into operating, investing, and financing activities on the statement of cash flows.
Answer: TRUE
Explanation: The statement categorizes cash flows into these three main types to show how cash was obtained and spent.
Diff: 1
LO: 1-5

4) Operating activities include buying and selling long-term assets such as equipment and buildings.
Answer: FALSE
Explanation: Investing activities involve long-term asset transactions, not operating activities.
Diff: 1
LO: 1-5

5) Operating activities are generally considered the most important source of cash for a company.
Answer: TRUE
Explanation: Operating cash flows reflect the company's core business performance and its ability to generate cash internally.
Diff: 1
LO: 1-5

6) Investing activities include transactions related to long-term assets that a company expects to use for more than one year.
Answer: TRUE
Explanation: Investing activities involve buying and selling long-term assets such as property, plant, and equipment.
Diff: 1
LO: 1-5

7) Financing activities include receiving cash from customers for sales.
Answer: FALSE
Explanation: Customer receipts are part of operating activities, not financing activities.
Diff: 1
LO: 1-5

8) Paying dividends to shareholders is classified as an operating activity.
Answer: FALSE
Explanation: Dividend payments are considered financing activities because they represent cash outflows to owners.
Diff: 1
LO: 1-5

9) The ending cash balance on the statement of cash flows must match the ending cash balance on the balance sheet.
Answer: TRUE
Explanation: The two statements are connected through the ending cash balance, ensuring consistency across financial statements.
Diff: 1
LO: 1-5

10) All business transactions affect only one financial statement at a time.
Answer: FALSE
Explanation: Many transactions affect multiple financial statements because of the interconnections among them.
Diff: 1
LO: 1-5

11) The statement of cash flows primarily provides information about:
A) a company's profitability during the period.
B) the amount of equity issued during the year.
C) the company's assets and liabilities at year-end.
D) how cash was generated and used during the reporting period.
Answer: D
Explanation: The statement of cash flows reports cash inflows and outflows from operating, investing, and financing activities over a specific period.
Diff: 2
LO: 1-5

12) Which of the following activities is classified as an investing activity on the statement of cash flows?
A) Paying salaries to employees
B) Purchasing or selling long-term assets
C) Issuing common stock to investors
D) Receiving payments from customers
Answer: B
Explanation: Investing activities involve cash flows related to the acquisition and disposal of long-term assets.
Diff: 2
LO: 1-5

13) Which type of activity on the statement of cash flows includes transactions such as issuing stock or repaying borrowed funds?
A) Operating activities
B) Investing activities
C) Financing activities
D) Nonrecurring activities
Answer: C
Explanation: Financing activities involve raising and repaying capital through stock issuance, loans, or dividends.
Diff: 2
LO: 1-5

14) Which type of activity on the statement of cash flows is generally considered the most important?
A) Operating activities
B) Investing activities
C) Financing activities
D) Supplementary activities
Answer: A
Explanation: Operating activities represent the core business operations and should be the main source of cash generation.
Diff: 2
LO: 1-5

15) The cash flows related to buying or selling long-term assets are included in which section of the statement of cash flows?
A) Operating activities
B) Financing activities
C) Investing activities
D) Operating adjustments
Answer: C
Explanation: Investing activities involve cash used for or received from buying and selling long-term assets held for more than one year.
Diff: 2
LO: 1-5

16) Which of the following correctly connects the statement of cash flows to another financial statement?
A) The ending cash balance on the statement of cash flows matches the cash balance on the balance sheet.
B) The beginning cash balance equals total stockholders' equity.
C) Cash dividends declared appear on the income statement.
D) Cash inflows from financing appear on the statement of retained earnings.
Answer: A
Explanation: The ending cash balance reported on the statement of cash flows must agree with the cash balance reported on the balance sheet.
Diff: 2
LO: 1-5

17) Which of the following transactions would be classified as a financing activity?
A) Purchasing a piece of equipment
B) Paying dividends to shareholders
C) Paying suppliers for inventory
D) Selling goods to customers
Answer: B
Explanation: Paying dividends is a financing activity because it involves returning funds to the company's owners.
Diff: 2
LO: 1-5

18) Which type of activity would include the repayment of borrowed funds to a lender?
A) Operating activity
B) Investing activity
C) Noncash activity
D) Financing activity
Answer: D
Explanation: Repaying borrowed funds is a financing activity since it relates to debt management and company funding.
Diff: 2
LO: 1-5

19) Which statement best explains the relationship among the financial statements?
A) The statement of cash flows connects to the balance sheet through the ending cash balance.
B) The income statement reports ending Retained Earnings, which links to the balance sheet.
C) The statement of cash flows connects to the income statement through total revenues.
D) The balance sheet connects to the income statement through dividends paid.
Answer: A
Explanation: The statement of cash flows ends with a cash balance that must match the cash account reported on the balance sheet.
Diff: 2
LO: 1-5

20) Which of the following best describes the purpose of categorizing cash flows into operating, investing, and financing activities?
A) To simplify the preparation of the balance sheet
B) To separate retained earnings from net income
C) To explain how cash was generated and used by type of business activity
D) To eliminate noncash transactions from reporting
Answer: C
Explanation: Categorizing cash flows by type of activity helps users understand how different business operations contribute to cash inflows and outflows.
Diff: 2
LO: 1-5

21) A company's statement of cash flows for the year ended December 31, 20x1, reports cash inflows from operating activities of $650,000 and cash outflows from operating activities of $400,000. What is the net cash flow from operating activities?
A) $230,000
B) $250,000
C) $260,000
D) $270,000
Answer: B
Explanation: Net cash flow from operating activities = $650,000 − $400,000 = $250,000.
Diff: 2
LO: 1-5

22) During 20x1, a company purchased long-term equipment for $180,000 and sold old equipment for $50,000. What is the net cash flow from investing activities for the year ended December 31, 20x1?
A) $110,000 inflow
B) $120,000 outflow
C) $130,000 inflow
D) $130,000 outflow
Answer: D
Explanation: Net cash flow from investing activities = $50,000 inflow − $180,000 outflow = ($130,000) net outflow.
Diff: 2
LO: 1-5

23) A company reports an increase in cash of $95,000 during the year ended December 31, 20x1. It had beginning cash of $325,000 on January 1, 20x1. What is the ending cash balance on December 31, 20x1?
A) $420,000
B) $410,000
C) $405,000
D) $400,000
Answer: A
Explanation: Ending cash = Beginning cash + Increase in cash = $325,000 + $95,000 = $420,000.
Diff: 2
LO: 1-5

24) A company's cash flows include $480,000 from operations, ($250,000) from investing, and $90,000 from financing for the year ended December 31, 20x1. What is the total change in cash for the year?
A) $290,000
B) $300,000
C) $320,000
D) $330,000
Answer: C
Explanation: Net change in cash = $480,000 − $250,000 + $90,000 = $320,000.
Diff: 3
LO: 1-5

25) For the year ended December 31, 20x1, a company reports net cash inflow from operating activities of $310,000, cash outflow from investing activities of $210,000, and cash outflow from financing activities of $40,000. What is the net increase in cash?
A) $50,000
B) $60,000
C) $70,000
D) $80,000
Answer: B
Explanation: Net increase in cash = $310,000 − $210,000 − $40,000 = $60,000.
Diff: 3
LO: 1-5

26) A company had beginning cash of $540,000 on January 1, 20x1. During the year, total cash inflows were $900,000, and total cash outflows were $700,000. What is the ending cash balance on December 31, 20x1?
A) $730,000
B) $740,000
C) $750,000
D) $760,000
Answer: B
Explanation: Ending cash = $540,000 + $900,000 − $700,000 = $740,000.
Diff: 3
LO: 1-5

27) The statement of cash flows shows cash inflows from financing activities of $400,000 and cash outflows from financing activities of $250,000 for the year ended December 31, 20x1. What is the net cash flow from financing activities?
A) $150,000
B) $140,000
C) $130,000
D) $120,000
Answer: A
Explanation: Net cash flow from financing = $400,000 − $250,000 = $150,000.
Diff: 2
LO: 1-5

28) A company reports cash inflows from operations of $700,000, cash outflows from investing of $500,000, and cash inflows from financing of $80,000 for the year ended December 31, 20x1. What is the total change in cash for the year?
A) $250,000
B) $260,000
C) $280,000
D) $300,000
Answer: C
Explanation: Net change in cash = $700,000 − $500,000 + $80,000 = $280,000.
Diff: 3
LO: 1-5

29) During the year ended December 31, 20x1, a company reported an increase in cash from operating activities of $350,000, a decrease in cash from investing activities of $500,000, and an increase in cash from financing activities of $200,000. What is the overall change in cash?
A) $40,000 decrease
B) $30,000 increase
C) $20,000 decrease
D) $50,000 decrease
Answer: D
Explanation: Net change in cash = $350,000 − $500,000 + $200,000 = ($50,000) net decrease.
Diff: 3
LO: 1-5

30) A company begins the year with cash of $600,000. It reports a net cash inflow from operations of $320,000, a cash outflow from investing of $150,000, and a cash outflow from financing of $120,000 for the year ended December 31, 20x1. What is the ending cash balance?
A) $630,000
B) $650,000
C) $660,000
D) $670,000
Answer: B
Explanation: Ending cash = $600,000 + $320,000 − $150,000 − $120,000 = $650,000.
Diff: 3
LO: 1-5

31) A student claims that a company with positive net income will always have an increase in cash. Which statement best challenges this reasoning?
A) Net income does not always result in higher cash because non-cash items and timing differences affect cash flow.
B) A positive net income automatically increases the balance of cash on the balance sheet.
C) Companies record expenses only when cash is spent, ensuring income equals cash flow.
D) Net income and cash flow from financing are identical measures.
Answer: A
Diff: 2
LO: 1-5

32) A manager argues that investing activities must always increase a company's cash balance. Which statement best refutes this claim?
A) Investing activities only record gains, not losses.
B) Investing activities often involve cash outflows for purchasing long-term assets, which decrease cash.
C) Investing activities are unrelated to the company's cash position.
D) Investing activities are included under financing rather than in a separate section.
Answer: B
Diff: 2
LO: 1-5

