Module 2

Introducing Financial Statements

Learning Objectives – Coverage by question					
	True/False	Multiple Choice	Exercises	Problems	Essays
LO1 – Examine and interpret a balance sheet.	1-7, 11	1-8, 13-15, 24, 26, 27, 29	1-7, 9-13	1-3, 5, 6, 9-12	1
LO2 – Examine and interpret an income statement.	7-9	9-12, 25, 28, 30	1, 2, 9, 10	4, 5, 9-12	
LO3 – Examine and interpret a statement of stockholders' equity.			1, 2, 10	9-12	
LO4- Describe a statement of cash flows.	10	20-23	1, 2, 10	9-12	
LO5 – Construct and apply linkages among the four financial statements.	12-14	16-23	8-10	7-12	2
LO6 – Locate and use additional information from public sources.	15, 16				

Module 2: Introducing Financial Statements and Transaction Analysis

True/False

Topic: Definition of an Asset
LO: 1

1. In order for an asset to be reported on the balance sheet, it must be owned or controlled by the company and be expected to provide future benefits.

Answer: True
Rationale: Assets reported on the balance sheet must be owned or controlled by the company and must be expected to provide future benefits. These benefits can relate to the expected receipt of cash or another asset, or the expected decrease in a liability.

Topic: Historical Cost
LO: 1

2. Assets are reported on the balance sheet at their current market value.

Answer: False
Rationale: Assets are generally reported at historical costs. An exception is marketable securities.

Topic: Book vs. Market Value
LO: 1

3. The book value of stockholders' equity (the amount reported on the balance sheet) is most typically equal to the market value of the equity of a company.

Answer: False
Rationale: Book value and market value differ for many reasons, including reporting assets at historical costs instead of current market value, and differences between the accounting periods in which transactions are recognized in the financial statements and when the value implications of those transactions are recognized by the capital markets.

Topic: Reporting of Assets and Liabilities
LO: 1

4. Assets are listed on the balance sheet in order of liquidity and liabilities are listed in order of maturity.

Answer: True
Rationale: Assets are reported in the order that they are generally expected to be converted into cash. Receivables are, thus, reported before inventories, and inventories before PPE. Liabilities are reported in order of maturity, with current liabilities expected to be paid within one year and long-term liabilities expected to be paid over a longer period of time.

Topic: Unrecorded Assets
LO: 1

5. In addition to purchased assets like inventories and equipment, companies also may report on their balance sheets intangible assets such as the value of a brand name.

Answer: True
Rationale: Companies *may* report intangible assets if they acquired them in an arms' length transaction. But if the intangible was not purchased, if it was internally generated it may not be included on the balance sheet because its future economic benefits cannot be reliably measured. So, all internally generated intangible assets are excluded from the balance sheet under GAAP.

Topic: Liabilities
LO: 1

6. Liabilities and equities are both claims against the assets of a company.

Answer: True
Rationale: Both liabilities and equity are claims against the assets. In the event of default of a company, liabilities are settled first against the assets of the company. The owners, however, still have an interest in the remaining assets.

Topic: Unearned Revenue and Revenue Recognition Principle
(more challenging—involves unearned revenue and recognition thereof.)
LO: 1, 2

7. A customer's prepayment for services not yet rendered is initially recorded as unearned revenue (a liability). Then, at the end of the accounting period, the unearned revenue is moved from the balance sheet to the income statement. This is an example of the revenue recognition principle.

Answer: False
Rationale: Unearned revenue is recorded for customer prepayments. But it is only moved to the income statement when the services have been rendered and not automatically at the end of the accounting period.

Topic: Revenue Recognition Principle and Cash
LO: 2

8. According to the revenue recognition principle, companies are required to record revenue when cash is received as this provides the most objective evidence for the auditors.

Answer: False
Rationale: Revenue is recognized when the company has done what it is obligated to do under the sales contract, such as, when goods have been transferred or services performed for the customer. This means a sale of goods on credit would qualify for recognition of revenue although no cash was received.

Topic: Accrual Accounting for Expenses
LO: 2

9. Under accrual accounting principles, the cost of inventory should be reported as an expense in the income statement when it is sold, regardless of when it was purchased.

Answer: True
Rationale: Under accrual accounting, the cost of inventory is reported as expense in the period in which it is used up, typically at the point of sale. Purchased inventories that have not yet been sold are reported as assets, notwithstanding whether or not they have been paid for.

Topic: Statement of Cash Flows
LO: 4
10. The statement of cash flows has three main sections: cash flows from operating activities, cash flows from investing activities, and cash flows from capital activities.

Answer: False
Rationale: The statement of cash flows has three sections: cash flows from operating activities, cash flows from investing activities, and cash flows from financing activities.

Topic: Net working Capital
LO: 1
11. Net working capital = Current assets + Current liabilities

Answer: False
Rationale: Net working capital = Current assets less current liabilities.

Topic: Articulation of Financial Statements
LO: 5
12. Articulation refers to the concept that financial statements are linked to each other and linked across time.

Answer: True
Rationale: Balance sheets are linked over time because the permanent accounts' closing balance last period becomes the opening balance in the current period. The statements are linked to each other via cash (statements of cash flow and balance sheets), via retained earnings (income statements and balance sheets), and via equity accounts (statements of stockholders' equity and balance sheets).

Topic: Articulation of Financial Statements
LO: 5
13. The income statements of the prior and current year are linked via the balance sheet.

Answer: False
Rationale: The balance sheets of the prior and current year are linked via the income statement.

Topic: Articulation of Retained Earnings
LO: 5
14. Retained earnings articulate across time which means that last period's retained earnings plus current period net income (or loss) is equal to the current period's retained earnings.

Answer: False
Rationale: Last period's retained earnings plus current period net income (or loss) less any dividends paid, is equal to the current period's retained earnings.

Topic: Additional Information Sources
LO: 6

15. All companies must file with the SEC a detailed annual report and discussion of their business activities in their Form 10-K.

Answer: False
Rationale: Companies with publicly traded securities must file with the SEC, not all companies.

Topic: Additional Information Sources
LO: 6

16. A publicly traded company must file a Form 8-K with the SEC within four business days following a change in its certified public accounting firm.

Answer: True
Rationale: A change in a company's certified public accounting firm is one of several events in which the SEC requires a company to disclose the change by filing a Form 8-K within four business days following the event.

