

Chapter 01 Accounting: The Language of Business

True / False Questions

1. The purpose of accounting is to provide financial information about an economic or social entity.

True False

2. An accounting system is designed to accumulate and classify data about a firm's financial affairs and summarize it in the general journal.

True False

3. In a sole proprietorship, the owner is responsible for the debts of the business if the firm is unable to pay.

True False

4. Laws passed by Congress in 1933 and 1934 gave the Securities and Exchange Commission (SEC) final say on matters of financial reporting by publicly owned corporations.

True False

5. Currently, generally accepted accounting principles are developed by the American Institute of Certified Public Accountants (AICPA)

True False

6. The Securities and Exchange Commission (SEC) requires that publicly owned corporations submit financial statements to it each year.

True False

7. Public accounting firms provide three major types of services: auditing, tax accounting, and management advisory services.

True False

8. The financial statements and the auditor's report must be made available to stockholders of publicly owned corporations.

True False

9. Anyone can invest in a closely held corporation.

True False

10. Tax planning is any activity associated with the preparation of tax returns and the audit of those returns.

True False

11. The separate entity assumption applies only to the corporate form of business.

True False

12. As the first step in the development of generally accepted accounting principles, the FASB writes an exposure draft, which explains the topic under consideration.

True False

13. Public accountants work on the staff of federal, state, or local governmental units.

True False

14. The SEC uses financial information to determine a company's tax base.

True False

15. The death or withdrawal of one partner ends the partnership.

True False

16. Accounting is defined as the process by which financial information about a business is recorded, classified, summarized, interpreted, and communicated to owners, managers, and other interested parties.

True False

17. The owners and managers of a business are the only users of the Financial Information.

True False

18. Most owners and managers rely heavily on the accountant's judgment and knowledge when making financial decisions.

True False

19. Accountants provide financial information to various parties so they can make business decisions.

True False

20. When a business is organized as a sole proprietorship, the owner may combine his/her personal financial information with the business financial information.

True False

21. A business partnership can have only two partners.

True False

Fill in the Blank Questions

22. Accounting is often referred to as the language of _____.

23. The results of the accounting process are summarized in periodic reports called financial _____.

24. Nonprofit organizations, such as cities, public schools, and public hospitals, are referred to as _____ entities.

25. The three major legal forms of business entity are the sole proprietorship, the partnership, and the _____.

26. A partnership has _____ or more owners.

27. Ownership in a corporation is evidenced by shares of _____.

28. The Securities and Exchange Commission (SEC) regulates the accounting methods and financial reporting of _____ owned corporations.

29. The financial statements submitted to the SEC by a corporation must be _____ by an independent accountant to ensure their fairness and adherence to generally accepted accounting principles.

30. Accountants normally choose to practice in one of three areas: public accounting, managerial accounting, or _____ accounting.

31. A form of business entity owned by one person is called a(n) _____.

32. The people, companies, or government agencies to whom a firm owes money are called _____.

33. The process by which financial information about a business is recorded, classified, summarized, interpreted, and communicated to owners, managers, and other interested parties is called _____.

34. Tax accounting is a service offered by public accounting firms that involves tax _____ and tax planning.

35. Generally accepted accounting _____ are financial accounting standards that are changed and refined in response to changes in the environment in which businesses operate.

36. The owners of a corporation are called _____.

Multiple Choice Questions

37. Which of the following is NOT an area in which accountants usually practice?

- A. Public Accounting
- B. Industrial Accounting
- C. Governmental Accounting
- D. Managerial (Private) Accounting

38. An example of an economic entity is

- A. a town.
- B. a business.
- C. a nonprofit hospital.
- D. a church.

39. The form of a business organization that is not affected by the withdrawal or death of an owner and can continue forever is

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- B. the partnership.
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40. Which of the following is NOT a type of information communicated by the financial statements?

- A. Whether or not the business is profitable
- B. What types of assets business owns
- C. How long the business has been in operation
- D. How much the business owes others

41. Which of the following is NOT a type of information communicated by the financial statements?

- A. The equity, or value, of the business
- B. The amount spent on costs (expenses) of the business
- C. The types of products and services the business provides
- D. The amount of revenue earned by the business

42. The Financial Accounting Standards Board is responsible for

- A. auditing financial statements.
- B. developing generally accepted accounting principles.
- C. establishing accounting systems for businesses.
- D. making recommendations to the Securities and Exchange Commission.

