Test Bank for Financial Accounting v4 1st Edition by Hoyle, Kratz, Skender

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Chapter 1

What Is Financial Accounting, and Why Is It Important?

Section 1

True/False Questions

1. The definition of financial accounting is the communication of financial information about a business or other type of organization to internal audiences to help them assess its financial health and future prospects.
   False; Easy

2. Financial accounting is limited to analyzing the financial information conveyed through financial statements.
   False; Easy

3. The knowledge of financial accounting can assist people with decisions such as whether to extend credit to a business.
   True; Easy

4. Employees of a company would not have a reason to use the information provided by financial accounting.
   False; Easy

5. Financial accounting should be used for assessing the financial health of large organizations only.
   False; Moderate

6. Financial accounting can be helpful for a job candidate who is assessing the financial future of a potential employer.
   True; Easy

7. Lenders might use the information produced by financial accounting when making loan decisions.
   True; Easy

8. Credit analysts prefer not to use information provided by financial accounting, as it is not accurate.
   False; Easy

9. Financial accounting is helpful to investment advisors.
   True; Easy

10. Financial accounting is more useful than managerial accounting.
    False; Easy

11. The decision to buy or rent equipment is an example of a decision aided by managerial accounting.
    True; Moderate

Multiple Choice Questions

12. Which of the following statements is true of financial accounting?
    a. It is used to make lease or purchase decisions.
    b. It is primarily used to make internal decisions of a business.
    c. It is used by external parties to make investment decisions.
    d. Managerial accounting is another name for financial accounting,
    e. The effectiveness of advertising can be judged using financial accounting.
    c; Moderate

13. The charge for using money over time, often associated with long-term loans, is known as:
    a. cash dividend
    b. interest
    c. preferred dividend
    d. principal
    e. distribution charge
    b; Easy

14. Which of the following is a decision that would most likely involve managerial accounting information?
    a. loaning money to another company
    b. deciding whether to buy or rent equipment
    c. investing in the stock of another company
    d. deciding whether to extend credit to a potential customer
    e. choosing which employer to work for based on future prospects
    b; Moderate

15. Which of the following decisions would be considered more of a managerial accounting decision than a financial accounting decision?
    a. loaning money to Company X instead of Company Y
    b. determining that Company J is more profitable than Company K
    c. investing in the stock of Company T instead of Company U
    d. deciding the price to be charged for a new product
    e. deciding whether to extend credit to Company L
    d; Moderate

16. Who among the following are the users of managerial accounting information?
    a. lender
    b. competitors
    c. government

d. third party investor
e. board of directors

e; Moderate

17. Who are the common users of financial and managerial accounting information?
    a. government
    b. managers
    c. shareholders
    d. competitors
    e. customers

    b; Moderate

18. Which of the following is a common feature of financial and managerial accounting?
    a. Both have same objectives.
    b. Both are reported at year end in the annual report.
    c. Both are analyzed by external users while making investment decisions.
    d. Both are used by the management in making decisions.
    e. Both are prepared according to U.S. GAAP.

    d; Moderate

19. Financial accounting rules require interest to be reported at a reasonable rate
    a. at the beginning of the accounting period.
    b. when a floating rate is set by the creditor.
    c. when specified interest rate is higher than market rate.
    d. when specified interest rate is less than market rate.
    e. when interest rate is not specifically mentioned in the debt agreement.

    e; Moderate

20. Which of the following statements is true of financial accounting?
    a. Managerial accounting is a branch of financial accounting.
    b. Financial accounting reports are based on accounting principles.
    c. Financial accounting and managerial accounting have same objectives.
    d. Financial accounting information has no relevance for the employees of a company.
    e. Financial accounting is optional for companies.

    b; Moderate

21. The communication of financial information within an organization so that internal decisions can be made in an appropriate manner is known as:
   a. financial accounting
   b. managerial accounting
   c. cost analysis
   d. tax accounting
   e. information analysis

   b; Moderate

Fill In the Blanks

22. _____ accounting is the communication of information about a business so that its financial health can be assessed.
    Financial; Easy

23. The two types of accounting are _____ accounting and _____ accounting.
    financial, managerial; Easy

24. _____ is the communication of financial information for decision-making purposes.
    Accounting; Easy

