

*Foundations of Management Specialization*

**Accounting: Making Sound Decisions**

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**Quiz 1 Answers & Explanations**

1. Suppose a business had assets totaling €20,000 and liabilities totaling €17,000. What was its owners' equity?

- a) **€3,000**
- b) €10,000
- c) €20,000
- d) €37,000

Answer: The correct answer is a). Remember the basic accounting identity that always has to hold:  $A = OE + L$ . Therefore  $OE = A - L = 20,000 - 17,000 = 3,000$ .

2. A building, an item of equipment, and an automobile for a company that manufactures and sells clothes may all be examples of:

- a) Current assets
- b) **Non-current assets**
- c) Current liabilities
- d) Non-current liabilities

Answer: The correct answer is b). These are assets that a clothing company normally purchases to run its operations and it plans on keeping them for the long-term.

3. An asset is classified as "current" if:

- a) It is not cash
- b) **It can be converted into cash in the near future**
- c) It can be sold in the near future
- d) It can be converted into cash within 2 years

Answer: The correct answer is b). Current assets include cash and other assets that will be consumed or turned into cash in the short run (usually less than a year).

4. A three-year bank loan to be repaid at maturity is an example of:

- a) Current asset
- b) **Non-current asset**

- c) Current liability
- d) Non-current liability

Answer: The correct answer is d). A non-current liability is an obligation that needs to be repaid in more than one year, like this three-year bank loan. If the maturity of this bank loan had been only one year, then we would have classified it as a current liability.

5. Which of the following statements is correct?

- a) Financial Accounting produces information for internal purposes only.
- b) Auditors are responsible for preparing the annual report.
- c) Only cash transactions should be recorded in the financial statements.
- d) Investors and creditors are, among others, users of financial accounting.

Answer: The correct answer is d). Financial Accounting is the language that managers use to communicate financial and economic information to external users such as investors and creditors. Managers are the ones responsible for preparing the financial statements. Auditors only certify that the financial statements have been prepared according to the accounting principles. Accrual accounting records all the economic transactions that take place in the firm, regardless of whether there is a receipt or payment of cash.

For the remaining questions, please consider the following transactions that happened upon the incorporation of Berry Company by its owner, John Berry, during the first week of January:

- It received €50,000 in cash from John Berry as capital.
- It borrowed €30,000 from local bank.
- It purchased €15,000 of equipment for cash.
- It purchased €20,000 of inventory on account.
- It pre-paid €3,000 for the office rent and €2,000 for the insurance.

6. What is the cash balance at the end of the week?

- a) €40,000
- b) €50,000
- c) €60,000
- d) €80,000

Answer: The correct answer is c). Summary of payments and receipts: +50,000 contributed capital + 30,000 bank loan – 15,000 purchase of equipment – 3,000 prepaid rent – 2,000 prepaid insurance = €60,000.

7. What are the total current assets at the end of the week?

- a) €75,000
- b) €80,000
- c) €85,000
- d) €90,000

Answer: The correct answer is c). Current assets include: +60,000 cash + 20,000 inventory + 3,000 prepaid rent + 2,000 prepaid insurance = €85,000.

8. What are the total liabilities at the end of the week?

- a) €20,000
- b) €30,000
- c) €50,000
- d) €100,000

Answer: The correct answer is c). Total liabilities include: + 30,000 bank loan + 20,000 accounts payable (i.e. amount we owe to suppliers of inventory) = €50,000.

9. What are the total assets at the end of the week?

- a) €15,000
- b) €50,000
- c) €80,000
- d) €100,000

Answer: The correct answer is d). Total assets include: +60,000 cash + 20,000 inventory + 3,000 prepaid rent + 2,000 prepaid insurance + 15,000 equipment = €100,000.

The following table shows the balance of certain accounts of the balance sheet of Holmes, Inc. at the end of December 31 and the following three-day period. By December 31, the company had not yet started its primary operations. However, they had begun some minor activities:

Balances at the close of...	Cash	Inventories	Fixed Assets*	A/P	Bank Loan	Sh. Equity
Dec, 31	11,000	14,000	15,000	5,000	8,000	27,000
Jan, 3	7,000	14,000	15,000	1,000	8,000	27,000
Jan, 4	12,000	14,000	15,000	1,000	13,000	27,000
Jan, 5	8,000	20,000	15,000	3,000	13,000	27,000

\*Fixed assets is the same as Non-current assets.

10. What activity took place on January 3?

- a) They purchased more inventories.
- b) They repaid the bank loan.
- c) They borrowed additional money from the bank.
- d) They paid their suppliers.

Answer: The correct answer is d). Cash decreases by €4,000 and the liability accounts payable also decreases by the same amount. This means they have paid part of the obligation they had with the suppliers.

11. What activity took place on January 4?

- a) They purchased more inventories.

- b) They repaid the bank loan.
- c) They borrowed additional money from the bank.
- d) They paid their suppliers.

Answer: The correct answer is c). Cash increases by €5,000 and the bank loan liability also increases by the same amount. So the bank is lending the company additional money.

12. What activity took place on January 5?

- a) They purchased more inventory.
- b) They repaid the bank loan.
- c) They borrowed additional money from the bank.
- d) They paid their suppliers.

Answer: The correct answer is a). Inventories increase by €6,000. So this means they purchased inventories. As you can observe, €4,000 was paid in cash and the rest on credit (increase of accounts payable by €2,000).