43. The government agency that has final authority over the financial reporting of publicly owned corporations is

- A. the Securities and Exchange Commission.
- B. the Federal Trade Commission.
- C. the Internal Revenue Service.
- D. the Financial Accounting Standards Board.

44. The financial affairs of a business and the financial affairs of the owners should be

- A. combined in the firm's accounting records.
- B. reported in different parts of the firm's accounting records.
- C. combined only if the owner wants them to be.
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45. All financial statements submitted to the SEC by publicly owned corporations must include an auditor's report prepared by

- A. an internal auditor.
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46. The area of accounting that involves the preparation of internal reports for a firm's executives and the analysis of the data in these reports to aid in decision making is known as

- A. financial accounting.
- B. managerial accounting.
- C. auditing.
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47. The corporations whose stock can be bought and sold on stock exchanges and in over-the-counter markets are referred to as

- A. privately owned corporations.
- B. closely held corporations.
- C. publicly owned corporations.
- D. sole proprietorships.

48. The group of accounting educators who offer their opinions about proposed FASB statements, after research has been done to determine the possible effects on financial reporting and the economy, is

- A. the FCC.
- B. the AICPA.
- C. the SEC.
- D. the AAA.

49. Owners are not personally responsible for the debts of the business if the form of business organization is

- A. the sole proprietorship.
- B. the partnership.
- C. the corporation.
- D. the nonprofit organization.

50. A firm issues periodic reports called

- A. financial statements.
- B. summaries.
- C. tax returns.
- D. audits.

51. Which of the following is NOT part of the process of accounting for financial information?

- A. Recording
- B. Identifying
- C. Communicating
- D. Classifying

52. Which of the following is NOT a service of public accounting firms?

- A. Auditing
- B. Tax accounting
- C. Management advisory services
- D. Investment services

53. Tax accounting involves tax compliance and

- A. tax evaluation.
- B. tax planning.
- C. tax configuration.
- D. tax obfuscation.

54. Tax planning includes

- A. preparing tax returns.
- B. auditing tax returns.
- C. correcting tax returns.
- D. suggesting actions to reduce tax liability.

55. Managerial accounting is

- A. public accounting.
- B. government accounting.
- C. private accounting.
- D. tax accounting.

56. The following are all government agencies except

- A. SEC.
- B. AICPA.
- C. IRS.
- D. FBI.

57. An act passed in response to the wave of corporate accounting scandals is the

- A. Saxon-Ordanly Act.
- B. Sarbanes-Oxley Act.
- C. Sardonic-Oxone Act.
- D. Sorbine-Oxide Act.

58. Owners and managers need financial information in order to

- A. grant loans.
- B. issue credit.
- C. collect taxes.
- D. make decisions.

59. The Sarbanes-Oxley Act includes rules on

- A. auditor retention.
- B. auditor reliability.
- C. auditor rotation.
- D. auditor reporting.

60. A form of the partnerships business entity is

- A. LLP.
- B. LLC.
- C. INC.
- D. DBA.

61. The FASB develops Statements of Financial Accounting Standards in the following order

- A. issues an exposure draft, obtains responses to the exposure draft, issues a statement of principle, issues a discussion memorandum, obtains responses to the discussion memorandum
- B. issues a discussion memorandum, obtains responses to the discussion memorandum, issues an exposure draft, obtains responses to the exposure draft, issues a statement of principle
- C. issues a discussion memorandum, obtains responses to the discussion memorandum, issues a statement of principle, issues an exposure draft, obtains responses to the exposure draft
- D. issues a statement of principle, issues a discussion memorandum, obtains responses to the discussion memorandum, issues an exposure draft, obtains responses to the exposure draft

62. The review of financial statements to assess their fairness and adherence to GAAP is

- A. accounting.
- B. preparation.
- C. compliance.
- D. auditing.

63. Management advisory services are designed to help

- A. government agencies.
- B. clients.
- C. employers.
- D. creditors.

64. An independent accountant who provides accounting services to the public for a fee is a

- A. CIA.
- B. CFE.
- C. CMA.
- D. CPA.