33) An analyst concludes that financing activities have no impact on a company's total cash flow. Which of the following most directly challenges this conclusion?
A) Financing activities include issuing stock and repaying loans, both of which affect cash flow.
B) Financing activities are noncash transactions that appear only on the income statement.
C) Financing activities affect equity, not cash, so they are omitted from cash flow reporting.
D) Financing activities record only Retained Earnings and net income.
Answer: A
Diff: 2
LO: 1-5

34) A student argues that operating activities are less important than investing activities because they do not involve long-term assets. Which statement most effectively weakens this reasoning?
A) Investing activities are temporary and depend on short-term operations.
B) Operating activities record only cash outflows from financing transactions.
C) Operating activities have no effect on the company's cash balance.
D) Operating activities are the primary source of cash and reflect the company's core business performance.
Answer: D
Diff: 2
LO: 1-5

35) Which of the following statements, if true, would most weaken the claim that financing activities always produce cash inflows?
A) Financing activities include issuing stock to investors.
B) Financing activities are based on shareholder decisions only.
C) Financing activities include paying dividends or repaying borrowed funds, which are cash outflows.
D) Financing activities appear only when operating cash is negative.
Answer: C
Diff: 2
LO: 1-5

36) A student concludes that the statement of cash flows is unnecessary because the income statement already reports profits. Which statement best challenges this argument?
A) The income statement and the statement of cash flows are both based on cash transactions only.
B) The statement of cash flows reveals how cash actually moves, while the income statement measures profitability using accrual accounting.
C) The statement of cash flows only duplicates balance sheet totals.
D) The statement of cash flows is required only for nonprofit organizations.
Answer: B
Diff: 2
LO: 1-5

37) A manager believes that all cash inflows represent income. Which statement most directly refutes this reasoning?
A) All cash inflows are recorded as assets rather than income.
B) Income includes only cash inflows from financing activities.
C) Cash inflows can result from activities such as borrowing or selling assets, which are not income.
D) Income and cash inflows always occur in the same accounting period.
Answer: C
Diff: 2
LO: 1-5

38) A student claims that paying dividends increases cash flow because it rewards shareholders. Which statement most effectively challenges this conclusion?
A) Dividends are included under operating activities, not financing activities.
B) Paying dividends always results in an inflow of cash from investors.
C) Dividends are deducted from net income before cash is calculated.
D) Paying dividends is a financing cash outflow that reduces the company's cash balance.
Answer: D
Diff: 2
LO: 1-5

39) Which of the following, if true, would most strengthen the idea that the statement of cash flows connects with the balance sheet?
A) The ending cash balance on the statement of cash flows matches the cash account on the balance sheet.
B) The beginning retained earnings balance appears in both reports.
C) The income statement is used to prepare both documents.
D) Both reports are prepared for the same period but show unrelated information.
Answer: A
Diff: 2
LO: 1-5

40) A manager argues that selling equipment is an operating activity. Which statement best refutes this claim?
A) Selling equipment is unrelated to long-term investment activity.
B) Selling equipment is an investing activity because it involves long-term assets.
C) Selling equipment is a financing activity because it provides cash to owners.
D) Selling equipment is recorded as revenue in the income statement.
Answer: B
Diff: 2
LO: 1-5

41) An analyst claims that every cash inflow from financing activities increases a company's profits. Which of the following statements most directly weakens this argument?
A) Financing cash inflows are always offset by operating cash outflows.
B) Financing activities affect cash, but they do not necessarily affect net income.
C) Financing inflows include only dividends paid to shareholders.
D) Financing activities appear only on the balance sheet and are excluded from profits.
Answer: D
Diff: 3
LO: 1-5

42) A student concludes that purchasing equipment increases both cash and equity. Which statement best identifies the flaw in this reasoning?
A) Purchasing equipment is recorded as an investing outflow, decreasing cash but not equity.
B) Purchasing equipment reduces liabilities but not equity.
C) Purchasing equipment increases assets and decreases cash or increases liabilities or both.
D) Purchasing equipment always affects the income statement directly.
Answer: C
Diff: 3
LO: 1-5

43) Which of the following, if true, would most strengthen the argument that operating activities are the best indicator of financial health?
A) Operating cash flow shows whether a company can generate enough cash from its core business to sustain itself.
B) Operating cash flow includes only nonrecurring investment transactions.
C) Operating cash flow is calculated from total equity, not revenues.
D) Operating cash flow reflects only noncash adjustments for depreciation.
Answer: A
Diff: 2
LO: 1-5

44) A student argues that the cash balance on the statement of cash flows can differ from the cash reported on the balance sheet. Which statement most effectively weakens this argument?
A) The statement of cash flows uses a different accounting equation than the balance sheet.
B) The balance sheet reports total cash inflows only.
C) The statement of cash flows is based on the same cash balance that appears on the balance sheet.
D) The balance sheet shows Retained Earnings rather than cash balances.
Answer: B
Diff: 2
LO: 1-5

45) A manager asserts that cash inflows from investing activities always represent profits. Which statement best challenges this conclusion?
A) Profits arise from revenues and expenses, while investing cash inflows come from selling long-term assets.
B) Investing cash inflows are recorded as part of the company's Retained Earnings.
C) Investing cash inflows are treated as liabilities on the balance sheet.
D) Investing cash inflows always include dividends paid to shareholders.
Answer: A
Diff: 3
LO: 1-5

46) Explain the purpose of the statement of cash flows and describe how it helps users understand a company's financial health.
Answer: The statement of cash flows shows how cash was generated and used during a specific accounting period.
It separates cash flows into three categories–operating, investing, and financing activities–to show different sources and uses of cash.
Operating activities relate to day-to-day operations, such as cash received from customers and cash paid to suppliers.
Investing activities involve buying and selling long-term assets that the company uses to generate future income.
Financing activities involve obtaining and repaying funds from owners and creditors, such as issuing stock or paying dividends.
The statement of cash flows complements the income statement and balance sheet by explaining changes in cash and helping users assess liquidity, solvency, and long-term viability.
Diff: 3
LO: 1-5

47) Discuss how the statement of cash flows connects to the other three financial statements and why this connection is important.
Answer: The four financial statements are interrelated, and the statement of cash flows ties them together through the cash account.
Net income from the income statement affects retained earnings on the statement of stockholders' equity.
The ending Retained Earnings balance then appears in the stockholders' equity section of the balance sheet.
The ending cash balance from the statement of cash flows must match the cash reported on the balance sheet.
This linkage ensures consistency and accuracy across all financial statements.
By connecting all four statements, users can trace how transactions affect profitability, equity, and cash position, gaining a complete picture of financial performance and stability.
Diff: 3
LO: 1-5

48) A company provides the following cash activity for the year ended December 31, 20x1: cash received from customers $1,020,000; cash paid to suppliers and employees $760,000; interest paid $10,000; income taxes paid $35,000; cash paid to acquire equipment $240,000; cash received from sale of an old machine $30,000; cash received from issuing common stock $150,000; cash paid to repay bank borrowing $80,000; cash dividends paid $40,000. Beginning cash on January 1, 20x1, was $275,000.
Required:
A) Compute net cash provided (used) by operating, investing, and financing activities.
B) Compute the net change in cash for 20x1 and the ending cash balance at December 31, 20x1.
C) Briefly comment on whether operations were a source or use of cash.
Answer:
A) Operating cash flows = Cash received from customers − Cash paid to suppliers/employees − Interest paid − Income taxes paid
= $1,020,000 − $760,000 − $10,000 − $35,000 = $215,000 (source).
Investing cash flows = Proceeds from sale of machine − Purchase of equipment
= $30,000 − $240,000 = ($210,000) (use).
Financing cash flows = Proceeds from issuing stock − Debt repayment − Dividends paid
= $150,000 − $80,000 − $40,000 = $30,000 (source).
B) Net change in cash = Operating + Investing + Financing
= $215,000 + (−$210,000) + $30,000 = $35,000 increase.
Ending cash = Beginning cash + Net change = $275,000 + $35,000 = $310,000.
C) Operating activities were a net source of cash ($215,000), consistent with the goal that operations should provide cash.
Diff: 3
LO: 1-5

49) For the year ended December 31, 20x1, a company reports these cash transactions: cash paid for inventory and operating costs $690,000; cash collected from customers $845,000; cash received from sale of a long-term investment $55,000; cash paid to acquire long-term assets $180,000; cash received from new borrowing $200,000; cash paid to retire bonds $90,000; cash dividends paid $25,000. Cash at January 1, 20x1, was $360,000.
Required:
A) Classify each item as operating, investing, or financing and compute the net cash flow for each section.
B) Compute the net change in cash and ending cash at December 31, 20x1.
C) If the balance sheet at December 31, 20x1, reports cash of $475,000, does it reconcile to your statement of cash flows? Show the check.
Answer:
A) Operating: Cash collected from customers − Cash paid for inventory/operating costs
= $845,000 − $690,000 = $155,000 (source).
Investing: Proceeds from sale of long-term investment − Purchases of long-term assets
= $55,000 − $180,000 = ($125,000) (use).
Financing: New borrowing − Bond retirement − Dividends paid
= $200,000 − $90,000 − $25,000 = $85,000 (source).
B) Net change in cash = $155,000 + (−$125,000) + $85,000 = $115,000 increase.
Ending cash = Beginning cash + Net change = $360,000 + $115,000 = $475,000.
C) Ending cash from statement of cash flows $475,000 equals balance sheet cash $475,000, so the linkage is confirmed.
Diff: 3
LO: 1-5

Learning Objective 1-6

1) ESG stands for environmental, social, and governance.
Answer: TRUE
Explanation: ESG is an acronym for environmental, social, and governance, representing three key areas of sustainable and ethical business practices.
Diff: 1
LO: 1-6

2) The environmental component of ESG focuses primarily on employee well-being and community engagement.
Answer: FALSE
Explanation: The environmental component deals with how a company manages its impact on the environment, such as waste management and resource use.
Diff: 1
LO: 1-6

3) The social aspect of ESG includes labor practices, diversity, and community involvement.
Answer: TRUE
Explanation: The social dimension emphasizes how a company manages relationships with employees, customers, suppliers, and communities.
Diff: 1
LO: 1-6

4) Governance refers to how a company interacts with the public and handles environmental conservation.
Answer: FALSE
Explanation: Governance focuses on internal policies, board structure, ethical conduct, and transparency in company management.
Diff: 1
LO: 1-6

