

Chapter 02

Financial Statements and Accounting Concepts/Principles

Multiple Choice Questions

1. Which of the following is **not** a transaction to be recorded in the accounting records of an entity?
 - A. Investment of cash by the owners.
 - B. Sale of product to customers.
 - C. Receipt of a plaque recognizing the firm's encouragement of employee participation in the United Way fund drive.
 - D. Receipt of services from a "quick-print" shop in exchange for the promise to provide advertising design services of equivalent value.
2. The balance sheet might also be called:
 - A. Statement of Financial Position.
 - B. Statement of Assets.
 - C. Statement of Changes in Financial Position.
 - D. None of these.
3. Transactions are summarized in:
 - A. The notes for the financial statements.
 - B. The independent auditor's opinion letter.
 - C. The entity's accounts.
 - D. None of these.
4. A fiscal year:
 - A. is always the same as the calendar year.
 - B. is frequently selected based on the firm's operating cycle.
 - C. must always end on the same date each year.
 - D. must end on the last day of a month.

5. Which of the following is not a principal form of business organization?
- A. Partnership.
 - B. Sole proprietorship.
 - C. Limited unregistered business.
 - D. Corporation.
 - E. None of these.
6. The time frame associated with a balance sheet is:
- A. a point in time in the past.
 - B. a one-year past period of time.
 - C. a single date in the future.
 - D. a function of the information included in it.
7. Current U.S. Generally Accepted Accounting Principles and auditing standards require the financial statements of an entity for the reporting period to include:
- A. Earnings and gross receipts of cash for the period.
 - B. Projected earnings for the subsequent period.
 - C. Financial position at the end of the period.
 - D. Current fair values of all assets at the end of the period.
8. The balance sheet equation can be represented by:
- A. $\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$.
 - B. $\text{Assets} - \text{Liabilities} = \text{Stockholders' Equity}$.
 - C. $\text{Net Assets} = \text{Stockholders' Equity}$.
 - D. All of these.
9. Stockholders' equity refers to which of the following?
- A. A listing of the organization's assets and liabilities.
 - B. The ownership right of the stockholder(s) of the entity.
 - C. Probable future sacrifices of economic benefits.
 - D. All of these.
 - E. None of these.

10. Accumulated depreciation on a balance sheet:

- A. is part of stockholders' equity.
- B. represents the portion of the cost of an asset that is assumed to have been "used up" in the process of operating the business.
- C. represents cash that will be used to replace worn out equipment.
- D. recognizes the economic loss in value of an asset because of its age or use.

11. The distinction between a current asset and other assets:

- A. is based on how long the asset has been owned.
- B. is based on amounts that will be paid to other entities within a year.
- C. is based on the ability to determine the current fair value of the asset.
- D. is based on when the asset is expected to be converted to cash, or used to benefit the entity.

12. The income statement shows amounts for:

- A. revenues, expenses, losses, and liabilities.
- B. revenues, expenses, gains, and fair value per share.
- C. revenues, assets, gains, and losses.
- D. revenues, gains, expenses and losses.

13. The time frame associated with an income statement is:

- A. a point in time in the past.
- B. a past period of time.
- C. a future period of time.
- D. a function of the information included in it.

14. Revenues are:

- A. cash receipts.
- B. increases in net assets from selling a product.
- C. increases in net assets from occasional sales of equipment.
- D. increases in net assets from selling common stock.

15. Expenses are:

- A. cash disbursements.
- B. decreases in net assets from uninsured accidents.
- C. decreases in net assets from dividends to stockholders.
- D. decreases in net assets resulting from usual operating activities.

16. The purpose of the income statement is to show the:

- A. change in the fair value of the assets from the prior income statement.
- B. market value per share of stock at the date of the statement.
- C. revenues collected during the period covered by the statement.
- D. net income or net loss for the period covered by the statement.

17. The Statement of Changes in Stockholders' Equity shows:

- A. the change in cash during a year.
- B. revenues, expenses, and liabilities for the period.
- C. net income and dividends for the period.
- D. paid-in capital and long-term debt at the end of the period.

18. Paid-in Capital represents:

- A. earnings retained for use in the business.
- B. the amount invested in the entity by the stockholders.
- C. fair value of the entity's common stock.
- D. net assets of the entity at the date of the statement.

19. Retained Earnings represents:

- A. the amount invested in the entity by the stockholders.
- B. cash that is available for dividends.
- C. cumulative net income that has not been distributed to stockholders as dividends.
- D. par value of common stock outstanding.