Multiple Choice

Topic: Reporting of Assets
LO: 1

1. Assets are recorded in the balance sheet in order of:
A) Market Value
B) Historic Value
C) Liquidity
D) Maturity
E) None of the above

Answer: C
Rationale: Liquidity refers to the ease of conversation to cash. Current Assets are to be used during the current operating cycle. Non-current assets, like equipment and goodwill are reported after current assets. Market value and historic value refer not to the order but to the valuation of assets. Maturity refers to the order in which liabilities are recorded in the balance sheet.

Topic: Current Assets
LO: 1

2. Which of the following are included in current assets?
A) Prepaid rent
B) Taxes payable
C) Automobiles
D) Common stock
E) None of the above

Answer: A
Rationale: Taxes payable is a liability, automobiles is not a current asset but a long-term one, and common stock is an equity.

Topic: Net Working Capital—Numerical calculations required
LO: 1

3. In 2016, Southwest Airlines had negative net working capital of $(2,346) million and current assets of $4,498 million.

The firm's current liabilities are:
A) $2,152 million
B) $6,844 million
C) $2,346 million
D) $5,236 million
E) There is not enough information to calculate the amount.

Answer: B
Rationale: Net working capital = Current assets – Current liabilities.
Current liabilities = Current assets – Net working capital
Current liabilities = $4,498 – $(2,346)
Current liabilities = $6,844 million

Topic: Net Working Capital—Numerical calculations required
LO: 1

4. In 2016, Delphi Automotive PLC had current assets of $5,419 million and current liabilities of $4,148 million.

The firm's net working capital is:
A) $ 1,271 million
B) $ 5,419 million
C) $ (1,271) million
D) $ 9,567 million
E) None of the above

Answer: A
Rationale: Net working capital = Current assets – Current liabilities.
Net working capital = $5,419 – $4,148
Net working capital = $1,271 million.

Topic: Net Working Capital—Numerical calculations required
LO: 1

5. In 2016, Kohl's Corporation had net working capital of $2,273 million and current liabilities of $2,974 million.

The firm's current assets are:
A) $ 8,221 million
B) $ (8,221) million
C) $ 5,247 million
D) $ 2,974 million
E) None of the above

Answer: C
Rationale: Net working capital = Current assets – Current liabilities.
$2,273 = Current assets – $2,974
Current assets = $5,247

Topic: Liabilities
LO: 1

6. Which one of the following is *not* a current liability?
A) Taxes payable
B) Accounts payable
C) Wages payable
D) Wage expense
E) None of the above

Answer: D
Rationale: Wage expense is an income statement account, not a balance sheet account. It is not a current liability.

Topic: Stockholders' Equity
LO: 1

7. Which of the following is included as a component of stockholders' equity?
A) Buildings
B) Retained earnings
C) Prepaid property taxes
D) Accounts payable
E) Dividends

Answer: B
Rationale: Retained earnings is a component of stockholders' equity. Dividends affect retained earnings but they are not reported as a separate component.

Topic: Recognition of Costs as Expense
LO: 1

8. As inventory and property plant and equipment on the balance sheet are consumed, they are reflected:
A) As a revenue on the income statement
B) As an expense on the income statement
C) As a use of cash on the statement of cash flows
D) On the balance sheet because assets are never consumed
E) Both B and C because the financial statements articulate

Answer: B
Rationale: As assets are consumed (used up), their cost is transferred to the income statement as expenses. Cash is not involved so C and E are incorrect.

Topic: Income Statement
LO: 2

9. Interest expense appears in which financial statement?
A) Statement of stockholders' equity
B) Balance sheet
C) Income statement
D) Statement of cash flows
E) All of the above

Answer: C
Rationale: Expenses, including interest expense, appear in the income statement.

Topic: Gross Profit—Numerical calculations required
LO: 2

10. During fiscal 2016, Mattel had sales of $5,456,650, total expenses of $5,138,628 and gross profit of $2,554,391.

What was Mattel's cost of sales for 2016? ($ in thousands)

A) $2,102,065 thousand
B) $5,138,628 thousand
C) $2,902,259 thousand
D) $ 903,944 thousand
E) There is not enough information to calculate the cost of sales.

Answer: C
Rationale: Sales – Cost of sales = Gross profit
$ 5,456,650 – Cost of sales = $2,554,391
Cost of sales = $2,902,259 thousand

Topic: Net Income—Numerical calculations required
LO: 2

11. During fiscal 2016, Kohl's had sales of $18,686 million, Cost of merchandise sold of $11,944 million, and gross profit of $6,741 million.

What was net income for 2016?

A) $ 6,741 million
B) $11,944 million
C) $ 5,299 million
D) $18,686 million
E) There is not enough information to calculate the amount.

Answer: E
Rationale: Sales – Total expenses = Net income. There is no information about total expenses, so we cannot compute net income.

Topic: Net Income—Numerical calculations required
LO: 2

12. During 2016, Skechers U.S.A., Inc. had Sales of $3,563.3 million, Gross profit of $1,634.6 million and Selling, general, and administrative expenses of $1,278.0 million.

What was Skechers' Cost of sales for 2016?

A) $1,115.7 million
B) $1,928.7 million
C) $ 88.1 million
D) $1,549.5 million
E) There is not enough information to calculate the amount.

Answer: B
Rationale: Sales – Cost of sales = Gross profit
$3,563.3 – Cost of sales = $1,634.6.
Cost of sales = $1,928.7 million

Topic: Components of Financial Statements—Numerical calculations required (more challenging; total assets not given)
LO: 1

13. In its December 31, 2016 financial statements, Harley-Davidson reported the following (in millions):

Long-term Assets	Current Liabilities	Long-term Liabilities	Total Liabilities	Equity
$6,036	$ 2,863	$ 5,107	$7,970	$1,920

At December 31, 2016, current assets amount to:
A) $2,863 million
B) $3,854 million
C) $7,970 million
D) $5,519 million
E) None of the above

Answer: B
Rationale: Total assets = Total liabilities + Equity.
Total assets – Long-term assets = Current assets.
Current assets = $7,970 + $1,920 – $6,036.
Current assets = $3,854 million

Topic: Components of Financial Statements—Numerical calculations required
LO: 1

14. In 2016, Nordstrom, Inc. reported the following (in millions):

Current Assets	Current Liabilities	Long-term Liabilities	Equity
$3,242	$3,029	$3,959	$870

What amount did Nordstrom report as total assets?
A) $ 4,616 million
B) $ 3,950 million
C) $ 7,307 million
D) $13,170 million
E) None of the above

Answer: E
Rationale: Total assets = Total liabilities + Equity
Total assets = $3,029 + $3,959 + $870 = $7,858 million.
This amount is not given in the problem.

