

1

Introduction to Accounting and Business

QUIZ AND TEST HINTS

The following hints may be helpful to you in preparing for a quiz or a test over the material covered in Chapter 1.

1. Terminology is important in this chapter. Review the “Key Terms” section at the end of the chapter and be sure you understand each term. Do the Matching and Fill-in-the-Blank exercises included in this Study Guide. Expect multiple-choice, true/false, or matching questions to include the terms introduced throughout the chapter. For example, you should be able to distinguish between the different types of businesses and between financial and managerial accounting. Pay special attention to the terms beginning on page 2 through the end of the chapter. These terms will be used frequently throughout the remainder of the text.
2. Know the accounting equation: $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$. Be able to compute one amount when given the other two. For example, if assets equal \$100,000 and liabilities equal \$60,000, owner's equity must equal \$40,000. Be able to determine the effect of change in the basic elements on one another. For example, if assets increase by \$10,000 and liabilities decrease by \$5,000, owner's equity must increase by \$15,000.
3. Be able to record business transactions within the framework of the accounting equation. Use the illustration on pages 11–14 as a basis for review and study. Pay particular attention to items that are increased and decreased by transactions a through h. Note the introduction of new terms such as account payable, account receivable, revenue, and expense. These new terms are highlighted in color in the text.
4. Be able to describe each of the financial statements listed on page 16. You may be required to prepare a short income statement, statement of owner's equity, and balance sheet. You will probably not be required to prepare a statement of cash flows.
5. Review the summary data for NetSolutions on page 14. Trace the numbers into the statements shown in Exhibit 6 on page 18. Know the format of each statement such as the number of columns and placement of dollar signs. Some of the numbers in Exhibit 6 appear on more than one statement. Sometimes a quiz or a test question will provide partially completed statements, and you

will be required to complete the statements. Recognizing amounts that appear on more than one statement will aid you in answering this type of question. Also, reviewing the Interrelationship Among Financial Statements section on page 21 will aid you in preparing for this type of question.

6. Review the GPS graphic at the beginning of the chapter and the “At A Glance” section at the end of the chapter. Read and review each of the Key Points and related Learning Outcomes. For each Learning Outcome that has an Example Exercise, locate the Example Exercise in the chapter and be sure that you understand the solution and can work a similar item on a test. If you have any questions about an Example Exercise, read the section of the chapter immediately preceding the Example Exercise.
7. If your instructor covers the Financial Analysis and Interpretation item at the end of the chapter, you should know how to compute and interpret changes in the ratio of liabilities to owner’s equity.

MATCHING

Instructions: Match each of the statements below with its proper term. Some terms may not be used.

- | | |
|--|---|
| A. account form | S. International Accounting Standards Board (IASB) |
| B. account payable | T. liabilities |
| C. account receivable | U. limited liability company |
| D. accounting | V. managerial accounting |
| E. accounting equation | W. manufacturing |
| F. assets | X. matching concept |
| G. balance sheet | Y. merchandising |
| H. business | Z. net income |
| I. business entity concept | AA. net loss |
| J. business transaction | BB. objectivity concept |
| K. corporation | CC. owner's equity |
| L. cost concept | DD. partnership |
| M. ethics | EE. prepaid expenses |
| N. expenses | FF. proprietorship |
| O. financial accounting | GG. revenue |
| P. Financial Accounting Standards Board (FASB) | HH. service |
| Q. generally accepted accounting principle (GAAP) | II. statement of cash flows |
| R. income statement | JJ. statement of owner's equity |
| | KK. unit of measure concept |

- ___ 1. An organization in which basic resources (inputs), such as materials and labor, are assembled and processed to provide goods or services (outputs) to customers.
- ___ 2. A type of business that changes basic inputs into products that are sold to individual customers.
- ___ 3. A type of business that purchases products from other businesses and sells them to customers.
- ___ 4. A business owned by one individual.
- ___ 5. A business owned by two or more individuals.
- ___ 6. A business organized under state or federal statutes as a separate legal entity.
- ___ 7. A business that combines attributes of a partnership and a corporation.
- ___ 8. An information system that provides reports to stakeholders about the economic activities and condition of a business.
- ___ 9. Moral principles that guide the conduct of individuals.

