

Chapter 1—Accounting and the Financial Statements

TRUE/FALSE

1. The majority of business in Canada is conducted by corporations.

ANS: T PTS: 1 DIF: Easy OBJ: 1-2
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

2. The three main business activities are financing, operating, and investing.

ANS: T PTS: 1 DIF: Easy OBJ: 1-2
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-03-Business Forms

3. Internal users of accounting information include present creditors and management.

ANS: F PTS: 1 DIF: Easy OBJ: 1-1
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

4. The income statement summarizes the assets, liabilities and shareholders' equity for a period of time.

ANS: F PTS: 1 DIF: Easy OBJ: 1-3
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

5. The four basic financial statements are the income statement, statement of retained earnings, balance sheet, and statement of cash flows.

ANS: T PTS: 1 DIF: Easy OBJ: 1-3
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

6. The amount of earnings distributed to shareholders can be found in the income statement as an expense.

ANS: F PTS: 1 DIF: Moderate OBJ: 1-5 | 1-6
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

7. Shareholders' equity is composed of two main sources: liabilities and contributed capital.

ANS: F PTS: 1 DIF: Easy REF: CS1-2
OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

8. The first step in preparing the classified balance sheet is to list the assets in order of liquidity.

ANS: F PTS: 1 DIF: Moderate REF: CS1-2
OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

9. The only financial statement that reports the retained earnings balance at the end of the period is the statement of retained earnings.

ANS: F PTS: 1 DIF: Moderate OBJ: 1-4 | 1-6
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

10. An income statement provides information at one specific point in time, while the other basic financial statements provide information on activities that occur over a period of time.

ANS: F PTS: 1 DIF: Moderate OBJ: 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

11. When an entity's share issuances exceed its expenses for a period of time, the entity will report net income.

ANS: F PTS: 1 DIF: Moderate REF: CS1-3
OBJ: 1-5
NAT: AICPA FN-Measurement | AACSB Communication | ACBSP-APC-09-Financial Statement

12. Contributed capital is the residual interest that remains after deducting liabilities from shareholders' equity.

ANS: F PTS: 1 DIF: Moderate REF: CS1-2
OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

13. The four steps in preparing the income statement are: 1) prepare a heading; 2) list the revenues of the company; 3) list the expenses of the company; and 4) list the dividends of the company.

ANS: F PTS: 1 DIF: Moderate REF: CS1-3
OBJ: 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

14. Shareholders' equity is composed of contributed capital and retained earnings.

ANS: T PTS: 1 DIF: Moderate OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

15. The primary objective of internal auditors who are employees of the company is to provide assurance to the company's shareholders that the financial statements are fairly presented.

ANS: F PTS: 1 DIF: Easy OBJ: 1-9
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

16. The independent auditor's report conveys whether or not the business is a good investment.

ANS: F PTS: 1 DIF: Moderate OBJ: 1-9
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

17. The statement of cash flows shows cash inflows and cash outflows for a period of time.
- ANS: T PTS: 1 DIF: Moderate OBJ: 1-7
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
18. Because the four financial statements are interrelated (i.e., there is a natural progression from one financial statement to another), the balance sheet should be prepared first.
- ANS: F PTS: 1 DIF: Moderate OBJ: 1-8
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
19. The company's annual report includes an audit report, notes to the financial statements, but NOT management's discussion and analysis.
- ANS: F PTS: 1 DIF: Moderate OBJ: 1-9
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose
20. Investing is the business activity that measures the company's ability to generate cash from its revenue and expense activities.
- ANS: F PTS: 1 DIF: Easy OBJ: 1-2
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-03-Business Forms
21. The owners of a sole proprietorship, partnership, and corporations have limited liability.
- ANS: F PTS: 1 DIF: Easy OBJ: 1-1
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose
22. The purpose of financial reporting is to provide economic information to investors, creditors, and other financial statement users.
- ANS: T PTS: 1 DIF: Easy OBJ: 1-1
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose
23. Creditors use accounting information to evaluate whether to loan money to a company.
- ANS: T PTS: 1 DIF: Easy OBJ: 1-1
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose
24. Current assets include all of the following: cash, inventory, equipment, supplies, and accounts receivable.
- ANS: F PTS: 1 DIF: Easy OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
25. Current liabilities are typically listed in the order in which they will be paid.
- ANS: T PTS: 1 DIF: Moderate OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

26. Three common categories of long-term assets are: 1) property, plant, and equipment; 2) long-term investments; and 3) intangibles.

ANS: T PTS: 1 DIF: Easy REF: CS1-2

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

27. In the shareholders' equity section of a classified balance sheet, a distinction is made between amounts invested by owners and amounts financed by creditors.

ANS: F PTS: 1 DIF: Moderate REF: CS1-2

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

28. One primary purpose of a classified balance sheet is to help users evaluate the working capital of a company.

ANS: T PTS: 1 DIF: Easy OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

29. A classified balance sheet is to help users determine how a company obtained its resources.

ANS: T PTS: 1 DIF: Easy REF: CS1-2

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

30. The current ratio is useful in determining a company's ability to pay obligations when they become due.

ANS: T PTS: 1 DIF: Moderate OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-23-Financial Statement Analysis

31. Income from operations includes interest revenue and interest expense because these items are considered to be operating in nature.

ANS: F PTS: 1 DIF: Moderate OBJ: 1-5

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

32. Net loss reduces a company's retained earnings balance.

ANS: T PTS: 1 DIF: Moderate REF: CS1-4

OBJ: 1-6

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

33. Dividend payments appear on the statement of retained earnings.

ANS: T PTS: 1 DIF: Moderate REF: CS1-3 | CS1-4

OBJ: 1-6

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

34. The statement of cash flows, like the income statement, reports only operating activities and other activities of a company.

ANS: F PTS: 1 DIF: Easy OBJ: 1-8
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

35. The ending cash balance is shown on the balance sheet and the statement of retained earnings.

ANS: F PTS: 1 DIF: Moderate OBJ: 1-8
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

36. The company's annual report includes a section called Management's Discussion and Analysis.

ANS: T PTS: 1 DIF: Moderate OBJ: 1-9
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

37. Independent auditors render an opinion that the financial statements do or do not fairly present a company's financial position, operating results, and cash flows.

ANS: T PTS: 1 DIF: Moderate OBJ: 1-9
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

38. An independent auditor's report is a guarantee that the financial statements are free from fraud or material error.

ANS: F PTS: 1 DIF: Moderate OBJ: 1-9
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

39. In the independent auditors' report included with the annual report, management discusses the financial statements and provides the shareholders with explanations for certain amounts reported in the statements.

ANS: F PTS: 1 DIF: Moderate OBJ: 1-9
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

40. A company with healthy cash flows from operating activities is in a good position to repay its debts.

ANS: T PTS: 1 DIF: Easy OBJ: 1-7
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

COMPLETION

1. External users and outside decision makers use _____ accounting.

ANS: financial

PTS: 1 DIF: Easy OBJ: 1-1

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

2. The three forms of business organizations are _____, _____, and _____.

ANS:

sole proprietorships, partnerships, corporations
partnerships, corporations, sole proprietorships
corporations, sole proprietorships, partnerships

PTS: 1 DIF: Easy OBJ: 1-2

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-03-Business Forms

3. The type of business activity that relates to obtaining funds from either issuing shares or borrowing money is called _____.

ANS: financing

PTS: 1 DIF: Easy OBJ: 1-2

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-03-Business Forms

4. The names of the four basic financial statements are _____, _____, _____, and _____.

ANS:

income statement, balance sheet, statement of retained earnings, statement of cash flows
balance sheet, statement of retained earnings, statement of cash flows, income statement
statement of retained earnings, statement of cash flows, income statement, balance sheet
statement of cash flows, income statement, balance sheet, statement of retained earnings

PTS: 1 DIF: Easy OBJ: 1-3

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

5. The fundamental accounting equation is _____ = _____ + _____.

ANS:

assets, liabilities, shareholders' equity
assets, shareholders' equity, liabilities

PTS: 1 DIF: Easy REF: CS1-1 OBJ: 1-3

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

6. The step of listing the liabilities of the company in order of their time to maturity is performed for a financial statement called the _____.

ANS: classified balance sheet

PTS: 1 DIF: Moderate REF: CS1-2 OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

7. Current assets minus current liabilities is called _____.

ANS: working capital

PTS: 1 DIF: Moderate OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

8. The financial statement listing revenues, starting with sales revenue (service revenue), is called the _____.

ANS: income statement

PTS: 1 DIF: Easy REF: CS1-3 OBJ: 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

9. Both net income and dividends can be found on this financial statement: _____.

ANS: statement of retained earnings

PTS: 1 DIF: Easy REF: CS1-4 OBJ: 1-6
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

10. Net income from the income statement increases _____.

ANS: retained earnings

PTS: 1 DIF: Easy OBJ: 1-8
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

11. _____ have claims to an entity's economic resources.

ANS:
Creditors
Lenders
Investors
Shareholders

PTS: 1 DIF: Moderate OBJ: 1-3
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

12. _____ are cash and other assets that are reasonably expected to be converted into cash within one year or operating cycle, whichever is longer.

ANS: Current Assets

PTS: 1 DIF: Moderate OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

13. Property, plant, and equipment is classified as _____ assets on the balance sheet.

ANS: noncurrent

PTS: 1 DIF: Easy REF: CS1-2 OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

14. _____ is a liquidity measure that is calculated by subtracting current assets from current liabilities.

ANS: Working capital

PTS: 1 DIF: Easy OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-23-Financial Statement Analysis

15. The ability of a company to pay its debt as it comes due relates to _____.

ANS: liquidity

PTS: 1 DIF: Easy OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-23-Financial Statement Analysis

16. In a(n) _____-step income statement, all expenses and losses are added together then deducted from the sum of all revenues and gains.

ANS: single

PTS: 1 DIF: Easy OBJ: 1-5

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

17. The statement of cash flows classifies cash flow into these three categories: _____, _____, and _____.

ANS:

operating, investing, financing

investing, financing, operating

financing, operating, investing

PTS: 1 DIF: Easy OBJ: 1-7

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

18. The three financial statements in which net income can be found are the _____, _____, and _____.

ANS:

income statement, statement of retained earnings, statement of cash flows using the indirect method
statement of retained earnings, statement of cash flows using the indirect method, income statement
statement of cash flows using the indirect method, income statement, statement of retained earnings

PTS: 1 DIF: Moderate OBJ: 1-8

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

19. The demand for accounting information comes from users both inside and outside the business. The five user groups discussed in the text include _____, _____, _____, _____, and _____.

ANS:

managers
employees
investors
creditors
governments

PTS: 1 DIF: Easy OBJ: 1-1

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

20. The current ratio is found by dividing current assets by _____.

ANS: current liabilities

PTS: 1 DIF: Easy OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-23-Financial Statement Analysis

MATCHING

Provided is a list of important users of accounting information. Also provided are descriptions of a major need for accounting information that may be experienced by the various users. Identify the one user group that is most likely to have the need described. (*Choices may be used more than once.*)

- a. investors
 - b. management
 - c. supplier
 - d. banker
 - e. government
 - f. employees
 - g. labour union
 - h. investors *and* banker
 - i. supplier *and* banker
1. prospects for future dividend payments
 2. prospects for getting a raise this year
 3. profitability of the company based upon the tax authorities
 4. effectiveness of the last advertising campaign
 5. exact amount of profit on each product of the company
 6. ability of the company to pay its debts as they become due
 7. company's labour rate agreed to on the last contract
1. ANS: A PTS: 1 DIF: Challenging OBJ: 1-1
NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-01-Purpose
 2. ANS: F PTS: 1 DIF: Challenging OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-01-Purpose
 3. ANS: E PTS: 1 DIF: Challenging OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-01-Purpose
 4. ANS: B PTS: 1 DIF: Challenging OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-01-Purpose
 5. ANS: B PTS: 1 DIF: Challenging OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-01-Purpose
 6. ANS: I PTS: 1 DIF: Challenging OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose
 7. ANS: G PTS: 1 DIF: Challenging OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

Several items from the financial statements of Fireside Tires are listed. Use the following choices to identify the type of account for each item listed. (*Choices may be used more than once.*)

- a. assets
- b. liabilities
- c. revenues
- d. expenses
- e. shareholders' equity

- 8. Inventory
- 9. Net sales
- 10. Unearned revenue
- 11. Interest income
- 12. Research and development expense
- 13. Accounts receivable
- 14. Common shares
- 15. Long-term notes payable
- 16. Cash
- 17. Retained earnings
- 18. Patents

- 8. ANS: A PTS: 1 DIF: Easy REF: CS1-2
OBJ: 1-4 | 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
- 9. ANS: C PTS: 1 DIF: Easy REF: CS1-3
OBJ: 1-4 | 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
- 10. ANS: B PTS: 1 DIF: Easy REF: CS1-2
OBJ: 1-4 | 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
- 11. ANS: C PTS: 1 DIF: Easy REF: CS1-3
OBJ: 1-4 | 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
- 12. ANS: D PTS: 1 DIF: Easy REF: CS1-3
OBJ: 1-4 | 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
- 13. ANS: A PTS: 1 DIF: Easy REF: CS1-2
OBJ: 1-4 | 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
- 14. ANS: E PTS: 1 DIF: Easy REF: CS1-2
OBJ: 1-4 | 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
- 15. ANS: B PTS: 1 DIF: Easy REF: CS1-2
OBJ: 1-4 | 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
- 16. ANS: A PTS: 1 DIF: Easy REF: CS1-2
OBJ: 1-4 | 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

17. ANS: E PTS: 1 DIF: Easy REF: CS1-2
OBJ: 1-4 | 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
18. ANS: A PTS: 1 DIF: Easy REF: CS1-2
OBJ: 1-4 | 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

Match each statement to the item listed below.