20. Additional paid-in-capital represents:

- A. The difference between the total amounts invested by the stockholders and the par or stated value of the stock.
- B. Distributions of earnings that have been made to the stockholders.
- C. Distributions of earnings that have not been made to the stockholders.
- D. The summation of the total amount invested by the stockholders and the par or stated value of the stock.

21. The Statement of Cash Flows:

- A. shows how cash changed during the period.
- B. is an optional financial statement.
- C. shows the change in the fair value of the entity's common stock during the period.
- D. shows the dividends that will be paid in the future.

22. On January 31, an entity's balance sheet showed total assets of \$750 and liabilities of \$250. Stockholders' equity at January 31 was:

- A. \$500
- B. \$1,000
- C. \$750
- D. \$250

23. On January 31, an entity's balance sheet showed **net assets** of \$1,025 and liabilities of \$225. Stockholders' equity on January 31 was:

- A. \$800
- B. \$1,025
- C. \$1,250
- D. \$225

24. At the end of the year, retained earnings totaled \$1,700. During the year, net income was \$250, and dividends of \$120 were declared and paid. Retained earnings at the beginning of the year totaled:

- A. \$2,070
- B. \$1,330
- C. \$1,230
- D. \$1,570

25. At the beginning of the fiscal year, the balance sheet showed assets of \$1,364 and stockholders' equity of \$836. During the year, assets increased \$74 and liabilities decreased \$38.

Stockholders' equity at the end of the year totaled:

- A. \$836
- B. \$872
- C. \$948
- D. \$1,438

26. At the beginning of the fiscal year, the balance sheet showed assets of \$1,364 and stockholders' equity of \$836. During the year, assets increased \$74 and liabilities decreased \$38.

Liabilities at the end of the year totaled:

- A. \$490
- B. \$528
- C. \$836
- D. \$910

27. At the beginning of the year, paid-in capital was \$82 and retained earnings was \$47. During the year, the stockholders invested \$24 and dividends of \$6 were declared and paid. Retained earnings at the end of the year were \$52.

Total stockholders' equity at the end of the year was:

- A. \$82
- B. \$94
- C. \$106
- D. \$158

28. At the beginning of the year, paid-in capital was \$82 and retained earnings was \$47. During the year, the stockholders invested \$24 and dividends of \$6 were declared and paid. Retained earnings at the end of the year were \$52.

Net income for the year was:

- A. \$10
- B. \$11
- C. \$15
- D. \$20

29. The going concern concept refers to a presumption that:
- A. the entity will be profitable in the coming year.
 - B. the entity will not be involved in a merger within a year.
 - C. the entity will continue to operate in the foreseeable future.
 - D. top management of the entity will not change in the coming year.
30. Consolidated financial statements report financial position, results of operations, and cash flows for:
- A. a parent corporation and its subsidiaries.
 - B. a parent corporation alone.
 - C. two corporations that are owned by the same individual.
 - D. a parent corporation and its 100% owned subsidiaries only.
31. A concept or principle that relates to transactions is:
- A. materiality.
 - B. full disclosure.
 - C. original cost.
 - D. consistency.
32. Matching revenues and expenses refers to:
- A. having revenues equal expenses.
 - B. recording revenues when cash is received.
 - C. accurately reflecting the results of operations for a fiscal period.
 - D. recording revenues when a product is sold or a service is rendered.
33. Accrual accounting:
- A. is designed to match revenues and expenses.
 - B. results in the balance sheet showing the fair value of the entity's assets.
 - C. means that expenses are recorded when they are paid.
 - D. cannot result in the entity having net income unless cash is received from customers.

34. Which of the following accounting methods accomplishes much of the matching of revenues and expenses?
- A. Match accounting.
 - B. Cash accounting.
 - C. Accrual accounting.
 - D. Full disclosure accounting.
35. The principle of consistency means that:
- A. the accounting methods used by an entity never change.
 - B. the same accounting methods are used by all firms in an industry.
 - C. the effect of any change in an accounting method will be disclosed in the financial statements or notes thereto.
 - D. there are no alternative methods of accounting for the same transaction.
36. The principle of full disclosure pertains to:
- A. The entity fully discloses all client data.
 - B. The entity fully discloses all proprietary information.
 - C. The entity fully discloses all necessary information to prevent a reasonably astute user of financial statements from being misled.
 - D. The entity fully discloses all necessary information to prevent all users of financial statements from being misled.
 - E. All of these.
37. The balance sheet of an entity:
- A. shows the fair value of the assets at the date of the balance sheet.
 - B. reflects the impact of inflation on the replacement cost of the assets.
 - C. reports plant and equipment at its opportunity cost.
 - D. shows amounts that are not adjusted for changes in the purchasing power of the dollar.