- ___ 10. A specialized field of accounting concerned primarily with the recording and reporting of economic data and activities to stakeholders outside the business.
- ___ 11. A specialized field of accounting that uses estimated data to aid management in running day-to-day operations and in planning future operations.
- ___ 12. The authoritative body that has the primary responsibility for developing accounting principles in the United States.
- ___ 13. The authoritative body that sets accounting principles for many countries outside the United States.
- ___ 14. A concept of accounting that limits the economic data in the accounting system to data related directly to the activities of the business.
- ___ 15. The resources owned by a business.
- ___ 16. The rights of creditors that represent debts of the business.
- ___ 17. The rights of the owners.
- ___ 18. $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$
- ___ 19. An economic event or condition that directly changes an entity's financial condition or directly affects its results of operations.
- ___ 20. The liability created by a purchase on account.
- ___ 21. Items such as supplies that will be used in the business in the future.
- ___ 22. A claim against the customer.
- ___ 23. The amounts used in the process of earning revenue.
- ___ 24. The amount a business earns by selling goods or services to its customers.
- ___ 25. A summary of the revenue and expenses *for a specific period of time*, such as a month or a year.
- ___ 26. A summary of the changes in owner's equity that have occurred *during a specific period of time*, such as a month or a year.
- ___ 27. A list of the assets, liabilities, and owner's equity *as of a specific date*, usually at the close of the last day of a month or a year.
- ___ 28. A summary of the cash receipts and cash payments *for a specific period of time*, such as a month or a year.
- ___ 29. A concept of accounting in which expenses are matched with the revenue generated during a period by those expenses.
- ___ 30. The form of balance sheet that resembles the basic format of the accounting equation, with assets on the left side and the liabilities and owner's equity sections on the right side.

FILL IN THE BLANK—PART A

Instructions: Answer the following questions or complete the statements by writing the appropriate words or amounts in the answer blanks.

1. An organization in which basic resources (inputs), such as materials and labor, are assembled and processed to provide goods or services (outputs) to customers is a(n) _____.
2. A business organized under state or federal statutes as a separate legal entity is a(n) _____.
3. An information system that provides reports to stakeholders about the economic activities and condition of a business is _____.
4. Moral principles that guide the conduct of individuals are called _____.
5. A specialized field of accounting that uses estimated data to aid management in running day-to-day operations and in planning future operations is called _____ accounting.
6. A concept of accounting that requires that economic data be recorded in dollars is the _____ concept.
7. The resources owned by a business are called _____.
8. The rights of the owners are called _____.
9. $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$ is the _____.
10. Carson offered for sale at \$75,000 land that had been purchased for \$45,000. If Zimmer paid Carson \$70,000 for the land, the amount that Zimmer would record for the purchase of the land in the accounting records is _____.
11. The liability created by a purchase on account is referred to as a(n) _____.
12. If liabilities are \$85,000 and owner's equity is \$45,000, the amount of the assets is _____.
13. If assets are \$375,000 and owner's equity is \$295,000, the amount of the liabilities is _____.
14. The amount a business earns by selling goods or services to its customers is called _____.
15. If operations for an accounting period resulted in cash sales of \$60,000, sales on account of \$150,000, and expenses paid in cash of \$195,000, the net income or (net loss) for the period is _____.

16. A summary of the changes in the owner's equity that have occurred *during a specific period of time*, such as a month or a year, is the _____.
17. The owner's equity at the beginning of the period was \$19,000; at the end of the period, assets were \$98,000 and liabilities were \$41,000. The owner made no additional investments or withdrawals during the period. The net income or (net loss) for the period is _____.
18. The form of balance sheet that resembles the basic format of the accounting equation, with assets on the left side and the liabilities and owner's equity sections on the right side, is called the _____ form.
19. If total assets increased by \$85,000 and liabilities decreased by \$9,000 during the period, the amount and direction (increase or decrease) of the period's change in owner's equity was _____.
20. Cash reported on the end-of-the-year balance sheet also is reported on the _____.

FILL IN THE BLANK—PART B

Instructions: Answer the following questions or complete the statements by writing the appropriate words or amounts in the answer blanks.

1. A type of business that changes basic inputs into products that are sold to individual customers is a(n) _____ business.
2. A type of business that purchases products from other businesses and sells them to customers is a(n) _____ business.
3. A business owned by one individual is called a(n) _____.
4. A specialized field of accounting primarily concerned with the recording and reporting of economic data and activities to users outside the business is called _____ accounting.
5. The authoritative body that has the primary responsibility for developing accounting principles in the United States is the _____.
6. A concept of accounting that limits the economic data in the accounting system to data related directly to the activities of the business is the _____ concept.
7. The rights of creditors that represent debts of the business are called _____.