Topic: Components of Financial Statements—Numerical calculations required
LO: 1
15. In 2016, Caterpillar Inc. reported the following (in millions):

Current Assets	Long-term Assets	Current Liabilities	Total Liabilities
$31,967	$42,737	$26,132	$61,491

What amount did Caterpillar report as equity in 2016?
A) $36,721 million
B) $13,213 million
C) $84,896 million
D) $17,457 million
E) None of the above

Answer: B
Rationale: Total assets = Total liabilities + Equity
$31,967 + $42,737 = $61,491 + Equity
Equity = $13,213 million.

Topic: Articulation of Statement of Retained Earnings with Income Statement—Numerical calculations required
LO: 5
16. During fiscal year-end 2016, Kohl's Corporation reports the following (in $ millions): net income of $556, retained earnings at the end of the year of $12,522 and retained earnings at the beginning of the year of $12,329. Assume that there were no other retained earnings transactions during fiscal 2016.

What dividends did the firm pay in fiscal year ended January 28, 2017?
A) $ 683 million
B) $1,669 million
C) $ 363 million
D) $-0-
E) There is not enough information to calculate the amount.

Answer: C
Rationale: Retained earnings, 2016 = Retained earnings, 2015 + Net Income – Dividends
Dividends = Retained earnings, 2015 + Net Income – Retained earnings, 2016
Dividends = $12,329 + $556 – $12,522 = $363 million

Topic: Articulation of Statement of Retained Earnings with Balance Sheet—Numerical calculations required
LO: 5

17. Caterpillar Inc. reports a net loss for 2016 of $(67) million, retained earnings at the end of the year of $27,377 million, and dividends during the year of $1,802 million.

What was the company's retained earnings balance at the start of 2016?
A) $29,246 million
B) $30,361 million
C) $28,065 million
D) $26,572 million
E) There is not enough information to calculate the amount.

Answer: A
Rationale: Retained earnings, 2016 = Retained earnings, 2015 + Net Income – Dividends
$27,377 = Retained earnings, 2015 + $(67) – $1,802.
Retained earnings at the start of the year were $29,246 million.

Topic: Articulation of Statement of Retained Earnings with Balance Sheet—Numerical calculations required
LO: 5

18. Pfizer Inc., a pharmaceutical company, reported net income for fiscal 2016 of $7,215 million, retained earnings at the start of the year of $71,993 million and dividends of $7,448 million, and other transactions with shareholders that increased retained earnings during the year by $14 million.

If there were no additional transactions during the year that affected retained earnings, what was the balance of retained earnings at the end of the year?
A) $ 71,774 million
B) $ 38,748 million
C) $124,926 million
D) $ 47,729 million
E) There is not enough information to calculate the amount.

Answer: A
Rationale: Retained earnings, 2016 = Retained earnings, 2015 + Net Income – Dividends + Other
Retained earnings, 2016 = $71,993 + $7,215 - $7,448 +$14
Ending retained earnings = $71,774 million.

Topic: Articulation of Statement of Retained Earnings with Income Statement—Numerical calculations required
LO: 5

19. Intel reports retained earnings at the end of fiscal 2016 of $40,747 million and retained earnings at the end of fiscal 2015 of $37,614 million. The company reported dividends of $4,925 million and other transactions with shareholders that reduced retained earnings during the year by $2,258 million.

How much net income did the firm report in fiscal 2016?
A) $ 3,133 million net income
B) $ 3,133 million net loss
C) $10,316 million net income
D) $10,316 million net loss
E) None of the above

Answer: C
Rationale:
Retained earnings, 2016 = Retained earnings, 2015 + Net Income – Dividends +/- Other transactions
$40,747 = $37,614 + Net income – $4,925 – $2,258
Net income = $10,316 million net income.

Topic: Articulation of Statement of Cash Flows with Balance Sheet—Numerical calculations required
LO: 4, 5

20. In its fiscal 2016 annual report, Nike, Inc. reported cash of $3,138 million at year end. The statement of cash flows reports the following (in millions):

Net cash from operating activities	$3,096
Net cash from investing activities	(1,034)
Net cash from financing activities	(2,776)

What was the balance in Nike's cash account at the start of fiscal 2016?
A) $3,096 million
B) $1,020 million
C) $3,852 million
D) $4,357 million
E) None of the above

Answer: C
Rationale: Cash at end of year = Cash at beginning of year + Change in cash during the year
$3,138 = Cash at beginning of year + $3,096 – $1,034 – $2,776
Cash at beginning of year = $3,852 million

Topic: Articulation of Statement of Cash Flows with Balance Sheet—Numerical calculations required
LO: 4, 5

21. In its fiscal 2016 balance sheet, JetBlue Airways Corporation, reported cash of $443 million at year-end. The statement of cash flows reports that cash increased by $115 million during the year and that net cash flow from operating activities was $1,632 million.

What was the cash flow from investing activities during the year?
A) $533 million cash outflow
B) $715 million cash inflow
C) $533 million cash inflow
D) $715 million cash outflow
E) There is not enough information to determine the amount.

Answer: E
Rationale: Change in cash during the year = Cash from operations + Cash from investing + Cash from financing. We are only given two of the four amounts.

Topic: Articulation of Statement of Cash Flows with Balance Sheet—Numerical calculations required
LO: 4, 5

22. In its fiscal year ended January 28, 2017 balance sheet, Big Lots, Inc., reported cash and cash equivalents at the start of the year of $54,144 thousand. By the end of the year, the cash and cash equivalents had decreased to $51,164 thousand. The company's statement of cash flows reported cash from operating activities of $311,925 thousand, cash from financing activities of $(230,204) thousand.

What amount did the company report for cash from investing activities?
A) $122,391 thousand cash inflow
B) $ 7,966 thousand cash outflow
C) $ 84,701 thousand cash inflow
D) $ 84,701 thousand cash outflow
E) None of the above.

Answer: D
Rationale: Cash at end of year = Cash at start of year + Cash from operations + Cash from investing + Cash from financing.
$51,164 = $54,144 + $311,925 + Cash from investing + $(230,204)
Cash from investing is an outflow of $84,701 thousand.

Topic: Statement of Cash Flows—Numerical calculations required
LO: 4, 5

23. On its fiscal year ended February 3, 2017 statement of cash flows, Dell Technologies Inc. reports the following (in millions):

Net cash from operating activities	$2,222
Net cash from investing activities	(31,256)
Cash at the beginning of the year	6,576
Change in cash during the year	2,898

What did Dell report for "Net cash from financing activities" during fiscal year ended 2017?