Essay Questions

38. Listed below are a number of financial statement captions. Indicate in the spaces to the right of each caption (1) the category of each item, and (2) the financial statement on which the item can usually be found.

<i>Category</i>		<i>Financial Statement</i>	
Asset	A	Balance sheet	BS
Liability	L	Income statement	IS
Stockholders' Equity	SE		
Revenue	R		
Expense	E		
Gain	G		
Loss	LS		
	(1)	(2)	
Accounts receivable.....	_____	_____	
Cost of goods sold.....	_____	_____	
Retained earnings.....	_____	_____	
Interest income.....	_____	_____	
Loss on sale of building.....	_____	_____	
Notes payable.....	_____	_____	
Additional paid in capital.....	_____	_____	
Equipment.....	_____	_____	
Short-term debt.....	_____	_____	
General expense.....	_____	_____	

39. Listed below are a number of financial statement captions. Indicate in the spaces to the right of each caption (1) the category of each item, and (2) the financial statement on which the item can usually be found.

<i>Category</i>		<i>Financial Statement</i>	
Asset	A	Balance sheet	BS
Liability	L	Income statement	IS
Stockholders' Equity	SE		
Revenue	R		
Expense	E		
Gain	G		
Loss	LS		
	(1)	(2)	
Dividends payable.....			
Selling expenses.....			
Common stock.....			
Long-term debt.....			
Income tax expense.....			
Gain on sale of land.....			
Buildings.....			
Accounts payable.....			
Merchandise inventory.....			
Net income.....			

40. From the data given below, calculate the Retained Earnings balance of December 31, 2013.

Retained earnings, December 31, 2014	\$115,000
Increase in total liabilities during 2014	33,000
Gain on the sale of buildings during 2014	14,000
Dividends declared and paid in 2014	9,000
Proceeds from sale of common stock in 2014	32,000
Net income for the year ended December 31, 2014	41,000

41. From the data given below, calculate the Retained Earnings balance as of December 31, 2014.

Retained earnings, December 31, 2013	\$420,000
Cost of equipment purchased during 2014	125,000
Net loss for the year ended December 31, 2014	43,000
Dividends declared and paid in 2014	55,000
Decrease in cash balance from January 1, 2014, to December 31, 2014	12,000
Decrease in long-term debt in 2014	67,000

42. Volunteer, Inc. is in the process of liquidating and going out of business. The firm has \$34,910 in cash, inventory totaling \$107,000, accounts receivable of \$72,000, plant and equipment with a \$192,000 book value, and total liabilities of \$307,000. It is estimated that the inventory can be disposed of in a liquidation sale for 75% of its cost, all but 15% of the accounts receivable can be collected, and plant and equipment can be sold for \$210,000.

(a.) Calculate the amount of cash that would be available to the stockholders if the accounts receivable are collected, the other assets are sold as described, and the liabilities are paid in full.

(b.) Describe how the difference between book value and liquidation value would be treated on the final income statement for Volunteer, Inc. with respect to the following assets: inventory, accounts receivable, and plant and equipment. What income statement accounts would be affected when these assets are sold or collected as described above?

43. Ann Kimber is thinking about going out of business and retiring. Her firm has \$25,000 in cash, other assets totaling \$35,700, and total liabilities of \$25,500. The other assets can be sold for an estimated \$34,000 cash in a liquidation sale. Calculate the amount of cash that would be available upon Ann's retirement if the other assets were sold and the liabilities were paid.

44. Presented below is a statement of cash flows for Plum, Inc., for the year ended December 31, 2014. Also shown is a partially completed comparative balance sheet as of December 31, 2014 and 2013.

PLUM, INC. Statement of Cash Flows For the year ended December 31, 2014	
Cash flows from operating activities:	
Net income	\$ 9,000
Add (deduct) items not affecting cash:	
Depreciation expense	45,000
Decrease in accounts receivable	23,000
Increase in inventory	(7,000)
Increase in short-term debt	5,000
Increase in notes payable	12,000
Decrease in accounts payable	<u>(6,000)</u>
Net cash provided by operating activities	\$81,000
Cash flows from investing activities:	
Purchase of equipment	\$(50,000)
Purchase of buildings	<u>(48,000)</u>
Net cash used by investing activities	(98,000)
Cash flows from financing activities:	
Cash used for retirement of long-term debt	\$(25,000)
Proceeds from issuance of common stock	10,000
Payment of cash dividends on common stock	<u>(3,000)</u>
Net cash used by financing activities	<u>(18,000)</u>
Net decrease in cash for the year	\$(35,000)

