

## Chapter 2 Business Processes and Accounting Information

### MATCHING

1. Fit for Fun, Inc. sells fitness equipment. The company has 75 stores located in malls throughout the country. The company recently engaged in the following activities. Identify each activity as part of the (B) Business Organization and Strategy Process, (O) operating process, (CR) capital resources process, or (P) Performance Measurement and Management.

- \_\_\_\_\_ (A) Purchased 300 treadmills for resale.
- \_\_\_\_\_ (B) Borrowed \$50,000 from the bank.
- \_\_\_\_\_ (C) Sold 45 stepping machines.
- \_\_\_\_\_ (D) Purchased 10 new cash registers.
- \_\_\_\_\_ (E) Made a \$4,000 payment on the mortgage.
- \_\_\_\_\_ (F) Purchased office supplies for cash.
- \_\_\_\_\_ (G) Paid employees' salaries.
- \_\_\_\_\_ (H) Developed operating budget.
- \_\_\_\_\_ (I) Calculated ratio analysis.
- \_\_\_\_\_ (J) The owners invested an additional \$100,000 into the business.

Answers: (A) O; (B) CR; (C) O; (D) CR; (E) CR; (F) CR; (G) O; (H) B; (I) P; (J) CR

2. Extreme Enterprises, which manufactures mountain climbing tools, engaged in the following activities. Identify the subprocess in the operating process that the following activities are associated with. Use (MS) for marketing/sales/collection/customer service, (P) for purchase/human resources/payment, and (C) for conversion.

- \_\_\_\_\_ (A) Purchased raw materials for production.
- \_\_\_\_\_ (B) Factory employees worked in production.
- \_\_\_\_\_ (C) Sold \$10,000 of its product to EMS on account, terms 2/10, n/30.
- \_\_\_\_\_ (D) Clips were installed on belts in the production process.
- \_\_\_\_\_ (E) Paid \$5,000 for an advertisement in a trade journal.
- \_\_\_\_\_ (F) Requisitioned raw materials for production.
- \_\_\_\_\_ (G) Received \$9,800 payment from EMS (see above).
- \_\_\_\_\_ (H) Belts were finished and sent to the warehouse.
- \_\_\_\_\_ (I) Paid the cost to repair a machine used in production.
- \_\_\_\_\_ (J) Paid the president's salary.

Answers: (A) P; (B) C; (C) MS; (D) C; (E) P; (F) C; (G) MS; (H) C; (I) P; (J) P

3. Metal Fabricators, Inc. manufactures file cabinets. Some of the company's activities are listed below. Identify the phase of the management cycle in which each activity occurs. Use (PL) for planning, (PR) for performing, and (E) for evaluating.

- \_\_\_\_\_ (A) Management sets a goal of obtaining a 22% share of the total market.
- \_\_\_\_\_ (B) A new customer purchases 3,000 file cabinets.
- \_\_\_\_\_ (C.) Based on less than expected sales volume, production of a four-drawer file cabinet is discontinued.
- \_\_\_\_\_ (D) The building of a new warehouse is being considered.
- \_\_\_\_\_ (E) Management decides to add desks to the product line.
- \_\_\_\_\_ (F) Raw materials are purchased for production.
- \_\_\_\_\_ (G) A review of customers' payment schedules reveals several problems requiring corrective action.
- \_\_\_\_\_ (H) Executive salaries are paid.
- \_\_\_\_\_ (I) The company decides a distribution center in Alabama is unnecessary, so it will be closed.
- \_\_\_\_\_ (J) Payment is received from a customer.