Short Answer Questions

25. Explain why non-accountants need an understanding of financial accounting.

    Financial accounting conveys information, which helps users make decisions about the financial health of an organization. Employees, prospective employees, loan officers, and investment counselors are just a few of the groups who could benefit from understanding financial accounting.
    Easy

26. Explain the difference between financial accounting and managerial accounting.

    Financial accounting provides information to external users to make decisions about that organization. Managerial accounting provides information for internal decision makers.
    Easy

Section 2

True/False Questions

27. To be considered an owner of a corporation, one must own at least five shares of the corporation's stock.
    False; Easy

28. Stockholders of a corporation are granted all rights as specified by the state government or the stock certificate.
    True; Moderate

29. Stocks traded on a stock exchange will continually go up and down in value.
    True; Easy

30. Owners of business wishing to form a corporation must apply to the federal government for recognition as a legal entity.
    False; Hard

31. To have a business identified as a corporation, its owners must apply to the state government for incorporation.
    True; Easy

32. Stockholders in large corporations like The Coca Cola Company do not typically have a say in the day-to-day operations of the company.
    True; Easy

33. Management of a corporation votes to elect the Board of Directors to make the day-to-day decisions for the company.
    False; Easy

34. A company's stock price is affected by its past profitability.
    True; Moderate

35. Investors hope to make money by investing in stock that will rise in price.
    True; Easy

36. Investors enjoy tax benefits if they sell their stock before they have held it for a year.
    False; Moderate

37. Dividends are required to be paid to stockholders on an annual basis.
    False; Easy

38. An individual who owns one or more shares of stock in a corporation is an owner of that corporation.

True; Easy

39. Corporations do not exist as separate legal entities apart from their owners.
False; Moderate

40. Federal laws prohibit one investor from owning the majority of shares in a corporation.
False; Hard

41. Stock markets match up investors who wish to buy shares with those who wish to sell them.
True; Easy

42. It is difficult to buy or sell ownership shares of a corporation in a stock exchange.
False; Moderate

43. An investor expecting a company's stock price to rise believes that the company has a bright future.
True; Easy

44. An investment in stock is considered virtually risk free.
False; Moderate

45. The only way for stockholders to make money on their investment is when the stock price rises.
False; Moderate

Multiple Choice Questions

46. Which of the following has the authority to formally recognize a business as a separate legal entity?
a. FASB
b. State Government
c. NASDAQ
d. Board of Directors
e. SEC
b; Easy

47. NASDAQ refers to
    a. National Association of Securities Dealers Automated Quotations.
    b. National Association of Stock Dealers Automated Quotations.
    c. National Association of Shares Dealers Automated Quotations.
    d. National Administration for Shares Dealers Automated Quotations.
    e. National Administration of Securities Dealers Automated Quotations.
    a; Easy

48. Legal process by which owners of an organization apply to a state government to have it identified as an entity legally separate from its owners is called:
    a. incorporation
    b. registration
    c. filling
    d. stocking
    e. attributing
    a; Moderate

49. Which of the following is the largest stock exchange in the world?
    a. NASDAQ
    b. New York Stock Exchange
    c. London Stock Exchange
    d. Tokyo Stock Exchange
    e. Shanghai Stock Exchange
    b; Easy

50. An advantage of ownership in a sole proprietorship over ownership in a corporation is
    a. separation of owner and business as legal entities.
    b. tax benefits.
    c. the ability to raise capital through issuance of stock.
    d. limited liability for debts.
    e. having a board of directors.
    b; Moderate

51. An advantage of ownership in a corporation over ownership in a partnership is
    a. tax benefits.
    b. easy establishment.
    c. each stockholder has a say in the operation of the corporation.
    d. the ability to raise capital through issuance of stock.
    e. owner decides the amount of dividend to be distributed.
    d; Moderate

52. The group stockholders elected to oversee their corporation is:
   a. management
   b. the board of directors
   c. employees
   d. a stock exchange
   e. investors
   b; Easy

53. Who elects a corporation's board of directors?
   a. management
   b. stockholders
   c. employees
   d. creditor
   e. government
   b; Easy

54. Who hires the management of a corporation?
   a. board of directors
   b. stockholders
   c. government
   d. creditors
   e. SEC
   a; Easy

55. Who is involved in the day-to-day operations of a corporation?
   a. board of directors
   b. stockholders
   c. government
   d. creditors
   e. management
   e; Easy