A) $31,932 million cash inflow
B) $31,932 million cash outflow
C) $2,898 million cash inflow
D) $2,898 million cash outflow
E) None of the above

Answer: A
Rationale: Change in cash during the year = Cash from operations + Cash from investing + Cash from financing.
$2,898 = $2,222 + $(31,256) + Cash from financing
Cash from financing = $31,932 million

Topic: Transaction Effects on the Balance Sheet
LO: 1

24. How would cash collected on accounts receivable affect the balance sheet?

A) Increase liabilities and decrease equity
B) Decrease liabilities and increase equity
C) Increase assets and decrease assets
D) Increase assets and increase equity

Answer: C
Rationale: Cash collected on accounts receivable produces an increase in cash and a decrease in accounts receivable, both asset accounts. There is no impact on liabilities or on equity.

Topic: Transaction Effects on the Income Statement (more challenging)
LO: 2

25. How would a purchase of inventory on credit affect the income statement?

A) It would increase liabilities
B) It would decrease retained earnings
C) It would increase assets
D) Both A and C, above
E) None of the above

Answer: E
Rationale: The purchase on credit increases both accounts payable and inventory, which are balance sheet accounts. It would, therefore, have no effect on the income statement.

Topic: Cash Conversion Cycle
LO: 1

26. The cash conversion cycle is computed as
A) Days sales outstanding + Days inventory outstanding – Days payable outstanding
B) Days sales outstanding – Days payable outstanding
C) Days sales outstanding – Days inventory outstanding
D) Days sales outstanding – Days inventory outstanding + Days payable outstanding
E) None of the above

Answer: A
Rationale: Cash conversion cycle = Days sales outstanding + Days inventory outstanding – Days payable outstanding.

Topic: Cash Conversion Cycle—Numerical calculations required
LO: 1

27. Prestige Company has determined the following information for its recent fiscal year.

Days inventory outstanding	42.7 days
Days payable outstanding	56.8 days
Days sales outstanding	91.3 days

Compute Prestige Company's cash conversion cycle.
A) 8.2 days
B) 77.2 days
C) 105.4 days
D) 99.5 days
E) None of the above

Answer: B
Rationale: 91.3 days + 42.7 days – 56.8 days = 77.2 days

Topic: Gross Profit Margin—Numerical calculations required
LO: 2
28. Following is Stanley Black & Decker's income statement for 2016 (in millions):

STANLEY BLACK & DECKER, INC. Income Statement For the year ended December 31, 2016 ($ millions)	
Sales	$11,406.9
Cost of goods sold	7,139.7
Gross profit	$4,267.2
Selling, general and administrative expenses	2,602.0
Other operating expenses	268.2
Operating income	1,397.0
Interest and other nonoperating expenses	171.3
Income before income tax	1,225.7
Income tax expense	261.2
Net income	$964.5

Compute Stanley Black & Decker's gross profit margin.
A) 63.6%
B) 12.2%
C) 37.4%
D) 8.5%
E) None of the above

Answer: C
Rationale: $4,267.2 / $11,406.9 = 37.4%

Topic: Identifying and Classifying Balance Sheet Items
LO: 1
29. Identify which of the following items would be reported in the balance sheet.

a.	Cash	d.	Wage expense	g.	Net income
b.	Sales	e.	Wages payable	h.	Inventory
c.	Long-term debt	f.	Retained earnings	i.	Cost of goods sold

Items reported in the balance sheet would include:
A) a, b, c, e, and f
B) b, e, f, h, and i
C) c, d, e, h, and i
D) a, c, e, f, and h
E) c, e, f, h, and i

Answer: D
Rationale: Balance sheet items include: a. Cash, c. Long-term debt, e. Wages payable, f. Retained earnings, and h. Inventory.

Topic: Identifying and Classifying Income Statement Items
LO: 2
30. Identify which of the following items would be reported in the income statement.

a.	Cash	d.	Wage expense	g.	Net income
b.	Sales	e.	Wages payable	h.	Inventory
c.	Long-term debt	f.	Retained earnings	i.	Cost of goods sold

Items reported in the income statement would include:
A) b, e, g, and h
B) a, b, d, and i
C) b, e, f, and g
D) d, f, g, and h
E) b, d, g, and i

Answer: E
Rationale: Income statement items include: b. Sales, d. Wages expense, g. Net income, and i. Cost of goods sold.

Exercises

Topic: Financial Statement Accounts
LO: 1, 2, 3, 4

1. Identify the financial statements in which you would find each of the items listed below. Some items may appear on more than one statement. Indicate all financial statements that apply to each item. The possible choices are:

B :	Balance Sheet
SE :	Statement of Stockholders' Equity
I :	Income Statement
CF :	Statement of Cash Flows

	Financial Statement Item	Financial Statement
a.	Cost of goods sold	
b.	Trademarks	
c.	Inventories	
d.	Retained earnings	
e.	Accrued expenses	
f.	Cash	

Answer:

	Financial Statement Item	Financial Statement
a.	Cost of goods sold	I
b.	Trademarks	B
c.	Inventories	B
d.	Retained earnings	B and SE
e.	Accrued expenses	B
f.	Cash	B and CF

Topic: Financial Statement Accounts
LO: 1, 2, 3, 4

2. Identify the financial statements in which you would find each of the items listed below. Some items may appear on more than one statement. Indicate all financial statements that apply to each item. The possible choices are:

B :	Balance Sheet
SE :	Statement of Stockholders' Equity
I :	Income Statement
CF :	Statement of Cash Flows

	Financial Statement Item	Financial Statement
a.	Land	
b.	Cash	
c.	Prepaid insurance expense	
d.	Insurance expense	
e.	Revenue	
f.	Unearned revenue	

Answer:

	Financial Statement Item	Financial Statement
a.	Land	B
b.	Cash	B and CF
c.	Prepaid insurance expense	B
d.	Insurance expense	I
e.	Revenue	I
f.	Unearned revenue	B

Topic: Balance Sheet Relations
LO: 1

3. Compute the missing amounts for Nike Inc. for 2016 and 2015, in the table below:

($ millions)	2016	2015
Total assets	?	$21,597
Contributed capital	$7,789	6,776
Earned capital	$4,469	?
Total Liabilities	$9,138	$8,890
Liabilities and equity	?	$21,597

Answer:

($ millions)	2016	2015
Total assets	**$21,396**	$21,597
Contributed capital	$7,789	$6,776
Earned capital	$4,469	**$5,931**
Total Liabilities	$9,138	$8,890
Liabilities and equity	**$21,396**	$21,597

Topic: Balance Sheet Accounts
LO: 1
4. Identify the following as a component of Assets (A), Liabilities (L), or Equity (E)

Financial Statement Item	A / L / E
a. Common stock	________
b. Unearned revenue	________
c. Notes payable	________
d. Retained earnings	________
e. Trademark	________
f. Prepaid rent	________
g. Accounts payable	________

Answer:

Financial Statement Item	A / L / E
a. Common stock	E
b. Unearned revenue	L
c. Notes payable	L
d. Retained earnings	E
e. Trademark	A
f. Prepaid rent	A
g. Accounts payable	L

Topic: Reporting of Assets
LO: 1
5. Indicate the order of appearance on the balance sheet of the assets listed on the left.