Short Answer Questions

65. What is the "language of business?" List three groups who use this financial information.

66. Cullen Company of country X and Shaw Industries of country Y have issued financial statements in compliance with the accounting principles of their respective countries. They would like to work together on a project and need to compare their current financial statements prior to beginning. However, the accounting principles of the two countries differ. What organization might they turn to regarding this issue? (Give both the full name of the organization and its acronym.) What is the function of this organization?

67. You have just entered college and decide to pursue a career as an accountant. What are the three areas in which an accountant can practice?

68. There are three general services public accountants offer. List and briefly describe each.

69. List at least five activities performed by managerial accountants.

70. Discuss the differences among: entity, economic entity, and social entity.

71. How do sole proprietorships, partnerships, and corporations differ?

72. List three individuals or groups who use financial information to make decisions about a firm. For each listed, give an example of why they would need the information.

73. List the "Big Four" public accounting firms in the United States.

74. Audited financial statements include an auditor's report. What does this auditor's report contain?

75. List at least three of the provisions of the Sarbanes-Oxley Act.

76. Explain the process the Financial Accounting Standards Board (FASB) employs to develop and issue Statements of Financial Accounting Standards.

77. What determines the independence of Certified Public Accountants (CPAs)?

Chapter 01 Accounting: The Language of Business **Answer Key**

True / False Questions

1. The purpose of accounting is to provide financial information about an economic or social entity.

TRUE

*AACSB: Analytic
AICPA BB: Industry
Bloom's: Remember
Learning Objective: 01-01 Define accounting.
Level: Easy
Topic: What is Accounting?*

2. An accounting system is designed to accumulate and classify data about a firm's financial affairs and summarize it in the general journal.

FALSE

*AACSB: Analytic
AICPA BB: Industry
Bloom's: Remember
Learning Objective: 01-01 Define accounting.
Learning Objective: 01-06 Define the accounting terms new to this chapter.
Level: Easy
Topic: What is Accounting?*

3. In a sole proprietorship, the owner is responsible for the debts of the business if the firm is unable to pay.

TRUE

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AICPA BB: Critical Thinking
Bloom's: Remember
Learning Objective: 01-04 Compare and contrast the three types of business entities.
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Topic: Business and Accounting*

4. Laws passed by Congress in 1933 and 1934 gave the Securities and Exchange Commission (SEC) final say on matters of financial reporting by publicly owned corporations.

TRUE

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AICPA BB: Legal
Bloom's: Remember
Learning Objective: 01-03 Identify the users of financial information.
Level: Medium
Topic: What is Accounting?*

5. Currently, generally accepted accounting principles are developed by the American Institute of Certified Public Accountants (AICPA)

FALSE

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Learning Objective: 01-05 Describe the process used to develop generally accepted accounting principles.
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6. The Securities and Exchange Commission (SEC) requires that publicly owned corporations submit financial statements to it each year.

TRUE

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Learning Objective: 01-05 Describe the process used to develop generally accepted accounting principles.
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7. Public accounting firms provide three major types of services: auditing, tax accounting, and management advisory services.

TRUE

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AICPA BB: Industry
Bloom's: Remember
Learning Objective: 01-02 Identify and discuss career opportunities in accounting.
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8. The financial statements and the auditor's report must be made available to stockholders of publicly owned corporations.

TRUE

AACSB: Analytic

AICPA BB: Industry

Bloom's: Remember

Learning Objective: 01-05 Describe the process used to develop generally accepted accounting principles.

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Topic: Business and Accounting

9. Anyone can invest in a closely held corporation.

FALSE

AACSB: Analytic

AICPA BB: Industry

Bloom's: Remember

Learning Objective: 01-04 Compare and contrast the three types of business entities.

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10. Tax planning is any activity associated with the preparation of tax returns and the audit of those returns.

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FALSE

AACSB: Analytic

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Learning Objective: 01-05 Describe the process used to develop generally accepted accounting principles.

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Topic: Business and Accounting

13. Public accountants work on the staff of federal, state, or local governmental units.

FALSE

AACSB: Analytic

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Learning Objective: 01-02 Identify and discuss career opportunities in accounting.

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FALSE

AACSB: Analytic

AICPA BB: Legal

Bloom's: Remember

Learning Objective: 01-03 Identify the users of financial information.

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15. The death or withdrawal of one partner ends the partnership.

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Learning Objective: 01-04 Compare and contrast the three types of business entities.

