

EXERCISES: UNIT 1

SHORT ANSWER QUESTIONS, EXERCISES AND PROBLEMS

A) Question

Accounting has often been called the language of business. In what respects would you agree with this description? How might you argue that this description is deficient?

B) Comprehensive Review Questions

- Why do we need financial information?
- What is accounting?
- What is Business?
- Who are the three people that want to know the story of your business?
- Describe the language of Accounting does the government use?
- Describe the language of Accounting do Investors use?
- Describe the language of Accounting do internal users employ?
- Describe the difference between Financial and Managerial Accounting.
- Define the Accounting Cycle.
- Identify internal and external users of financial information?
- What is general purpose of financial statements?
- What are the most common types of business entities?
- How a corporation differ from a partnership in context of the ownership?
- Describe the Limited-Liability Company?
- What is the purpose of Sarbanes–Oxley Act?
- What is the role of the Securities and Exchange Commission?
- What is the role of ethics in accounting?

Exercises

Exercise A Match the descriptions in Column B with the appropriate terms in Column A.

	Column A		Column B
1.	Corporation.	a.	An unincorporated business owned by an individual.
2.	Merchandising company.	b.	The form of organization used by most large businesses.
3.	Partnership.	c.	Buys raw materials and converts them into finished products.
4.	Manufacturing company.	d.	Buys goods in their finished form and sells them to

5.	Service company.		customers in that same form.
6.	Single proprietorship.	e.	An unincorporated business with more than one owner.
		f.	Performs services for a fee.

Beyond the numbers—critical thinking

Business decision case A Upon graduation from high school, Jim Crane went to work for a builder of houses and small apartment buildings. During the next six years, Crane earned a reputation as an excellent employee—hardworking, dedicated, and dependable—in the light construction industry. He could handle almost any job requiring carpentry, electrical, or plumbing skills.

Crane then decided to go into business for himself under the name Jim’s Fix-It Shop, Inc. He invested cash, some power tools, and a used truck in his business. He completed many repair and remodeling jobs for homeowners and apartment owners. The demand for his services was so large that he had more work than he could handle. He operated out of his garage, which he had converted into a shop, adding several new pieces of power woodworking equipment.

Now, two years after going into business for himself, Crane must decide whether to continue in his own business or to accept a position as construction supervisor for a home builder. He has been offered an annual salary of \$ 50,000 and a package of fringe benefits (medical and hospitalization insurance, pension contribution, vacation and sick pay, and life insurance) worth approximately \$ 8,000 per year. The offer is attractive to Crane. But he dislikes giving up his business since he has thoroughly enjoyed being his own boss, even though it has led to an average workweek well in excess of the standard 40 hours

Suppose Crane comes to you for assistance in gathering the information needed to help him make a decision. He brings along the accounting records that have been maintained for his business by an experienced accountant. Using logic and your own life experiences, indicate the nature of the information Jim needs if he is to make an informed decision. Pay particular attention to the information likely to be found in his business accounting records. Does the accounting information available enter directly into the decision? Write a memorandum to Jim describing the information he will need to make an informed decision. The memo’s headings should include Date, To, From, and Subject. (See the format in Group Project E below.)

Annual report analysis B Recall that in this chapter we showed that the equity ratio is calculated by dividing stockholders’ equity by total equities (or total assets). Another format for analyzing solvency is to divide total debt by total equities. This latter calculation tells the proportion of assets financed by debt rather than the proportion of assets financed by stockholders’ equity. These two ratios are complements and must add to 100 per cent. Thus, if 25 per cent of assets were financed by debt, 75 per cent were financed by stockholders’ equity.

Using the following historical data from Gateway, calculate the “total-debt-to total-capital” ratio for each year.

	2003	2002	2001	2000	1999	1998	1997
Total liabilities (000’s)	\$ 1,772,205	\$ 1,937,570	\$ 1,546,005	\$ 1,109,337	\$ 857,870	\$ 568,492	\$ 394,545
Total stockholders equity	2380339	2017118	1344375	930044	815541	555519	376035

Study these amounts and comment on the solvency of the company. Is there a trend in the company's solvency over time? Gateway has experienced tremendous growth in stockholders' equity during the past six years, but has also increased liabilities significantly. Could Gateway have grown this much without increasing liabilities?