Asset	Balance sheet order
Equipment	________
Accounts receivable	________
Cash	________
Inventory	________
Goodwill	________

Answer:

Asset	Balance sheet order
Equipment	4
Accounts receivable	2
Cash	1
Inventory	3
Goodwill	5

Topic: Reporting of Liabilities and Equity
LO: 1

6. Indicate the order of appearance on the balance sheet of the liabilities and equity accounts listed on the left.

Liability / Equity	Balance sheet order
Bonds payable	
Retained earnings	
Accounts payable	
Contributed capital	

Answer:

Liability / Equity	Balance sheet order
Bonds payable	2
Retained earnings	4
Accounts payable	1
Contributed capital	3

Topic: Balance Sheet Accounts
LO: 1

7. For each of the following financial statement items, indicate the correct balance sheet classification, from the list below. You may use each balance sheet classification item only once.

Balance sheet classification

a. Current asset
b. Long term asset
c. Current liability
d. Long term liability
e. Equity
f. None of the above

Financial statement item	Balance sheet classification
Interest payable	
Treasury stock	
Insurance expense	
Goodwill	
Note payable, due in 2025	
Prepaid insurance expense	

Answer:

Financial statement item	Balance sheet classification
Interest payable	c. Current liability
Treasury stock	e. Equity
Insurance expense	f. None of the above
Goodwill	b. Long term asset
Note payable, due in 2025	d. Long term liability
Prepaid insurance expense	a. Current asset

Topic: Articulation of Retained Earnings Account
LO: 5

8. Caterpillar Inc.'s statement of stockholders' equity for 2016 and 2015 shows the following amounts. Fill in the missing items to show how retained earnings articulate across the years.

($ millions)	2016	2015
Retained earnings, beginning of year	?	$28,515
Net income(loss) for the year	(67)	?
Dividends	?	(1,781)
Retained earnings, end of year	$27,377	$29,246

Answer:

($ millions)	2016	2015
Retained earnings, beginning of year	**$29,246**	$28,515
Net income (loss) for the year	(67)	**2,512**
Dividends	**(1,802)**	(1,781)
Retained earnings, end of year	$27,377	$29,246

Topic: Preparation of Financial Statements and Income Statement / Balance Sheet Articulation (more challenging—requires preparation of two financial statements)
LO: 1, 2

9. Super Style Clothing begins operations in November. During the month the company receives $46,000 from a shareholder for common stock and gets a $6,000 loan from a bank. The company buys $38,000 of inventory for cash and sells half of the inventory for $30,000 on credit. The company had no other transactions in November. Fill in the missing amounts below.

SUPER STYLE CLOTHING Income Statement For the Month of November	
Sales	______
Cost of sales	______
Net income	______

SUPER STYLE CLOTHING Balance Sheet At the End of November	
Cash	______
Accounts receivable	______
Inventory	______
Total assets	______
Accounts payable	______
Bank loan	______
Total liabilities	______
Contributed capital	______
Retained earnings	______
Total equity	______
Total liabilities and equity	______

Answer:

SUPER STYLE CLOTHING Income Statement For the Month of November	
Sales	$30,000
Cost of sales	19,000
Net income	$11,000

SUPER STYLE CLOTHING Balance Sheet At the End of November	
Cash	$ 14,000
Accounts receivable	30,000
Inventory	19,000
Total assets	$63,000
Accounts payable	$ 0
Bank loan	6,000
Total liabilities	6,000
Contributed capital	46,000
Retained earnings	11,000
Total equity	57,000
Total liabilities and equity	$63,000

Topic: Applying Financial Statement Linkages to Understand Transactions
LO: 1, 2, 3, 4, 5

10. Consider the effects of the independent transactions, a through d, on a company's balance sheet, income statement, statement of cash flows, and statement of stockholders' equity.

a. Services were performed for cash.
b. Inventory was purchased for cash.
c. Wages were accrued at the end of the period.
d. Rent was paid in cash.

Complete the table below to explain the effects and financial statement linkages. Use "+" to indicate the account increases and "–" to indicate the account decreases.

	a.	*b.*	*c.*	*d.*
Balance sheet				
Cash				
Noncash assets				
Total liabilities				
Contributed capital				
Retained earnings				
Other equity				
Statement of cash flows				
Operating cash flow				
Investing cash flow				
Financing cash flow				
Income statement				
Revenues				
Expenses				
Net earnings				
Statement of stockholders' equity				
Contributed capital				
Retained earnings				

Answer:

	a.	*b.*	*c.*	*d.*
Balance sheet				
Cash	+	–		–
Noncash assets		+		
Total liabilities			+	
Contributed capital				
Retained earnings	+		–	–
Other equity				
Statement of cash flows				
Operating cash flow	+	–		–
Investing cash flow				
Financing cash flow				
Income statement				
Revenues	+			
Expenses			+	+
Net earnings	+		–	–
Statement of stockholders' equity				
Contributed capital				
Retained earnings	+		–	–

Topic: Effects of Transactions on Balance Sheet Accounts
LO: 1

11. Miguel decided to open a lemonade stand on Saturdays. Match Miguel's business activities to the following balance sheet items. (*Note:* each balance sheet item can only be used once).

a.	Borrowed cash from Dad to be repaid in two years.	1)	Long-term liability
b.	Purchased tent from neighbor, at a garage sale.	2)	Accounts payable
c.	Bought lemons, sugar and (secret ingredient) grapefruit.	3)	Accounts receivable
d.	The items in (c) will not be paid for until next month.	4)	Long-term asset
e.	At the end of the day, Miguel has cash in his pocket from sales.	5)	Inventory
f.	Mr. Wisner, a potential customer had no cash with him. Miguel agrees to let Mr. Wisner pay for his lemonade next Monday.	6)	Cash