5) The term Corporate Social Responsibility (CSR) refers to ideas similar to those covered by ESG.
Answer: TRUE
Explanation: CSR, like ESG, addresses sustainability, ethical practices, and community engagement.
Diff: 1
LO: 1-6

6) Integrated reporting combines financial and non-financial information to provide a comprehensive view of how a company creates value.
Answer: TRUE
Explanation: Integrated reporting links financial and sustainability information to show how organizations build value over time.
Diff: 1
LO: 1-6

7) The Global Reporting Initiative (GRI) is the least widely used framework for ESG reporting.
Answer: FALSE
Explanation: GRI is currently the most widely used global framework for ESG reporting.
Diff: 1
LO: 1-6

8) ESG reporting is standardized globally under one universally accepted framework.
Answer: FALSE
Explanation: There is no single universal ESG framework, which makes comparison between companies difficult.
Diff: 1
LO: 1-6

9) Third-party assurance of ESG reports increases confidence in the accuracy of a company's disclosures.
Answer: TRUE
Explanation: Independent verification of ESG information enhances the credibility and reliability of the report.
Diff: 1
LO: 1-6

10) Accountants have little involvement in ESG reporting because it does not include financial data.
Answer: FALSE
Explanation: Accountants play a key role in ESG reporting by ensuring accuracy, compliance, and credibility in sustainability disclosures.
Diff: 1
LO: 1-6

11) Which of the following best describes ESG?
A) A financial reporting method used for measuring cash flow
B) A government regulation requiring tax reporting
C) A framework for managing a company's accounting procedures
D) A set of criteria assessing environmental, social, and governance practices
Answer: D
Explanation: ESG stands for environmental, social, and governance, and evaluates companies on sustainability and ethical performance.
Diff: 2
LO: 1-6

12) Which component of ESG focuses on how a company manages relationships with employees, suppliers, and communities?
A) Governance
B) Social
C) Environmental
D) Financial
Answer: B
Explanation: The social aspect of ESG covers labor practices, diversity, human rights, and community engagement.
Diff: 2
LO: 1-6

13) The environmental component of ESG includes which of the following activities?
A) Managing waste and energy use to reduce environmental impact
B) Determining executive compensation and shareholder rights
C) Overseeing employee benefits and work-life balance programs
D) Managing customer relationships and loyalty programs
Answer: A
Explanation: The environmental component focuses on how the company manages its effect on the natural environment.
Diff: 1
LO: 1-6

14) Governance practices in ESG primarily relate to:
A) a company's internal controls, board structure, and ethical standards.
B) a company's use of renewable energy and waste management.
C) a company's treatment of suppliers and customers.
D) a company's total profitability and cash management.
Answer: A
Explanation: Governance addresses the internal systems of oversight and accountability, including ethical conduct and transparency.
Diff: 2
LO: 1-6

15) Which of the following terms emphasizes similar ideas to ESG by focusing on people, planet, and profit?
A) Regulatory accounting
B) Value creation model
C) Triple Bottom Line
D) Financial benchmarking
Answer: C
Explanation: The Triple Bottom Line (TBL) approach emphasizes balancing people, planet, and profit–principles aligned with ESG.
Diff: 2
LO: 1-6

16) What is the main purpose of integrated reporting?
A) To replace financial statements with ESG reports
B) To eliminate the need for external auditing
C) To focus exclusively on corporate profits
D) To combine financial and non-financial data to show overall value creation
Answer: D
Explanation: Integrated reporting links sustainability and financial results to show how a company creates value over time.
Diff: 2
LO: 1-6

17) Which ESG reporting framework is the most widely used by organizations worldwide?
A) International Accounting Standards Board (IASB)
B) Global Reporting Initiative (GRI)
C) United Nations Sustainable Goals Framework (UNSG)
D) Financial Stability Oversight Council (FSOC)
Answer: B
Explanation: The Global Reporting Initiative (GRI) is currently the most commonly used framework for ESG reporting.
Diff: 2
LO: 1-6

18) Why is it difficult to compare ESG reports across companies?
A) Companies rarely disclose environmental information.
B) ESG data is restricted to private organizations only.
C) There is no single, universally accepted ESG reporting framework.
D) ESG reports are prepared only for internal management.
Answer: C
Explanation: The lack of a global standard leads companies to use different frameworks, reducing comparability between reports.
Diff: 2
LO: 1-6

19) How do accountants contribute to ESG reporting?
A) By ensuring that ESG information is accurate, transparent, and compliant with reporting standards
B) By making investment decisions for companies based on ESG data
C) By preparing tax returns that include ESG-related deductions
D) By establishing executive compensation based on ESG scores
Answer: A
Explanation: Accountants play a key role in ensuring the credibility and accuracy of ESG reports through expertise in reporting and compliance.
Diff: 1
LO: 1-6

20) What is the purpose of third-party assurance in ESG reporting?
A) To replace a company's internal audit department
B) To create industry-wide performance rankings
C) To reduce a company's costs associated with sustainability reporting.
D) To verify that ESG disclosures are accurate and consistent with reporting standards
Answer: D
Explanation: Third-party assurance provides independent verification, improving the credibility and reliability of ESG information for stakeholders.
Diff: 2
LO: 1-6

21) A company spent \$420,000 in 20x1 on environmental improvements and saved \$140,000 in reduced waste disposal costs. What is the company's net environmental cost for 20x1?
A) \$250,000
B) \$260,000
C) \$270,000
D) \$280,000
Answer: D
Explanation: Net environmental cost = \$420,000 − \$140,000 = \$280,000.
Diff: 2
LO: 1-6

22) In 20x1, a company invested \$500,000 in renewable energy projects and expects annual savings of \$100,000 starting in 20x2. How many years will it take to recover the initial investment through savings?
A) 3 years
B) 5 years
C) 6 years
D) 7 years
Answer: B
Explanation: Payback period = \$500,000 ÷ \$100,000 = 5 years.
Diff: 2
LO: 1-6

23) A company donates \$75,000 to community programs and spends an additional \$25,000 on employee volunteer initiatives in 20x1. If its total social investment budget is \$120,000, what percent of the budget has been used?
A) 75%
B) 80%
C) 83%
D) 85%
Answer: C
Explanation: Percent used = (\$75,000 + \$25,000) ÷ \$120,000 × 100 = 83%.
Diff: 1
LO: 1-6

24) During 20x2, a company reduces energy consumption by 12% from its 20x1 level of 500,000 kilowatt-hours. What is its energy use in 20x2?
A) 440,000 kilowatt-hours
B) 445,000 kilowatt-hours
C) 450,000 kilowatt-hours
D) 460,000 kilowatt-hours
Answer: A
Explanation: 20x2 energy use = 500,000 × (1 − 0.12) = 440,000 kilowatt-hours.
Diff: 2
LO: 1-6

25) A company's greenhouse gas emissions were 900 metric tons in 20x1 and 720 metric tons in 20x2. What is the percentage reduction in emissions from 20x1 to 20x2?
A) 15%
B) 18%
C) 20%
D) 22%
Answer: C
Explanation: Reduction = (900 − 720) ÷ 900 × 100 = 20%.
Diff: 2
LO: 1-6

26) In 20x1, a company's total waste generated was 400 tons, and it successfully recycled 280 tons. What percentage of its waste was recycled?
A) 70%
B) 65%
C) 60%
D) 55%
Answer: A
Explanation: Percent recycled = (280 ÷ 400) × 100 = 70%.
Diff: 2
LO: 1-6

27) A company's governance budget for 20x1 is $300,000, including $120,000 for compliance, $80,000 for audit costs, and the remainder for training programs. How much is allocated to training?
A) $90,000
B) $100,000
C) $110,000
D) $120,000
Answer: B
Explanation: Training = $300,000 − ($120,000 + $80,000) = $100,000.
Diff: 1
LO: 1-6

28) In 20x2, a company reports total ESG-related spending of $750,000, with 45% spent on environmental efforts, 35% on social initiatives, and the remainder on governance. How much was spent on governance?
A) $130,000
B) $140,000
C) $160,000
D) $150,000
Answer: D
Explanation: Governance = $750,000 × (1 − 0.45 − 0.35) = $750,000 × 0.20 = $150,000.
Diff: 2
LO: 1-6

29) A firm's social responsibility investments increased from $240,000 in 20x1 to $300,000 in 20x2. What is the percentage increase?
A) 25%
B) 20%
C) 18%
D) 15%
Answer: A
Explanation: Increase = (300,000 − 240,000) ÷ 240,000 × 100 = 25%.
Diff: 2
LO: 1-6

30) A company's sustainability department spent $480,000 on ESG programs during 20x2, broken down as follows: 40% environmental, 35% social, and 25% governance. How much was spent on governance initiatives?
A) $192,000
B) $130,000
C) $120,000
D) $140,000
Answer: C
Explanation: Governance = $480,000 × 0.25 = $120,000.
Diff: 1
LO: 1-6

31) A manager claims that ESG practices are only about protecting the environment. Which statement most effectively challenges this claim?
A) ESG focuses solely on energy use and waste management.
B) ESG addresses financial performance without considering ethics.
C) ESG excludes governance and social responsibility.
D) ESG also includes social and governance factors, such as employee welfare and ethical conduct.
Answer: D
Diff: 2
LO: 1-6

32) A student argues that governance has no connection to sustainability. Which statement most directly refutes this argument?
A) Governance focuses only on product design and innovation.
B) Governance ensures ethical practices, transparency, and accountability, which support sustainability.
C) Governance reports are not considered part of ESG disclosures.
D) Governance applies only to companies in the manufacturing industry.
Answer: B
Diff: 2
LO: 1-6

33) An investor concludes that a company's social practices have no impact on its reputation. Which statement most effectively challenges this conclusion?
A) Social practices include activities like product pricing and advertising.
B) Social practices affect only internal employee relations, not external stakeholders.
C) Poor social practices, such as unsafe labor conditions, can harm a company's public image and trust.
D) Social practices are primarily designed to reduce tax expenses.
Answer: C
Diff: 2
LO: 1-6