56. Which of the following statements is true of stock?
   a. A capital gain is recorded by the corporation when the stock prices increase over a year.
   b. The stock prices are expected to fall after a company declares dividend.
   c. The dividends to be distributed on stock is determined by stockholders.
   d. Investor should own 1 percent of total stock of a company to become a stockholder of the company.
   e. The value of stock traded on a stock exchange fluctuate based on the future prospects of an organization.
   e; Easy

57. One of the advantages of a sole proprietorship or a partnership over incorporation is
    a. easy access to equity capital.
    b. easy access to debt capital.
    c. potential income tax benefits.
    d. limited liability.
    e. access to government funding during distress
    c; Moderate

58. Who makes the decision to pay dividends in a company?
    a. employees
    b. management
    c. stockholders
    d. board of directors
    e. creditors
    d; Moderate

59. Dividend refers to a(n)
    a. reward for being an owner of a prospering business.
    b. reward for being a creditor of a prospering business.
    c. ownership right on a corporation.
    d. liability for holding shares of a corporation.
    e. tax benefit received for holding stocks for over twelve months.
    a; Easy

60. Which of the following benefits can a stockholder accrue from the ownership of capital shares?
    a. cash dividend
    b. receipt of interest
    c. decrease in stock price
    d. increase in competitor's stock price
    e. increase in subsidiary's stock price
    a; Easy

61. Kendra Jackson purchases 120 shares of Kingdom Corporation on May 30 for $36 per share. During July, Kingdom paid dividends of $4.00 per share. On October 19, Kendra is considering selling all of her shares, which are now selling for $40 per share. The value of Kendra's investment on October 19 is:
    a. $4,000
    b. $4,320
    c. $4,800
    d. $5,000
    e. $5,280
    e; Moderate

62. Jonathan purchases 100 shares of Carnival Corporation on July 1, Year One for $20 per share. During September, Carnival distributed dividends of $5 per share. The market price of the stock was $28 per share as of December 31, Year One. Jonathan decided to sell the stock on December 31, Year Two when the stock price was $30 per share. Determine the capital gain to be reported by Jonathan in Year One.
    a. $0
    b. $200
    c. $800
    d. $1,000
    e. $1,500
    c; Moderate

63. A company purchases shares on 1/1/X1 for $150. During the year, quarterly dividends of $1.50 per share were declared and paid. The market price of the stock on 12/31/X1 is $162. What is the investor's return for the year?
    a. 4 percent
    b. 8 percent
    c. 9 percent
    d. 11 percent
    e. 12 percent
    e; Moderate

64. _____ is a factor influencing the movement of a company’s stock price.
    a. The perceived quality of the company’s management
    b. The number of employees working in the company
    c. The death of a shareholder of the company
    d. The salary of the chief executive officer of the company
    e. The movement of a company’s stock which is not in the same industry
    a; Easy

65. The strategy of a corporation is approved by:
    a. an investor
    b. a stockholder
    c. a lender
    d. the government
    e. the board of directors
    e; Moderate

66. The annual rate of return on stock
    a. quantifies the financial benefit earned due to change in net income.
    b. quantifies the financial benefit due to change in cash position of a corporation.
    c. helps select from among multiple investment opportunities.
    d. compares the benefit due to change in stock price with dividend earned on stock.
    e. determines the income earned by holding a stock for less than a year.

    c; Moderate

Fill In the Blanks

67. In income taxes, the difference between the buy and sale price for stock held for over twelve months is a _____.
    long-term capital gain or loss; Moderate

68. A _____ is a reward for being an owner of a business that is prospering.
    dividend; Easy

69. A _____ is a type of organization legally separate from its owners.
    corporation; Easy

70. An individual must own at least _____ share(s) to be considered an owner in a corporation.
    one; Moderate

71. Stock is sold and bought on _____.
    stock exchanges or markets; Moderate

Short Answer Questions

72. Why would a person or organization choose to become a stockholder in a corporation?

    Individuals and organizations invest in the stock of corporations to earn a return. In other words, they hope to see the value of their investment increase. This can be accomplished in two ways: 1) the stock price rises after the stock is purchased and/or 2) the corporation pays dividends to its stockholders.
    Easy

73. What is the role of the board of directors of a corporation?

Not all the stockholders can be a part of the day-to-day operations of a corporation. Therefore, they elect the board of directors to oversee the management of the corporation. The board of directors selects the management of the company as well as determines the timing and amount of dividends.
Moderate