Answer:
a. 1) Long-term liability
b. 4) Long-term asset
c. 5) Inventory
d. 2) Accounts payable
e. 6) Cash
f. 3) Accounts receivable

Topic: Effects of Transactions on Balance Sheet
LO: 1

12. Consider the transactions listed on the left. Match them to the financial statement effects listed on the right.

	Transaction			Financial Statement Effect
a.	Sell common stock for cash	______	1.	Decrease assets and decrease equity
b.	Pay accounts payable	______	2.	Decrease liabilities and decrease assets
c.	Repurchase common stock	______	3.	Increase assets and decrease assets
d.	Purchase inventory for cash	______	4.	Increase assets and increase equity

Answer:

	Transaction	
a.	Sell common stock for cash	4
b.	Pay accounts payable	2
c.	Repurchase common stock	1
d.	Purchase inventory for cash	3

Topic: Effects of Transactions on Balance Sheet
LO: 1

13. Consider the transactions listed on the left. Match them to the financial statement effects listed on the right.

	Transaction			Financial Statement Effect
a.	Pay wages with cash	______	1.	Increase assets and increase liabilities
b.	Repay bank loan	______	2.	Decrease liabilities and decrease assets
c.	Prepay insurance expense	______	3.	Decrease assets and decrease equity
d.	Receive prepayment from customer	______	4.	Decrease assets and increase assets

Answer:

	Transaction	
a.	Pay wages with cash	3
b.	Repay bank loan	2
c.	Prepay insurance expense	4
d.	Receive prepayment from customer	1

Problems

Topic: Analyzing Balance Sheet Accounts
LO: 1
1. Selected balance sheet amounts for Harley Davidson Inc. for five recent years follow.

($ millions)	Current Assets	Long-term Assets	Total Assets	Current Liabilities	Long-term Liabilities	Total Liabilities	Equity
2012	4,050.9		9,170.8		5,110.0	6,613.1	2,557.7
2013	3,988.8	5,416.2		2,509.5	3,886.0	6,395.5	
2014		5,580.0	9,528.1	2,389.3	4,229.5		2,909.3
2015	3,977.9	5,995.1		2,747.3	5,386.0	8,133.3	
2016		6,036.4	9,890.2	2,862.5	5,107.5		1,920.2

Compute the missing balance sheet amounts for each of the five years.

Answer:

($ millions)	Current Assets	Long-term Assets	Total Assets	Current Liabilities	Long-term Liabilities	Total Liabilities	Equity
2012	4,050.9	**5,119.9**	9,170.8	**1,503.1**	5,110.0	6,613.1	2,557.7
2013	3,988.8	5,416.2	**9,405.0**	2,509.5	3,886.0	6,395.5	**3,009.5**
2014	**3,948.1**	5,580.0	9,528.1	2,389.3	4,229.5	**6,618.8**	2,909.3
2015	3,977.9	5,995.1	**9,973.0**	2,747.3	5,386.0	8,133.3	**1,839.7**
2016	**3,853.8**	6,036.4	9,890.2	2,862.5	5,107.5	**7,970.0**	1,920.2

Topic: Analyzing Balance Sheet Accounts
LO: 1

2. Selected balance sheet amounts for Nordstrom Inc. for four recent years follow.

($ millions)	Current Assets	Long-term Assets	Total Assets	Current Liabilities	Long-term Liabilities	Total Liabilities	Equity
2013	5,228	3,346		2,541	3,953		2,080
2014	5,224	4,021			4,005	6,805	
2015	3,014		7,698	2,911		6,827	871
2016	3,242	4,616		3,029	3,959		870

Compute the missing balance sheet amounts for each of the four years.

Answer:

($ millions)	Current Assets	Long-term Assets	Total Assets	Current Liabilities	Long-term Liabilities	Total Liabilities	Equity
2013	5,228	3,346	**8,574**	2,541	3,953	**6,494**	2,080
2014	5,224	4,021	**9,245**	**2,800**	4,005	6,805	**2,440**
2015	3,014	**4,684**	7,698	2,911	**3,916**	6,827	871
2016	3,242	4,616	**7,858**	3,029	3,959	**6,988**	870

Topic: Preparing a Balance Sheet from a List of Accounts
LO: 1

3. Use the accounts below for Stanley Black & Decker, Inc. to prepare a balance sheet at December 31, 2016.

($ millions)	
Contributed capital	$3,186.8
Cash	1,131.8
Long-term debt	3,815.3
Accounts receivable	1,302.8
Other current assets	875.9
Other long-term assets	9,395.2
Current liabilities	2,807.5
Inventory	1,478.0
Other long-term liabilities	2,638.5
Property plant and equipment	1,451.2
Retained earnings	5,127.3
Other equity	(1,940.5)

Answer:

STANLEY BLACK & DECKER, INC. Balance Sheet At December 31, 2016 ($ millions)	
Cash	$1,131.8
Accounts receivable	1,302.8
Inventory	1,478.0
Other current assets	875.9
Current assets	4,788.5
Property plant and equipment	1,451.2
Other long-term assets	9,395.2
Total assets	$15,634.9
Current liabilities	$2,807.5
Long-term debt	3,815.3
Other long-term liabilities	2,638.5
Total liabilities	9,261.3
Contributed capital	3,186.8
Retained earnings	5,127.3
Other equity	(1,940.5)
Total equity	6,373.6
Total liabilities and equity	$15,634.9

Topic: Preparing an Income Statement from a List of Accounts
LO: 2

4. Use the accounts below for Stanley Black & Decker, Inc. to prepare an income statement for the year ended December 31, 2016.

($ millions)	
Cost of goods sold	$7,139.7
Sales	11,406.9
Other operating expenses	268.2
Selling, general and administrative expenses	2,602.0
Income tax expense	261.2
Interest and other nonoperating expenses, net	171.3

Answer:

STANLEY BLACK & DECKER, INC. Income Statement For the year ended December 31, 2016 ($ millions)	
Sales	$11,406.9
Cost of goods sold	7,139.7
Gross profit	$4,267.2
Selling, general and administrative expenses	2,602.0
Other operating expenses	268.2
Operating income	1,397.0
Interest and other nonoperating expenses	171.3
Income before income tax	1,225.7
Income tax expense	261.2
Net income	$964.5

Topic: Preparing a Balance Sheet and Income Statement from a List of Accounts
LO: 1, 2

5. Use the accounts below for Delphi Automotive PLC for December 31, 2016 to prepare an income statement and a balance sheet.