34) A student claims that ESG practices are optional and provide no benefits to companies. Which statement most directly weakens this claim?
A) Investors increasingly use ESG criteria to evaluate a company's long-term potential.
B) ESG activities are unrelated to investor decision-making.
C) ESG reporting is required for all businesses globally.
D) ESG frameworks only apply to nonprofit organizations.
Answer: A
Diff: 2
LO: 1-6

35) A company claims that ESG reports are consistent across all firms because one global framework exists. Which of the following best refutes this claim?
A) ESG reports are identical because they follow a universal format.
B) All companies rely on a single standard from the International Sustainability Standards Board.
C) Companies use different frameworks, making ESG reports difficult to compare.
D) Companies must use only the Global Reporting Initiative framework.
Answer: C
Diff: 2
LO: 1-6

36) A manager asserts that environmental reporting is unrelated to company performance. Which reasoning most effectively challenges this assertion?
A) Environmental actions, such as efficient resource use, can reduce costs and improve operations.
B) Environmental reports are completed separately from other business reports.
C) Environmental reporting is required only in the government sector.
D) Environmental reports focus only on short-term profits.
Answer: A
Diff: 2
LO: 1-6

37) A student believes that the term "Corporate Social Responsibility" has no relationship to ESG. Which statement best refutes this belief?
A) Corporate Social Responsibility refers only to environmental concerns.
B) Corporate Social Responsibility and ESG both promote ethical, sustainable, and community-focused business practices.
C) Corporate Social Responsibility focuses solely on executive compensation.
D) Corporate Social Responsibility is a government program separate from ESG principles.
Answer: B
Diff: 2
LO: 1-6

38) A company argues that accountants are not needed in ESG reporting because it does not involve financial data. Which statement most effectively refutes this argument?
A) Accountants are only responsible for internal auditing and budgeting.
B) Accountants track ESG data only for tax purposes.
C) Accountants oversee daily operations unrelated to reporting.
D) Accountants ensure ESG disclosures are accurate, transparent, and compliant with reporting standards.
Answer: D
Diff: 2
LO: 1-6

39) Which of the following, if true, would most strengthen the argument that third-party assurance enhances investor confidence in ESG reports?
A) Third-party assurance verifies that the company's ESG data meets accepted standards.
B) Investors rely exclusively on financial statements, not ESG disclosures.
C) Third-party reviewers have no impact on stakeholder trust.
D) ESG reports are not influenced by external evaluations.
Answer: A
Diff: 2
LO: 1-6

40) A student concludes that ESG and the Triple Bottom Line represent entirely different ideas. Which statement best challenges this conclusion?
A) Both focus on balancing people, planet, and profit for long-term value creation.
B) ESG includes only social and governance principles, not environmental ones.
C) The Triple Bottom Line measures only profits rather than social impacts.
D) ESG deals exclusively with internal company processes.
Answer: A
Diff: 2
LO: 1-6

41) A critic argues that ESG reports cannot be trusted because there is no way to verify the information. Which statement most weakens this argument?
A) ESG reporting is optional for all companies.
B) Independent third-party assurance can verify the accuracy of ESG information.
C) Companies never disclose ESG data to the public.
D) Investors ignore companies' ESG reports when making decisions.
Answer: B
Diff: 2
LO: 1-6

42) A manager believes that only large multinational companies should report on ESG performance. Which reasoning best refutes this claim?
A) ESG frameworks can be adapted to organizations of any size or type.
B) ESG reporting applies only to public corporations listed on stock exchanges.
C) ESG standards are enforced only in the energy industry.
D) ESG reporting is limited to companies with more than 500 employees.
Answer: A
Diff: 3
LO: 1-6

43) Which of the following statements, if true, would most weaken the claim that ESG reporting has no effect on investor decisions?
A) Investors are increasingly analyzing ESG performance to assess risk and long-term sustainability.
B) ESG data are unrelated to financial performance or corporate governance.
C) ESG information cannot be integrated with financial data.
D) Investors only review past profits when making decisions.
Answer: C
Diff: 3
LO: 1-6

44) A student asserts that integrated reporting only benefits management and not investors. Which statement most effectively challenges this claim?
A) Integrated reporting provides financial and non-financial information useful to both management and investors.
B) Integrated reporting focuses exclusively on internal policies and governance controls.
C) Integrated reporting is a confidential tool not shared publicly.
D) Integrated reporting is used only for government compliance purposes.
Answer: A
Diff: 3
LO: 1-6

45) A manager concludes that governance has little relevance to ethical business conduct. Which statement most directly refutes this conclusion?
A) Governance includes ethical conduct, transparency, and accountability, all of which influence ethical business behavior.
B) Governance applies only to companies with strong environmental records.
C) Governance focuses on operations rather than management oversight.
D) Governance eliminates the need for board supervision and compliance.
Answer: A
Diff: 2
LO: 1-6

46) Explain why environmental, social, and governance (ESG) practices are increasingly important for companies and investors.
Answer: ESG practices provide a broader assessment of company performance by addressing sustainability and ethical conduct in addition to financial outcomes.
The environmental component focuses on how a company manages its impact on the planet through waste reduction, pollution control, and resource conservation.
The social component emphasizes fair treatment of employees, suppliers, and communities, including diversity, inclusion, and safety.
The governance component ensures that companies operate transparently with strong internal controls, ethical leadership, and accountability to stakeholders.
Investors consider ESG information when evaluating long-term stability and risk, as sustainable and responsible practices often lead to improved reputation and financial resilience.
ESG practices build stakeholder trust and support sustainable value creation over the long term.
Diff: 3
LO: 1-6

47) Discuss the challenges and benefits of ESG reporting and describe the role of accountants in ensuring reliable ESG disclosures.
Answer: ESG reporting allows companies to communicate their sustainability goals, risks, and achievements, but challenges arise due to the absence of a single global reporting standard.
Companies often rely on multiple frameworks, such as the Global Reporting Initiative (GRI) and the Task Force on Climate-related Financial Disclosures (TCFD), which can make comparisons difficult.
The credibility of ESG reports can be questioned without third-party assurance or verification.
Accountants play a key role by applying their expertise in measurement, data integrity, and compliance to improve the accuracy and transparency of ESG disclosures.
Their involvement helps ensure consistency between financial and non-financial information.
Reliable ESG reporting strengthens investor confidence, enhances corporate reputation, and supports decision-making focused on long-term sustainability.
Diff: 3
LO: 1-6

48) A company plans its ESG program for the year ended December 31, 20x1, with a total budget of $1,200,000 allocated across pillars as follows: Environmental 50%, Social 30%, Governance 20%. For 20x2, management increases the total ESG budget by 8% while keeping the same allocation percentages. Within the Environmental pillar for 20x1, the company funds two initiatives: (i) Energy efficiency at $300,000 that generates annual cash savings of $90,000 beginning January 1, 20x2; and (ii) Waste reduction at $120,000 that generates annual cash savings of $36,000 beginning January 1, 20x2.
Required:
A) Calculate dollar allocations by pillar for 20x1.
B) Calculate the total ESG budget for 20x2.
C) Calculate the 20x2 Governance budget.
D) Calculate the simple payback (in years) for each Environmental initiative.
E) Calculate the ratio of combined annual savings from the two initiatives (effective in 20x2) to the 20x1 Environmental spend (as a percentage).
Answer:
A) 20x1 allocations:
— Environmental = $1,200,000 × 50% = $600,000
— Social = $1,200,000 × 30% = $360,000
— Governance = $1,200,000 × 20% = $240,000
B) 20x2 total ESG budget = $1,200,000 × 1.08 = $1,296,000
C) 20x2 Governance = $1,296,000 × 20% = $259,200
D) Simple payback:
— Energy efficiency = $300,000 ÷ $90,000 = 3.33 years
— Waste reduction = $120,000 ÷ $36,000 = 3.33 years
E) Combined annual savings (start 20x2) = $90,000 + $36,000 = $126,000; 20x1 Environmental spend = $600,000; Percentage = ($126,000 ÷ $600,000) × 100 = 21.0%
Diff: 3
LO: 1-6

49) For ESG targets and reporting over 20x1−20x2, a company tracks the following:
Greenhouse gas emissions: 1,000 metric tons in 20x1; 780 metric tons in 20x2.
Social investments: $250,000 in 20x1; $325,000 in 20x2.
Governance outlays in 20x2 total $180,000, comprising Board oversight/training $60,000, Ethics/compliance $45,000, and Transparency/disclosure $75,000.
The company's total ESG spend in 20x2 is $1,400,000. It obtains third-party assurance on its ESG report at a fee equal to 1.5% of total ESG spend.
Required:
A) Calculate the percentage reduction in emissions from 20x1 to 20x2.
B) Calculate the percentage increase in social investments from 20x1 to 20x2.
C) Within Governance for 20x2, calculate each category as a percent of Governance total.
D) Calculate the third-party assurance fee (in $) for 20x2.
E) Calculate Governance as a percent of total ESG spend in 20x2.
Answer:
A) Emissions reduction % = (1,000 − 780) ÷ 1,000 × 100 = 22.0%
B) Social increase % = ($325,000 − $250,000) ÷ $250,000 × 100 = 30.0%
C) Governance category shares (base $180,000):
— Board oversight/training = $60,000 ÷ $180,000 × 100 = 33.3%
— Ethics/compliance = $45,000 ÷ $180,000 × 100 = 25.0%
— Transparency/disclosure = $75,000 ÷ $180,000 × 100 = 41.7%
D) Assurance fee = $1,400,000 × 1.5% = $21,000
E) Governance % of total ESG (20x2) = $180,000 ÷ $1,400,000 × 100 = 12.9%
Diff: 3
LO: 1-6

Learning Objective 1-7

1) Accounting is a dynamic field that involves collaboration, decision-making, and problem-solving, not just working with numbers.
Answer: TRUE
Explanation: Accounting includes strategic analysis, communication, and teamwork across various organizational areas.
Diff: 1
LO: 1-7

2) Accountants mainly work in isolation and have little interaction with other departments within a company.
Answer: FALSE
Explanation: Accountants regularly collaborate with multiple teams to support business decisions and ensure financial accuracy.
Diff: 1
LO: 1-7

3) External auditors work for public accounting firms and evaluate companies' financial records for accuracy and compliance.
Answer: TRUE
Explanation: External auditors provide independent assurance that financial statements are accurate and comply with regulations.
Diff: 1
LO: 1-7