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Topic: Business and Accounting

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Learning Objective: 01-01 Define accounting.
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FALSE

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21. A business partnership can have only two partners.

FALSE

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Learning Objective: 01-04 Compare and contrast the three types of business entities.
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Fill in the Blank Questions

22. Accounting is often referred to as the language of _____.

business

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23. The results of the accounting process are summarized in periodic reports called financial

_____.
statements

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24. Nonprofit organizations, such as cities, public schools, and public hospitals, are referred to as _____ entities.

social

AACSB: Analytic
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25. The three major legal forms of business entity are the sole proprietorship, the partnership, and the _____.

corporation

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Learning Objective: 01-04 Compare and contrast the three types of business entities.
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26. A partnership has _____ or more owners.

two

AACSB: Analytic
AICPA BB: Industry
Bloom's: Remember
Learning Objective: 01-04 Compare and contrast the three types of business entities.
Level: Easy
Topic: Business and Accounting

27. Ownership in a corporation is evidenced by shares of _____.
stock

AACSB: Analytic
AICPA BB: Industry
Bloom's: Remember
Learning Objective: 01-04 Compare and contrast the three types of business entities.
Level: Easy
Topic: Business and Accounting

28. The Securities and Exchange Commission (SEC) regulates the accounting methods and financial reporting of _____ owned corporations.
publicly

AACSB: Analytic
AICPA BB: Legal
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29. The financial statements submitted to the SEC by a corporation must be _____ by an independent accountant to ensure their fairness and adherence to generally accepted accounting principles.
audited

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Learning Objective: 01-05 Describe the process used to develop generally accepted accounting principles.
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30. Accountants normally choose to practice in one of three areas: public accounting, managerial accounting, or _____ accounting.
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31. A form of business entity owned by one person is called a(n) _____.
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32. The people, companies, or government agencies to whom a firm owes money are called _____.
creditors

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34. Tax accounting is a service offered by public accounting firms that involves tax _____ and tax planning.

compliance

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principles

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Learning Objective: 01-05 Describe the process used to develop generally accepted accounting principles.

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Topic: Business and Accounting

36. The owners of a corporation are called _____.

stockholders; shareholders

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Multiple Choice Questions

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AACSB: Analytic

AICPA BB: Legal

Bloom's: Remember

Learning Objective: 01-02 Identify and discuss career opportunities in accounting.

Level: Easy

Topic: What is Accounting?

57. An act passed in response to the wave of corporate accounting scandals is the

- A. Saxon-Ordanly Act.
- B. Sarbanes-Oxley Act.**
- C. Sardonic-Oxone Act.
- D. Sorbine-Oxide Act.

AACSB: Analytic

AICPA BB: Legal

Bloom's: Remember

Learning Objective: 01-03 Identify the users of financial information.

Level: Medium

Topic: What is Accounting?

58. Owners and managers need financial information in order to
- A. grant loans.
 - B. issue credit.
 - C. collect taxes.
 - D.** make decisions.

AACSB: Analytic
AICPA BB: Industry
Bloom's: Remember
Learning Objective: 01-03 Identify the users of financial information.
Level: Easy
Topic: What is Accounting?

59. The Sarbanes-Oxley Act includes rules on
- A. auditor retention.
 - B. auditor reliability.
 - C.** auditor rotation.
 - D. auditor reporting.

AACSB: Analytic
AICPA BB: Legal
Bloom's: Remember
Learning Objective: 01-03 Identify the users of financial information.
Level: Medium
Topic: What is Accounting?

60. A form of the partnerships business entity is
- A.** LLP.
 - B. LLC.
 - C. INC.
 - D. DBA.

AACSB: Analytic
AICPA BB: Industry
Bloom's: Remember
Learning Objective: 01-04 Compare and contrast the three types of business entities.
Level: Medium
Topic: Business and Accounting

61. The FASB develops Statements of Financial Accounting Standards in the following order
- A. issues an exposure draft, obtains responses to the exposure draft, issues a statement of principle, issues a discussion memorandum, obtains responses to the discussion memorandum
 - B.** issues a discussion memorandum, obtains responses to the discussion memorandum, issues an exposure draft, obtains responses to the exposure draft, issues a statement of principle
 - C. issues a discussion memorandum, obtains responses to the discussion memorandum, issues a statement of principle, issues an exposure draft, obtains responses to the exposure draft
 - D. issues a statement of principle, issues a discussion memorandum, obtains responses to the discussion memorandum, issues an exposure draft, obtains responses to the exposure draft

AACSB: Analytic

AICPA BB: Legal

Bloom's: Remember

Learning Objective: 01-05 Describe the process used to develop generally accepted accounting principles.