74. Name three factors that influence a stock's price.

Choose three:

1) The perceived quality of the company's management
2) Historical trends in profitability
3) The viability of the industry in which it operates
4) The health of the economy as a whole

Moderate

Problems

75. Marjorie Reynolds recently received a bonus at work and has decided to invest it in the stock of either Fabulous Corporation or Terrific Corporation. Following information is provided:

	Fabulous Corp.	Terrific Corp.
Stock price, 1/1/X1	$98	$76
Stock price, 12/31/X1	$103	$92
Dividend per share during year	$3	$0

a. Determine the value of each share of stock on December 31 as compared with January 1.

Fabulous Corp: **$103 + $3 = $106 per share**
Terrific Corp: **$92 + $0 = $92 per share**

b. Determine the annual rate of return on the two stocks.

Fabulous Corp: **($106 – $98)/$98 = 8.2%**
Terrific Corp: **($92 – $76)/$76 = 21.1%**

c. Based on only your calculations above, in which stock would you recommend Marjorie invest?

Based on only the annual rate of return, it appears that Terrific Corporation would be the better investment alternative as its rate of return of 21.1 percent far outpaces the rate of return of Fabulous Corporation at 8.2 percent.
Moderate

76. Jacqueline Jackson is an investor in Ophelia Corporation. On February 4, 20X8, she purchased 1,000 shares of stock at a price of $15 per share. On June 15, 20X8, Ophelia distributed dividends of $3.00 per share. On December 31, 20X8, Ophelia's stock is selling for $18 per share.

a) Determine the value of a share of Ophelia's stock on December 31.

$18 + $3 = $21 per share

b) Determine the value of Ms. Jackson's investment on December 31.

$21 × 1,000 shares = $21,000
Moderate

77. Mark Ballows is an investment advisor at Young and Ballows. He is looking at the value of two stocks and is considering recommending to clients. Information about these two stocks is as follows:

	Parham Corp.	Ontario Corp.
Stock price, 1/1/X1	$14	$52
Stock price, 12/31/X1	$18	$60
Dividend per share during year	$.50	$1.00

a. Determine the value of each share of stock on December 31 as compared with January 1.

Parham Corp.: $18 + $.5 = $18.50 per share
Ontario Corp.: $60 + $1 = $61 per share

b. Determine the annual rate of return on the two stocks.

Parham Corp.: ($18.50 – $14)/$14 = 32.1%
Ontario Corp.: ($61 – $52)/$52 = 17.3%
Moderate

Section 3

True/False Questions

78. Potential creditors are interested in the existing amount of debt of a company.
    True; Easy

79. Financial data includes information, which can be measured in both monetary and nonmonetary terms.
    False; Easy

80. The number of employees of a company is not considered as financial information.
    True; Moderate

81. The number of mp3 players in a company's inventory is not financial information, but the fact that they have a value of $489,000 is considered financial information.
    True; Moderate

82. Verbal explanations of financial information are not permitted.
    False; Easy

83. Financial data is only beneficial to investors and potential investors.
    False; Easy

84. Financial data is measured in monetary terms.
    True; Easy

85. The fact that a company has a cash balance of $456,000 is financial information.
    True; Easy

86. Financial information can be accompanied by verbal explanations.
    True; Easy

Multiple Choice Questions

87. A company's creditors are those who
    a. have invested in the company's shares.
    b. have purchased the company's inventory.
    c. have lent the company money.
    d. the company have lent money.
    e. are eligible to receive dividends declared by the company.
    c; Easy

88. Hank Dowell is a loan officer at Small Town Bank. He is reviewing Chessney Company for a loan. Which of the following is likely to be the most important in Hank's decision whether to approve the loan for Chessney?
   a. Chessney has paid dividends to stockholders for the past two years.
   b. Chessney's stock price has risen over the past year.
   c. Chessney has sufficient cash flow to pay interest.
   d. Analysts predict that Chessney's stock will continue to rise.
   e. Chessney's board of directors has indicated that the company will pay dividends again this year.
   c; Moderate

89. Inventory refers to the
   a. excess amount paid for an asset over its fair value.
   b. amount of net income reinvested by company for future operations.
   c. merchandise bought or manufactured for the purpose of selling.
   d. intangible assets of a business.
   e. revenue generated from investment.
   c; Easy