4) Internal auditors focus exclusively on preparing external financial statements for shareholders.
Answer: FALSE
Explanation: Internal auditors assess internal processes, identify risks, and recommend improvements rather than preparing external reports.
Diff: 1
LO: 1-7

5) Management accountants provide internal financial analysis and guidance to help improve company performance.
Answer: TRUE
Explanation: Management accountants analyze financial data to support internal decision-making, budgeting, and strategic planning.
Diff: 1
LO: 1-7

6) Tax accountants help individuals and businesses comply with tax laws and minimize tax liabilities.
Answer: TRUE
Explanation: Tax accountants prepare tax returns, ensure compliance, and assist with strategic tax planning.
Diff: 1
LO: 1-7

7) Earning a professional accounting certification has little impact on career advancement or earning potential.
Answer: FALSE
Explanation: Professional certifications greatly enhance career opportunities, credibility, and salary prospects.
Diff: 1
LO: 1-7

8) The Certified Public Accountant (CPA) certification requires passing an exam and meeting experience and licensing requirements.
Answer: TRUE
Explanation: The CPA credential involves the Uniform CPA Exam, relevant work experience, and obtaining a state license.
Diff: 1
LO: 1-7

9) The Certified Management Accountant (CMA) certification focuses mainly on auditing and public accounting services.
Answer: FALSE
Explanation: The CMA emphasizes internal financial management, planning, and strategic decision-making.
Diff: 2
LO: 1-7

10) The Certified Fraud Examiner (CFE) designation focuses on detecting and preventing fraudulent activity within organizations.
Answer: TRUE
Explanation: CFEs specialize in fraud prevention, detection, and investigation, ensuring organizations maintain ethical and legal standards.
Diff: 2
LO: 1-7

11) Which of the following best describes why accounting is considered a dynamic profession?
A) It involves communication, analysis, and decision-making across multiple business areas.
B) It is limited to recording transactions and preparing financial statements.
C) It primarily focuses on repetitive mathematical calculations.
D) It rarely changes and requires minimal adaptation to new standards.
Answer: A
Explanation: Accounting is an evolving field that requires analytical, communication, and strategic decision-making skills.
Diff: 2
LO: 1-7

12) Which of the following professionals reviews business processes and identifies areas of risk within an organization?
A) External auditor
B) Internal auditor
C) Management accountant
D) Tax accountant
Answer: B
Explanation: Internal auditors evaluate internal operations to identify risks and recommend process improvements.
Diff: 2
LO: 1-7

13) Which of the following professionals provides independent assurance that a company's financial statements are accurate and comply with regulations?
A) Management accountant
B) Tax accountant
C) Budget analyst
D) External auditor
Answer: D
Explanation: External auditors are employed by public accounting firms to ensure that company records meet legal and regulatory standards.
Diff: 2
LO: 1-7

14) Which of the following roles focuses primarily on analyzing financial data to support internal decision-making and performance improvement?
A) Management accountant
B) Tax accountant
C) Internal auditor
D) External auditor
Answer: A
Explanation: Management accountants use internal financial data to guide management in achieving strategic objectives.
Diff: 2
LO: 1-7

15) What is the primary focus of a tax accountant?
A) Internal auditing and risk control
B) Preparing budgets and forecasts
C) Preparing tax returns and providing tax planning advice
D) Evaluating long-term investment strategies
Answer: C
Explanation: Tax accountants ensure compliance with tax laws, prepare tax returns, and advise on tax-saving opportunities.
Diff: 2
LO: 1-7

16) Which certification focuses on preventing, detecting, and investigating fraudulent activities?
A) Certified Internal Auditor (CIA)
B) Chartered Global Management Accountant (CGMA)
C) Certified Management Accountant (CMA)
D) Certified Fraud Examiner (CFE)
Answer: D
Explanation: The CFE credential emphasizes fraud prevention, detection, and investigation.
Diff: 2
LO: 1-7

17) Which certification focuses on financial planning, performance, and internal strategic management?
A) Certified Internal Auditor (CIA)
B) Certified Management Accountant (CMA)
C) Certified Fraud Examiner (CFE)
D) Certified Public Accountant (CPA)
Answer: B
Explanation: The CMA designation emphasizes internal decision-making, budgeting, and strategic financial management.
Diff: 2
LO: 1-7

18) What is the primary purpose of obtaining a professional accounting certification?
A) To eliminate the need for practical work experience
B) To meet tax filing requirements
C) To demonstrate expertise, enhance credentials, and increase career opportunities
D) To satisfy continuing education requirements only
Answer: C
Explanation: Certifications demonstrate professional mastery, improve marketability, and expand career prospects.
Diff: 2
LO: 1-7

19) Which of the following is a key skill that supports success in an accounting career?
A) Critical thinking and effective communication
B) Minimal interaction with other departments
C) Focus on repetitive and isolated work
D) Avoidance of strategic decision-making
Answer: A
Explanation: Accountants must apply critical thinking and communication skills to contribute to business strategy and collaboration.
Diff: 2
LO: 1-7

20) Which certification is administered by the Institute of Internal Auditors (IIA) and focuses on internal auditing and risk management?
A) Certified Fraud Examiner (CFE)
B) Certified Public Accountant (CPA)
C) Chartered Global Management Accountant (CGMA)
D) Certified Internal Auditor (CIA)
Answer: D
Explanation: The CIA credential, overseen by the IIA, focuses on internal auditing, control, and risk assessment.
Diff: 2
LO: 1-7

21) A student claims that accounting careers are mostly repetitive and involve limited interaction with others. Which statement best refutes this claim?
A) Accountants perform only routine calculations and rarely collaborate.
B) Accounting involves communication, teamwork, and strategic decision-making across departments.
C) Accountants work independently of other business functions.
D) Accounting positions require minimal creative problem-solving.
Answer: B
Diff: 2
LO: 1-7

22) A manager argues that only individuals who want to become auditors should major in accounting. Which statement most directly challenges this view?
A) Accounting majors cannot work outside public accounting.
B) Auditing is the only field that requires technical accounting knowledge.
C) Accounting provides skills applicable to many roles beyond auditing.
D) Accounting degrees are limited to external financial reporting.
Answer: C
Diff: 2
LO: 1-7

23) An employee believes management accountants and internal auditors perform identical duties. Which statement best challenges this belief?
A) Management accountants focus on analyzing internal financial performance, while internal auditors assess risk and controls.
B) Both roles prepare external audit reports for shareholders.
C) Internal auditors are responsible for filing corporate tax returns.
D) Management accountants only prepare financial statements for public use.
Answer: A
Diff: 2
LO: 1-7

24) A student concludes that tax accountants have no need to stay current on changing laws. Which of the following best identifies the flaw in this reasoning?
A) Tax accountants must remain up-to-date because laws and regulations frequently change.
B) Tax accountants work only in nonprofit sectors where laws are static.
C) Tax accountants deal solely with historical transactions.
D) Tax accountants rely on auditors to manage legal compliance.
Answer: A
Diff: 2
LO: 1-7

25) A person claims that professional certifications do not affect an accountant's career advancement. Which statement best weakens this claim?
A) Certifications are only required for entry-level accounting roles.
B) Certifications focus only on theoretical knowledge, not practice.
C) Certifications enhance career growth by demonstrating expertise and credibility.
D) Certifications have no impact on earning potential or reputation.
Answer: C
Diff: 2
LO: 1-7

26) A student argues that the Certified Management Accountant (CMA) and Certified Public Accountant (CPA) certifications test the same knowledge areas. Which statement best refutes this claim?
A) Both focus entirely on tax preparation and auditing.
B) The CPA focuses on auditing and external reporting, while the CMA emphasizes internal financial management.
C) The CMA and CPA require identical exams and work experience.
D) The CPA focuses only on fraud prevention and internal auditing.
Answer: B
Diff: 2
LO: 1-7

27) A manager claims that accounting offers little variety in daily work tasks. Which statement most effectively weakens this argument?
A) The dynamic nature of accounting presents new challenges and opportunities daily.
B) Accountants perform identical tasks each day without variation.
C) Accounting involves repetitive procedures that rarely change.
D) Accountants avoid adapting to new systems or technology.
Answer: A
Diff: 2
LO: 1-7

28) An analyst concludes that accountants only work for large corporations. Which of the following statements most effectively challenges this conclusion?
A) Accountants are employed exclusively by Fortune 500 companies.
B) Accountants can work for small businesses, nonprofits, or government agencies.
C) Accountants must specialize in tax law to work for private companies.
D) Accountants often work in government and nonprofit sectors as well as business.
Answer: D
Diff: 2
LO: 1-7

29) A student argues that obtaining any certification automatically guarantees success in accounting. Which statement best identifies the flaw in this reasoning?
A) Success depends on ongoing professional development and practical experience, not certification alone.
B) Certifications ensure immediate promotion regardless of skill level.
C) Certifications automatically eliminate all ethical requirements.
D) Success depends only on the reputation of the certification organization.
Answer: A
Diff: 2
LO: 1-7

30) Which of the following, if true, would most strengthen the argument that accountants play a vital role in organizational success?
A) Accountants provide insights that guide strategic business decisions.
B) Accountants record transactions but do not influence decisions.
C) Accountants focus solely on regulatory compliance.
D) Accountants limit their work to internal auditing tasks.
Answer: A
Diff: 2
LO: 1-7

31) A student argues that the Certified Fraud Examiner (CFE) and Certified Internal Auditor (CIA) certifications cover identical topics. Which statement most effectively refutes this argument?
A) Both certifications are administered by the same professional body.
B) The CFE focuses on fraud prevention and detection, while the CIA emphasizes auditing and control.
C) The CIA is unrelated to accounting and focuses on tax law.
D) The CFE is a general management certification unrelated to fraud.
Answer: B
Diff: 2
LO: 1-7

32) A manager concludes that accountants do not need to develop communication skills. Which statement best challenges this conclusion?
A) Accountants must clearly explain financial results and insights to non-financial stakeholders.
B) Accountants rely solely on technical analysis to make decisions.
C) Communication is unnecessary because accounting work is automated.
D) Accountants interact only with other accounting professionals.
Answer: A
Diff: 2
LO: 1-7