($ millions)	
Contributed capital	$1,636
Cost of sales	13,107
Cash	839
Long-term liabilities	5,381
Accounts receivable	2,938
Other current assets	410
Other long-term assets	3,358
Other current liabilities	1,585
Other operating expenses	1,572
Other nonoperating expenses	414
Inventory	1,232
Accounts payable	2,563
Property, net	3,515
Retained earnings	1,980
Sales	16,661
Tax expense	242
Other equity	(853)

Answer:

DELPHI AUTOMOTIVE PLC Income Statement For the Year Ended December 31, 2016 ($ millions)	
Sales	$16,661
Cost of sales	13,107
Gross profit	3,554
Other operating expenses	1,572
Operating income	1,982
Other nonoperating expenses	414
Income before taxes	1,568
Tax expense	242
Net income	$1,326

Continued next page

Continued

Delphi Automotive PLC Balance Sheet At December 31, 2016 ($ millions)	
Cash	$839
Accounts receivable	2,938
Inventory	1,232
Other current assets	410
Current assets	5,419
Property, net	3,515
Other long-term assets	3,358
Total assets	$12,292
Accounts payable	$2,563
Other current liabilities	1,585
Current liabilities	4,148
Long-term liabilities	5,381
Total liabilities	9,529
Contributed capital	1,636
Retained earnings	1,980
Other equity	(853)
Total equity	2,763
Total liabilities and equity	$12,292

Topic: Market to Book Value and Unrecorded Intangible Assets
LO: 1

6. Below are selected balance sheet and market data for three shoe companies. ($ millions)

Company	Company Year End	Assets	Liabilities	Number of shares outstanding (in millions)	End of year stock price (per share)
Nike, Inc.	May 31, 2016	21,396	9,138	1,682	$55.22
Skechers, USA, Inc.	Dec. 31, 2016	2,394	708	155	$24.58
Caleres, Inc.	Jan. 28, 2017	1,475	861	43	$32.82

a. Calculate the market capitalization of each company.
b. Calculate the market to book ratio for each company.
c. Comment on differences you observe.

Answer:
a. and b.

Company	Book Value of Equity (Assets – Liabilities)	Market Capitalization (Shares outstanding × stock price)	Market to book ratio
Nike, Inc.	12,258	92,880	7.58
Skechers, USA, Inc.	1,686	3,810	2.26
Caleres, Inc.	614	1,411	2.30

c. Nike has a market to book ratio of 7.56, the highest among the three companies. This means that Nike's economic value exceeds its GAAP book value by a factor of over 7.5. This is due to the fact that significant, valuable intangible assets are omitted from Nike's GAAP balance sheet. GAAP does not allow firms to capitalize (add to their balance sheets) the value of self-generated intangible assets. Nike's brand name and the "swoosh" symbol will bring future economic benefits—assets that the market clearly values. At the other end, Caleres and Skechers both have a market to book of about 2.30. This means that their brand names, while still valuable, are not significant enough to boost their stock price. Note that it would also be possible for a company to have a book value of equity that exceeds its market value. This would mean that the market undervalues this company, relative to GAAP, perhaps because the company's earning power is low.

Topic: Articulation of Retained Earnings
LO: 5

7. Following is information for Snap-On, Inc., for three recent years. Reconcile the retained earnings account for the three-year period.

(in millions)	
Retained earnings, December 31, 2016	3,384.9
Net income, 2016	546.4
Net income, 2015	478.7
Net income, 2014	421.9
Dividends*, 2016	148.4
Dividends*, 2015	129.0
Dividends*, 2014	108.8

*Dividends include "dividend reinvestment plan and other" amounts of: 1.2 (2014), 1.1 (2015) and 0.9 (2016).

Answer:

SNAP-ON, INC.
Retained Earnings Reconciliation
For Years Ending December 31

(in millions)	2016	2015	2014
Retained earnings, beginning of year	$2,986.9	$2,637.2	$2,324.1
Net income (loss) for the year	546.4	478.7	421.9
Dividends declared	(148.4)	(129.0)	(108.8)
Retained earnings, end of year	$3,384.9	$2,986.9	$2,637.2

Topic: Articulation of Retained Earnings
LO: 5

8. Following is information for Goodyear Tire & Rubber Company for three recent years. Reconcile the retained earnings account for the three-year period.

(in millions)	
Retained earnings, December 31, 2016	5,808
Net income, 2016	1,264
Net income, 2015	307
Net income, 2014	2,452
Other, 2016	56
Dividends, 2016	82
Dividends, 2015	68
Dividends, 2014	67

Answer:

GOODYEAR TIRE & RUBBER COMPANY
Retained Earnings Reconciliation
For Years Ending December 31

(in millions)	2016	2015	2014
Retained earnings, beginning of year	$4,570	$4,331	$1,946
Net income (loss) for the year	1,264	307	2,452
Other	56	—	—
Dividends	(82)	(68)	(67)
Retained earnings, end of year	$5,808	$4,570	$4,331

Topic: Applying Financial Statement Linkages to Understand Transactions
LO: 1, 2, 3, 4, 5

9. Consider the effects of the independent transactions, a through f, on a company's balance sheet, income statement, statement of cash flows, and statement of stockholders' equity.

a. Owner invests cash into the business in exchange for stock.
b. Recognizes account receivable for services provided.
c. Pays account payable with cash.
d. Buys land with cash.
e. Buys plant equipment on credit.
a. Borrows money by taking out loan at bank.

Complete the table below to explain the effects and financial statement linkages. Use "+" to indicate the account increases and "–" to indicate the account decreases.

	a.	*b.*	*c.*	*d.*	*e.*	*f.*
Balance sheet						
Cash						
Noncash assets						
Total liabilities						
Contributed capital						
Retained earnings						
Other equity						
Statement of cash flows						
Operating cash flow						
Investing cash flow						
Financing cash flow						
Income statement						
Revenues						
Expenses						
Net earnings						
Statement of stockholders' equity						
Contributed capital						
Retained earnings						

Answer:

	a.	*b.*	*c.*	*d.*	*e.*	*f.*
Balance sheet						
Cash	**+**	**+**	**–**	**–**		**+**
Noncash assets		**–**		**+**	**+**	
Total liabilities			**–**		**+**	**+**
Contributed capital	**+**					
Retained earnings						
Other equity						

	a.	*b.*	*c.*	*d.*	*e.*	*f.*
Statement of cash flows						
Operating cash flow		**+**	**–**			
Investing cash flow				**–**		
Financing cash flow	**+**					**+**

	a.	*b.*	*c.*	*d.*	*e.*	*f.*
Income statement						
Revenues						
Expenses						
Net earnings						

	a.	*b.*	*c.*	*d.*	*e.*	*f.*
Statement of stockholders' equity						
Contributed capital	**+**					
Retained earnings						

Topic: Applying Financial Statement Linkages to Understand Transactions
LO: 1, 2, 3, 4, 5

10. Consider the effects of the independent transactions, a through d, on a company's balance sheet, income statement, statement of cash flows, and statement of stockholders' equity.

a. The company purchased inventory on credit.
b. The company paid cash for rent expense.
c. The company collected cash from clients previously billed for goods sold.
d. The company paid cash for inventory purchased in Transaction *a*.