- a. cash flows from financing activities
 - b. cash flows from investing activities
 - c. cash flows from operating activities
19. cash flows directly related to earning income
20. cash flows related to obtaining capital for the company
21. cash flows related to the acquisition or sale of investment and long-term assets
19. ANS: C PTS: 1 DIF: Moderate OBJ: 1-7
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
20. ANS: A PTS: 1 DIF: Moderate OBJ: 1-7
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
21. ANS: B PTS: 1 DIF: Moderate OBJ: 1-7
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

Match each statement to the item listed below.

- a. current assets
 - b. current liabilities
 - c. gross margin
 - d. income from operations
 - e. intangible assets
 - f. long-term investments
 - g. long-term liabilities
 - h. net profit margin
22. net sales less cost of goods sold expense
23. resources that provide a benefit over a number of years but which lack physical substance
24. investment in the debt and shares of other companies that is expected to be held for more than a year
25. obligations that must be satisfied within a year
26. net income divided by sales revenue
27. gross margin less operating expenses
28. obligations that will require payment beyond one year
29. cash and other resources that are expected to become cash or used up within a year's time or less
22. ANS: C PTS: 1 DIF: Easy OBJ: 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
23. ANS: E PTS: 1 DIF: Easy OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
24. ANS: F PTS: 1 DIF: Easy OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
25. ANS: B PTS: 1 DIF: Easy OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
26. ANS: H PTS: 1 DIF: Easy OBJ: 1-5

- NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
27. ANS: D PTS: 1 DIF: Easy OBJ: 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
28. ANS: G PTS: 1 DIF: Easy OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
29. ANS: A PTS: 1 DIF: Easy OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

Match each statement to the item listed below.

- a. audit report
 - b. fiscal year
 - c. financial statements
 - d. management's discussion and analysis
 - e. notes to the financial statements
30. section in the annual report that highlights favourable or unfavourable trends and significant risks facing the company
31. accounting period that may or may not cover January 1–December 31
32. contains the auditor's opinion as to whether the financial statements fairly present the company's financial position and results of operations
33. set of reports that communicate a company's financial position and results of operations
34. information that clarifies and expands upon the information presented in the financial statements

30. ANS: D PTS: 1 DIF: Easy OBJ: 1-9
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
31. ANS: B PTS: 1 DIF: Easy OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
32. ANS: A PTS: 1 DIF: Easy OBJ: 1-9
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
33. ANS: C PTS: 1 DIF: Easy OBJ: 1-3
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
34. ANS: E PTS: 1 DIF: Easy OBJ: 1-9
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

Match the statement to one of the items listed below.

- a. Financial Accounting Standards Board
 - b. Generally accepted accounting principles
 - c. International Accounting Standards Board
 - d. International financial reporting standards
 - e. Securities and Exchange Commission
35. organization currently working to establish international financial reporting standards
35. ANS: C PTS: 1 DIF: Easy OBJ: 1-3
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

MULTIPLE CHOICE

1. Which of the following is an internal user of financial information?
- company manager
 - government
 - creditor
 - investor

ANS: A PTS: 1 DIF: Easy REF: page 4

OBJ: 1-1

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

BLM: Remember

2. Which one of the following is an internal user of financial statements?
- Canada Revenue Agency
 - creditor
 - shareholder
 - company president

ANS: D PTS: 1 DIF: Easy REF: page 4

OBJ: 1-1

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

BLM: Remember

3. Which of the following is considered an internal user of financial statements?
- a supplier considering selling to the company on credit
 - a labour union representing employees of a company in labour negotiations
 - a financial analyst preparing recommendations on companies in a certain industry
 - a manager of a company who is supervising production workers

ANS: D PTS: 1 DIF: Easy REF: page 4

OBJ: 1-1

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

BLM: Understand

4. What is the term for a person who lends funds to a business entity and expects repayment with interest?
- creditor
 - owner
 - proprietor
 - shareholder

ANS: A PTS: 1 DIF: Easy REF: page 4

OBJ: 1-1

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

BLM: Remember

5. What is the term for the branch of accounting concerned with providing outside decision makers with information to assess the amounts, timing, and uncertainties of the company's future cash flows?
- financial accounting
 - auditing
 - managerial accounting
 - bookkeeping

ANS: A PTS: 1 DIF: Easy REF: page 5

OBJ: 3-1

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

BLM: Remember

6. Which of the following invests funds in a business and is considered an owner?
- shareholder
 - creditor
 - banker
 - lender

ANS: A PTS: 1 DIF: Easy REF: page 6

OBJ: 1-2

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

BLM: Remember

7. Which of the following is NOT a form of business entity?
- sole proprietorship
 - partnership
 - cooperative
 - corporation

ANS: C PTS: 1 DIF: Easy REF: page 6

OBJ: 1-2

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-03-Business Forms

BLM: Remember

8. In which form of organization are the owners' legal responsibilities for the debts of the business limited to the amount they invested in it?
- cooperative
 - corporation
 - partnership
 - proprietorship

ANS: B PTS: 1 DIF: Moderate REF: page 6

OBJ: 1-2

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-03-Business Forms

BLM: Understand

9. Which of the following three main activities are businesses engaged in?
- financing, investing, operating
 - cash, credit, noncash
 - financing, crediting, operating
 - financing, managing, operating

ANS: A PTS: 1 DIF: Easy REF: page 7

OBJ: 1-2

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-03-Business Forms

BLM: Remember

10. Which of the following describes “revenues”?
- decreases in assets resulting from the sale of goods or services
 - increases in equity resulting from the sale of products or services
 - assets used or consumed in the sale of products or services
 - increases in the financing activities

ANS: B PTS: 1 DIF: Moderate REF: page 8

OBJ: 1-2

NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-03-Business Forms

BLM: Remember

11. What type of account is unearned revenue?
- shareholders' equity
 - liability
 - asset
 - expense

ANS: B PTS: 1 DIF: Moderate REF: page 8

OBJ: 1-2

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-03-Business Forms

BLM: Remember

12. Which of the following best describes the term “expenses”?
- the cost of assets used in the investing activities of a business
 - the amount of interest or claim that the owners have in the business
 - the future economic resources of a business entity
 - the cost of assets used in the operations of a business

ANS: D PTS: 1 DIF: Easy REF: page 8

OBJ: 1-2

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-03-Business Forms

BLM: Understand

13. Which type of business activity is purchasing new equipment?
- a. financing
 - b. operating
 - c. investing
 - d. measuring

ANS: C PTS: 1 DIF: Easy REF: page 7

OBJ: 1-2

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-03-Business Forms

BLM: Understand

14. You are a potential creditor and are concerned that a particular company you are ready to lend money to may have too much debt. Which financial statement will provide you with the information you need to evaluate your concern?
- a. balance sheet
 - b. income statement
 - c. statement of retained earnings
 - d. statement of public accounting

ANS: A PTS: 1 DIF: Moderate REF: page 8

OBJ: 1-3

NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-09-Financial Statement

BLM: Understand

15. Which financial statement would you analyze to assess a firm's operating performance over the past year?
- a. balance sheet
 - b. statement of retained earnings
 - c. income statement
 - d. statement of public accounting

ANS: C PTS: 1 DIF: Moderate REF: page 8

OBJ: 1-3

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

16. Which financial statement would you refer to in order to determine the resources (assets) a company owns?
- a. balance sheet
 - b. statement of retained earnings
 - c. income statement
 - d. statement of cash flows

ANS: A PTS: 1 DIF: Moderate REF: page 8

OBJ: 1-3

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

17. Which of the following financial statements show the end-of-year cash balance for a business entity?
- income statement and statement of retained earnings
 - balance sheet and statement of cash flows
 - statement of retained earnings and statement of cash flows
 - balance sheet and statement of retained earnings

ANS: B PTS: 1 DIF: Challenging REF: page 8

OBJ: 1-3

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

BLM: Understand

18. On January 1, a company reported assets of \$1,000,000 and liabilities of \$600,000. During the year, assets decreased by \$100,000 and shareholders' equity decreased \$200,000. What is the amount of liabilities at December 31?
- \$200,000
 - \$500,000
 - \$600,000
 - \$700,000

ANS: D

	<u>Assets</u>		<u>Liabilities</u>		<u>Equity</u>
Jan. 01	\$1,000,000	=	\$600,000	+	\$400,000
During the year	<u>-100,000</u>	=	<u>100,000</u>	±	<u>-200,000</u>
Dec. 31	900,000	=	700,000	+	200,000

PTS: 1 DIF: Challenging REF: page 10 OBJ: 1-3

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

BLM: Evaluate

19. Which of the following correctly represents one of the basic financial statement models?
- assets – liabilities = net income
 - assets + liabilities = total assets
 - revenues + expenses = net income
 - beginning retained earnings + net income – dividends = ending retained earnings

ANS: D PTS: 1 DIF: Challenging REF: page 10

OBJ: 1-3

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

20. Which of the following is a correct fundamental accounting equation?
- assets + liabilities = shareholders' equity
 - assets + retained earnings = shareholders' equity
 - assets + shareholders' equity = liabilities
 - assets = liabilities + shareholders' equity

ANS: D PTS: 1 DIF: Moderate REF: page 10

OBJ: 1-3

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Remember

21. In which of the following ways is the balance sheet linked to the other financial statements?
- a. The amount of retained earnings is reported on the balance sheet as a liability.
 - b. Retained earnings is added to total assets and reported on the balance sheet.
 - c. Retained earnings is reported on the balance sheet.
 - d. There is no such link, as each statement contains different accounts and provides different information.

ANS: C PTS: 1 DIF: Challenging REF: page 12

OBJ: 1-3

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

22. Which account is a liability?
- a. cash
 - b. retained earnings
 - c. accounts receivable
 - d. accounts payable

ANS: D PTS: 1 DIF: Moderate REF: page 12

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-01-Purpose

BLM: Understand

23. Which of the following best describes the term “retained earnings” of a company?
- a. the amount of total profits earned by a company since it began operations
 - b. the amount of claim that the owners have on the assets of the company
 - c. the future economic resources of a company
 - d. the accumulated net income that has not been distributed to owners as dividends

ANS: D PTS: 1 DIF: Moderate REF: page 12

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

24. Which of the following describes the term “current assets”?
- a. the amount of total assets earned by a business since it began operations plus all other resources
 - b. the amount of claim that the owners have in the business in the current year
 - c. assets expected to be converted into cash within one year or one operating cycle, whichever is longer
 - d. the cumulative profits earned by a business less any dividends distributed in the current period

ANS: C PTS: 1 DIF: Moderate REF: page 12

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

25. Which of the following is a classification on the classified balance sheet?
- a. operating accounts
 - b. shareholders' equity
 - c. revenues and expenses
 - d. net income and dividends

ANS: B PTS: 1 DIF: Challenging REF: page 12

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Remember

26. Which of the following assets are noncurrent?
- a. machinery and equipment
 - b. accounts receivable
 - c. inventories
 - d. unearned revenues

ANS: A PTS: 1 DIF: Challenging REF: page 12

OBJ: 1-4

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

BLM: Remember

27. Which of the following items appears on a balance sheet?
- a. service revenue
 - b. unearned revenue
 - c. dividends
 - d. cash flow from operations

ANS: B PTS: 1 DIF: Easy REF: page 12

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Remember

28. Which of the following statements reports an entity's financial position at a specific date?
- a. balance sheet
 - b. statement of retained earnings
 - c. income statement
 - d. statement of cash flows

ANS: A PTS: 1 DIF: Easy REF: page 12

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

29. What is another term for “short-term investments”?
- a. inventories
 - b. accounts receivable
 - c. contributed capital
 - d. marketable securities

ANS: D PTS: 1 DIF: Moderate REF: page 12

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Remember

30. Which of the following terms best describes a distribution of the net income of a corporation to its owners?
- a. retained earnings
 - b. dividends
 - c. expense
 - d. monetization

ANS: B PTS: 1 DIF: Easy REF: page 18

OBJ: 1-5

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

31. Which of the following is the correct date format for the financial statement heading?
- a. Balance Sheet – For the Year Ended June 30
 - b. Income Statement – At December 31
 - c. Income Statement – For the Year Ended December 31
 - d. Statement of Retained Earnings – At December 31