33) A student believes that internal auditors and external auditors perform the same type of work for the same employers. Which statement most directly refutes this belief?
A) Internal auditors are employed by companies to assess internal controls, while external auditors are independent reviewers.
B) Internal auditors report directly to shareholders, like external auditors.
C) Internal auditors perform tax preparation and external auditors focus on budgeting.
D) Internal auditors are responsible for compliance with state CPA licensing.
Answer: A
Diff: 2
LO: 1-7

34) A manager claims that accountants rarely impact major business decisions. Which statement most effectively weakens this claim?
A) Accountants provide financial insights that influence management strategies and operational choices.
B) Accountants primarily perform clerical data-entry duties.
C) Accountants avoid participating in strategic planning processes.
D) Accountants focus only on compliance without analysis.
Answer: A
Diff: 2
LO: 1-7

35) An executive asserts that accounting knowledge has little relevance outside the accounting profession. Which statement best challenges this assertion?
A) Accounting principles provide essential financial literacy and decision-making skills useful in any career.
B) Accounting education is only beneficial for those planning to earn certifications.
C) Non-accountants have no need for understanding financial information.
D) Accounting is limited to the public accounting industry.
Answer: A
Diff: 2
LO: 1-7

36) Explain how an accounting degree can lead to a variety of career paths and discuss the key skills that make accountants valuable contributors in any organization.
Answer: An accounting degree provides a foundation for multiple career paths such as auditing, management accounting, tax, budgeting, and financial analysis.
External auditors provide independent assurance of financial accuracy, while internal auditors assess risk and improve internal controls.
Management accountants support internal decision-making by analyzing costs, preparing budgets, and enhancing efficiency.
Tax accountants ensure compliance with tax laws and offer strategic advice to minimize tax liabilities.
Budget analysts and financial analysts evaluate financial data to align spending and investments with strategic goals.
Accountants also find opportunities in government, nonprofit organizations, and consulting roles.
Key skills include communication, critical thinking, analytical reasoning, and strategic decision-making.
These skills allow accountants to collaborate across departments and contribute to a company's overall success.
The diversity and evolving nature of accounting make it an engaging and impactful career choice.
Diff: 3
LO: 1-7

37) Discuss the importance of professional accounting certifications and explain how they contribute to career advancement and credibility in the field.
Answer: Professional certifications validate an accountant's expertise, ethics, and commitment to professional excellence.
The Certified Public Accountant (CPA) credential is the most recognized and signifies mastery in auditing, tax, and financial reporting.
The Certified Management Accountant (CMA) focuses on strategic management, planning, and internal decision support.
The Certified Internal Auditor (CIA) demonstrates proficiency in internal auditing and risk management.
The Certified Fraud Examiner (CFE) emphasizes fraud prevention, detection, and investigation.
The Chartered Global Management Accountant (CGMA) certification highlights global management and leadership skills.
Certifications enhance career opportunities by increasing credibility with employers and clients.
They often lead to higher salaries, greater professional responsibility, and leadership roles.
Maintaining certifications requires ongoing education, ensuring professionals stay current with evolving standards and regulations.
Earning certifications demonstrates a long-term commitment to ethical practice and professional growth.
Diff: 3
LO: 1-7

Learning Objective 1-8

1) Accountants today rely on evolving technologies that allow them to make better, faster, and more accurate decisions.
Answer: TRUE
Explanation: Modern accounting tools provide more accurate, timely, and visual data, improving decision-making and efficiency.
Diff: 1
LO: 1-8

2) Accounting today is limited to manual calculations and paper-based recordkeeping.
Answer: FALSE
Explanation: Accounting now involves advanced tools like data analytics, artificial intelligence, and robotic process automation.
Diff: 1
LO: 1-8

3) Data analytics helps accountants identify trends, improve processes, and enhance business efficiency.
Answer: TRUE
Explanation: Data analytics transforms raw data into useful insights that guide better decisions and improve performance.
Diff: 2
LO: 1-8

4) Artificial intelligence and machine learning eliminate the need for human judgment in accounting.
Answer: FALSE
Explanation: While AI and machine learning automate many processes, human interpretation and judgment remain essential.
Diff: 2
LO: 1-8

5) Robotic Process Automation (RPA) allows repetitive and routine accounting tasks to be completed accurately and efficiently.
Answer: TRUE
Explanation: RPA bots can perform repetitive tasks with complete accuracy and allow accountants to focus on analysis and interpretation.
Diff: 1
LO: 1-8

6) The rise of automation in accounting means that accountants will soon be replaced entirely by bots.
Answer: FALSE
Explanation: Technology enhances accountants' roles by freeing them from repetitive work and enabling them to focus on higher-level thinking.
Diff: 2
LO: 1-8

7) Spreadsheets are one of the most powerful and widely used technologies in accounting.
Answer: TRUE
Explanation: Spreadsheets like Excel remain essential tools for organizing, calculating, and analyzing accounting data.
Diff: 1
LO: 1-8

8) Excel, Google Sheets, and Apple Numbers can all perform similar data manipulation and calculation functions.
Answer: TRUE
Explanation: While Excel is most common, other spreadsheet programs offer similar functionality and tools.
Diff: 2
LO: 1-8

9) The ribbon, formula bar, and worksheet tabs are all components of a spreadsheet program like Excel.
Answer: TRUE
Explanation: These components form part of Excel's user interface, allowing users to input, manage, and navigate data efficiently.
Diff: 2
LO: 1-8

10) Technology in accounting is static and changes very little over time.
Answer: FALSE
Explanation: Accounting technology is evolving rapidly, making the field more dynamic, data-driven, and exciting.
Diff: 1
LO: 1-8

11) Which statement best describes how technology has changed the accounting profession?
A) It has made accounting entirely manual and less accurate.
B) It has reduced the need for accountants to analyze data.
C) It has limited accountants to data entry and report generation.
D) It has enabled accountants to make better, faster, and more informed decisions.
Answer: D
Explanation: Technology allows accountants to use more accurate, timely, and visual data to support better decision-making.
Diff: 2
LO: 1-8

12) Which of the following best defines data analytics in accounting?
A) The process of manually entering financial data into spreadsheets
B) The process of transforming raw data into insights for improved decision-making
C) The practice of summarizing data without analysis or interpretation
D) The automation of transaction processing without human oversight
Answer: B
Explanation: Data analytics turns raw data into useful insights that help identify trends and improve business decisions.
Diff: 2
LO: 1-8

13) Artificial intelligence and machine learning contribute to accounting by:
A) reducing the reliability of financial statements.
B) replacing the need for professional judgment.
C) automating processes and improving accuracy in data analysis.
D) eliminating human oversight from all financial decisions.
Answer: C
Explanation: AI and machine learning automate routine processes and enhance accuracy, allowing accountants to focus on interpretation.
Diff: 2
LO: 1-8

14) Which of the following statements best describes the role of human judgment when using artificial intelligence in accounting?
A) Human judgment remains essential to interpret and apply insights from AI tools.
B) Human oversight is no longer required when AI is used.
C) Human judgment is only needed for data entry tasks.
D) AI completely replaces the need for professional expertise.
Answer: A
Explanation: AI supports accounting by automating tasks, but human interpretation and analysis remain critical for sound decisions.
Diff: 2
LO: 1-8

15) Which of the following describes the main advantage of robotic process automation (RPA) in accounting?
A) RPA replaces accountants with machines.
B) RPA reduces the accuracy of accounting records.
C) RPA performs repetitive tasks accurately, freeing accountants for higher-level work.
D) RPA increases manual effort needed for calculations.
Answer: C
Explanation: RPA bots handle repetitive tasks efficiently, allowing accountants to focus on value-added analysis and strategy.
Diff: 2
LO: 1-8

16) Which of the following statements about spreadsheets in accounting is true?
A) Spreadsheets are powerful tools for organizing, calculating, and analyzing data.
B) Spreadsheets are outdated and no longer used in accounting.
C) Spreadsheets are used only for basic addition and subtraction.
D) Spreadsheets cannot create graphs or summaries.
Answer: A
Explanation: Spreadsheets remain essential for organizing and analyzing accounting data efficiently and effectively.
Diff: 2
LO: 1-8

17) Which spreadsheet feature allows users to find and apply built-in mathematical and financial formulas?
A) Ribbon tabs
B) Insert Function dialog box
C) Worksheet tabs
D) Row header numbers
Answer: B
Explanation: The Insert Function dialog box helps users find and use functions to perform specific calculations.
Diff: 2
LO: 1-8

18) How has robotic process automation affected the accounting profession?
A) It has made accounting tasks more repetitive and time-consuming.
B) It has replaced the need for accountants in all industries.
C) It has reduced the accuracy of financial data analysis.
D) It has made accounting more engaging by removing repetitive tasks.
Answer: D
Explanation: Bots perform repetitive work, freeing accountants to focus on analysis, interpretation, and strategic contributions.
Diff: 2
LO: 1-8

19) What is the main purpose of using data analytics in accounting?
A) To identify trends and gain insights that support better decision-making
B) To replace professional accountants with automated systems
C) To generate random results for comparison purposes
D) To create manual summaries of accounting transactions
Answer: A
Explanation: Data analytics helps accountants interpret large volumes of data to discover patterns, trends, and opportunities for improvement.
Diff: 2
LO: 1-8

20) Which of the following best describes the impact of technology on the accounting field?
A) Technology continues to evolve rapidly, increasing accuracy and efficiency.
B) Technology has replaced the need for all human accountants.
C) Technology has remained unchanged over the past several decades.
D) Technology only affects industries outside of accounting.
Answer: A
Explanation: Accounting technologies are evolving quickly, leading to more efficient, data-driven, and insightful practices in the profession.
Diff: 2
LO: 1-8

21) A student claims that technology is replacing accountants entirely. Which statement most effectively challenges this claim?
A) Technology automates routine work, allowing accountants to focus on higher-level analysis.
B) Technology eliminates the need for human judgment in accounting.
C) Technology prevents accountants from interpreting complex data.
D) Technology reduces the importance of accountants' strategic roles.
Answer: A
Diff: 2
LO: 1-8