Answers: (A) PL; (B) PR; (C) E; (D) PL; (E) PL; (F) PR; (G) E; (H) PR; (I) E; (J) PR

4. Match the following terms with the definitions below.

- A. Business process
- B. Internal control system
- C. Operating process
- D. Organizational strategy
- E. Investing activities
- F. Financing activities
- G. Mechanistic organizational structure
- H. Organic organizational structure

- \_\_\_\_\_ 1. Activities that involve obtaining the cash or other resources as means to pay for long-term assets, to repay borrowed funds, and provide a return to owners.
- \_\_\_\_\_ 2. The set of policies and procedures that promotes operational efficiency, accurate accounting information, and compliance with laws and regulation
- \_\_\_\_\_ 3. A collection of activities that takes one or more kinds of input and creates an output that is valued by customers
- \_\_\_\_\_ 4. A company's long-term plan for using its resources both physical and human
- \_\_\_\_\_ 5. A structure in which activities and people are arranged in cross-functional teams
- \_\_\_\_\_ 6. Activities that involve the purchase and sale of long-term assets and other major items to achieve the business's strategy
- \_\_\_\_\_ 7. A structure in which activities and people are arranged by functions
- \_\_\_\_\_ 8. The profit-making activities of a business enterprise

Answers: 1. F; 2. B; 3. A; 4. D; 5. H; 6. E; 7. G; 8. C

5. Match the following terms with the definitions listed below.

- A. Appraisal cost
- B. Customer response time
- C. External failure cost
- D. Internal failure cost
- E. Value-added time
- F. Prevention cost

- \_\_\_\_\_ 1. A cost incurred to prevent mistakes from occurring
- \_\_\_\_\_ 2. A cost incurred to fix mistakes after the mistakes become known by the customer
- \_\_\_\_\_ 3. A cost incurred to fix mistakes before the mistakes become known to the customer
- \_\_\_\_\_ 4. Time spent on activities that add worth to the company's products, services, or processes
- \_\_\_\_\_ 5. The cost incurred to detect mistakes as early in the process as possible.
- \_\_\_\_\_ 6. The amount of time from when a customer places an order until the order is received

Answer: 1. F; 2. C; 3. D; 4. E; 5. A; 6. B

6. The Balanced Scorecard Approach has four perspectives: financial, internal, customer, learning, and growth. Match the four perspectives labeled A-D below with the 10 events listed.

- A. Financial perspective
- B. Internal perspective
- C. Customer perspective
- D. Learning and growth perspective

- \_\_\_\_\_ 1. Accounts Payable Turnover
- \_\_\_\_\_ 2. Assessing the effectiveness of research and development
- \_\_\_\_\_ 3. Monitoring the number of new customers acquired during a new time period
- \_\_\_\_\_ 4. Return on Investment Ratio
- \_\_\_\_\_ 5. Gross Margin Ratio
- \_\_\_\_\_ 6. Identifying value added and non-value added activities
- \_\_\_\_\_ 7. Inventory Turnover
- \_\_\_\_\_ 8. Assessing the amount and effectiveness of employee training
- \_\_\_\_\_ 9. Monitoring quality of customer service
- \_\_\_\_\_ 10. Upgrading information technology

Answers: 1. B; 2. D; 3. C; 4. A; 5. A; 6. I; 7. I; 8. D; 9. C; 10. D

## MULTIPLE CHOICE

7. The profit-making activities of an enterprise are referred to as

- A) financing activities.
- B) planning activities.
- C) operating activities.
- D) investing activities.

Answer: C Difficulty: Easy

8. Activities involving the purchase and sale of long-term assets as well as other major items used in a business's operation are referred to as

- A) operating activities.
- B) investing activities.
- C) financing activities.
- D) planning activities.

Answer: B Difficulty: Easy

9. Morland Corp purchased a building that will house its new manufacturing plant. This is part of Morland's

- A) operating activities.
- B) investing activities.
- C) financing activities.
- D) planning activities.

Answer: B Difficulty: Easy

10. Activities involving obtaining necessary funds to purchase long-term assets, repay existing obligations, and provide a return for owners are referred to as

- A) financing activities.
- B) operating activities.
- C) investing activities.
- D) planning activities.

Answer: A Difficulty: Easy

11. Riga Corp borrowed \$1,000,000 to buy a new manufacturing plant is part of their

- A) operating activities.
- B) financing activities.
- C) investing activities.
- D) planning activities.

