**1. (**[**LO 1**](https://jigsaw.vitalsource.com/books/9781119752523/epub/OPS/c01.xhtml?brand=vitalsource&create=true&favre=brett#c01-feafxd-0003)**)** Which of the following is **not** a step in the accounting process?

1. Identification.
2. Economic entity.
3. Recording.
4. Communication.

**b.** Economic entity is not one of the steps in the accounting process. The other choices are true because (a) identification is the first step in the accounting process, (c) recording is the second step in the accounting process, and (d) communication is the third and final step in the accounting process.

**2. (**[**LO 1**](https://jigsaw.vitalsource.com/books/9781119752523/epub/OPS/c01.xhtml?brand=vitalsource&create=true&favre=brett#c01-feafxd-0003)**)** Which of the following statements about users of accounting information is **incorrect**?

1. Management is an internal user.
2. Taxing authorities are external users.
3. Present creditors are external users.
4. Regulatory authorities are internal users.

**d.** Regulatory authorities are external, not internal, users of accounting information. The other choices are true statements.

**3. (**[**LO 2**](https://jigsaw.vitalsource.com/books/9781119752523/epub/OPS/c01.xhtml?brand=vitalsource&create=true&favre=brett#c01-feafxd-0005)**)** The historical cost principle states that:

1. assets should be initially recorded at cost and adjusted when the fair value changes.
2. activities of an entity are to be kept separate and distinct from its owner.
3. assets should be recorded at their cost.
4. only transaction data capable of being expressed in terms of money be included in the accounting records.

**c.** The historical cost principle states that assets should be recorded at their cost. The other choices are incorrect because (a) the historical cost principle does not say that assets should be adjusted for changes in fair value, (b) describes the economic entity assumption, and (d) describes the monetary unit assumption.

**4. (**[**LO 2**](https://jigsaw.vitalsource.com/books/9781119752523/epub/OPS/c01.xhtml?brand=vitalsource&create=true&favre=brett#c01-feafxd-0005)**)** Which of the following statements about basic assumptions is **correct**?

1. Basic assumptions are the same as accounting principles.
2. The economic entity assumption states that there should be a particular unit of accountability.
3. The monetary unit assumption enables accounting to measure employee morale.
4. Partnerships are not economic entities.

**b.** The economic entity assumption states that there should be a particular unit of accountability. The other choices are incorrect because (a) basic assumptions are not the same as accounting principles, (c) the monetary unit assumption allows accounting to measure economic events, and (d) partnerships are economic entities.

**5. (**[**LO 2**](https://jigsaw.vitalsource.com/books/9781119752523/epub/OPS/c01.xhtml?brand=vitalsource&create=true&favre=brett#c01-feafxd-0005)**)** The three types of business entities are:

1. proprietorships, small businesses, and partnerships.
2. proprietorships, partnerships, and corporations.
3. proprietorships, partnerships, and large businesses.
4. financial, manufacturing, and service companies.

**b.** Proprietorships, partnerships, and corporations are the three types of business entities. Choices (a) and (c) are incorrect because small and large businesses only denote the sizes of businesses. Choice (d) is incorrect because financial, manufacturing, and service companies are types of businesses, not business entities.

**6. (**[**LO 3**](https://jigsaw.vitalsource.com/books/9781119752523/epub/OPS/c01.xhtml?brand=vitalsource&create=true&favre=brett#c01-feafxd-0010)**)** Net income will result during a time period when:

1. assets exceed liabilities.
2. assets exceed revenues.
3. expenses exceed revenues.
4. revenues exceed expenses.

**d.** Net income results when revenues exceed expenses. The other choices are incorrect because (a) assets and liabilities are not used in the computation of net income; (b) revenues, not assets, are included in the computation of net income; and (c) when expenses exceed revenues, a net loss results.

**7. (**[**LO 3**](https://jigsaw.vitalsource.com/books/9781119752523/epub/OPS/c01.xhtml?brand=vitalsource&create=true&favre=brett#c01-feafxd-0010)**)** As of December 31, 2022, Reed Company has assets of $3,500 and stockholders’ equity of $1,500. What are the liabilities for Reed Company as of December 31, 2022?

1. $1,500.
2. $1,000.
3. $2,500.
4. $2,000.

**d.** Using a variation of the basic accounting equation, Assets − Stockholders’ equity = Liabilities, $3,500 − $1,500 = $2,000. Therefore, choices (a) $1,500, (b) $1,000, and (c) $2,500 are incorrect.