22) A manager argues that data analytics has no real value because accountants already have all the information they need from financial statements. Which statement most directly refutes this argument?
A) Data analytics replaces the need for financial statements altogether.
B) Data analytics helps uncover trends and patterns that financial statements alone may not reveal.
C) Data analytics removes the need for accountants to interpret numbers.
D) Data analytics only applies to industries outside accounting.
Answer: B
Diff: 2
LO: 1-8

23) A critic concludes that artificial intelligence (AI) decreases accuracy in accounting. Which statement best challenges this conclusion?
A) AI enhances accuracy by automating repetitive tasks and detecting errors efficiently.
B) AI requires human oversight for all financial transactions.
C) AI increases manual work required in financial reporting.
D) AI eliminates the need for verification processes.
Answer: A
Diff: 2
LO: 1-8

24) A student concludes that robotic process automation (RPA) makes accounting jobs more tedious. Which statement most effectively challenges this conclusion?
A) RPA focuses only on replacing auditors, not accountants.
B) RPA automates complex decision-making processes.
C) RPA eliminates accountants' involvement in business planning.
D) RPA handles repetitive work, allowing accountants to engage in more interesting analytical tasks.
Answer: D
Diff: 2
LO: 1-8

25) A student argues that spreadsheets are no longer important tools in accounting. Which statement most weakens this argument?
A) Spreadsheets are being replaced by handwritten ledgers.
B) Spreadsheets have no analytical functions beyond basic arithmetic.
C) Spreadsheets remain widely used for data organization, calculations, and analysis.
D) Spreadsheets cannot create graphs or visualizations for accounting reports.
Answer: C
Diff: 2
LO: 1-8

26) A manager asserts that artificial intelligence eliminates the need for human oversight in accounting. Which reasoning best refutes this claim?
A) AI operates independently without needing human input.
B) Human judgment is still required to interpret data and make informed decisions.
C) AI can perform strategic management decisions more effectively than humans.
D) AI fully replaces the ethical decision-making role of accountants.
Answer: B
Diff: 2
LO: 1-8

27) A supervisor believes that using bots reduces accuracy in financial data processing. Which statement best challenges this belief?
A) Bots can only perform tasks related to auditing.
B) Bots require manual entry of every transaction.
C) Bots perform repetitive work with high accuracy, reducing human error.
D) Bots depend on manual recalculations for verification.
Answer: C
Diff: 2
LO: 1-8

28) Which of the following, if true, would most weaken the claim that new technologies make accounting less valuable as a career?
A) Technology allows accountants to focus on analysis, strategy, and interpretation rather than data entry.
B) Technology eliminates the need for accountants in decision-making roles.
C) Technology reduces the relevance of data analytics in accounting.
D) Technology enables accountants to engage in higher-level problem solving and decision-making.
Answer: D
Diff: 3
LO: 1-8

29) A student claims that robotic process automation has made accounting more monotonous. Which statement best identifies the flaw in this reasoning?
A) RPA eliminates repetitive tasks, freeing accountants for more meaningful work.
B) RPA has no impact on the pace or type of accounting work.
C) RPA requires manual approval for all transactions.
D) RPA limits access to real-time data.
Answer: A
Diff: 2
LO: 1-8

30) A manager argues that data analytics should be used only by marketing professionals, not accountants. Which statement most effectively refutes this argument?
A) Data analytics helps accountants identify financial trends and process improvements.
B) Data analytics is useful only for tracking customer behavior.
C) Data analytics cannot be used to interpret accounting information.
D) Data analytics is unrelated to decision-making processes.
Answer: A
Diff: 2
LO: 1-8

31) A student concludes that machine learning in accounting removes the need for ethical decision-making. Which statement most directly refutes this conclusion?
A) Machine learning cannot process large amounts of financial data accurately.
B) Accountants still need to interpret results and make ethical decisions based on context.
C) Machine learning performs only clerical tasks unrelated to ethics.
D) Accountants are no longer responsible for interpreting AI outputs.
Answer: B
Diff: 2
LO: 1-8

32) Which of the following statements, if true, would most weaken the claim that spreadsheets are outdated and irrelevant in today's accounting environment?
A) Spreadsheets continue to serve as a powerful tool for performing calculations and visualizing data.
B) Spreadsheets require manual processing that is inefficient for analysis.
C) Spreadsheets can only be used for basic budgeting tasks.
D) Spreadsheets are not compatible with modern accounting systems.
Answer: A
Diff: 2
LO: 1-8

33) A manager argues that technology has made accountants less important to organizations. Which statement most effectively weakens this argument?
A) Technology has increased the value accountants provide through data interpretation and strategic insight.
B) Technology prevents accountants from collaborating with other departments.
C) Technology has replaced human input in all financial reporting.
D) Technology has made accountants obsolete in most industries.
Answer: A
Diff: 2
LO: 1-8

34) A student concludes that machine learning requires no data input from humans. Which statement best refutes this conclusion?
A) Machine learning relies on data provided by humans to identify patterns and learn from them.
B) Machine learning eliminates the need for human input at all stages.
C) Machine learning produces results without relying on any data sets.
D) Machine learning is fully independent of human oversight.
Answer: A
Diff: 2
LO: 1-8

35) A manager asserts that automation tools have no impact on the quality of accounting work. Which statement most strongly weakens this assertion?
A) Automation improves efficiency and accuracy by reducing human error in routine tasks.
B) Automation limits accountants to repetitive manual data processing.
C) Automation reduces the ability of accountants to analyze complex data.
D) Automation removes the need for accountants to understand financial concepts.
Answer: A
Diff: 2
LO: 1-8

36) Explain how modern tools and technologies have transformed the accounting profession, and discuss how these changes affect the role of accountants in organizations.
Answer: The accounting profession has evolved from manual calculations and paper-based ledgers to using advanced digital tools and technologies.
Data analytics allows accountants to convert large volumes of raw data into meaningful insights, improving decision-making and identifying trends.
Artificial intelligence (AI) and machine learning automate time-consuming tasks such as data entry and auditing, increasing accuracy and efficiency.
Robotic process automation (RPA) performs repetitive tasks continuously and with precision, freeing accountants to focus on more complex analytical and advisory roles.
Spreadsheets remain foundational tools that enable data organization, calculations, and visual analysis, supporting decision-making across business functions.
These technologies enhance the relevance of accountants by enabling them to provide strategic insights rather than only recording transactions.
Technology has shifted accountants' roles from transactional to analytical and consultative, making them critical contributors to business strategy.
Diff: 3
LO: 1-8

37) Discuss the importance of human judgment and analytical skills in an era of automation and artificial intelligence in accounting.
Answer: Even though AI and automation have increased accuracy and efficiency, human judgment remains essential in interpreting complex financial data.
Machines can process information but cannot fully evaluate ethical, strategic, or contextual factors that influence financial decisions.
Accountants use critical thinking to identify risks, evaluate inconsistencies, and draw conclusions that technology cannot make independently.
Analytical and communication skills help accountants explain data-driven insights to management and stakeholders in clear and meaningful ways.
Accountants ensure that automated systems comply with regulations and ethical standards, reinforcing accountability and trust.
Human insight complements technology by ensuring decisions are grounded in business context, ethics, and professional expertise.
As technology handles repetitive work, accountants' value increases through their ability to analyze, interpret, and guide strategic business decisions.
Diff: 3
LO: 1-8

Learning Objective 1-9

1) 1) The main set of accounting standards used in the United States is called generally accepted accounting principles (GAAP).
Answer: TRUE
Explanation: GAAP represents the common set of rules and guidelines that govern financial reporting in the United States.
Diff: 1
LO: 1-9

2) The Financial Accounting Standards Board (FASB) is responsible for establishing international accounting standards.
Answer: FALSE
Explanation: The FASB establishes accounting standards in the United States, while the International Accounting Standards Board (IASB) develops international standards.
Diff: 2
LO: 1-9

3) Relevance and faithful representation are the two fundamental qualitative characteristics of useful accounting information.
Answer: TRUE
Explanation: To be useful, financial information must be both relevant to decision-making and faithfully represent economic reality.
Diff: 1
LO: 1-9

4) Materiality refers to information that is minor enough that, if omitted, it would not influence users' decisions.
Answer: FALSE
Explanation: Material information is significant enough that its omission or misstatement could affect users' decisions.
Diff: 2
LO: 1-9

5) Faithful representation requires information to be complete, neutral, and free from error.
Answer: TRUE
Explanation: Faithful representation ensures that reported information accurately reflects the economic situation without bias or omission.
Diff: 1
LO: 1-9

6) Comparability means that financial information must be consistent over time and comparable among different companies.
Answer: TRUE
Explanation: Comparability allows users to evaluate performance across time periods and against other companies.
Diff: 1
LO: 1-9

7) The cost constraint in accounting assumes that the benefits of information should always exceed the cost of providing it.
Answer: TRUE
Explanation: Because financial reporting is costly, managers must ensure that the benefits justify the cost of producing the information.
Diff: 1
LO: 1-9

8) The entity assumption combines all personal and business financial activities into a single accounting record.
Answer: FALSE
Explanation: The entity assumption keeps business and personal financial activities separate to avoid confusion and maintain clear reporting boundaries.
Diff: 2
LO: 1-9

9) The historical cost principle requires that assets be recorded at their original purchase price rather than their current fair value.
Answer: TRUE
Explanation: Assets are recorded at the amount paid at acquisition, providing a verifiable and objective basis for measurement.
Diff: 1
LO: 1-9

10) The stable-monetary-unit assumption assumes that the purchasing power of money changes significantly over time due to inflation.
Answer: FALSE
Explanation: The stable-monetary-unit assumption presumes that the dollar's purchasing power remains relatively stable, allowing consistent comparison of financial data over time.
Diff: 2
LO: 1-9

11) Which organization is responsible for developing generally accepted accounting principles (GAAP) in the United States?
A) Financial Accounting Standards Board
B) International Accounting Standards Board
C) Securities and Exchange Commission
D) Internal Revenue Service
Answer: A
Explanation: The FASB establishes U.S. GAAP, which governs how companies prepare and report financial statements.
Diff: 1
LO: 1-9

12) What is the primary objective of accounting information according to the conceptual framework?
A) To record every financial transaction in detail
B) To provide information useful for investors, lenders, and creditors in decision-making
C) To report only internal financial information for management use
D) To calculate a company's taxes owed to the government
Answer: B
Explanation: The objective of accounting is to provide useful information for investors, lenders, and other users making economic decisions.
Diff: 2
LO: 1-9