Answer: B Difficulty: Easy

12. A sporting-goods store sells a set of golf clubs to a customer for cash. This is an example of a(n)  
A) planning activity.  
B) investing activity.  
C) financing activity.  
D) operating activity.  
Answer: D Difficulty: Medium

13. An accounting firm provides services for a client and sends the client a bill. This is an example of a(n)  
A) operating activity.  
B) investing activity.  
C) financing activity.  
D) planning activity.  
Answer: A Difficulty: Medium

14. A corporation borrows \$1,500,000 in cash from a bank to acquire a new building. This is an example of a(n)  
A) operating activity.  
B) investing activity.  
C) financing activity.  
D) planning activity.  
Answer: C Difficult: Medium

15. Eastwood Company pays its employees every Friday. This is an example of a(n)  
A) investing activity.  
B) planning activity.  
C) operating activity.  
D) financing activity.  
Answer: C Difficulty: Medium

16. A health-food retailer buys food for resale. This is an example of a(n)  
A) financing activity.  
B) operating activity.  
C) investing activity.  
D) planning activity.  
Answer: B Difficulty: Medium

17. A bookcase manufacturer purchases brackets to install on the bookcases in production. This is an example of a(n):

- A) financing activity.
- B) investing activity.
- C) planning activity.
- D) operating activity.

Answer: D Difficulty: Medium

18. A jet ski manufacturer pays \$6,000 for six months insurance. This is an example of a(n):

- A) operating activity.
- B) investing activity.
- C) financing activity.
- D) planning activity.

Answer: A Difficulty: Medium

19. An law firm purchases a \$100,000 computer system for its accounting department. This is an example of a(n)

- A) financing activity.
- B) investing activity.
- C) operating activity.
- D) planning activity.

Answer: B Difficulty: Medium

20. Chili Willi, a restaurant serving southwestern cuisine, purchases a new chili pot for \$25,000. This is an example of a(n)

- A) financing activity.
- B) operating activity.
- C) planning activity.
- D) investing activity.

Answer: D Difficulty: Medium

21. A delivery service purchases a new truck for \$130,000. This is an example of a(n)

- A) operating activity.
- B) planning activity.
- C) investing activity.
- D) financing activity.

Answer: C Difficulty: Medium

22. When a manufacturing plant of Hays Corporation ships its finished goods to the company's retail stores, this is part of its

- A) financing activities.
- B) operating activities.
- C) investing activities.
- D) planning activities.

Answer: B Difficulty: Easy

23. A fitness center repays \$10,000 it borrowed from the bank to purchase an exercise machine. This is an example of a(n)  
A) investing activity.  
B) financing activity.  
C) operating activity.  
D) planning activity.  
Answer: B Difficulty: Medium
24. A law firm signs a \$700,000 mortgage note with a local bank for the purchase of an office building. This is an example of a(n)  
A) financing activity.  
B) planning activity.  
C) operating activity.  
D) investing activity.  
Answer: A Difficulty: Medium
25. The owners of a pizzeria invest \$90,000 into the business for expansion purposes. This is an example of a(n)  
A) operating activity.  
B) investing activity.  
C) planning activity.  
D) financing activity  
Answer: D Difficulty: Medium
26. Which of the following is not one of the four business processes?  
A) Performance measurement and management process  
B) Capital resources process  
C) Internal control process  
D) Business organization and strategy process  
Answer: C Difficulty: Easy
27. Which of the following is not considered a subprocess of the operating process?  
A) Conversion  
B) Performance  
C) Marketing/sales/collection/customer service  
D) Purchasing/human resources/payment  
Answer: B Difficulty: Medium

28. Which one of the following processes is responsible for purchase and sale of long-term investments?

- A) Capital resources process
- B) Operating process
- C) Investing process
- D) Business organization and strategy process

Answer: A Difficulty: Easy

29. The process responsible for updating the information technology of a business is the

- A) Capital resources process.
- B) Operating process.
- C) Investing process.
- D) Learning and growth process.