**8. (**[**LO 4**](https://jigsaw.vitalsource.com/books/9781119752523/epub/OPS/c01.xhtml?brand=vitalsource&create=true&favre=brett#c01-feafxd-0014)**)** Performing services on account will have the following effects on the components of the basic accounting equation:

1. increase assets and decrease stockholders’ equity.
2. increase assets and increase stockholders’ equity.
3. increase assets and increase liabilities.
4. increase liabilities and increase stockholders’ equity.

**b.** When services are performed on account, assets are increased and stockholders’ equity is increased. The other choices are incorrect because when services are performed on account (a) stockholders’ equity is increased, not decreased; (c) liabilities are not affected; and (d) stockholders’ equity is increased and liabilities are not affected.

**9. (**[**LO 4**](https://jigsaw.vitalsource.com/books/9781119752523/epub/OPS/c01.xhtml?brand=vitalsource&create=true&favre=brett#c01-feafxd-0014)**)** Which of the following events is **not** recorded in the accounting records?

1. Equipment is purchased on account.
2. An employee is terminated.
3. A cash investment is made into the business.
4. The company pays a cash dividend.

**b.** If an employee is terminated, this represents an activity of a company, not a business transaction. Assets, liabilities, and stockholders’ equity are not affected. Thus, there is no effect on the accounting equation. The other choices are incorrect because they are all recorded: (a) when equipment is purchased on account, both assets and liabilities increase; (c) when a cash investment is made into a business, both assets and stockholders’ equity increase; and (d) when a dividend is paid, both assets and stockholders’ equity decrease.

**10. (**[**LO 4**](https://jigsaw.vitalsource.com/books/9781119752523/epub/OPS/c01.xhtml?brand=vitalsource&create=true&favre=brett#c01-feafxd-0014)**)** During 2022, Seisor Company’s assets decreased $50,000 and its liabilities decreased $90,000. Its stockholders’ equity therefore:

1. increased $40,000.
2. decreased $140,000.
3. decreased $40,000.
4. increased $140,000.

**a.** Using the basic accounting equation, Assets = Liabilities + Stockholders’ equity, −$50,000 = −$90,000 + Stockholders’ equity, so stockholders’ equity increased $40,000, not (b) decreased $140,000, (c) decreased $40,000, or (d) increased $140,000.

**11. (**[**LO 4**](https://jigsaw.vitalsource.com/books/9781119752523/epub/OPS/c01.xhtml?brand=vitalsource&create=true&favre=brett#c01-feafxd-0014)**)** Payment of an account payable affects the components of the accounting equation in the following way.

1. Decreases stockholders’ equity and decreases liabilities.
2. Increases assets and decreases liabilities.
3. Decreases assets and increases stockholders’ equity.
4. Decreases assets and decreases liabilities.

**d.** Payment of an account payable results in an equal decrease of assets (cash) and liabilities (accounts payable). The other choices are incorrect because payment of an account payable (a) does not affect stockholders’ equity, (b) does not increase assets, and (c) does not affect stockholders’ equity.

**12. (**[**LO 5**](https://jigsaw.vitalsource.com/books/9781119752523/epub/OPS/c01.xhtml?brand=vitalsource&create=true&favre=brett#c01-feafxd-0016)**)** Which of the following statements is **false**?

1. A statement of cash flows summarizes information about the cash inflows (receipts) and outflows (payments) for a specific period of time.
2. A balance sheet reports the assets, liabilities, and stockholders’ equity at a specific date.
3. An income statement presents the revenues, expenses, changes in stockholders’ equity, and resulting net income or net loss for a specific period of time.
4. A retained earnings statement summarizes the changes in retained earnings for a specific period of time.

**c.** An income statement represents the revenues, expenses, and resulting net income or net loss for a specific period of time but not the changes in stockholders’ equity. The other choices are true statements.

**13. (**[**LO 5**](https://jigsaw.vitalsource.com/books/9781119752523/epub/OPS/c01.xhtml?brand=vitalsource&create=true&favre=brett#c01-feafxd-0016)**)** On the last day of the period, Alan Cesska Company buys a $900 machine on credit. This transaction will affect the:

1. income statement only.
2. balance sheet only.
3. income statement and retained earnings statement only.
4. income statement, retained earnings statement, and balance sheet.

**b.** This transaction will cause assets to increase by $900 and liabilities to increase by $900. The other choices are incorrect because this transaction (a) will have no effect on the income statement, (c) will have no effect on the income statement or the retained earnings statement, and (d) will affect the balance sheet but not the income statement or the retained earnings statement.