ANS: C PTS: 1 DIF: Challenging REF: page 9

OBJ: 1-4 | 1-5 | 1-6

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

32. Which of these statements summarizes the results of a company’s operations?
- a. statement of cash flows
 - b. statement of retained earnings
 - c. balance sheet
 - d. income statement

ANS: D PTS: 1 DIF: Easy REF: page 18

OBJ: 1-5

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

33. What are the resources used to earn revenues during a period called?
- net income
 - expenses
 - revenues
 - dividends

ANS: B PTS: 1 DIF: Easy REF: page 18

OBJ: 1-5

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

Bargain Spot Fabrics

This company's end-of-year balance sheet consisted of the following amounts:

Cash	\$ 75,000	Accounts receivable	\$250,000
Property, plant, and equipment	350,000	Long-term debt	200,000
Common shares	500,000	Accounts payable	100,000
Retained earnings	?	Inventory	175,000

34. Refer to the figure Bargain Spot Fabrics. What amount should the company report on its balance sheet for total assets?
- \$550,000
 - \$775,000
 - \$850,000
 - \$950,000

ANS: C

$\$75,000 + \$250,000 + \$350,000 + \$175,000 = \$850,000$

PTS: 1 DIF: Moderate REF: page 12 OBJ: 1-4

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

BLM: Evaluate

35. Refer to the figure Bargain Spot Fabrics. What is the retained earnings balance at the end of the current year?
- \$50,000
 - \$550,000
 - \$800,000
 - \$850,000

ANS: A

$\text{Assets} = \$75,000 + \$350,000 + \$250,000 + \$175,000 = \$850,000$

$\text{Liabilities} = \$200,000 + \$100,000 = \$300,000$

$\text{Shareholders' Equity} = \$850,000 - \$300,000 = \$550,000$

$\text{Retained Earnings} = \$550,000 - \$500,000 = \$50,000$

PTS: 1 DIF: Challenging REF: page 12 OBJ: 1-4

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

BLM: Evaluate

Bay Camera

The company reported the following items on its financial statements for the year ended December 31:

Sales	\$780,000	Cost of sales	\$700,000
Selling, general and administrative expense	20,000	Other expense	15,000
Dividends	5,000	Income tax expense	12,500

36. Refer to the figure Bay Camera. What is the company's net income for the current year?
- \$22,500
 - \$32,500
 - \$42,500
 - \$80,000

ANS: B

$$\$780,000 - \$700,000 - \$20,000 - \$15,000 - \$12,500 = \$32,500$$

PTS: 1 DIF: Moderate REF: page 18 OBJ: 1-5
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement
 BLM: Evaluate

37. Refer to the figure Bay Camera. What amount will be reported as retained earnings on the balance sheet at December 31, assuming this is the first year of operations?
- \$22,500
 - \$27,500
 - \$42,500
 - \$80,000

ANS: B

$$\text{Net income: } \$780,000 - \$700,000 - \$20,000 - \$15,000 - \$12,500 = \$32,500$$

$$\text{Retained earnings: } \$32,500 - \$5,000 = \$27,500$$

PTS: 1 DIF: Challenging REF: page 12 OBJ: 1-4
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement
 BLM: Evaluate

Beard Marine

The company reported the following information for the year ended December 31, Year 1:

Net income	\$100,000
Dividends	6,000
Retained earnings at December 31, Year 1	120,000

38. Refer to the figure Beard Marine. What was the balance of retained earnings at January 1, Year 1?
- \$ 21,000
 - \$ 26,000
 - \$106,000
 - \$214,000

ANS: B

$$\$120,000 + \$6,000 - \$100,000 = \$26,000$$

PTS: 1 DIF: Moderate REF: page 12 OBJ: 1-4
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement
 BLM: Evaluate

39. Refer to the figure Beard Marine. What was the economic effect of the dividend payment?
- It reduced net income.
 - It increased net income.
 - It reduced total retained earnings.
 - It reduced liabilities.

ANS: C PTS: 1 DIF: Easy REF: page 23
 OBJ: 1-6
 NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
 BLM: Evaluate

B&B Painting

The company reported the following information for the year ended December 31, Year 2:

Revenues	\$2,500,000
Expenses	2,000,000
Retained earnings at December 31, Year 1	100,000
Retained earnings at December 31, Year 2	450,000

40. Refer to the figure B&B Painting . How much was paid out in dividends in Year 2?
- \$150,000
 - \$250,000
 - \$350,000
 - \$500,000

ANS: A

$$\$100,000 + \$2,500,000 - \$2,000,000 - X = \$450,000$$

$$X = \$150,000$$

PTS: 1 DIF: Moderate REF: page 23 OBJ: 1-4 | 1-6
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement
 BLM: Evaluate

Barr Attorneys

The company reported the following information for the year ended December 31, Year 2:

Revenue	\$14,000,000
Expenses	11,500,000
Dividends	1,000,000
Retained earnings at December 31, Year 2	1,750,000

41. Refer to the figure Barr Attorneys . What was the retained earnings balance at December 31, Year 1?
- \$ 250,000
 - \$3500,000
 - \$1,500,000
 - \$2,500,000

ANS: A

$$X + \$14,000,000 - \$11,500,000 - \$1,000,000 = \$1,750,000$$

$$X = \$250,000$$

PTS: 1 DIF: Moderate REF: page 26 OBJ: 1-4 | 1-6
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement
 BLM: Evaluate

42. A company had total assets of \$650,000 and total shareholders' equity of \$250,000 at the beginning of the year. During the year, total assets increased by \$350,000, total liabilities increased by \$100,000, and dividends were paid in the amount of \$300,000. No other transactions occurred except revenues and expenses. How much is net income for the year?
- \$500,000
 - \$550,000
 - \$650,000
 - \$750,000

ANS: B

Assets:	$\$650,000 + \$350,000 = \$1,000,000$
Liabilities:	$(\$650,000 - \$250,000) + \$100,000 = \$500,000$
Shareholders' equity at year end:	$\$1,000,000 - \$500,000 = \$500,000$
Net income:	$\$500,000 - \$250,000 + \$300,000 = \$550,000$

PTS: 1 DIF: Challenging REF: page 18 OBJ: 1-5
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement
 BLM: Evaluate

43. On January 1, Year 1, a company's balance in retained earnings was \$10,000,000. At December 31, Year 1, the balance in retained earnings was \$9,400,000. If the company earned net income of \$440,000 during the year, how much were dividends?
- \$440,000
 - \$600,000
 - \$1,000,000
 - \$1,040,000

ANS: D

$$\$10,000,000 + \$440,000 - \$9,400,000 = \$1,040,000$$

PTS: 1 DIF: Moderate REF: page 23 OBJ: 1-6
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement
 BLM: Evaluate

44. On January 1, Year 1, a company's balance in retained earnings was \$275,000. During Year 1, the company earned net income of \$23,500 and paid \$11,200 in dividends. Calculate the retained earnings balance at December 31, Year 1.
- \$262,700
 - \$263,800
 - \$287,300
 - \$298,500

ANS: C

$$\$275,000 + \$23,500 - \$11,200 = \$287,300$$

PTS: 1 DIF: Moderate REF: page 23 OBJ: 1-6
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement
 BLM: Evaluate

Beaver Tree Service

Beginning retained earnings	\$550,000
Ending retained earnings	700,000
Dividends paid	100,000
Revenue	525,000

45. Refer to the figure Beaver Tree Service. What is the company's net income?
- \$150,000
 - \$250,000
 - \$300,000
 - \$350,000

ANS: B

$$\$550,000 + X - \$100,000 = \$700,000$$

$$X = \$250,000$$

PTS: 1 DIF: Moderate REF: page 18 OBJ: 1-5
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement
 BLM: Evaluate

46. Refer to the figure Beaver Tree Service. What are the company's expenses?
- \$100,000
 - \$150,000
 - \$275,000
 - \$450,000

ANS: C

$$\$550,000 + X - \$100,000 = \$700,000$$

$$X = \$250,000 \text{ or Net Income}$$

$$\$525,000 \text{ (Revenue)} - \$250,000 \text{ (Net income)} = \$275,000 \text{ (Expenses)}$$

PTS: 1

DIF: Moderate

REF: page 18

OBJ: 1-5

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

BLM: Evaluate

47. A company has \$10,500,000 of revenues, declares and pays \$550,000 in dividends, and has net income of \$1,600,000. How much were expenses for the year?
- \$1,050,000
 - \$2,150,000
 - \$8,900,000
 - \$9,950,000

ANS: C

$$\$10,500,000 \text{ (Revenues)} - \$1,600,000 \text{ (Net income)} = \$8,900,000 \text{ (Expenses)}$$

PTS: 1

DIF: Moderate

REF: page 18

OBJ: 1-5 | 1-6

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

BLM: Evaluate

Company A

A company reports the following information at December 31, Year 1:

Sales	\$15,000,000
Cash	3,000,000
Unearned revenue	400,000
Dividends	1,000,000
Cost of sales	8,500,000

48. Refer to the figure Company A. What is the company's gross profit?
- \$5,500,000
 - \$6,100,000
 - \$6,500,000
 - \$12,000,000

ANS: C

$$\$15,000,000 \text{ (Sales)} - \$8,500,000 \text{ (Cost of sales)} = \$6,500,000 \text{ (Gross profit)}$$

PTS: 1

DIF: Moderate

REF: page 21

OBJ: 1-5

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

BLM: Evaluate

49. A company has assets of \$5,000,000, liabilities of \$3,000,000, and retained earnings of \$1,200,000. How much is total shareholders' equity?
- a. \$800,000
 - b. \$1,800,000
 - c. \$2,000,000
 - d. \$3,800,000

ANS: C

$\$5,000,000 \text{ (Assets)} - \$3,000,000 \text{ (Liabilities)} = \$2,000,000 \text{ Shareholders' equity}$

PTS: 1

DIF: Moderate

REF: page 12

OBJ: 1-4

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

BLM: Evaluate

50. What is the total sales for a company that reported a net loss of \$1,500,000 and total expenses of \$2,900,000?
- a. \$1,400,000
 - b. \$1,600,000
 - c. \$2,400,000
 - d. \$4,400,000

ANS: A

$\$2,900,000 \text{ (Total expenses)} + \$1,500,000 \text{ (Net loss)} = \$1,400,000 \text{ (Total revenues)}$

PTS: 1

DIF: Moderate

REF: page 18

OBJ: 1-5

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

BLM: Evaluate

51. What is the primary objective of financial reporting?
- a. to help investors make credit decisions
 - b. to help management assess cash flows
 - c. to protect users from fraudulent financial information
 - d. to provide useful information for decision making

ANS: D

PTS: 1

DIF: Easy

REF: page 27

OBJ: 1-9

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

BLM: Understand

52. What are economic resources?
- a. assets
 - b. liabilities and shareholders' equity
 - c. owners' equity and shareholders' equity
 - d. revenues

ANS: A

PTS: 1

DIF: Moderate

REF: page 27

OBJ: 1-9

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

53. Which of the following can be said of external users of financial information?
- They need detailed records of the business to make informed decisions.
 - They are primarily responsible for the preparation of financial statements.
 - They rely on the financial statements to make informed decisions.
 - They rely on management to tell them whether the company is a good investment.