Complete the table below to explain the effects and financial statement linkages. Use "+" to indicate the account increases and "-" to indicate the account decreases.

	a.	*b.*	*c.*	*d.*
Balance sheet				
Cash				
Noncash assets				
Total liabilities				
Contributed capital				
Retained earnings				
Other equity				
Statement of cash flows				
Operating cash flow				
Investing cash flow				
Financing cash flow				
Income statement				
Revenues				
Expenses				
Net earnings				
Statement of stockholders' equity				
Contributed capital				
Retained earnings				

Answer:

	a.	*b.*	*c.*	*d.*
Balance sheet				
Cash		–	+	–
Noncash assets	+		–	
Total liabilities	+			–
Contributed capital				
Retained earnings		–		
Other equity				
Statement of cash flows				
Operating cash flow		–	+	–
Investing cash flow				
Financing cash flow				
Income statement				
Revenues				
Expenses		+		
Net earnings		–		
Statement of stockholders' equity				
Contributed capital				
Retained earnings		–		

Topic: Applying Financial Statement Linkages to Understand Transactions
LO: 1, 2, 3, 4, 5

11. Consider the effects of the independent transactions, a through h, on a company's balance sheet, income statement, statement of cash flows, and statement of stockholders' equity.

a. The company purchased inventory on credit.
b. The company sold all inventory purchased in transaction *a)* on credit (and for more than its cost).
c. The company collected cash from customers from transaction *b)*.
d. The company purchased equipment with cash.
e. The company paid cash for a note payable that came due.
f. The company paid cash for interest on borrowings.
g. Wages were earned by company employees but not yet paid.
h. The company paid cash in dividends.

Complete the table below to explain the effects and financial statement linkages. Use "+" to indicate the account increases and "–" to indicate the account decreases.

	a.	*b.*	*c.*	*d.*	*e.*	*f.*	*g.*	*h.*
Balance sheet								
Cash								
Noncash assets								
Total liabilities								
Contributed capital								
Retained earnings								
Other equity								
Statement of cash flows								
Operating cash flow								
Investing cash flow								
Financing cash flow								
Income statement								
Revenues								
Expenses								
Net earnings								
Statement of stockholders' equity								
Contributed capital								
Retained earnings								

Answer:

	a.	b.	c.	d.	e.	f.	g.	h.
Balance sheet								
Cash			+	–	–	–		–
Noncash assets	+	+	–	+				
Total liabilities	+				–		+	
Contributed capital								
Retained earnings		+				–	–	–
Other equity								
Statement of cash flows								
Operating cash flow			+			–		
Investing cash flow				–				
Financing cash flow					–			–
Income statement								
Revenues		+						
Expenses		+				+	+	
Net earnings		+				–	–	
Statement of stockholders' equity								
Contributed capital								
Retained earnings		+				–	–	–

Topic: Applying Financial Statement Linkages to Understand Transactions
LO: 1, 2, 3, 4, 5

12. Consider the effects of the independent transactions, a through g, on a company's balance sheet, income statement, statement of cash flows, and statement of stockholders' equity.

a. The company issued stock in exchange for cash.
b. The company paid cash for rent.
c. The company performed services for clients and immediately received cash.
d. The company performed services for clients and sent a bill with payment due in 30 days.
e. The company compensated its employees with cash for wages.
f. The company received cash as payment on the amount owed from clients.
g. The company paid cash in dividends.

Complete the table below to explain the effects and financial statement linkages. Use "+" to indicate the account increases and "–" to indicate the account decreases.

	a.	*b.*	*c.*	*d.*	*e.*	*f.*	*g.*
Balance sheet							
Cash							
Noncash assets							
Total liabilities							
Contributed capital							
Retained earnings							
Other equity							
Statement of cash flows							
Operating cash flow							
Investing cash flow							
Financing cash flow							
Income statement							
Revenues							
Expenses							
Net earnings							
Statement of stockholders' equity							
Contributed capital							
Retained earnings							

Answer:

	a.	*b.*	*c.*	*d.*	*e.*	*f.*	*g.*
Balance sheet							
Cash	+	–	+		–	+	–
Noncash assets				+		–	
Total liabilities							
Contributed capital	+						
Retained earnings		–	+	+	–		–
Other equity							
Statement of cash flows							
Operating cash flow		–	+		–	+	
Investing cash flow							
Financing cash flow	+						–
Income statement							
Revenues			+	+			
Expenses		+			+		
Net earnings		–	+	+	–		
Statement of stockholders' equity							
Contributed capital	+						
Retained earnings		–	+	+	–		–

Essay Questions

Topic: Book Value vs. Market Value
LO: 1

1. Book value of stockholders' equity usually differs from company market value. Explain some reasons why a company's book value of stockholders' equity can differ from a company's market value.

Answer:

1. GAAP generally reports assets and liabilities at historical costs; whereas the market attempts to estimate fair values for assets.
2. GAAP excludes resources that cannot be reliably measured such as talented management, employee morale, recent innovations and successful marketing; whereas the market attempts to value these with some recognition of uncertainty.
3. GAAP does not consider market differences in which companies operate such as competitive conditions and expected changes; where as the market attempts to factor in these differences in determining value.
4. GAAP does not usually report expected future performance; whereas the market does attempt to predict future performance.

Topic: Articulation of the Financial Statements
LO: 5

2. Explain the concept of articulation among the four financial statements.

Answer:
Articulation refers to the fact that the four financial statements are linked to each other and that changes in one statement affect the other three. For example, net income reported on the income statement is linked to the statement of stockholders' equity, which in turn is linked to the balance sheet. Also, the statement of cash flows explains how the cash reported on the balance sheet changes from one period to the next. Understanding how the financial statements articulate, helps us to analyze transactions and events and to understand how events affect each financial statement separately and all four together.