Level: Medium

Topic: Business and Accounting

62. The review of financial statements to assess their fairness and adherence to GAAP is
- A. accounting.
 - B. preparation.
 - C. compliance.
 - D.** auditing.

AACSB: Analytic

AICPA BB: Industry

Bloom's: Remember

Learning Objective: 01-02 Identify and discuss career opportunities in accounting.

Learning Objective: 01-06 Define the accounting terms new to this chapter.

Level: Easy

Topic: What is Accounting?

63. Management advisory services are designed to help
- A. government agencies.
 - B.** clients.
 - C. employers.
 - D. creditors.

AACSB: Analytic

AICPA BB: Industry

Bloom's: Remember

Learning Objective: 01-02 Identify and discuss career opportunities in accounting.

Learning Objective: 01-06 Define the accounting terms new to this chapter.

Level: Easy

Topic: What is Accounting?

64. An independent accountant who provides accounting services to the public for a fee is a
- A. CIA.
 - B. CFE.
 - C. CMA.
 - D.** CPA.

AACSB: Analytic

AICPA BB: Industry

Bloom's: Remember

Learning Objective: 01-02 Identify and discuss career opportunities in accounting.

Learning Objective: 01-06 Define the accounting terms new to this chapter.

Level: Easy

Topic: What is Accounting?

Short Answer Questions

65. What is the "language of business?" List three groups who use this financial information.

Accounting is the language of business. The groups who use this information are owners and managers, suppliers, banks, tax authorities, regulatory agencies and investors, customers, and employees and unions.

AACSB: Analytic

AICPA BB: Industry

Bloom's: Understand

Learning Objective: 01-01 Define accounting.

Learning Objective: 01-03 Identify the users of financial information.

Level: Easy

Topic: What is Accounting?

66. Cullen Company of country X and Shaw Industries of country Y have issued financial statements in compliance with the accounting principles of their respective countries. They would like to work together on a project and need to compare their current financial statements prior to beginning. However, the accounting principles of the two countries differ. What organization might they turn to regarding this issue? (Give both the full name of the organization and its acronym.) What is the function of this organization?

Organization: International Accounting Standards Board (IASB). The function of the IASB is to deal with issues caused by the lack of uniform accounting principles and make recommendations to enhance comparability.

AACSB: Analytic

AICPA BB: Global

Bloom's: Understand

Learning Objective: 01-05 Describe the process used to develop generally accepted accounting principles.

Level: Medium

Topic: Business and Accounting

67. You have just entered college and decide to pursue a career as an accountant. What are the three areas in which an accountant can practice?

Public accounting, managerial (private) accounting, and governmental accounting

AACSB: Analytic

AICPA BB: Industry

Bloom's: Remember

Learning Objective: 01-02 Identify and discuss career opportunities in accounting.

Level: Easy

Topic: What is Accounting?

68. There are three general services public accountants offer. List and briefly describe each.

Auditing: the review of financial statements to assess their fairness and adherence to GAAP.

Tax accounting: tax compliance-dealing with the preparation of tax returns and the audit of those returns, and tax planning-giving advice to clients on how to structure their financial affairs in order to reduce their tax liability.

Management advisory services: helping clients improve their information systems or their business performance.

AACSB: Analytic

AICPA BB: Industry

Bloom's: Understand

Learning Objective: 01-02 Identify and discuss career opportunities in accounting.

Level: Easy

Topic: What is Accounting?

69. List at least five activities performed by managerial accountants.

Establishing accounting policies, managing the accounting system, preparing financial statements, interpreting financial information, providing financial advice to management, preparing tax forms, performing tax planning services, and preparing internal reports for management.

AACSB: Analytic

AICPA BB: Industry

Bloom's: Remember

Learning Objective: 01-02 Identify and discuss career opportunities in accounting.

Level: Easy

Topic: What is Accounting?

70. Discuss the differences among: entity, economic entity, and social entity.

Entity-recognized as having its own separate identity. **Social entity-**nonprofit organizations.