PLUM, INC. Balance Sheets December 31, 2014, and 2013		
	2014	2013
Assets		
Current assets:		
Cash	\$	\$ 88,000
Accounts receivable		73,000
Inventory	<u>56,000</u>	
Total current assets	\$	\$
Land		40,000
Buildings and Equipment	260,000	
Less: Accumulated depreciation		(123,000)
Total land, buildings and equipment		
Total assets	\$	\$
Liabilities		
Current liabilities:		
Short-term debt	\$ 32,000	\$
Notes payable		36,000
Accounts payable		<u>29,000</u>
Total current liabilities	\$	\$
Long-term debt	85,000	
Stockholders' Equity		
Common stock	\$ 40,000	
Retained earnings		
Total stockholders' equity	\$	\$
Total liabilities and stockholders' equity	\$	\$

Required:

- (a.) Complete the December 31, 2014 and 2013 balance sheets.
- (b.) Prepare a Statement of Changes in Retained Earnings for the year ended December 31, 2014.

Chapter 02 Financial Statements and Accounting Concepts/Principles

Answer Key

Multiple Choice Questions

1. Which of the following is **not** a transaction to be recorded in the accounting records of an entity?
- A. Investment of cash by the owners.
 - B. Sale of product to customers.
 - C.** Receipt of a plaque recognizing the firm's encouragement of employee participation in the United Way fund drive.
 - D. Receipt of services from a "quick-print" shop in exchange for the promise to provide advertising design services of equivalent value.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Decision Making
Blooms: Understand
Difficulty: 1 Easy

Learning Objective: 02-02 Identify and explain the kind of information reported in each financial statement and describe how financial statements are related to each other.

2. The balance sheet might also be called:
- A.** Statement of Financial Position.
 - B. Statement of Assets.
 - C. Statement of Changes in Financial Position.
 - D. None of these.

AACSB: Analytic
AICPA BB: Industry
AICPA FN: Reporting
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-02 Identify and explain the kind of information reported in each financial statement and describe how financial statements are related to each other.

3. Transactions are summarized in:

- A. The notes for the financial statements.
- B. The independent auditor's opinion letter.
- C.** The entity's accounts.
- D. None of these.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-01 Explain what transactions are.

4. A fiscal year:

- A. is always the same as the calendar year.
- B.** is frequently selected based on the firm's operating cycle.
- C. must always end on the same date each year.
- D. must end on the last day of a month.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-05 Identify and explain the broad; generally accepted concepts and principles that apply to the accounting process.

5. Which of the following is not a principal form of business organization?

- A. Partnership.
- B. Sole proprietorship.
- C.** Limited unregistered business.
- D. Corporation.
- E. None of these.

AACSB: Analytic
AICPA BB: Industry
AICPA FN: Decision Making
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-05 Identify and explain the broad; generally accepted concepts and principles that apply to the accounting process.

6. The time frame associated with a balance sheet is:

- A. a point in time in the past.
- B. a one-year past period of time.
- C. a single date in the future.
- D. a function of the information included in it.

AACSB: Analytic
AICPA BB: Industry
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Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-02 Identify and explain the kind of information reported in each financial statement and describe how financial statements are related to each other.

7. Current U.S. Generally Accepted Accounting Principles and auditing standards require the financial statements of an entity for the reporting period to include:

- A. Earnings and gross receipts of cash for the period.
- B. Projected earnings for the subsequent period.
- C. Financial position at the end of the period.
- D. Current fair values of all assets at the end of the period.

AACSB: Communication
AICPA BB: Industry
AICPA FN: Reporting
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-01 Explain what transactions are.

8. The balance sheet equation can be represented by:

- A. $\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$.
- B. $\text{Assets} - \text{Liabilities} = \text{Stockholders' Equity}$.
- C. $\text{Net Assets} = \text{Stockholders' Equity}$.
- D. All of these.

AACSB: Analytic
AICPA BB: Industry
AICPA FN: Reporting
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-03 Explain the meaning and usefulness of the accounting equation.

9. Stockholders' equity refers to which to the following?

- A. A listing of the organization's assets and liabilities.
- B.** The ownership right of the stockholder(s) of the entity.
- C. Probable future sacrifices of economic benefits.
- D. All of these.
- E. None of these.

AACSB: Analytic
AICPA BB: Industry
AICPA FN: Reporting
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-04 Explain the meaning of each of the captions on the financial statements illustrated in this chapter.

10. Accumulated depreciation on a balance sheet:

- A. is part of stockholders' equity.
- B.** represents the portion of the cost of an asset that is assumed to have been "used up" in the process of operating the business.
- C. represents cash that will be used to replace worn out equipment.
- D. recognizes the economic loss in value of an asset because of its age or use.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Decision Making
Blooms: Understand
Difficulty: 3 Hard

Learning Objective: 02-04 Explain the meaning of each of the captions on the financial statements illustrated in this chapter.