**14. (**[**LO 5**](https://jigsaw.vitalsource.com/books/9781119752523/epub/OPS/c01.xhtml?brand=vitalsource&create=true&favre=brett#c01-feafxd-0016)**)** The financial statement that reports assets, liabilities, and stockholders’ equity is the:

1. income statement.
2. retained earnings statement.
3. balance sheet.
4. statement of cash flows.

**c.** The balance sheet is the statement that reports assets, liabilities and stockholders’ equity. The other choices are incorrect because (a) the income statement reports revenues and expenses, (b) the retained earnings statement reports details about stockholders’ equity, and (d) the statement of cash flows reports inflows and outflows of cash.

**\*15. (**[**LO 6**](https://jigsaw.vitalsource.com/books/9781119752523/epub/OPS/c01.xhtml?brand=vitalsource&create=true&favre=brett#c01-feafxd-0021)**)** Services performed by a public accountant include:

1. auditing, taxation, and management consulting.
2. auditing, budgeting, and management consulting.
3. auditing, budgeting, and cost accounting.
4. auditing, budgeting, and management consulting.



**a.** Auditing, taxation, and management consulting are all services performed by public accountants. The other choices are incorrect because public accountants do not perform budgeting or cost accounting.

Use basic accounting equation.

1. (LO 3) At the beginning of the year, Ortiz Company had total assets of $900,000 and total liabilities of $440,000. Answer the following questions.

If total assets decreased $100,000 during the year and total liabilities increased $80,000 during the year, what is the amount of stockholders’ equity at the end of the year?

During the year, total liabilities decreased $100,000, and stockholders’ equity increased $200,000. What is the amount of total assets at the end of the year?

If total assets increased $50,000 during the year and stockholders’ equity increased $60,000 during the year, what is the amount of total liabilities at the end of the year?

($900,000 − $440,000) − $100,000 − $80,000 = $280,000 stockholders’ equity

$900,000 − $100,000 + $200,000 = $1,000,000 total assets

$440,000 − $60,000 + $50,000 = $430,000 total liabilities

Determine effect of transactions on basic accounting equation.

2. (LO 4) The following are three business transactions. Create a table with rows (a), (b), and (c), and columns for assets, liabilities, and stockholders’ equity. For each column, indicate whether the transactions increased (+), decreased (−), or had no effect (NE) on assets, liabilities, and stockholders’ equity.

Purchased equipment on account.

Payment of cash dividends.

Paid expenses in cash.

  Assets Liabilities Stockholders’ Equity

a. + + NE

b. − NE −

c. − NE −

Determine effect of transactions on basic accounting equation.

3. (LO 4) Follow the same format as in Practice Brief Exercise 2. Determine the effect on assets, liabilities, and stockholders’ equity of the following three transactions.

Performed accounting services for clients for cash.

Borrowed cash from a bank on a note payable.

Paid cash for rent for the month.

  Assets Liabilities Stockholders’ Equity

a. + NE +

b. + + NE

c. − NE −

Determine where items appear on financial statements.

4. (LO 5) Indicate whether the following items would appear on the income statement (IS), balance sheet (BS), or retained earnings statement (RES).

Common stock.

Cash.

Salaries and wages expense.

Service revenue.

Accounts payable.

   BS    Common stock.

   BS   Cash.

   IS    Salaries and wages expense.

   IS   Service revenue.

   BS    Accounts payable.

Prepare a balance sheet.

5. (LO 5) Presented below in alphabetical order are balance sheet items for Feagler Company at December 31, 2022. Prepare a balance sheet following the format of Illustration 1.10.

Accounts receivable $12,500

Cash 38,000

Common stock 5,000

Notes payable 40,000

Retained earnings 5,500

Feagler Company

Balance Sheet

December 31, 2022

Assets

Cash   $38,000

Accounts receivable    12,500

Total assets   $50,500

Liabilities and Stockholders’ Equity

Liabilities

Notes payable $40,000

Total liabilities   $40,000

Stockholders’ equity

Common stock 5,000

Retained earnings 5,500  10,500

Total liabilities and stockholders’ equity   $50,500

Practice Exercises

Analyze the effect of transactions.

1. (LO 3, 4) Selected transactions for Beale Lawn Care Company are as follows.

Sold common stock for cash to start business.

Paid monthly utilities.

Purchased land on account.