ANS: C PTS: 1 DIF: Easy REF: page 27

OBJ: 1-9

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

BLM: Understand

54. Which financial statement(s) does net income appear on?
- a balance sheet only
 - an income statement only
 - a balance sheet, income statement, and statement of cash flows using the indirect method
 - an income statement, statement of cash flows using the indirect method, and statement of retained earnings

ANS: D PTS: 1 DIF: Easy REF: page 18 | 23 | 25

OBJ: 1-5 | 1-6

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

Benchmark Surveyors

The following balances are provided:

Cash	\$234,000	Accounts payable	\$ 97,000
Inventories	121,000	Notes payable (due 2018)	211,000
Land	453,000	Accounts receivable	46,000

55. Refer to the figure Benchmark Surveyors. How much is current assets?
- \$401,000
 - \$498,000
 - \$709,000
 - \$854,000

ANS: A

$\$234,000 \text{ (Cash)} + \$46,000 \text{ (Accounts receivable)} + \$121,000 \text{ (Inventory)} = \$401,000$

PTS: 1 DIF: Easy REF: page 13 OBJ: 1-4

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

BLM: Evaluate

56. Refer to the figure Benchmark Surveyors. How much is current liabilities?
- \$97,000
 - \$143,000
 - \$211,000
 - \$354,000

ANS: A

\$97,000 (Accounts payable)

PTS: 1 DIF: Easy REF: page 14 OBJ: 1-4
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement
 BLM: Evaluate

57. Which of these items is reported as a current shareholders' equity on a classified balance sheet?
- net income
 - accounts payable
 - land
 - common shares

ANS: D PTS: 1 DIF: Easy REF: page 12
 OBJ: 1-4
 NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
 BLM: Remember

Barnes Restaurant

Barnes Restaurant reports the following amounts:

Cash	\$125,000	Inventory	\$215,000
Land	275,000	Unearned revenue	117,000
Equipment	350,000	Common shares	300,000

58. Refer to the figure Barnes Restaurant. How much are current assets?
- \$125,000
 - \$340,000
 - \$457,000
 - \$615,000

ANS: B

\$125,000 (Cash) + \$215,000 (Inventory) = \$340,000

PTS: 1 DIF: Easy REF: page 13 OBJ: 1-4
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement
 BLM: Evaluate

59. Which of the following accounts are normally reported as current liabilities on a classified balance sheet?
- a. accounts payable and prepaid insurance
 - b. interest payable and interest receivable
 - c. income taxes payable and salaries payable
 - d. common shares and accounts payable

ANS: C PTS: 1 DIF: Moderate REF: page 14

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

60. Which of the following are considered current assets?
- a. intangibles
 - b. property, plant, and equipment
 - c. inventory
 - d. patents

ANS: C PTS: 1 DIF: Moderate REF: page 13

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

61. Which of the following are considered tangible assets?
- a. franchises
 - b. copyrights
 - c. investments
 - d. trademarks

ANS: C PTS: 1 DIF: Moderate REF: page 14

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

62. Assets are expected to be realized in cash, sold, or consumed within the normal operating cycle of a business or within one year (if the operating cycle is shorter than one year). How are they reported on a classified balance sheet?
- a. as property, plant, and equipment
 - b. as current assets
 - c. as intangible assets
 - d. as current liabilities

ANS: B PTS: 1 DIF: Moderate REF: page 12-17

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

63. Which of the following are current assets?
- accounts receivable, net income, inventory, and dividends
 - cash, accounts receivable, common shares, and sales
 - net income, cash, office supplies, and inventory
 - cash, accounts receivable, inventory, and office supplies

ANS: D PTS: 1 DIF: Moderate REF: page 13

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

64. What is distinguished on a classified balance sheet?
- assets and liabilities
 - current and noncurrent items
 - liabilities and shareholders' equity
 - resources invested by the owners and amounts borrowed from creditors

ANS: B PTS: 1 DIF: Easy REF: page 12

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

65. For the most recent year, a company's current ratio was significantly lower than its industry's average. What is the best possible explanation for this situation?
- The company's competitors were profitable.
 - The company's liquidity improved.
 - The company had less equity than the rest of the industry.
 - The company's liquidity was worse than the industry.

ANS: D PTS: 1 DIF: Challenging REF: page 17

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-23-Financial Statement Analysis

BLM: Understand

Bass Tours

The following balances were taken from the company's records:

Inventory	\$380,000	Accounts receivable	\$190,000
Land	290,000	Accounts payable	180,000
Cash	129,000	Unearned revenue	110,000
Prepaid rent	33,000	Common shares	312,000
Retained earnings	220,000	Long-term notes payable	200,000

66. Refer to the figure Bass Tours. How much is the total current assets?
- \$732,000
 - \$842,000
 - \$974,000
 - \$1,022,000

ANS: A

$\$129,000 \text{ (Cash)} + \$190,000 \text{ (Accounts receivable)} + \$380,000 \text{ (Inventory)} + \$33,000 \text{ (Prepaid rent)} = \$732,000$

PTS: 1

DIF: Moderate

REF: page 13

OBJ: 1-4

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-23-Financial Statement Analysis

BLM: Evaluate

67. Refer to the figure Bass Tours. How much is the current ratio?
- 2.10 to 1
 - 2.52 to 1
 - 2.75 to 1
 - 3.00 to 1

ANS: B

$[\$129,000 \text{ (Cash)} + \$190,000 \text{ (Accounts receivable)} + \$380,000 \text{ (Inventory)} + \$33,000 \text{ (Prepaid rent)}] / [\$180,000 \text{ (Accounts payable)} + \$110,000 \text{ (Unearned revenue)}] = 2.52 \text{ to } 1$

PTS: 1

DIF: Moderate

REF: page 17

OBJ: 1-4

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-23-Financial Statement Analysis

BLM: Evaluate

68. Refer to the figure Bass Tours. If the average current ratio for similar companies is 2.0 to 1, what does this tell you about this company's liquidity?
- The company is more liquid than its competitors.
 - The company has more long-term assets than its competitors.
 - The company is bankrupt.
 - The company is more profitable than its competitors.

ANS: A

PTS: 1

DIF: Challenging

REF: page 17

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-23-Financial Statement Analysis

BLM: Evaluate

69. A company has current assets of \$2,100,000 and current liabilities of \$500,000. How much is its working capital?
- \$500,000
 - \$1,600,000
 - \$2,100,000
 - \$2,600,000

ANS: B

$\$2,100,000 \text{ (Current assets)} - \$500,000 \text{ (Current liabilities)} = \$1,600,000$

PTS: 1

DIF: Moderate

REF: page 17

OBJ: 1-4

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-23-Financial Statement Analysis

BLM: Evaluate

70. Which of the following calculates working capital?
- a. current assets divided by current liabilities
 - b. total assets minus total liabilities
 - c. current assets minus current liabilities
 - d. current assets plus current liabilities

ANS: C PTS: 1 DIF: Easy REF: page 17
OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-23-Financial Statement Analysis
BLM: Remember

71. A company has current assets of \$100,000, total assets of \$250,000, current liabilities of \$20,000, and long-term liabilities of \$50,000. How much of its existing cash can the company use to acquire equipment without allowing its current ratio to decline below 2.0 to 1?
- a. \$40,000
 - b. \$60,000
 - c. \$150,000
 - d. \$180,000

ANS: B
 $\$40,000 / 20,000 = 2.0$ to 1
 $\$100,000$ total assets – $\$40,000 = \$60,000$

PTS: 1 DIF: Challenging REF: page 17 OBJ: 1-4
NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-23-Financial Statement Analysis
BLM: Evaluate

72. A company has increased its dollar amount of working capital over the past several years. Which of the following measures should be used to further evaluate the company's liquidity?
- a. the asset ratio
 - b. an analysis of the company's long-term debt
 - c. an analysis of the return on shareholders' equity
 - d. the current ratio

ANS: D PTS: 1 DIF: Moderate REF: page 17
OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-23-Financial Statement Analysis
BLM: Analyze

73. Which financial statement reports information helpful in assessing working capital?
- a. balance sheet
 - b. capital statement
 - c. statement of retained earnings
 - d. statement of cash flows

ANS: A PTS: 1 DIF: Easy REF: page 17
OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-23-Financial Statement Analysis
BLM: Analyze

Barrett Oil

Barrett Oil Company reported the following balances as of December 31, Year 1:

Accounts receivable	\$125,000	Unearned revenue	\$ 5,000
Cash	150,000	Notes payable (due in 6 months)	115,000
Land	200,000	Accounts payable	70,000
Building	400,000	Equipment	165,000
Inventories	105,000	Notes payable (due 07/01/2020)	600,000

74. Refer to the figure Barrett Oil. What is the company's current ratio?

- a. .48 to 1
- b. 2.00 to 1
- c. 2.55 to 1
- d. 2.86 to 1

ANS: B

$[\$125,000 \text{ (Accounts receivable)} + \$150,000 \text{ (Cash)} + \$105,000 \text{ (Inventories)}] / [\$70,000 \text{ (Accounts payable)} + \$5,000 \text{ (Unearned revenue)} + \$115,000 \text{ (Notes payable—due 6 months)}] = 2.00 \text{ to } 1$

PTS: 1

DIF: Challenging

REF: page 17

OBJ: 1-4

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-23-Financial Statement Analysis

BLM: Evaluate

75. If the current ratio is 2 to 1 and total assets equal \$200,000, how much is working capital?

- a. \$0
- b. \$100,000
- c. \$200,000
- d. \$300,000

ANS: B

$\$200,000 \text{ (Current assets)} / 2 = \$100,000 \text{ in current liabilities. } \$200,000 \text{ (Current assets)} - \$100,000 \text{ (Current liabilities)} = \$100,000$

PTS: 1

DIF: Challenging

REF: page 17

OBJ: 1-4

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-23-Financial Statement Analysis

BLM: Evaluate

76. Which of the following is working capital and current ratio most useful for evaluating?

- a. a company's liquidity
- b. a company's solvency
- c. a company's profitability
- d. a company's revenues

ANS: A

PTS: 1

DIF: Easy

REF: page 17

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-23-Financial Statement Analysis

BLM: Understand

77. Which of the following is NOT a characteristic of liquidity?
- a. measures the ability of the firm to pay financial obligations as they become due
 - b. can be measured in terms of working capital
 - c. can be assessed by the current ratio
 - d. measures the ability of the company to pay its long-term debts

ANS: D PTS: 1 DIF: Easy REF: page 17

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-23-Financial Statement Analysis
BLM: Understand

78. Which of the following would appear on an income statement?
- a. unearned revenue
 - b. cost of sales
 - c. retained earnings
 - d. dividends

ANS: B PTS: 1 DIF: Moderate REF: page 18

OBJ: 1-5

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
BLM: Remember

79. Which of the following is shown on the income statement?
- a. how much profit the company has earned since it began operations
 - b. net income equal to the amount of cash on the balance sheet
 - c. a summary of the results of operations for a period of time
 - d. the liquidity of the company on an annual basis

ANS: C PTS: 1 DIF: Moderate REF: page 18

OBJ: 1-5

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
BLM: Understand

80. Which of the following items would NOT be reported on a multiple-step income statement after income from operations?
- a. income taxes
 - b. interest income
 - c. selling expenses
 - d. interest expense

ANS: C PTS: 1 DIF: Easy REF: page 21

OBJ: 1-5

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
BLM: Remember

81. A question frequently asked by investors is, "How much debt does this company have?" Which financial statement answers this question?
- single-step income statement
 - cash flow statement
 - multiple-step income statement
 - classified balance sheet

ANS: D PTS: 1 DIF: Moderate REF: page 21

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

82. On a multiple-step income statement, operating income results from subtracting total operating expenses from which of the following amounts?
- gross margin
 - cost of goods sold
 - income before taxes
 - net sales

ANS: A PTS: 1 DIF: Moderate REF: page 21

OBJ: 1-5

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Remember

83. The list below contains several items that appear on a multiple-step income statement.

- other income and expense
- income before income taxes
- net Income
- operating expenses
- gross margin
- net sales
- income from operations

In which order would these items appear on a multiple-step income statement?

- 6, 5, 4, 7, 1, 2, 3
- 7, 6, 1, 4, 2, 3, 5
- 6, 5, 4, 1, 7, 2, 3
- 6, 7, 4, 1, 2, 3, 5

ANS: A PTS: 1 DIF: Moderate REF: page 21

OBJ: 1-5

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Analyze

Bellweather Times

The company reports the following balances:

Other revenue	\$180,000	General and administrative expense	\$320,000
Dividends paid	\$220,000	Operating revenues	\$700,000
Selling expenses	\$280,000	Income tax expense	\$60,000

84. Refer to the figure Bellweather Times. What is the company's income from operations?
- a. \$40,000
 - b. \$100,000
 - c. \$220,000
 - d. \$280,000

ANS: B

$\$700,000$ (Operating revenues) – $\$320,000$ (General & administrative expenses) – $\$280,000$ (Selling expenses) = $\$100,000$

PTS: 1 DIF: Easy REF: page 18 OBJ: 1-5
NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement
BLM: Evaluate

85. Refer to the figure Bellweather Times. What is the company's net income?
- a. \$40,000
 - b. \$100,000
 - c. \$220,000
 - d. \$280,000

ANS: C

$\$700,000$ (Operating revenues) – $\$320,000$ (General & administrative expenses) – $\$280,000$ (Selling expenses) = $\$100,000$ + $\$180,000$ [Other revenues (Expenses)] – $\$60,000$ (Income taxes) = $\$220,000$

PTS: 1 DIF: Easy REF: page 18 OBJ: 1-5
NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement
BLM: Evaluate

86. Refer to the figure Bellweather Times. By what amount will net income on a single-step income statement differ from net income on a multiple-step income statement if the company prepares both formats?
- a. \$0
 - b. \$2,000
 - c. \$6,000
 - d. \$8,000

ANS: A PTS: 1 DIF: Easy REF: page 18 - 21
OBJ: 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement
BLM: Evaluate

87. Which of the following financial statements shows the earnings-per-share measure?
- a. statement of cash flows
 - b. retained earnings statement
 - c. income statement
 - d. balance sheet

ANS: C PTS: 1 DIF: Moderate REF: page 21
OBJ: 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-23-Financial Statement
Analysis BLM: Remember

Company B

A company reported the following income statement amounts:

	<u>Year 2</u>	<u>Year 1</u>
Sales revenues	\$950,000	\$800,000
Operating expenses	\$700,000	\$550,000
Income taxes	\$100,000	\$100,000

88. Refer to the figure Company B. Which of the following best describes the company's performance?
- The company's operating profit as a percentage of operating revenues decreased.
 - The company has become more profitable.
 - The increase in operating revenues increased the company's net income.
 - The operating expenses as a percentage of operating revenues remained the same.