11. The distinction between a current asset and other assets:

- A. is based on how long the asset has been owned.
- B. is based on amounts that will be paid to other entities within a year.
- C. is based on the ability to determine the current fair value of the asset.
- D.** is based on when the asset is expected to be converted to cash, or used to benefit the entity.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Decision Making
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-04 Explain the meaning of each of the captions on the financial statements illustrated in this chapter.

12. The income statement shows amounts for:

- A. revenues, expenses, losses, and liabilities.
- B. revenues, expenses, gains, and fair value per share.
- C. revenues, assets, gains, and losses.
- D. revenues, gains, expenses and losses.**

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-04 Explain the meaning of each of the captions on the financial statements illustrated in this chapter.

13. The time frame associated with an income statement is:

- A. a point in time in the past.
- B. a past period of time.**
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AICPA BB: Critical Thinking
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Learning Objective: 02-04 Explain the meaning of each of the captions on the financial statements illustrated in this chapter.

14. Revenues are:

- A. cash receipts.
- B. increases in net assets from selling a product.**
- C. increases in net assets from occasional sales of equipment.
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AICPA FN: Decision Making
Blooms: Analyze
Difficulty: 3 Hard

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- A. cash disbursements.
- B. decreases in net assets from uninsured accidents.
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- D.** decreases in net assets resulting from usual operating activities.

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AICPA BB: Critical Thinking
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Learning Objective: 02-04 Explain the meaning of each of the captions on the financial statements illustrated in this chapter.

16. The purpose of the income statement is to show the:

- A. change in the fair value of the assets from the prior income statement.
- B. market value per share of stock at the date of the statement.
- C. revenues collected during the period covered by the statement.
- D.** net income or net loss for the period covered by the statement.

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AICPA BB: Critical Thinking
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- A. the change in cash during a year.
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- D. paid-in capital and long-term debt at the end of the period.

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AICPA FN: Reporting
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Learning Objective: 02-04 Explain the meaning of each of the captions on the financial statements illustrated in this chapter.

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AICPA FN: Decision Making
Blooms: Apply
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Difficulty: 3 Hard

Learning Objective: 02-04 Explain the meaning of each of the captions on the financial statements illustrated in this chapter.

26. At the beginning of the fiscal year, the balance sheet showed assets of \$1,364 and stockholders' equity of \$836. During the year, assets increased \$74 and liabilities decreased \$38.

Liabilities at the end of the year totaled:

A. \$490
B. \$528
C. \$836
D. \$910

AACSB: Analytic
AICPA BB: Critical Thinking

AICPA FN: Decision Making

Blooms: Apply

Difficulty: 3 Hard

Learning Objective: 02-04 Explain the meaning of each of the captions on the financial statements illustrated in this chapter.

27. At the beginning of the year, paid-in capital was \$82 and retained earnings was \$47. During the year, the stockholders invested \$24 and dividends of \$6 were declared and paid. Retained earnings at the end of the year were \$52.

Total stockholders' equity at the end of the year was:

- A. \$82
- B. \$94
- C. \$106
- D. \$158**

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Decision Making

Blooms: Analyze

Difficulty: 3 Hard

Learning Objective: 02-04 Explain the meaning of each of the captions on the financial statements illustrated in this chapter.

28. At the beginning of the year, paid-in capital was \$82 and retained earnings was \$47. During the year, the stockholders invested \$24 and dividends of \$6 were declared and paid. Retained earnings at the end of the year were \$52.

Net income for the year was:

- A. \$10
- B. \$11**
- C. \$15
- D. \$20

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Decision Making

Blooms: Analyze

Difficulty: 3 Hard

Learning Objective: 02-04 Explain the meaning of each of the captions on the financial statements illustrated in this chapter.

29. The going concern concept refers to a presumption that:

- A. the entity will be profitable in the coming year.
- B. the entity will not be involved in a merger within a year.
- C.** the entity will continue to operate in the foreseeable future.
- D. top management of the entity will not change in the coming year.

AACSB: Analytic
AICPA BB: Industry
AICPA FN: Decision Making
Blooms: Remember
Difficulty: 2 Medium
Learning Objective: 02-05 Identify and explain the broad; generally accepted concepts and principles that apply to the accounting process.

30. Consolidated financial statements report financial position, results of operations, and cash flows for:

- A.** a parent corporation and its subsidiaries.
- B. a parent corporation alone.
- C. two corporations that are owned by the same individual.
- D. a parent corporation and its 100% owned subsidiaries only.