8. An economic event or condition that directly changes an entity's financial condition or directly affects its results of operations is called a(n) _____.
9. Items such as supplies that will be used in the business in the future are called _____.
10. A claim against the customer is called a(n) _____.
11. If owner's equity is \$46,000 and liabilities are \$34,000, the amount of assets is _____.
12. If assets are \$98,000 and liabilities are \$32,500, the amount of owner's equity is _____.
13. The amounts used in the process of earning revenue are _____.
14. A summary of the revenue and expenses *for a specific period of time*, such as a month or a year, is called a(n) _____.
15. If operations for an accounting period resulted in cash sales of \$90,000, sales on account of \$40,000, and expenses paid in cash of \$135,000, the net income or (net loss) for the period is _____.
16. A list of the assets, liabilities, and owner's equity *as of a specific date*, usually at the close of the last day of a month or a year, is called a(n) _____.
17. If total assets increased by \$21,500 and owner's equity increased by \$8,000 during a period, the amount and direction (increase or decrease) of the period's change in total liabilities was _____.
18. A summary of the cash receipts and cash payments *for a specific period of time*, such as a month or a year, is called a(n) _____.
19. The owner's equity at the beginning of the period was \$46,000; at the end of the period, assets were \$99,000 and liabilities were \$22,000. If the owner made an additional investment of \$10,000 and withdrew \$8,000 during the period, the net income or (net loss) for the period is _____.
20. The owner's capital at the end of the year reported on the statement of owner's equity is also reported on the _____.

MULTIPLE CHOICE

Instructions: Circle the best answer for each of the following questions.

1. Accountants employed by a particular business firm or not-for-profit organization, perhaps as chief accountant, controller, or financial vice-president, are said to be engaged in:
 - a. general accounting
 - b. public accounting
 - c. independent accounting
 - d. private accounting
2. A type of business that changes basic inputs into products that are sold to individual customers.
 - a. service business
 - b. manufacturing business
 - c. merchandising business
 - d. proprietorship business
3. The accounting concept that requires economic data be recorded in dollars.
 - a. cost concept
 - b. objectivity concept
 - c. business entity concept
 - d. unit of measure concept
4. The amounts for recording properties and services purchased by a business are determined using the:
 - a. business entity concept
 - b. cost concept
 - c. matching principle
 - d. proprietorship principle
5. Another way of writing the accounting equation is:
 - a. $\text{Assets} + \text{Liabilities} = \text{Owner's Equity}$
 - b. $\text{Owner's Equity} + \text{Assets} = \text{Liabilities}$
 - c. $\text{Assets} = \text{Owner's Equity} - \text{Liabilities}$
 - d. $\text{Assets} - \text{Liabilities} = \text{Owner's Equity}$
6. If total liabilities increased by \$20,000 during a period of time and owner's equity increased by \$5,000 during the same period, the amount and direction (increase or decrease) of the period's change in total assets is:
 - a. \$20,000 increase
 - b. \$20,000 decrease
 - c. \$25,000 decrease
 - d. \$25,000 increase

7. A business paid \$6,000 to a creditor in payment of an amount owed. The effect of the transaction on the accounting equation was:
- an increase in an asset and a decrease in another asset
 - a decrease in an asset and an increase in a liability
 - a decrease in an asset and a decrease in a liability
 - an increase in an asset and an increase in owner's equity
8. The total assets and the total liabilities of a particular business enterprise at the beginning and at the end of the year are stated below. During the year, the owner had withdrawn \$30,000 for personal use and had made an additional investment in the enterprise of \$25,000.

	<u>Assets</u>	<u>Liabilities</u>
Beginning of year.....	\$290,000	\$190,000
End of year	355,000	220,000

The amount of net income for the year was:

- \$5,000
 - \$25,000
 - \$30,000
 - \$40,000
9. If revenue was \$70,000, expenses were \$59,000, and the owner's withdrawals were \$25,000, the amount of net income or net loss was:
- net income of \$11,000
 - net income of \$36,000
 - net loss of \$59,000
 - net income of \$70,000
10. Which of the following is not one of the major sections of the statement of cash flows?
- cash flows from marketing activities
 - cash flows from investing activities
 - cash flows from financing activities
 - cash flows from operating activities

TRUE/FALSE

Instructions: Indicate whether each of the following statements is true or false by placing a check mark in the appropriate column.