ANS: A

Operating profit / revenue: Year 1: $(\$800,000 - \$550,000) / \$800,000 = .31$

Year 2: $(\$950,000 - \$700,000) / \$950,000 = .26$

PTS: 1

DIF: Challenging REF: page 18 - 21 OBJ: 1-5

NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-23-Financial Statement Analysis

BLM: Analyze

89. Which of the following equations represents the statement of retained earnings activity?
- beginning retained earnings + net income + dividends = ending retained earnings
 - beginning retained earnings + cash inflows – cash outflows = ending retained earnings
 - beginning retained earnings + dividends – net income = ending retained earnings
 - beginning retained earnings + net income – dividends = ending retained earnings

ANS: D

PTS: 1

DIF: Moderate

REF: page 23

OBJ: 1-6

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

Been There Used Furniture

Been There Used Furniture began operations on January 1, Year 1, with an initial investment of \$100,000 from each of its five shareholders. During the year, the company had net income of \$200,000 and paid dividends of \$50,000.

90. Refer to the figure Been There Used Furniture. What is the retained earnings balance at December 31, Year 1?
- a. \$150,000
 - b. \$200,000
 - c. \$500,000
 - d. \$650,000

ANS: A

$\$ -0- \text{ (Beginning balance)} + \$200,000 \text{ (Net income)} - 50,000 \text{ (Dividends)} = \$150,000$

PTS: 1

DIF: Moderate

REF: page 23

OBJ: 1-6

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

BLM: Evaluate

91. Refer to the figure Been There Used Furniture. Which of the following can be said about its dividends for the year?
- a. They increased the amount of capital shares reported by the company.
 - b. They were part of the company's operating expense.
 - c. They were reported on the statement of retained earnings.
 - d. They were reported on the income statement.

ANS: C

PTS: 1

DIF: Easy

REF: page 23

OBJ: 1-6

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

92. Refer to the figure Been There Used Furniture. If the company's revenues were \$500,000 for the year ended December 31, Year 1, how much were total expenses?
- a. \$250,000
 - b. \$300,000
 - c. \$350,000
 - d. \$800,000

ANS: B

$\$500,000 \text{ (Revenues)} - \$200,000 \text{ (Net income)} = \$300,000$

PTS: 1

DIF: Easy

REF: page 18

OBJ: 1-5

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

BLM: Evaluate

93. Which of the following is NOT one of the activities on the statement of cash flows?
- a. operating activities
 - b. investing activities
 - c. business activities
 - d. financing activities

ANS: C

PTS: 1

DIF: Easy

REF: page 25

OBJ: 1-7

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Remember

94. Which of the following best describes a company's operating activities?
- a. They are cash flows directly related to earning income.
 - b. They are necessary to provide the money to start a business.
 - c. They are needed to provide the valuable assets required to run a business.
 - d. They represent the right to receive a benefit in the future.

ANS: A PTS: 1 DIF: Easy REF: page 25

OBJ: 1-7

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

95. Which of the following best relates to the "notes to the financial statements"?
- a. It should be shown at the bottom of the income statement.
 - b. It should be excluded, as they are not an integral part of the financial statements.
 - c. It should be included as an integral part of the financial statements.
 - d. It should be considered an optional part of the financial statements.

ANS: C PTS: 1 DIF: Moderate REF: page 27

OBJ: 1-9

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Remember

96. Which of the following items will be found in a corporate annual report?
- a. industry standards
 - b. notes to the financial statements
 - c. selected financial data from noncompetitor companies
 - d. management's statement that the auditors are responsible for the financial statements

ANS: B PTS: 1 DIF: Easy REF: page 27

OBJ: 1-9

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Remember

97. Which of the following sections is NOT found in a corporate annual report?
- a. Notes to the Financial Statements
 - b. Internal Budget Reports
 - c. Report of the Independent Auditor
 - d. Management's Discussion and Analysis

ANS: B PTS: 1 DIF: Moderate REF: page 27

OBJ: 1-9

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Remember

98. Which of the following best describes a report's section titled "Management's Discussion and Analysis"?
- a. It is a report of the independent auditor.
 - b. It can be a substituted for the notes to the financial statements.
 - c. It explains various items reported in the financial statements.
 - d. It provides assurances that the auditors are responsible for the financial statements.

ANS: C PTS: 1 DIF: Moderate REF: page 27

OBJ: 1-9

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Remember

99. In which section of the annual report would you find the following: "The financial statements, in our opinion, present fairly the financial position, operating results, and cash flows, in conformity with generally accepted accounting principles"?
- a. Management Report
 - b. Notes to the Financial Statements
 - c. Management's Discussion and Analysis
 - d. Report of the Independent Auditor

ANS: D PTS: 1 DIF: Moderate REF: page 27

OBJ: 1-9

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Understand

100. Which of the following is one purpose of the Report of the Independent Auditor?
- a. to provide a place for management to justify questionable items in the statements
 - b. to provide comparative ratios for the company's financial data
 - c. to provide the accountant's opinion of the fairness of the financial statements
 - d. to satisfy the need for full disclosure of all the facts relevant to a company's results and financial position

ANS: C PTS: 1 DIF: Challenging REF: page 27

OBJ: 1-9

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

BLM: Remember

PROBLEM**Backus Tractor Sales**

The accountant prepared the following list of account balances from the company's records for the year ended December 31, Year 1.

Sales Revenue	\$1,650,000	Cash	\$300,000
Accounts Receivable	140,000	Selling Expenses	440,000
Equipment	420,000	Common Stock	170,000
Accounts Payable	120,000	Interest Income	30,000
Salaries & Wages Expense	400,000	Cost of Sales	510,000
Inventories	220,000	Prepaid Expenses	20,000
Income Taxes Payable	50,000	Income Taxes Expense	180,000
Notes Payable	200,000	Retained Earnings	?

1. Determine the following amounts for Backus Tractor Sales:
 - A) current assets at the end of Year 1
total assets at the end of Year 1
 - B) current liabilities at the end of Year 1
 - C) What parties have a claim on the company's assets? Explain your answer in the terms of the accounting equation.

ANS:

- A) Current Assets = \$680,000
(\$300,000 Cash + \$140,000 Accounts Receivable + \$220,000 Inventories + 20,000 Prepaid Expenses = \$680,000)

Total Assets = \$1,100,000
(\$300,000 Cash + \$140,000 Accounts Receivable + \$220,000 Inventories + \$20,000 Prepaid Expenses + \$420,000 Equipment)
- B) Current Liabilities = \$370,000
(\$120,000 Accounts Payable + \$50,000 Income Taxes Payable + \$200,000 Notes Payable = \$370,000)
- C) Both the creditors and the owners have a claim on the assets of the corporation. The creditors have their claim arising from the liabilities of the corporation, while the owners have a claim through the shareholders' equity.

PTS: 1 DIF: Moderate REF: page 12-17 OBJ: 1-4
NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

2. Determine the following amounts for Backus Tractor Sales:

- A) the balance of retained earnings at the end of year 1
- B) the total shareholders' equity at the end of Year 1
- C) Name the two events that might cause shareholders' equity to increase.

ANS:

- A) \$560,000
($\$1,100,000 \text{ Total Assets} - \$370,000 \text{ Total Liabilities} - \$170,000 \text{ Common Shares} = \$560,000$)
- B) \$730,000
($\$1,100,000 \text{ Total Assets} - \$370,000 \text{ Total Liabilities} = \$730,000$)
OR
($\$170,000 \text{ Common Shares} + \$560,000 \text{ Retained Earnings} = \$730,000$)
- C) Shareholders' Equity can increase when common shares is issued to investors. It also can increase through increases to retained earnings or the net income of the business is greater than any dividends paid to the shareholders.

PTS: 1 DIF: Challenging REF: CS1-1 OBJ: 1-3 | 1-6
NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

3. Determine the following amounts for Backus Tractor Sales:

- A) the total revenues for Year 1
- B) the total expenses for Year 1
- C) What is the purpose of the income statement?
- D) Is this company profitable? Explain your answer.
- E) Is this the first year of operations for this company? Explain your answer.

ANS:

- A) \$1,680,000
($\$1,650,000 \text{ Sales Revenue} + \$30,000 \text{ Interest Income} = \$1,680,000$)
- B) \$1,530,000
($\$510,000 \text{ Cost of Sales} + \$400,000 \text{ Salaries \& Wages Expense} + \$440,000 \text{ Selling Expenses} + \$180,000 \text{ Income Taxes Expense} = \$1,530,000$)
- C) The purpose of the Income Statement is to provide information regarding the revenues and expenses of the entity. The difference shows the profitability of the company for a particular period of time.
- D) The company had net income for the period of \$150,000. Since revenues exceeded expenses for the period, the company would be considered profitable.

- E) This would not be the first year of operations for this company. The reasons for this are that the ending Retained Earnings balance is greater than the net income of \$150,000. Since the ending balance of Retained Earnings is \$560,000, and Net Income for the period was \$150,000 as well as apparently no dividends being paid to the shareholders during the year, the company began the year with a balance of \$410,000 (\$560,000 – \$150,000) in Retained Earnings.

PTS: 1 DIF: Moderate REF: page 18-21 OBJ: 1-5
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

4. Prepare an income statement for Backus Tractor Sales in good form.

ANS:

Backus Tractor Sales Income Statement For the Year Ended December 31, Year 1		
Revenues:		
Sales revenue	\$1,650,000	
Interest income	<u>30,000</u>	\$1,680,000
Expenses:		
Cost of sales	\$ 510,000	
Salaries & wages expense	400,000	
Selling expenses	440,000	
Income taxes expense	<u>180,000</u>	<u>1,530,000</u>
Net income		<u>\$ 150,000</u>

PTS: 1 DIF: Moderate REF: page 18-21 OBJ: 1-5
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

5. Prepare a balance sheet for Backus Tractor Sales in good form.

ANS:

Backus Tractor Sales Balance Sheet December 31, Year 1			
<u>Assets</u>		<u>Liabilities & Shareholders' Equity</u>	
Cash	\$ 300,000	Accounts payable	\$ 120,000
Accounts receivable	140,000	Income taxes payable	50,000
Inventories	220,000	Notes payable	200,000
Prepaid expenses	20,000	Common shares	170,000
Equipment	<u>420,000</u>	Retained earnings	<u>560,000</u>
Total assets	<u>\$1,100,000</u>	Total liabilities & shareholders' equity	<u>\$1,100,000</u>

PTS: 1 DIF: Moderate REF: page 12-17 OBJ: 1-4
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

Ben & Terry's Ice Cream

The accountant prepared the following list from the company's accounting records for the year ended December 31, Year 1:

Retained Earnings	?	Prepaid Expenses	\$ 50,000
Cash	\$ 77,000	Common Stock	400,000
Accounts Payable	50,000	Accounts Receivable	170,000
Sales Revenue	955,000	Interest Income	50,000
Cost of Sales	700,000	Salary Expense	140,000
Land	750,000	Income Tax Expense	20,000
Notes Payable	450,000	Selling Expense	45,000
Inventory	200,000	Salaries Payable	40,000

6. Determine the following amounts for Ben & Terry's Ice Cream.

- A) total assets at the end of Year 1
- B) total liabilities at the end of Year 1
- C) total equity at the end of Year 1

ANS:

- A) \$1,247,000
(\$77,000 Cash + \$170,000 Accounts Receivable + \$200,000 Inventories + \$50,000 Prepaid Expense + \$750,000 Land = \$1,247,000)
- B) \$540,000
(\$50,000 Accounts Payable + \$450,000 Notes Payable + \$40,000 Salaries Payable = \$540,000)
- C) \$707,000
(\$1,247,000 Total Assets – \$540,000 Total Liabilities = \$707,000)

PTS: 1 DIF: Moderate REF: page 12-17 OBJ: 1-4
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

7. Determine the following amounts for Ben & Terry's Ice Cream:

- A) total revenues for Year 1
- B) total expenses for Year 1
- C) net income for Year 1

ANS:

- A) \$1,005,000
(\$955,000 Sales Revenue + \$50,000 Interest Income = \$1,005,000)
- B) \$905,000
(\$700,000 Cost of Sales + \$140,000 Salary Expense + \$20,000 Income Tax Expense + \$45,000 Selling Expense = \$905,000)
- C) \$100,000
(\$1,005,000 Total Revenue – \$905,000 Total Expenses = \$100,000)

PTS: 1 DIF: Moderate REF: page 18-21 OBJ: 1-5
NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

8. Using good form, prepare an income statement for Ben & Terry's Ice Cream.

ANS:

Ben & Terry's Ice Cream Income Statement For the Year Ended December 31, Year 1			
Revenues:			
Sales revenue	\$955,000		
Interest income	<u>50,000</u>	\$1,005,000	
Expenses:			
Cost of sales	\$700,000		
Salary expense	140,000		
Selling expense	45,000		
Income tax expense	<u>20,000</u>	<u>905,000</u>	
Net Income		<u>\$ 100,000</u>	

PTS: 1 DIF: Moderate REF: page 18-21 OBJ: 1-5
NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

9. Using good form, prepare a balance sheet for Ben & Terry's Ice Cream.

ANS:

Ben & Terry's Ice Cream Balance Sheet As of December 31, Year 1			
<u>Assets</u>		<u>Liabilities & Owners' Equity</u>	
Cash	\$ 77,000	Accounts payable	\$ 50,000
Accounts receivable	170,000	Salaries payable	40,000
Inventory	200,000	Notes payable	450,000
Prepaid expenses	50,000	Common shares	400,000
Land	<u>750,000</u>	Retained earnings	<u>307,000</u>
Total assets	<u>\$1,247,000</u>	Total liabilities and owners' equity	<u>\$1,247,000</u>

PTS: 1 DIF: Moderate REF: page 12-17 OBJ: 1-4
NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

10. Dunn, Inc., started the year with total assets of \$1,400,000 and total liabilities of \$240,000. Net income for the year is \$1,000,000 and dividends declared and paid during the year are \$450,000.