Annual report analysis C Look at The Limited, Inc., annual report in the Annual report appendix. In that report you will find a letter outlining Management's responsibilities concerning the financial statements, as well as the report of the independent auditors.

Write answers to the following questions:

Who is responsible for preparing the financial statements?

Of what importance is the internal audit?

What is the role of the audit committee?

Why are no officers or employees on the audit committee?

What is the responsibility of the external independent auditor?

Does the independent auditor have absolute assurance that the financial statements are free of material misstatement?

To what extent does the independent auditor examine evidence?

Ethics case- writing experience D Refer to "An ethical perspective: State university". Write a short essay discussing the alternatives James Stevens could pursue and the likely outcomes of those alternatives. Which of the alternatives you have discussed would you recommend?

Group project E In teams of two or three students, interview a businessperson in your community. Ask how that person uses accounting information in making business decisions and obtain specific examples. Each team should write a memorandum to the instructor summarizing the results of the interview. Information contained in the memo should include:

Date:

To:

From:

Subject:

Content of the memo must include the name and title of the person interviewed, name of the company, date of the interview, examples of the use of accounting information for decision making, and any other pertinent information.

Group project F With a team composed of one or two other students, conceive of a business that you would like to form after graduation. Then describe approximately 15–20 transactions that the business might undertake in its first month of operations. Prepare a summary of transactions showing how each transaction affects the accounting equation. Identify each asset, liability, and stockholders' equity item in your summary of transactions. For instance, instead of grouping all assets in one number, show cash, accounts receivable, and so on in your accounting equation.

Group project G With a team of one or two other students and using library sources, write a paper on the American Institute of Certified Public Accountants, their services to members, and their activities. Be careful to cite sources for your information. Direct quotes should be labeled as such and should be single-spaced and indented if relatively long or in quote marks and not indented if relatively short. To quote without giving the source is plagiarism and should be avoided at all costs.

Using the Internet—A view of the real world

Visit the following website for Nokia:

<http://www.nokia.com>

Write a short paper describing company information, products and services, and support available for their products.

Visit the following website for Ford Motor Company:

<http://www.ford.com>

When the web page appears, search for Investor Information and then locate the Ford Motor Company Annual Report. Based on your investigation, write a short paper describing the general content of the annual report.

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GLOSSARY UNIT 1

GLOSSARY

Asset Things of value owned by the business. Examples include cash, machines, and buildings. To their owners, assets possess service potential or utility that can be measured and expressed in money terms.

Balance sheet Financial statement that lists a company's assets, liabilities, and stockholders' equity (including dollar amounts) as of a specific moment in time. Also called a *statement of financial position*.

Business entity concept (or accounting entity concept) The separate existence of the business organization.

Corporation Business incorporated under the laws of one of the states and owned by a few stockholders or by thousands of stockholders.

Entity A business unit that is deemed to have an existence separate and apart from its owners, creditors, employees, customers, other interested parties, and other businesses, and for which accounting records are maintained.

Going-concern (continuity) concept The assumption by the accountant that unless strong evidence exists to the contrary, a business entity will continue operations into the indefinite future.

Income statement Financial statement that shows the revenues and expenses and reports the profitability of a business organization for a stated period of time. Sometimes called an *earnings statement*.

Manufacturing companies Companies that buy materials, convert them into products, and then sell the products to other companies or to final customers.

Merchandising companies Companies that purchase goods ready for sale and sell them to customers.

Money measurement concept Recording and reporting economic activity in a common monetary unit of measure such as the dollar.

Partnership An unincorporated business owned by two or more persons associated as partners.

Periodicity (time periods) concept An assumption that an entity's life can be meaningfully subdivided into time periods (such as months or years) for purposes of reporting its economic activities.

Profitability Ability to generate income. The income statement reflects a company's profitability.

Service companies Companies (such as accounting firms, law firms, or dry cleaning establishments) that perform services for a fee.

Sole proprietorship An unincorporated business owned by an individual and often managed by that individual.

Stockholders or shareholders Owners of a corporation; they buy shares of stock, which are units of ownership, in the corporation.

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