AACSB: Communication
AICPA BB: Industry
AICPA FN: Reporting
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 02-05 Identify and explain the broad; generally accepted concepts and principles that apply to the accounting process.

31. A concept or principle that relates to transactions is:

- A. materiality.
- B. full disclosure.
- C.** original cost.
- D. consistency.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Remember
Difficulty: 2 Medium
Learning Objective: 02-05 Identify and explain the broad; generally accepted concepts and principles that apply to the accounting process.

32. Matching revenues and expenses refers to:

- A. having revenues equal expenses.
- B. recording revenues when cash is received.
- C.** accurately reflecting the results of operations for a fiscal period.
- D. recording revenues when a product is sold or a service is rendered.

AACSB: Analytic
AICPA BB: Industry
AICPA FN: Measurement
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-05 Identify and explain the broad; generally accepted concepts and principles that apply to the accounting process.

33. Accrual accounting:

- A.** is designed to match revenues and expenses.
- B. results in the balance sheet showing the fair value of the entity's assets.
- C. means that expenses are recorded when they are paid.
- D. cannot result in the entity having net income unless cash is received from customers.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-05 Identify and explain the broad; generally accepted concepts and principles that apply to the accounting process.

34. Which of the following accounting methods accomplishes much of the matching of revenues and expenses?

- A. Match accounting.
- B. Cash accounting.
- C.** Accrual accounting.
- D. Full disclosure accounting.

AACSB: Analytic
AICPA BB: Industry
AICPA FN: Measurement
Blooms: Understand
Difficulty: 1 Easy

Learning Objective: 02-05 Identify and explain the broad; generally accepted concepts and principles that apply to the accounting process.

35. The principle of consistency means that:

- A. the accounting methods used by an entity never change.
- B. the same accounting methods are used by all firms in an industry.
- C.** the effect of any change in an accounting method will be disclosed in the financial statements or notes thereto.
- D. there are no alternative methods of accounting for the same transaction.

AACSB: Communication
AICPA BB: Industry
AICPA FN: Reporting
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-05 Identify and explain the broad; generally accepted concepts and principles that apply to the accounting process.

36. The principle of full disclosure pertains to:

- A. The entity fully discloses all client data.
- B. The entity fully discloses all proprietary information.
- C.** The entity fully discloses all necessary information to prevent a reasonably astute user of financial statements from being misled.
- D. The entity fully discloses all necessary information to prevent all users of financial statements from being misled.
- E. All of these.

AACSB: Communication
AICPA BB: Industry
AICPA FN: Reporting
Blooms: Understand
Difficulty: 3 Hard

Learning Objective: 02-05 Identify and explain the broad; generally accepted concepts and principles that apply to the accounting process.

37. The balance sheet of an entity:

- A. shows the fair value of the assets at the date of the balance sheet.
- B. reflects the impact of inflation on the replacement cost of the assets.
- C. reports plant and equipment at its opportunity cost.
- D.** shows amounts that are not adjusted for changes in the purchasing power of the dollar.

AACSB: Communication
AICPA BB: Industry
AICPA FN: Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-05 Identify and explain the broad; generally accepted concepts and principles that apply to the accounting process.

Essay Questions

38. Listed below are a number of financial statement captions. Indicate in the spaces to the right of each caption (1) the category of each item, and (2) the financial statement on which the item can usually be found.

<i>Category</i>		<i>Financial Statement</i>	
Asset	A	Balance sheet	BS
Liability	L	Income statement	IS
Stockholders' Equity	SE		
Revenue	R		
Expense	E		
Gain	G		
Loss	LS		
	(1)	(2)	
Accounts receivable.....			
Cost of goods sold.....			
Retained earnings.....			
Interest income.....			
Loss on sale of building.....			
Notes payable.....			
Additional paid in capital.....			
Equipment.....			
Short-term debt.....			
General expense.....			

	<i>Category</i>	<i>Financial Statement</i>
Accounts receivable.....	A	BS
Cost of goods sold.....	E	IS
Retained earnings.....	SE	BS
Interest income.....	R	IS
Loss on sale of building.....	LS	IS
Notes payable.....	L	BS
Additional paid in capital.....	SE	BS
Equipment.....	A	BS
Short-term debt.....	L	BS
General expense.....	E	IS

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the meaning of each of the captions on the financial statements illustrated in this chapter.

39. Listed below are a number of financial statement captions. Indicate in the spaces to the right of each caption (1) the category of each item, and (2) the financial statement on which the item can usually be found.