- A) What is the amount of Dunn's total shareholders' equity at the end of the year?
- B) Could Dunn have paid additional dividends during the year? Explain your answer.

ANS:

- A) \$1,710,000
(\$1,400,000 Total Assets at the beginning of the year – \$240,000 Total Liabilities at beginning of the year = \$1,160,000 Total Shareholders' Equity at the beginning of the year)
(\$1,160,000 Total Shareholders' Equity at the beginning of the year + \$1,000,000 Net Income for the year – \$450,000 Dividends = \$1,710,000)
- B) Yes. Assuming the company has enough cash to do so, additional dividends can be paid. Net income exceeded the amount of dividends paid by \$550,000 (\$1,000,000 – \$450,000), so the amount paid could have been increased. Also the company has total positive retained earnings.

PTS: 1 DIF: Moderate REF: page 23 OBJ: 1-3 | 1-6
NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

11. A certain company started business on January 1, Year 1 with assets of \$1,000,000 and shareholders' equity of \$565,000. By the end of the year, assets increased by \$100,000 and liabilities decreased by \$150,000. Other than net income or loss, the only change in shareholders' equity was dividends of \$50,000.

- A) What was the amount total shareholders' equity at the end of the year?
- B) What was the amount net income or net loss for the year?

ANS:

				<u>Shareholders</u>	
<u>Assets</u>		<u>Liabilities</u>		<u>Equity</u>	
Beginning of year	\$1,000,000		\$435,000		\$565,000
Change during year	<u>+100,000</u>		<u>(150,000)</u>		<u>+250,000</u>
End of year	\$1,100,000	=	285,000		\$815,000

B) Change in equity	\$ 250,000
Add: Dividends	<u>50,000</u>
Net Income	<u>\$ 300,000</u>

PTS: 1 DIF: Challenging REF: page 23 OBJ: 1-3 | 1-6
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

12. Presented below are selected data from the balance sheet:

Current assets	\$250,000
Property, plant, and equipment	700,000
Other assets	???
Current liabilities	200,000
Total long-term debt	500,000
Total shareholders' equity	275,000

- A) Determine the amount of "Other assets."
 (Hint: you must use the accounting equation concept to determine your answer.)
- B) How much of the company is financed by creditors? How much is financed by the owners?

ANS:

- A) \$25,000
 (\$200,000 Current liabilities + \$500,000 Long-term debt + \$275,000 Shareholders' equity = \$975,000 Total Assets)
- B) Amount of financing by creditors: \$700,000
 (\$200,000 Current liabilities + \$500,000 Long-term debt = \$700,000)
- Amount of financing by owners': \$275,000
 (\$275,000 Shareholders' equity)

PTS: 1 DIF: Moderate REF: page 12-17 OBJ: 1-3 | 1-4
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

13. Presented below are selected data from the accounting records for Year 1:

Sales	\$900,000
Income tax expense	80,000
Cost of sales	550,000
Operating expenses	150,000
Dividends	75,000

- A) Calculate the net income or loss for the year.
- B) Did the company's financial position improve or deteriorate during the year? Explain.
- C) Is the company profitable? Explain.

ANS:

- A) \$120,000
 (\$900,000 Sales – \$550,000 Cost of sales – \$150,000 Operating expenses – \$80,000 Income tax expense = \$120,000)
- B) The financial position improved since the net income increases the company's retained earnings.
- C) Yes. The amount of revenues exceeds the amount of expenses by \$120,000.

PTS: 1 DIF: Moderate REF: page 18-21 OBJ: 1-5
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

14. The following balance sheet information is provided:

	<u>Assets</u>	<u>Liabilities</u>	<u>Shareholder's Equity</u>
January 1, Year 1	\$1,500,000	\$540,000	\$
December 31, Year 1	1,810,000	_____	1,400,000

- A) What is the amount of shareholders' equity at January 1, Year 1?
- B) What is the amount of liabilities at December 31, Year 1?
- C) Assume that the company paid dividends of \$620,000 during the year. How much net income did it earn during the year?
- D) Assume that the company paid no dividends during the year. Without looking at the income statement, how can you tell if the company is profitable or not?

ANS:

- A) \$960,000
 (\$1,500,000 Assets – \$540,000 Liabilities = \$960,000)
- B) \$410,000
 (\$1,810,000 Assets – \$1,400,000 Shareholders' Equity = \$410,000 Liabilities)
- C) \$1,060,000
 (\$960,000 Beginning Shareholders' Equity + X – \$620,000 Dividend = \$1,400,000 Ending Shareholders' Equity)
 (X = \$1,060,000)
- D) Assuming that the increase in shareholders' equity would come from net income, the company would have to be considered profitable. Net income will increase retained earnings which is a part of shareholders' equity.

PTS: 1 DIF: Moderate REF: page 12-17 OBJ: 1-3

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

15. A certain company began the year with total assets of \$10,000,000 and total liabilities of \$6,200,000. No additional shares were issued during the year. Use the accounting equation to answer the following questions.
- A) What was the amount of total assets at the end of the year if liabilities decreased by \$600,000 and shareholders' equity increased by \$900,000?
- B) Was the company profitable? Explain your answer.

ANS:

- A) \$10,300,000

	<u>Assets</u>	<u>Liabilities</u>	<u>Shareholders' Equity</u>
Beginning of the year	\$10,000,000	\$6,200,000	\$3,800,000
Change during the year	<u>300,00</u>	<u>(600,000)</u>	<u>900,000</u>
	0		
End of the year	\$10,300,000	\$5,600,000	\$4,700,000

- B) Yes, the company was profitable because the shareholders' equity increased from the beginning of the year to the end of the year.

PTS: 1 DIF: Moderate REF: page 12-17 OBJ: 1-1

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-01-Purpose

16. The beginning balance of retained earnings was \$800,000, and the ending balance was \$500,000. The company paid dividends of \$50,000.

- A) Determine the amount of net income (loss) for the year.
- B) What information would one find on the income statement in addition to net income?

ANS:

- A) (250,000) loss
 $[\$500,000 \text{ Ending Retained Earnings} - \$800,000 \text{ Beginning Retained Earnings} = (\$300,000)]$
 $[(\$300,000) \text{ decrease} + \$50,000 \text{ Dividends Paid} = (\$250,000) \text{ loss}]$

- B) The income statement will show the sources of amounts earned (revenues) as well as the amount and type of costs incurred by the company (expenses) during the period.

PTS: 1 DIF: Easy REF: page 18-21 OBJ: 1-1 | 1-5 | 1-6
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

17. Best Deal Auto Parts began Year 1 with \$400,000 in assets, \$140,000 in liabilities, and \$160,000 of retained earnings. Net income for the year was \$100,000, and dividends of \$80,000 were paid.

- A) Prepare a statement of retained earnings for Year 1.
- B) What is the nature or purpose of the statement of retained earnings?
- C) What was the amount of common shares at the beginning of Year 1?
- D) What events would cause the two shareholders' equity items to increase?
- E) How do you identify whether the company was profitable during Year 1 by examining the statement of retained earnings?

ANS:

A)	Best Deal Auto Parts	
	Statement of Retained Earnings	
	For the Year Ended December 31, year 1	
	Retained earnings, January 1, Year 1	\$160,000
	Add: Net income	100,000
	Deduct: Dividends	<u>(80,000)</u>
	Retained earnings, December 31, Year 1	<u>\$180,000</u>

- B) Retained earnings is the amount of income earned by the company less any dividends paid to the shareholders' since the company began operations. The statement of retained earnings shows the portion of shareholders' equity created by the company.
- C) \$100,000
 $(\$400,000 \text{ Total Assets} - \$140,000 \text{ Total Liabilities} - \$160,000 \text{ Beginning Retained Earnings} = \$100,000)$

- D) One way that the company can increase shareholders' equity is to sell additional shares to investors. Another way is to increase retained earnings when the company reports net income for the period greater than the dividends paid.
- E) The statement of retained earnings shows that the company was profitable for the year by reporting net income for the period. If the company were to experience an operating loss, then this would be shown as a deduction from the beginning balance of retained earnings.

PTS: 1 DIF: Moderate REF: page 12-17 OBJ: 1-3 | 1-6
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

18. The following accounts were taken from a company's accounting records. Answer the questions that follow.

Total liabilities, end of the yr.	\$920,000	Total assets, end of the yr.	\$1,430,000
Common shares, end of the yr.	160,000	Retained earnings, beginning of yr.	150,000
Dividends for the period	200,000	Net income for the yr.	400,000

- A) How much is the balance of retained earnings at the end of the year?
- B) Show the company's accounting equation at the end of the year with the respective dollar amounts.
- C) If shareholders' equity increases during the year, does that mean that the company is profitable? Explain your answer.

ANS:

- A) \$350,000
 (\$150,000 Retained earnings, beginning of the year + \$400,000 Net income – \$200,000 Dividends for the period = \$350,000)
 OR
 (\$1,430,000 Total assets, end of the year – \$920,000 Total liabilities, end of the year – \$160,000 Common shares, end of the year = \$350,000)
- B) \$1,430,000 Total assets, end of the year = \$920,000 Total liabilities, end of the year + \$510,000 Shareholders' Equity, end of the year
 (\$160,000 Common shares, end of the year + \$350,000 Retained earnings, end of the year)
- C) This would depend upon what causes the shareholders' equity to increase. If the increase were due to an increase in retained earnings, then the company would have been profitable for the period. But if the increase were due to an increase in the amount of common shares issued, this would not be a measure of profitability.

PTS: 1 DIF: Moderate REF: page 23 OBJ: 1-3 | 1-4 | 1-6
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

19. Classify the following items according to the financial statement on which each belongs, either the income statement (IS), statement of retained earnings (RE), or the balance sheet (BS). Also indicate whether each is a revenue (R), expense (E), asset (A), liability (L), or shareholders' equity (SE) item.

	<u>Appears on Which Statement?</u>	<u>Type of Account</u>
1. Retained earnings	_____	_____
2. Equipment	_____	_____
3. Common shares	_____	_____
4. Unearned revenue	_____	_____
5. Sales	_____	_____
6. Rent expense	_____	_____
7. Inventories	_____	_____
ANS:		
1. Retained earnings	BS, RE	SE
2. Equipment	BS	A
3. Common shares	BS	SE
4. Unearned revenue	BS	L
5. Sales	IS	R
6. Rent expense	IS	E
7. Inventories	BS	A

PTS: 1 DIF: Easy REF: page 12-17 OBJ: 1-4 | 1-5 | 1-6
 NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

20. The following amounts were taken from the accounting records at December 31:

Service revenue	\$600,000	Salaries expense	\$200,000
Dividends paid	50,000	Rent expense	86,000
Buildings	110,000	Land	100,000
Accounts payable	40,000	Accounts receivable	28,000
Common shares	60,000	Retained earnings, Jan. 1	400,000
Utilities expense	19,000	Notes payable	30,000
Income tax payable	4,000	Income tax expense	110,000

- A) Calculate net income for the year.
- B) Calculate retained earnings at the end of the year.

ANS:

- A) \$185,000
 (\$600,000 Service Revenue – \$200,000 Salaries Expense – \$86,000 Rent Expense – \$19,000 Utilities Expense – \$110,000 Income Tax Expense = \$185,000)
- B) \$535,000
 (\$400,000 Retained Earnings, Jan 1 + \$185,000 Net Income – \$50,000 Dividends Paid = \$535,000)

PTS: 1 DIF: Moderate REF: page 18-21 OBJ: 1-5 | 1-6
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

21. The following amounts were taken from the accounting records at December 31:

Accounts payable	\$400,000	Dividends paid	\$100,000
Cash	\$100,000	Expenses	\$600,000
Inventories	\$700,000	Revenue	\$750,000

- A) Calculate total assets.
- B) Calculate net income for the year.
- C) Calculate total shareholders' equity at the end of the year.
- D) Calculate total shareholders' equity at the beginning of the year assuming there were no shares transactions during the year.