Economic entity-business or organization whose major purpose is to produce a profit.

AACSB: Analytic

AICPA BB: Industry

Bloom's: Understand

Learning Objective: 01-04 Compare and contrast the three types of business entities.

Level: Medium

Topic: Business and Accounting

71. How do sole proprietorships, partnerships, and corporations differ?

Sole proprietorships-business entities owned by one person who is responsible for the business debts and taxes. The business ends when the owner dies. Partnerships-business entities owned by two or more individuals who are individually, and as a group, responsible for the partnership's debts and taxes. A partnership ends when one or more partners withdraw or die. Corporations-business entities with one or more owners which can continue indefinitely unless bankruptcy occurs or the stockholders vote to liquidate. Stockholders (owners) are not personally responsible for the corporation's debts and can only lose the amount they invested.

AACSB: Analytic

AICPA BB: Industry

Bloom's: Evaluate

Learning Objective: 01-04 Compare and contrast the three types of business entities.

Level: Easy

Topic: Business and Accounting

72. List three individuals or groups who use financial information to make decisions about a firm. For each listed, give an example of why they would need the information.

Owners and managers-to evaluate results of operations or to make decisions about the future. Suppliers-to assess the ability of the firm to pay its bills and to set credit limits. Banks-to determine whether the firm can repay the loan in a timely manner. Tax authorities-to determine the tax base of the firm. Regulatory agencies and investors-to fulfill the requirements of the law. Customers-to determine whether service on purchases will continue into the future. Employees and unions-to negotiate wages and benefits.

AACSB: Analytic

AICPA BB: Industry

Bloom's: Remember

Learning Objective: 01-03 Identify the users of financial information.

Level: Easy

Topic: What is Accounting?

73. List the "Big Four" public accounting firms in the United States.

Deloitte & Touche, Ernst & Young, KPMG, and PricewaterhouseCoopers

AACSB: Analytic
AICPA BB: Industry
Bloom's: Remember
Learning Objective: 01-02 Identify and discuss career opportunities in accounting.
Level: Medium
Topic: What is Accounting?

74. Audited financial statements include an auditor's report. What does this auditor's report contain?

It contains the auditor's opinion regarding the fairness of the firm's financial statements and confirms the adherence to GAAP in those financial reports.

AACSB: Analytic
AICPA BB: Industry
Bloom's: Analyze
Learning Objective: 01-05 Describe the process used to develop generally accepted accounting principles.
Level: Hard
Topic: Business and Accounting

75. List at least three of the provisions of the Sarbanes-Oxley Act.

The act: tightens regulation of financial reporting by publicly held companies and their accountants and auditors; creates a five-member Public Company Accounting Oversight Board to oversee the accounting profession which in turn is overseen by the SEC; includes rules on consulting services, auditor rotation, criminal penalties, corporate governance, and securities regulation; requires auditors to maintain all audit or review work papers for five years; requires chief executives and chief financial officers of publicly traded corporations to certify their financial statements; requires quicker disclosure of material changes in a firm's financial position; provides protection for whistle blowers; and lengthens the time investors have to file lawsuits for securities fraud.

AACSB: Analytic
AICPA BB: Legal
Bloom's: Analyze
Learning Objective: 01-02 Identify and discuss career opportunities in accounting.
Level: Medium
Topic: What is Accounting?

76. Explain the process the Financial Accounting Standards Board (FASB) employs to develop and issue Statements of Financial Accounting Standards.

The FASB writes a discussion memorandum explaining the topic under consideration. Then it holds public hearings so interested parties can express their opinions orally or in writing. After these hearings, the FASB releases an exposure draft describing the proposed statement. FASB then receives and evaluates public comment about the draft, and finally FASB members vote on the statement, which, if approved by four of the seven members, is then issued.

AACSB: Analytic

AICPA BB: Legal

Bloom's: Analyze

Learning Objective: 01-05 Describe the process used to develop generally accepted accounting principles.

Level: Hard

Topic: Business and Accounting

77. What determines the independence of Certified Public Accountants (CPAs)?

They are not employees of the companies they audit and they do not have a financial interest in those companies.

AACSB: Analytic

AICPA BB: Industry

Bloom's: Analyze

Learning Objective: 01-05 Describe the process used to develop generally accepted accounting principles.

Level: Hard

Topic: Business and Accounting