<i>Category</i>		<i>Financial Statement</i>	
Asset	A	Balance sheet	BS
Liability	L	Income statement	IS
Stockholders' Equity	SE		
Revenue	R		
Expense	E		
Gain	G		
Loss	LS		
	(1)	(2)	
Dividends payable.....			
Selling expenses.....			
Common stock.....			
Long-term debt.....			
Income tax expense.....			
Gain on sale of land.....			
Buildings.....			
Accounts payable.....			
Merchandise inventory.....			
Net income.....			

	<i>Category</i>	<i>Financial Statement</i>
Dividends payable.....	L	BS
Selling expenses.....	E	IS
Common stock.....	SE	BS
Long-term debt.....	L	BS
Income tax expense.....	E	IS
Gain on sale of land.....	G	IS
Buildings.....	A	BS
Accounts payable.....	L	BS
Merchandise inventory.....	A	BS
Net income.....	SE	IS

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-04 Explain the meaning of each of the captions on the financial statements illustrated in this chapter.

40. From the data given below, calculate the Retained Earnings balance of December 31, 2013.

Retained earnings, December 31, 2014	\$115,000
Increase in total liabilities during 2014	33,000
Gain on the sale of buildings during 2014	14,000
Dividends declared and paid in 2014	9,000
Proceeds from sale of common stock in 2014	32,000
Net income for the year ended December 31, 2014	41,000

Prepare the retained earning portion of a statement of changes in stockholders' equity for the year ended December 31, 2014.

Retained earnings, December 31, 2013	\$?
Add: Net income for the year	41,000
Less: Dividends for the year	<u>(9,000)</u>
Retained earnings, December 31, 2014	<u>\$115,000</u>

Solving the model, retained earnings at December 31, 2013, was \$83,000.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Decision Making
Blooms: Apply
Difficulty: 2 Medium

Learning Objective: 02-04 Explain the meaning of each of the captions on the financial statements illustrated in this chapter.

41. From the data given below, calculate the Retained Earnings balance as of December 31, 2014.

Retained earnings, December 31, 2013	\$420,000
Cost of equipment purchased during 2014	125,000
Net loss for the year ended December 31, 2014	43,000
Dividends declared and paid in 2014	55,000
Decrease in cash balance from January 1, 2014, to December 31, 2014	12,000
Decrease in long-term debt in 2014	67,000

Prepare the retained earnings portion of a statement of changes in stockholders' equity for the year ended December 31, 2014:

Retained earnings, December 31, 2013	\$420,000
Less: Net loss for the year	(43,000)
Less: Dividends for the year	<u>(55,000)</u>
Retained earnings, December 31, 2014	<u>\$322,000</u>

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Decision Making
Blooms: Apply
Difficulty: 2 Medium

Learning Objective: 02-04 Explain the meaning of each of the captions on the financial statements illustrated in this chapter.

42. Volunteer, Inc. is in the process of liquidating and going out of business. The firm has \$34,910 in cash, inventory totaling \$107,000, accounts receivable of \$72,000, plant and equipment with a \$192,000 book value, and total liabilities of \$307,000. It is estimated that the inventory can be disposed of in a liquidation sale for 75% of its cost, all but 15% of the accounts receivable can be collected, and plant and equipment can be sold for \$210,000.

(a.) Calculate the amount of cash that would be available to the stockholders if the accounts receivable are collected, the other assets are sold as described, and the liabilities are paid in full.

(b.) Describe how the difference between book value and liquidation value would be treated on the final income statement for Volunteer, Inc. with respect to the following assets: inventory, accounts receivable, and plant and equipment. What income statement accounts would be affected when these assets are sold or collected as described above?

(a.)

Cash now available	\$ 34,910
Inventory liquidation value ($\$107,000 \times .75$)	80,250
Accounts receivable collections ($\$72,000 \times .85$)	61,200
Plant and equipment disposal value	<u>210,000</u>
Total cash available	\$386,360
Less: Payment of liabilities	<u>(307,000)</u>
Cash available to stockholders	<u>\$ 79,360</u>

(b.) The inventory was sold at less than cost, so cost of goods sold would be included in the income statement, and a loss on the market value decline might also be shown separately. Sales would also be shown in the revenues section of the income statement. Since less than 100% of the accounts receivable were collected, the difference should be treated as bad debts expense. Plant and equipment was sold for more than book value, so Volunteer, Inc. should record a gain on the sale of plant and equipment.

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Measurement

Blooms: Create

Difficulty: 3 Hard

Learning Objective: 02-06 Discuss why investors must carefully consider cash flow information in conjunction with accrual accounting results.