ANS:

- A) \$800,000
 (\$100,000 Cash + \$700,000 Inventories = \$800,000)
- B) \$150,000
 (\$750,000 Revenue – \$600,000 Expenses = \$150,000)
- C) \$400,000
 (\$800,000 Total Assets – \$400,000 Accounts Payable = \$400,000)
- D) \$350,000
 (\$400,000 End-of-year - \$150,000 (NI = \$750,000 - \$600,000) + \$100,000 (Dividends)

PTS: 1 DIF: Easy REF: page 23 OBJ: 1-4 | 1-5
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

22. The following information is taken from the balance sheet at December 31:

Cash	\$288,000	Retained earnings	\$168,000
Inventory	96,000	Accounts payable	84,000
Equipment	456,000	Bonds payable	276,000
Common shares	312,000		

- A) How much did creditors provide to this company?
- B) On which financial statement would an investor look to see if any shares were issued during the year?

ANS:

- A) \$360,000
(\$84,000 Accounts Payable + \$276,000 Bond Payable)
- B) The primary source for seeing whether any shares were issued during the year would be the statement of shareholders' equity. While the balance sheet may show an amount for "Common shares," this amount is an ending balance, and would not show the results of any transactions involving new issuances of shares during the period.

PTS: 1 DIF: Moderate REF: page 12-23 OBJ: 1-4
NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

Balloon-E-Tunes

Retained earnings	\$370,000	Notes payable (due in 6 years)	\$120,000
Accumulated depreciation	130,000	Salaries payable	10,000
Income taxes payable	240,000	Supplies	20,000
Plant	480,000	Accounts payable	360,000
Cash	110,000	Inventory	330,000
Accounts receivable	350,000	Land	500,000
Common shares	600,000	Prepaid insurance	40,000

23. Refer to Balloon-E-Tunes. Prepare the current assets section of the balance sheet at December 31. You may omit the heading. How does the concept of liquidity apply?

ANS:

Cash	\$110,000
Accounts receivable	350,000
Inventory	330,000
Prepaid insurance	40,000
Supplies	20,000
Total current assets	<u>\$850,000</u>

Liquidity is an indicator of how close to cash the company's assets are. Those assets that are most liquid are listed first. It relates to the company's ability to pay its obligations as they become due. Current assets are expected to be converted into cash within the next operating cycle, so they are a key determinant of liquidity.

PTS: 1 DIF: Moderate REF: page 12 OBJ: 1-4
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement | ACBSP-APC-23-Financial Statement Analysis

24. Refer to Balloon-E-Tunes. Prepare the current liabilities section of the balance sheet at December 31. You may omit the heading. If the amount of current liabilities were larger, what effect would this have on the current ratio?

ANS:

Accounts payable	\$360,000
Salaries payable	10,000
Income taxes payable	<u>240,000</u>
Total	<u>\$610,000</u>

When current liabilities increase, the denominator of the current ratio increases. This causes the current ratio itself to decrease.

PTS: 1 DIF: Moderate REF: page 14 OBJ: 1-4
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-23-Financial Statement Analysis | ACBSP-APC-09-Financial Statement

25. Refer to Balloon-E-Tunes. Prepare the long-term asset section of the balance sheet at December 31. You may omit the heading. Why are these amounts classified as "long term"?

ANS:

Land		\$500,000
Plant	\$480,000	
Less: Accumulated depreciation	<u>(130,000)</u>	<u>350,000</u>
Total		<u>\$850,000</u>

Long-term assets are those that are expected to benefit the company beyond the current accounting period. Both the land and the buildings are expected to benefit more than one accounting period. Accumulated depreciation is the portion of the cost of the building that has benefited the accounting periods to date.

PTS: 1 DIF: Moderate REF: page 14 OBJ: 1-4
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

26. Refer to Balloon-E-Tunes. Calculate the current ratio at December 31. What does this ratio tell you about the "composition" of the current assets?

ANS:

Current Assets = \$850,000

(\$110,000 Cash + \$350,000 Accounts receivable + \$330,000 Inventory + \$40,000 Prepaid Insurance + \$20,000 Supplies = \$850,000)

Current Liabilities = \$610,000

(\$360,000 Accounts Payable + \$10,000 Salaries Payable + \$240,000 Income Taxes Payable = \$610,000)

Current ratio = 1.39 to 1

(\$850,000 / \$610,000)

The current ratio does not provide information about the composition of the company's current assets and current liabilities. Only totals are used to calculate the current ratio.

PTS: 1

DIF: Moderate

REF: page 15 – 17

OBJ: 1-4

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-23-Financial Statement Analysis

27. Refer to Balloon-E-Tunes. Calculate the amount of working capital at December 31. What can you learn from the current ratio that you cannot learn from the amount of working capital?

ANS:

Current Assets = \$850,000

(\$110,000 Cash + \$350,000 Accounts receivable + \$330,000 Inventory + \$40,000 Prepaid Insurance + \$20,000 Supplies = \$850,000)

Current Liabilities = \$610,000

(\$360,000 Accounts Payable + \$10,000 Salaries Payable + \$240,000 Income Taxes Payable = \$610,000)

Working Capital = \$240,000

(\$850,000 – \$610,000)

The current ratio indicates the number of times current assets is greater than current liabilities. The current ratio is based on a relative relationship; whereas, working capital is based on total dollars.

PTS: 1

DIF: Moderate

REF: page 12-17

OBJ: 1-4

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-23-Financial Statement Analysis

B-There Transportation

B-There Transportation calculated the following amounts concerning its financial information for the years ending December 31, Year 2 and Year 1.

	<u>Year 2</u>	<u>Year 1</u>
Current ratio	4.0 to 1	2.0 to 1

28. Refer to B-There Transportation. Is the change in the current ratio favourable or not? Explain.

ANS:

The current ratio increased from 2.0 to 1 to 4.0 to 1. This is an unusually large increase for most companies. A larger current ratio means a company is more liquid. This increase is favourable, although care must be taken so that the current ratio does not become too large, which may indicate an inefficient cash management system.

PTS: 1

DIF: Moderate

REF: page 17

OBJ: 1-4

NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-23-Financial Statement Analysis

29. Refer to B-There Transportation. Suppose the company had a decrease in its cash account from Year 1 to Year 2. Would the other current asset amounts have increased or decreased? Explain.

ANS:

Since the current ratio increased from Year 1 to Year 2, the current assets other than cash would have had to increase substantially to offset the decline in cash. However, cash could also have been used to pay down current liabilities thus the current ratio would not be impacted. The decline in cash changes the liquidity somewhat, in that the other current assets must be converted to cash prior to paying the current period debt.

PTS: 1

DIF: Moderate

REF: page 17

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-23-Financial Statement Analysis

30. The following amounts were taken from the income statement of Beauty World for the year ending December 31, Year 1:

	<u>Year 1</u>
Net sales	\$750,000
Selling, general and administrative expense	450,000
Research and development expense	50,000
Other income (net)	25,000

How much is net income for the year ended December 31, Year 1? Would the net income amount have been different if the company had used a single-step income statement rather than the multiple-step statement? Explain.

ANS:

Net Income = \$275,000

(\$750,000 Net Sales + \$25,000 Other Income, net – \$450,000 Selling, General and Administrative Expenses – \$50,000 Research and Development Expense = \$275,000)

Net income is the same under a single-step or a multiple-step income statement. Only subtotals and the order the amounts are listed differ.

PTS: 1

DIF: Moderate

REF: page 18-21

OBJ: 1-5

NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-09-Financial Statement

31. After reporting a profit of \$20,000 for the year, a certain company reported the following items on its balance sheet at December 31, Year 1:

Cash	\$225,000
Accounts receivable	110,000
Inventory	80,000
Prepaid insurance	5,000
Land	100,000
Building	280,000
Accounts payable	60,000
Salaries payable	10,000
Common shares	500,000
Retained earnings	230,000

- A) Calculate the current ratio and determine the amount of working capital.
- B) Beyond the information provided in your answers to part A, what does the composition of the current assets tell you about the company's liquidity?
- C) What other information would one need to fully assess liquidity?

ANS:

- A) Current ratio: 6 to 1
 $(\$225,000 \text{ Cash} + \$110,000 \text{ Accounts receivable} + \$80,000 \text{ Inventory} + \$5,000 \text{ Prepaid insurance}) / (\$60,000 \text{ Accounts payable} + \$10,000 \text{ Salaries payable}) = 6 \text{ to } 1$

Working capital: \$350,000
 $(\$420,000 \text{ Total Current Assets} - \$70,000 \text{ Total Current Liabilities}) = \$350,000$

- B) The closer an asset is to being converted to cash, the more liquid the asset is. Some assets, like inventory, take much longer to turn into cash because they must be sold before collection of the cash can be made. Prepaid insurance is not as liquid as accounts receivable since it will be consumed as time passes. Receivables are more liquid than inventory because a sale has already occurred.
- C) The statement of cash flows would be helpful to determine the cash inflows and outflows that occurred during the year. The balance sheet represents only the ending balance of the cash account. The statement of cash flows also identifies the sources and uses of cash by accounting activity.

PTS: 1 DIF: Moderate REF: page 17 OBJ: 1-4
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-23-Financial Statement Analysis

32. Listed below are several amounts from the accounting records of Bike Links for the year ended December 31, Year 1. Prepare a multiple-step income statement in good form.

Service revenue	\$960,000
Selling expense	176,000
Income tax expense	160,000
General and administrative expenses	280,000
Interest revenue	8,000

ANS:

Bike Links	
Income Statement	
For the Year Ended December 31, Year 1	
Service revenue	\$960,000
Operating expenses:	
Selling expenses	\$176,000
General and administrative expenses	<u>280,000</u>
Total operating expenses	<u>456,000</u>
Income from operations	\$ 504,000
Other revenue and expenses	
Interest revenue	<u>8,000</u>
Income before taxes	\$ 512,000
Income tax expense	<u>160,000</u>
Net income	<u><u>\$ 352,000</u></u>

PTS: 1 DIF: Challenging REF: page 21 OBJ: 1-5
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

33. Listed below are several amounts from the accounting records of Big Tom's Pawn Shops for the year ended December 31, Year 1. Prepare a single-step income statement in good form.

Salaries expenses	\$145,000
Rent expense	12,000
Sales	225,000
Retained earnings	100,000
Insurance expense	11,000
Income taxes expense	30,000

ANS:

Big Tom's Pawn Shops Income Statement For the Year Ended December 31, Year 1		
Revenues:		
Sales		\$225,000
Expenses		
Salaries expense	\$145,000	
Rent expense	12,000	
Insurance expense	11,000	
Income tax expense	<u>30,000</u>	
Total expenses		<u>198,000</u>
Net income		<u>\$ 27,000</u>

PTS: 1 DIF: Moderate REF: page 21 OBJ: 1-5
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

34. Blackbeard's Restaurant began operations on January 1, Year 1, with a total investment of \$100,000 by its shareholders. The restaurant had a net loss its first year of business of \$15,000. During Year 2 and Year 3, the business was profitable with net incomes of \$25,000 and \$50,000, respectively. The company paid \$5,000 per year in dividends to its shareholders in Year 2 and Year 3.

- A) In good form, prepare a statement of retained earnings for the year ended December 31, Year 2.
- B) How much is total retained earnings on December 31, Year 3?
- C) Explain the link between the statement of retained earnings and the balance sheet.

ANS:

Blackbeard's Restaurant Statement of Retained Earnings For the Year Ended December 31, Year 2		
Beginning balance, January 1, Year 2		\$(15,000)*
Add: Net income for Year 2		25,000
Less: Dividends paid during the year		<u>(5,000)</u>
Ending balance, December 31, Year 2		<u>\$ 5,000</u>

* \$-15,000 Net Loss for 2011 – \$0 Dividends paid = \$(15,000) Balance, January 1, Year 2

- B) Retained earnings at December 31, Year 3 = \$50,000
 (\$5,000 Beginning Balance, January 1, Year 3 + \$50,000 Net Income for Year 3 – \$5,000 Dividends paid during the year = \$50,000)
- C) The ending balance of the retained earnings statement represents the cumulative earnings less all the dividends declared and paid for the life of the business. This amount appears on the balance sheet as a component of shareholders' equity.

PTS: 1 DIF: Moderate REF: page 23 OBJ: 1-6
 NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

35. Most annual reports contain the following list of basic elements. For each element, identify the person(s) who prepared the element and describe the information a user would expect to find in each element. Some information is verifiable while other information is subjectively chosen by management. Indicate whether the information in each element is verifiable.

Elements	Prepared By	Information Provided	Verifiable/ Yes or No?
Management's Discussion and Analysis			
Financial statements			
Notes to financial statements			
Report of the Independent Auditor			

ANS:

Elements	Prepared By	Information Provided	Verifiable/ Yes or No?
Management's Discussion and Analysis	Mgmt.	discussion of financial statements and explanation. highlights favourable and unfavourable trends	No
Financial statements	Mgmt.	income statement, balance sheet, statement of cash flows, statement of retained earnings	Yes
Notes to financial statements	Mgmt.	clarifications and explanations that expand upon the information presented in the financial statements	Yes
Report of the Independent Auditor	CA, CAM, CGA	opinion that the financial statements are presented fairly in accordance with generally accepted accounting principles	No

PTS: 1 DIF: Challenging REF: page 27 OBJ: 1-9
 NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

ESSAY

1. List three different groups of users of accounting information. Indicate the type of decisions each group typically makes from accounting information.