90. Investors use financial information to predict whether a
   a. company has invested in buildings.
   b. company will pay salaries.
   c. company will recruit more employees.
   d. company's stock price will increase
   e. company's bond price will increase.
   d; Easy

91. Creditors use financial information to predict whether a
   a. company will be able to pay dividends.
   b. company will be able to pay interest.
   c. company will be able to pay salaries.
   d. company will be able to issue additional shares.
   e. company's stock price will increase.
   b; Easy

92. Which of the following would be considered as financial information reported by a corporation?
   a. Buildings – $4,800,000
   b. Goods sold last year – 5,000 units
   c. Investment – 500 shares of Coco Cola Inc.
   d. Number of employees – 800
   e. Production rate – 5 units per hour
   a; Easy

93. Financial information reported by an organization consists of data that can be
    a. explained verbally.
    b. explained in quantifiable terms.
    c. measured in monetary terms.
    d. measured in numerical terms.
    e. measured in percentage.

    c; Easy

94. Which of the following would be considered as verbal explanation for Bullox Corporation?
    a. Bullox has buildings worth $4,800,000.
    b. Bullox had sales last year of $15,699,000.
    c. Bullox owes James River Bank $800,000.
    d. Bullox owns 7,000 acres of land.
    e. Bullox pays its employees $490,000.

    d; Easy

95. Saturn Corporation is facing a lawsuit for copyright infringement. Dealin Corporation filed the case. Determine which of the following estimates will be reported as financial information by Saturn Corporation.
    a. The market price of Saturn Corporation will drop in the current fiscal year.
    b. The case is expected to resolve in 2 years.
    c. The case is expected to be in favor of Dealin Corporation.
    d. The loss on lawsuit is expected to be $20,000.
    e. The company is expecting a 5 percent drop in sale after the lawsuit is resolved.

    d; Moderate

96. Which of the following statements provide rationale for investor's preference to invest in capital stock rather than other forms of investment like real estate?
    a. The rate of return is fixed in capital market.
    b. The capital stock market is liquid.
    c. The price of capital stock is not as volatile as prices of real estate.
    d. The capital stocks generally provide a smaller rate of return than real estate.
    e. The price of capital stock is not affected by changes in the taxation policy.

    b; Moderate

Fill In the blanks

97. _____ explanations are included with financial information to clarify information.
    Verbal; Easy

Short Answer Questions

98. Discuss how the assessment of a company's financial information by a potential stockholder would differ from the assessment of a potential creditor.

    Potential stockholders are primarily interested in assessing 1) the likelihood of company's stock price rise in the future and 2) the amount of cash dividends the company is likely to pay in the future. Potential creditors are more interested in the whether or not the company has sufficient cash flows to meet principal and interest payments.
    Moderate

99. Name at least three potential users of a company's financial information and briefly explain how each user might use the information.

    Choose three:

1) Investors predict the fluctuations in stock price of a company and the amount of dividends it may pay in the future.
2) Creditors are interested in how much debt a company already has and whether it has sufficient cash flows to meet principal and interest obligations.
3) Current employees are interested in whether their employer will remain in business and how much will be available for pay hikes and bonuses.
4) Prospective employees would want to see the likelihood of a company to remain in business.
5) Suppliers and others extending credit are interested in how much a company currently owes and the likelihood they will be paid.
    Easy

100. Explain why verbal explanations are included with financial information.

    Verbal explanations are included to clarify or expand on the monetary information presented. For example, the potential loss on a lawsuit might be included in the financial statements. A verbal explanation about the lawsuit could be included to provide more information to users.
    Easy

Problems

101. Mark each of the following with an (F) to indicate if it is financial information or an (N) to indicate if it is non-financial information.

a. ______ Building worth $5,000,000
b. ______ Number of employees = 900
c. ______ Inventory balance of $30,000
d. ______ Number of shares of stock = 840
e. ______ 11 locations around the city

a. F
b. N
c. F
d. N
e. N
Easy

102. Mark each of the following with an (F) to indicate if it is financial information or an (N) to indicate if it is non-financial information.

a. ______ 3,000 vehicles in stock
b. ______ 500 locations across the country
c. ______ Cash balance of $560
d. ______ Owes $450,000 to the bank
e. ______ Salaries for last year = $2,300,000

a. N
b. N
c. F
d. F
e. F
Easy