43. Ann Kimber is thinking about going out of business and retiring. Her firm has \$25,000 in cash, other assets totaling \$35,700, and total liabilities of \$25,500. The other assets can be sold for an estimated \$34,000 cash in a liquidation sale. Calculate the amount of cash that would be available upon Ann's retirement if the other assets were sold and the liabilities were paid.

$$\$25,000 + \$34,000 - \$25,500 = \$33,500$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Apply
Difficulty: 2 Medium

Learning Objective: 02-06 Discuss why investors must carefully consider cash flow information in conjunction with accrual accounting results.

44. Presented below is a statement of cash flows for Plum, Inc., for the year ended December 31, 2014. Also shown is a partially completed comparative balance sheet as of December 31, 2014 and 2013.

PLUM, INC. Statement of Cash Flows For the year ended December 31, 2014	
Cash flows from operating activities:	
Net income	\$ 9,000
Add (deduct) items not affecting cash:	
Depreciation expense	45,000
Decrease in accounts receivable	23,000
Increase in inventory	(7,000)
Increase in short-term debt	5,000
Increase in notes payable	12,000
Decrease in accounts payable	<u>(6,000)</u>
Net cash provided by operating activities	\$81,000
Cash flows from investing activities:	
Purchase of equipment	\$(50,000)
Purchase of buildings	<u>(48,000)</u>
Net cash used by investing activities	(98,000)
Cash flows from financing activities:	
Cash used for retirement of long-term debt	\$(25,000)
Proceeds from issuance of common stock	10,000
Payment of cash dividends on common stock	<u>(3,000)</u>
Net cash used by financing activities	<u>(18,000)</u>
Net decrease in cash for the year	\$(35,000)

PLUM, INC. Balance Sheets December 31, 2014, and 2013		
	2014	2013
Assets		
Current assets:		
Cash	\$	\$ 88,000
Accounts receivable		73,000
Inventory	<u>56,000</u>	
Total current assets	\$	\$
Land		40,000
Buildings and Equipment	260,000	
Less: Accumulated depreciation		(123,000)
Total land, buildings and equipment		
Total assets	\$	\$
Liabilities		
Current liabilities:		
Short-term debt	\$ 32,000	\$
Notes payable		36,000
Accounts payable		<u>29,000</u>
Total current liabilities	\$	\$
Long-term debt	85,000	
Stockholders' Equity		
Common stock	\$ 40,000	
Retained earnings		
Total stockholders' equity	\$	\$
Total liabilities and stockholders' equity	\$	\$

Required:

- (a.) Complete the December 31, 2014 and 2013 balance sheets.
- (b.) Prepare a Statement of Changes in Retained Earnings for the year ended December 31, 2014.

a.		
PLUM, INC. Balance Sheets December 31, 2014, and 2013		
	2014	2013
Assets		
Current assets:		
Cash	\$ 53,000	\$ 88,000
Accounts receivable	50,000	73,000
Inventory	<u>56,000</u>	<u>49,000</u>
Total current assets	<u>\$ 159,000</u>	<u>\$ 210,000</u>
Land	40,000	40,000
Buildings and Equipment	260,000	162,000
Less: Accumulated depreciation	<u>(168,000)</u>	<u>(123,000)</u>
Total land, buildings and equipment	<u>\$ 132,000</u>	<u>\$ 79,000</u>
Total assets	<u>\$ 291,000</u>	<u>\$ 289,000</u>
Liabilities		
Current liabilities:		
Short-term debt	\$ 32,000	\$ 27,000
Notes payable	48,000	36,000
Accounts payable	<u>23,000</u>	<u>29,000</u>
Total current liabilities	<u>\$ 103,000</u>	<u>\$ 92,000</u>
Long-term debt	85,000	110,000
Stockholders' Equity		
Common stock	\$ 40,000	\$ 30,000
Retained earnings	<u>63,000</u>	<u>57,000</u>
Total stockholders' equity	<u>\$ 103,000</u>	<u>\$ 87,000</u>
Total liabilities and stockholders' equity	<u>\$ 291,000</u>	<u>\$ 289,000</u>
b.		
PLUM, INC. Statement of Changes in Retained Earnings For the year ended December 31, 2014		
Retained earnings, January 1, 2014		\$ 57,000
Add: Net income for the year		9,000
Less: Cash dividends for the year		<u>(3,000)</u>
Retained earnings, December 31, 2014		<u>\$ 63,000</u>

AACSB: Analytic
 AICPA BB: Critical Thinking
 AICPA FN: Reporting
 Blooms: Analyze
 Difficulty: 3 Hard

Learning Objective: 02-06 Discuss why investors must carefully consider cash flow information in conjunction with accrual accounting results.