13) Which qualitative characteristic requires financial information to be complete, neutral, and free from error?
A) Comparability
B) Relevance
C) Verifiability
D) Faithful representation
Answer: D
Explanation: Faithful representation ensures that financial information accurately and fairly reflects the company's economic situation.
Diff: 2
LO: 1-9

14) The concept of materiality relates most directly to which characteristic of accounting information?
A) Relevance
B) Verifiability
C) Comparability
D) Timeliness
Answer: A
Explanation: Information is considered relevant only if it is material–meaning its omission or misstatement could influence users' decisions.
Diff: 2
LO: 1-9

15) Which enhancing qualitative characteristic ensures that accounting information is prepared consistently across time and among companies?
A) Verifiability
B) Timeliness
C) Comparability
D) Understandability
Answer: C
Explanation: Comparability allows users to identify similarities and differences in financial data across periods and organizations.
Diff: 2
LO: 1-9

16) Which accounting concept requires that the benefits of reporting information outweigh the costs of producing it?
A) Faithful representation
B) Relevance
C) Comparability
D) Cost constraint
Answer: D
Explanation: The cost constraint limits financial reporting to information whose benefits justify its preparation and disclosure costs.
Diff: 2
LO: 1-9

17) The assumption that a business will continue operating long enough to fulfill its obligations and pursue its goals is called the:
A) historical cost principle.
B) continuity (going-concern) assumption.
C) stable-monetary-unit assumption.
D) entity assumption.
Answer: B
Explanation: The continuity or going-concern assumption assumes a business will operate indefinitely rather than liquidate.
Diff: 2
LO: 1-9

18) Which assumption keeps a company's financial information separate from its owners' personal financial activities?
A) Stable-monetary-unit assumption
B) Continuity (going-concern) assumption
C) Entity assumption
D) Historical cost principle
Answer: C
Explanation: The entity assumption draws a clear boundary between a business's activities and those of its owners.
Diff: 1
LO: 1-9

19) The historical cost principle states that assets should be recorded:
A) at their original purchase price at the time of acquisition.
B) at their current resale or liquidation value.
C) at their fair value adjusted for inflation.
D) at the average market value determined by appraisers.
Answer: A
Explanation: The historical cost principle requires recording assets at the actual amount paid when acquired, ensuring objectivity and verifiability.
Diff: 1
LO: 1-9

20) The assumption that the value of money remains stable over time and inflation can be ignored is known as the:
A) entity assumption.
B) historical cost principle.
C) continuity (going-concern) assumption.
D) stable-monetary-unit assumption.
Answer: D
Explanation: The stable-monetary-unit assumption assumes that a dollar's purchasing power remains consistent over time, enabling comparability of financial data.
Diff: 1
LO: 1-9

21) A student argues that financial information does not need to be relevant as long as it is accurate. Which statement best challenges this argument?
A) Accuracy alone guarantees decision usefulness.
B) Investors rarely rely on financial information for decisions.
C) Information must be both relevant and faithfully represented to be useful.
D) Accuracy is more important than timeliness or comparability.
Answer: C
Diff: 2
LO: 1-9

22) A manager claims that accountants should include every possible detail in financial reports to avoid leaving out information. Which statement most directly refutes this view?
A) Reports are improved by including all available data.
B) Users can process an unlimited amount of financial detail effectively.
C) Omitting details always misleads financial statement users.
D) Only material information that could influence decisions should be disclosed.
Answer: D
Diff: 2
LO: 1-9

23) A student concludes that comparability is not important because each company's circumstances are unique. Which statement best challenges this conclusion?
A) Comparability allows users to evaluate differences and similarities across companies and time periods.
B) Unique company data eliminates the need for standardization.
C) Financial reports are useful only if they differ greatly from prior years.
D) Investors do not need to compare companies when making decisions.
Answer: A
Diff: 2
LO: 1-9

24) A manager asserts that financial statements should be released only after all data are perfect. Which statement best identifies the flaw in this reasoning?
A) Timeliness requires that reports be available early enough to influence decisions.
B) Financial statements cannot be audited after publication.
C) Perfection in accounting information is rarely achievable and delays reduce usefulness.
D) Minor errors do not affect decision-making in any way.
Answer: C
Diff: 2
LO: 1-9

25) A critic argues that faithful representation requires financial reports to predict future outcomes. Which statement best refutes this claim?
A) Faithful representation ensures completeness, neutrality, and accuracy of existing information, not prediction.
B) Prediction is part of the continuity assumption.
C) Financial forecasts replace the need for reliable reports.
D) Faithful representation focuses on comparability and verifiability.
Answer: A
Diff: 3
LO: 1-9

26) A manager claims that verifiability is unimportant because different people interpret financial results differently. Which statement most directly challenges this claim?
A) Verifiability ensures that different evaluators can reach similar conclusions about the same information.
B) Verifiability refers only to comparing multiple companies' revenues.
C) Verifiability replaces the need for faithful representation.
D) Verifiability is relevant only for tax reporting.
Answer: A
Diff: 3
LO: 1-9

27) An employee believes that historical cost is not reliable because market prices change over time. Which statement best challenges this belief?
A) Historical cost provides an objective, verifiable measure free from bias.
B) Historical cost is always adjusted for inflation.
C) Market values are always more accurate than recorded costs.
D) Historical cost reflects current fair value at all times.
Answer: A
Diff: 2
LO: 1-9

28) A student concludes that all companies should report at fair value rather than historical cost. Which statement best refutes this conclusion?
A) Fair value is always less reliable than historical cost.
B) Historical cost provides an estimate of current value that can fluctuate.
C) The continuity assumption supports using historical cost when businesses intend to continue operations.
D) Fair value reporting eliminates the need for faithful representation.
Answer: A
Diff: 2
LO: 1-9

29) A manager claims that including personal transactions in company accounts gives a more complete view of overall wealth. Which statement best identifies the flaw in this argument?
A) The entity assumption requires that personal and business activities be kept separate.
B) Combining personal and company finances provides more accurate totals.
C) Personal transactions are essential to assessing company performance.
D) The continuity assumption supports including all types of transactions.
Answer: A
Diff: 2
LO: 1-9

30) A student argues that inflation makes the stable-monetary-unit assumption invalid. Which reasoning best challenges this argument?
A) Users prefer detailed statements that include all minor transactions.
B) Too much information can obscure important facts and reduce understandability.
C) Materiality ensures that all information, regardless of size, is disclosed.
D) Investors are not influenced by excessive data.
Answer: B
Diff: 3
LO: 1-9

31) Which of the following, if true, would most weaken the argument that reporting more information always benefits users?
A) Users prefer detailed statements that include all minor transactions.
B) Too much information can obscure important facts and reduce understandability.
C) Materiality ensures that all information, regardless of size, is disclosed.
D) Investors are not influenced by excessive data.
Answer: B
Diff: 3
LO: 1-9

32) A company argues that it should value its assets at liquidation value because that represents the most conservative approach. Which statement best identifies the flaw in this argument?
A) The going-concern assumption assumes the entity will continue operating, not liquidate.
B) The entity assumption permits valuation based on liquidation prices.
C) The stable-monetary-unit assumption requires assets to be recorded at their future sale value.
D) The historical cost principle mandates using liquidation values.
Answer: A
Diff: 3
LO: 1-9

33) A manager concludes that it is unnecessary to verify financial information as long as it appears logical. Which statement best challenges this conclusion?
A) Verification ensures that data are complete, accurate, and free from bias.
B) Logical information cannot be relied upon without consistency across periods.
C) Verifiability is unrelated to the reliability of financial data.
D) Verification only applies to internal managerial reports.
Answer: A
Diff: 2
LO: 1-9

34) A student believes that cost constraints should never limit disclosure because all information is valuable. Which reasoning best refutes this belief?
A) The cost of providing information should not exceed its expected benefits to users.
B) Disclosure costs are usually insignificant compared to benefits.
C) Companies must disclose all data regardless of reporting expense.
D) Materiality eliminates the need to evaluate cost-benefit tradeoffs.
Answer: A
Diff: 2
LO: 1-9

35) A manager concludes that relevance and faithful representation are competing rather than complementary qualities. Which statement best challenges this claim?
A) Both characteristics work together to make information useful for decision-making.
B) Relevance is unrelated to the accuracy of financial data.
C) Faithful representation requires ignoring the relevance of information.
D) Relevance and faithful representation cannot coexist in practice.
Answer: A
Diff: 3
LO: 1-9

36) Explain how the qualitative characteristics of accounting information–relevance and faithful representation–enhance the usefulness of financial statements.
Answer: Relevance ensures that accounting information is meaningful and helps users make decisions by providing insights that can predict or confirm outcomes.
Information is relevant only if it is material, meaning its omission or misstatement could influence users' decisions.
Faithful representation ensures that financial information accurately reflects the underlying economic reality of the business.
To be faithfully represented, information must be complete, neutral (free from bias), and free from error.
Both characteristics work together to provide useful information–relevance ensures the data matters to users, and faithful representation ensures that it can be trusted.
These characteristics are essential for investors, creditors, and other users who rely on accurate and timely financial information to assess performance and make economic decisions.
Without these qualities, financial statements could be misleading or fail to meet the needs of decision-makers.
Diff: 3
LO: 1-9

37) Describe the main accounting assumptions and principles discussed in this learning objective and explain how they guide financial reporting.
Answer: The entity assumption separates a company's financial information from that of its owners or other entities, ensuring clarity and accountability.
The continuity (going-concern) assumption assumes that a business will continue operating long enough to fulfill its obligations and pursue future goals.
The historical cost principle requires that assets be recorded at their original purchase price, providing an objective and verifiable measure.
The stable-monetary-unit assumption presumes that the purchasing power of the monetary unit remains relatively constant, allowing consistent comparison across periods.
These assumptions and principles form the foundation for reliable and comparable financial reporting.
They ensure consistency, transparency, and objectivity in accounting, making financial information meaningful and credible for users.
Together, they create a structured framework that allows accountants to measure, record, and report transactions in a way that faithfully represents a company's financial position.
Diff: 3
LO: 1-9