	True	False
1. Accounting is often characterized as the “language of business.”	_____	_____
2. Accountants who render accounting services on a fee basis and staff accountants employed by them are said to be engaged in private accounting.	_____	_____
3. The accounting equation can be expressed as Assets – Liabilities = Owner’s Equity.	_____	_____
4. The concept that expenses incurred in generating revenue should be matched against the revenue in determining net income or net loss is called the cost concept.	_____	_____
5. The financing activities section of the statement of cash flows includes cash transactions that enter into the determination of net income.	_____	_____
6. The debts of a business are called its accounts receivable.	_____	_____
7. A partnership is owned by not less than four individuals.	_____	_____
8. A business transaction is the occurrence of an event or of a condition that must be recorded.	_____	_____
9. A summary of the changes in the owner’s equity of a business entity that have occurred during a specific period of time, such as a month or a year, is called a statement of cash flows.	_____	_____
10. A claim against a customer for sales made on credit is an account payable.	_____	_____

EXERCISE 1-1

Instructions: Some typical transactions of Clem’s Laundry Service are presented below. For each transaction, indicate the increase (+), the decrease (–), or no change (0) in the assets (A), liabilities (L), and owner’s equity (OE) by placing the appropriate sign(s) in the appropriate column(s). More than one sign may have to be placed in the A, L, or OE column for a given transaction.

	A	L	OE
1. Received cash from owner as an additional investment	_____	_____	_____
2. Purchased supplies on account	_____	_____	_____
3. Charged customers for services sold on account ...	_____	_____	_____
4. Received cash from cash customers	_____	_____	_____
5. Paid cash for rent on building	_____	_____	_____
6. Collected an account receivable in full	_____	_____	_____
7. Paid cash for supplies	_____	_____	_____
8. Returned supplies purchased on account and not yet paid for	_____	_____	_____
9. Paid cash to creditors on account	_____	_____	_____
10. Paid cash to owner for personal use	_____	_____	_____

PROBLEM 1-1

Instructions: The assets, liabilities, capital, drawing, revenue, and expenses of Ed Casey, who operates a small repair shop, are expressed in equation form below. Following the equation are ten transactions completed by Casey. On each of the numbered lines, show by addition or subtraction the effect of each of the transactions on the equation. On the lines labeled “Bal.,” show the new equation resulting from the transaction.

Trans.	Assets			=	Liabilities		+	Owner's Equity				
	Cash	+ Supplies	+ Land	=	Accts. Pay.	+ Ed Casey, Capital	- Ed Casey, Drawing	+ Fees Earned	- Rent Exp.	- Supplies Exp.	- Misc. Exp.	
1. Casey started a repair shop and deposited \$40,000 cash in the bank for use by the business.	(1)	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____
2. Casey purchased \$2,000 of supplies on account.	(2)	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____
Bal.												
3. Casey purchased land for a future building site for \$14,000 cash.	(3)	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____
Bal.												
4. Casey paid creditors \$1,800 on account.	(4)	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____
Bal.												
5. Casey withdrew \$2,000 for personal use.	(5)	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____
Bal.												
6. Casey paid \$2,800 for building and equipment rent for the month.	(6)	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____
Bal.												
7. During the month, \$900 of miscellaneous expenses were incurred on account by the business.	(7)	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____
Bal.												
8. During the month, Casey deposited another \$10,000 of personal funds in the business bank account.	(8)	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____
Bal.												
9. Casey received \$6,000 for cash service calls.	(9)	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____
Bal.												
10. Casey used \$600 worth of supplies.	(10)	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____	_____
Bal.												
		=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====

PROBLEM 1-2

The amounts of the assets and liabilities of Tom’s Painting Service at December 31 of the current year, and the revenues and expenses for the year are as follows:

Cash	\$10,050
Accounts receivable	8,950
Supplies.....	4,000
Accounts payable.....	4,450
Sales	27,450
Supplies expense	5,450
Advertising expense	4,825
Truck rental expense.....	1,525
Utilities expense	700
Miscellaneous expense.....	1,400

The capital of Tom Wallace, owner, was \$4,000 at the beginning of the current year. During the year, Wallace withdrew \$1,000 and made an additional investment of \$2,000.

Instructions: Using the forms provided, prepare the following:

- (1) An income statement for the year ended December 31, 20--.
- (2) A statement of owner’s equity for the year ended December 31, 20--.
- (3) A balance sheet as of December 31, 20--.

(1)

Tom’s Painting Service

Income Statement

For Year Ended December 31, 20--

(2) *Tom's Painting Service*

Statement of Owner's Equity

For Year Ended December 31, 20--

(3) *Tom's Painting Service*

Balance Sheet

December 31, 20--