ANS:

The groups and their decisions are as follows:

Shareholders:	Is the company profitable enough to pay dividends? Did the company make a profit for the period?
Management:	How should an item be priced? Should we continue operations? Can we give employees raises?
Bankers:	Can the company pay interest and principal when it comes due?
Creditors:	Can the company pay bills when they are due?
Government:	How much did the company earn? (i.e., how much taxes should be paid?)

PTS: 1 DIF: Moderate REF: page 4 OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-01-Purpose

2. What is the purpose of an income statement?

ANS:

An income statement reports the company's revenues and expenses for a period of time and shows the company's profitability (or lack thereof). The income statement is sometimes called the "profit or loss statement."

PTS: 1 DIF: Easy REF: page 8 OBJ: 1-5
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

3. List the four financial statements. Explain the connection between these four statements.

ANS:

1. balance sheet
2. income statement
3. statement of retained earnings
4. statement of cash flows

Net income on the income statement increases retained earnings on the statement of retained earnings. The balance in the statement of retained earnings goes to the balance sheet. The ending balance for cash on the statement of cash flows is also shown on the balance sheet.

PTS: 1 DIF: Challenging REF: page 8 OBJ: 1-3 | 1-8
NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-09-Financial Statement

Baker's Pride Bakery

Condensed data from the company's Year 2 and Year 1 financial statements are presented below. The figures are expressed in thousands.

Statement A	<u>Year 2</u>	<u>Year 1</u>
Assets:		
Total current assets	\$219,560	\$198,088
Property, plant, and equipment (net of accumulated depreciation)	18,320	13,996
Investments	3,370	1,167
Other assets	<u>12,22</u>	<u>11,667</u>
	<u>0</u>	
Total assets	<u>\$253,470</u>	<u>\$224,918</u>
Liabilities:		
Total current liabilities	\$	\$ 95,260
	92,990	
Long-term debt	<u>15,16</u>	<u>22,172</u>
	<u>0</u>	
Total liabilities	\$108,150	\$117,432
Shareholders' equity:		
Contributed capital	\$	\$ 35,475
	53,680	
Retained earnings	<u>91,64</u>	<u>72,011</u>
	<u>0</u>	
Total shareholders' equity	<u>\$145,320</u>	<u>\$ 107,486</u>
Total liabilities & shareholders' equity	<u>\$253,470</u>	<u>\$224,918</u>

Statement B	<u>Year 2</u>	<u>Year 1</u>
Net sales	\$229,301	\$203,171
Cost of sales	<u>135,453</u>	<u>131,212</u>
Gross margin	\$93,848	\$71,959
Selling, general and administrative expenses	64,832	57,442
Other income (expense)	<u>69</u>	<u>(130)</u>
	<u>3</u>	
Income (loss) before income taxes	\$29,709	\$14,387
Income tax expense	<u>3,534</u>	<u>2,320</u>
Net income (loss)	<u>\$ 26,175</u>	<u>\$ 12,067</u>

4. Refer to Baker's Pride Bakery.

A) What is the name of Statement A?

B) What is the name of Statement B?

ANS:

A) Statement A is the classified balance sheet

B) Statement B is the multiple-step income statement

PTS: 1 DIF: Moderate REF: page 12-21 OBJ: 1-4 | 1-5

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

5. Refer to Baker's Pride Bakery. Which statement indicates the financial position of the company? What information is provided on that statement that indicates the financial position of the company? Explain.

ANS:

The classified balance sheet provides information on the financial position of the company. It is expressed in terms of the accounting equation. When total liabilities are subtracted from total assets, the difference is shareholders' equity. This amount represents net worth or the financial position of a company at the balance sheet date.

PTS: 1

DIF: Easy

REF: page 12

OBJ: 1-5

NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-09-Financial Statement

6. Refer to Baker's Pride Bakery. Was the company profitable both years? What are the amounts of the total revenues and total expenses, respectively, for Year 2? Which financial statement provides this information to you?

ANS:

The company was profitable in both Year 2 and Year 1.

For Year 2, total revenues include net sales of \$229,301 and other income of \$693, for a total of \$229,994.

Total expenses for Year 2 include cost of sales of \$135,453, selling, general and administrative expenses of \$64,832, and income tax expense of \$3,534, or a total of \$203,819.

Information about revenues, expenses, and profitability is reported on the income statement.

PTS: 1

DIF: Moderate

REF: page 18-21

OBJ: 1-5

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

7. Refer to Baker's Pride Bakery. How much of the company is financed by owners at the end of December Year 2?

ANS:

The amount of financing by owners for Year 2 is represented by the amount of shareholders' equity, \$145,320. Over time, sales of shares and earnings retained by the company (cumulative net income minus cumulative dividends) cause the amount of shareholders' equity to increase.

PTS: 1

DIF: Moderate

REF: page 12-17

OBJ: 1-4

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

8. Refer to Baker's Pride Bakery. How much of the company is financed by creditors at the end of December Year 2? Evaluate the change from Year 1 to Year 2.

ANS:

The amount of financing provided by creditors for Year 2 is the amount of liabilities reported on the balance sheet, \$108,150. For Year 1, the amount was \$117,432. Total liabilities decreased by \$9,282, or about 8% from Year 1 to Year 2. The company was able to lower its debt while still increasing its assets and shareholders' equity. Of course, this decrease in liabilities must be examined relative to the company's entire financial position.

PTS: 1 DIF: Moderate REF: page 12-17 OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

9. Refer to Baker's Pride Bakery. Based on the information provided, is the company considered a business or nonbusiness entity? How do you know by examining the financial statements?

ANS:

This company is a business entity, because its purpose is to make a profit, not simply provide a service or product. Nonbusiness entities have no owners, but this company has owners, as evidenced by examining the shareholders' equity section of the balance sheet.

PTS: 1 DIF: Easy REF: page 6 OBJ: 1-2 | 1-5
NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-09-Financial Statement

10. Refer to Baker's Pride Bakery. Based on the information provided, is the company legally organized as a sole proprietorship, partnership, or corporation? How can you tell?

ANS:

The company is organized as a corporation, as evidenced by the shareholders' equity items.

PTS: 1 DIF: Easy REF: page 6 OBJ: 1-2
NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-09-Financial Statement

11. What financial statement items are investors and creditors each most interested in and why?

ANS:

Investors are most interested in cash receipts from dividends and the cash they can receive upon selling their shares. Creditors are most interested in cash to be received for interest payments and the repayment of the principal. If a company does not have sufficient cash flows, investors and creditors could suffer as a result. The financial position, shown on the company's balance sheet, is also a concern for both investors and creditors because even though the company may have what appears to be sufficient cash flows for the current period, the long-term cash flow could be weak.

PTS: 1 DIF: Moderate REF: page 4 OBJ: 1-4 | 1-7
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

12. How is a classified balance sheet useful to decision makers?

ANS:

A classified balance sheet helps evaluate the liquidity of a company by separating the current assets from long-term assets and the current liabilities from long-term liabilities. The user can then determine the amount of working capital and the current ratio, which are both useful measures of liquidity.

PTS: 1 DIF: Moderate REF: page 12 OBJ: 1-4
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

13. How does the definition of a current liability relate to that of a current asset?

ANS:

Current liabilities are obligations that will be satisfied within the operating cycle or within one year if the cycle is shorter than one year. Current assets will be realized in cash, or sold, or consumed during the operating cycle or within one year if the cycle is shorter. For most companies, both current assets and liabilities are reported on the balance sheet using a one-year time period.

PTS: 1 DIF: Moderate REF: page 14 OBJ: 1-4
 NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

14. Potential shareholders and lenders are interested in a company's financial statements. Several financial statement items appear below. Answer the questions that follow.

Accounts receivable	Accounts payable	Advertising expense
Cash	Depreciation expense	Income taxes
Common shares	Land held for future expansion	Dividends
Retained earnings	Loss on the sale of equipment	Service revenue
Office supplies	Patent amortization expense	Sales
Unearned revenue	Utilities expense	

- A) In which two items from above would shareholders be most interested? Explain why the two you selected are important to shareholders.
- B) In which item would lenders be most interested? Explain why this item is important.

ANS:

- A) Shareholders are interested in net income and dividends. They want to make sure the company is profitable. If a company is incurring losses, it may not pay dividends.
- B) Lenders are most interested in the company's ability to pay bills when they become due. Cash can be a big problem if a company does not have enough to pay its bills. This includes the company's ability to repay the lender.

PTS: 1 DIF: Moderate REF: page 12-17 OBJ: 1-4
 NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

15. What information is provided in an annual report in addition to the financial statements?

ANS:

An annual report contains the reports of management, the auditor's report, management's discussion and analysis of the amounts appearing in the statements, footnotes to the financial statements, and a summary of selected financial data over a period of years.

PTS: 1 DIF: Easy REF: page 27 OBJ: 1-9
 NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-09-Financial Statement

16. Assume that you have received copies of the financial statements for Best Buy for the years ending December 31, Year 1 and Year 2. Answer the following questions:
- A) If you were a banker, why would you need information from the company's financial statements?
 - B) If you were a potential investor in Best Buy shares, what information would you want from their financial statements?
 - C) If you were a labour negotiator for a union that represents a group of Best Buy employees, which financial statement would provide you with the most useful information?

ANS:

- A) A banker wants to be assured that the company will make its interest payments and repay the principle of the loan in a timely manner. A banker would also want to know about the value of the assets that could be used to secure the loan or liquidated if company can't repay the loan.
- B) Investors want to know whether they should make an investment in the company's shares, or continue to hold their investment. They will be looking at the company's recent performance, whether the company has been profitable, how their profits compare with other companies, and how much the company has paid in dividends.
- C) A labour negotiator needs to know how much profit the company has made. This information is found on the income statement.

PTS: 1 DIF: Moderate REF: page 4 OBJ: 1-1
NAT: AICPA FN-Measurement | AACSB Analytic | ACBSP-APC-09-Financial Statement

17. **You Decide Essay**

You are the chairman of the board of directors of NuWave Technology. You are in Vegas attending the company's annual meeting and it is now time for the question and answer session with shareholders. The very first question you take is this: "I own shares in a dozen companies. Every one of them pays me dividends except NuWave. Why is that?" How do you respond?

ANS:

First, point out that retained earnings is an important source of financing for NuWave. Then explain that you believe that it is in the shareholders' best interest to reinvest the company's earnings into the many profitable growth opportunities available rather than pay dividends. Remind the shareholder that the reinvestment of the earnings hopefully will result in higher share prices and increased wealth for shareholders in the future as the company profits from its growth.

PTS: 1 DIF: Challenging REF: page 23 OBJ: 1-6
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-23-Financial Statement Analysis

18. You Decide Essay

A friend of yours is seeking advice on which shares to buy. Right now, she is looking for shares that pay cash dividends on a regular basis. She has obtained six years worth of financial statements for the two shares under consideration. Describe at least one item on each financial statement that she should study to determine which shares are more likely to pay future cash dividends.

ANS:

Income statement: trend of profitable operations

Retained earnings statement: payment of cash dividends in the past

Balance sheet: existence of sufficient cash from which to pay dividends

Cash flow statement: trend of positive cash flows from operations

PTS: 1 DIF: Moderate REF: page 10-25 OBJ: 1-4 | 1-5 | 1-6 | 1-7

NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-23-Financial Statement Analysis

19. Each of the four statements that comprise a full set of financial statements has an underlying equation or formula. List the statements in the order they are prepared and the underlying equation of each.

ANS:

1. Income statement: revenues – expenses = net income (net loss)

2. Statement of retained earnings: beginning retained earnings + net income (net loss) – dividends = ending retained earnings

3. Balance sheet: assets = liabilities + shareholders' equity

4. Statement of cash flows: beginning cash ± operating cash flows ± investing cash flows ± financing cash flows = ending cash

PTS: 1 DIF: Moderate REF: page 4-27 OBJ: 1-4 | 1-5 | 1-6 | 1-7 | 1-8

NAT: AICPA FN-Reporting | AACSB Analytic | ACBSP-APC-09-Financial Statement

20. Complete the following table to compare and contrast sole proprietorships and corporations.

Item	Proprietorship	Corporation
Ease of formation		
Ability to raise large sums of capital		
Taxable entity		
Extent of owner liability		
Double taxation of profits (Yes/No)		

ANS:

Item	Proprietorship	Corporation
Ease of formation	Easy	More difficult
Ability to raise large sums of capital	Limited	Easier
Taxable entity	No	Yes
Extent of owner liability	Unlimited	Limited
Double taxation of profits (Yes/No)	No	Yes

PTS: 1 DIF: Challenging REF: page 6 OBJ: 1-2
NAT: AICPA FN-Reporting | AACSB Communication | ACBSP-APC-03-Business Forms