Answer: D Difficulty: Medium

30. Which of the following ratios is not part of the internal perspective?

- A) Accounts Receivable Turnover
- B) Inventory Turnover
- C) Quick Ratio
- D) Accounts Payable Turnover

Answer: C Difficulty: Medium

31. Which of the following combination of quality measurement cost are incurred voluntarily?

- A) Prevention cost and external failure cost
- B) Appraisal cost and internal failure cost
- C) External failure cost and internal failure cost
- D) Prevention cost and appraisal cost

Answer: D Difficulty: Hard

32. When a company operates in a more certain environment, it tends to focus inward and have a(an)

- A) flexible strategy.
- B) rigid strategy.
- C) loose strategy.
- D) efficiency strategy.

Answer: D Difficulty: Medium

33. When a company operates in an uncertain environment that has rapidly changing products, it is more likely to have a(an)

- A) mechanistic organizational structure with an efficiency strategy.
- B) organic organizational structure with a flexible strategy.
- C) holistic organizational structure with an organic strategy.
- D) synthetic organizational structure with a decentralized strategy.

Answer: B Difficulty: Medium



34. Which of the following strategies focuses mainly on reduction of cost?  
A) Flexible strategy  
B) Organic strategy  
C) Decentralized strategy  
D) Efficiency strategy  
Answer: D Difficulty: Medium
35. Which of the following strategies focuses mainly on developing new products to meet rapidly changing consumer demand?  
A) Flexible strategy  
B) Organic strategy  
C) Efficiency strategy  
D) Decentralized strategy  
Answer: A Difficulty: Medium
36. The Capital Resources Process features which of the following pairs of activities?  
A) Operating and investing activities  
B) Financing and investing activities  
C) Reporting and operating activities  
D) Financing and planning activities  
Answer: B Difficulty: Easy
37. The Balanced Scorecard Approach is part of which of the following processes?  
A) Operating process  
B) Capital resources process  
C) Performance measurement and management process  
D) Business organization and strategy process  
Answer: C Difficulty: Easy
38. Which of the following ratios measures the profitability of the money invested in the firm's assets?  
A) Quick Ratio  
B) Return on Owners' Equity  
C) Gross Margin Ratio  
D) Return on Investment  
Answer: D Difficulty: Easy

39. Which of the following measures the liquidity of a company?

- A) Return on Owners' Equity
- B) Gross Margin Ratio
- C) Return on Investment
- D) Quick Ratio

Answer: D Difficulty: Easy

40. The profitability generated by the net assets (assets-liability) of a corporation would be best measured by the:

- A) Quick Ratio.
- B) Return on Investment.
- C) Return on Owners' Equity.
- D) Gross Margin Ratio.

Answer: C Difficulty: Easy

41. The Gross Margin Ratio measures which of the following?

- A) The profitability of the firm's debt
- B) The liquidity of the firm's profit
- C) The percent of each dollar of sales that can cover the firm's operating expenses
- D) The percent of the assets that generate profit for the firm and that covers operating and financing expenses

Answer: C Difficulty: Medium

42. Which of the following is considered value added time?

- A) Order response time
- B) Production time
- C) Queue time
- D) Shipping time

Answer: B Difficulty: Easy

43. Identify the item below that is considered nonvalue -added time.

- A) Time it takes for customer to order goods
- B) Time it takes to process an order
- C) Time it takes to ship the order
- D) All of the above are nonvalue -added time

Answer: D Difficulty: Medium

44. Identify the ratio below that does not monitor nonvalue -added time.

- A) Quick Ratio
- B) Inventory Turnover
- C) Accounts Payable Turnover
- D) Accounts Receivable Turnover

Answer: A Difficulty: Medium

45. Which of the following businesses would have the shortest customer response time?
- A) Dell Computers
  - B) Ford Motor Company
  - C) Construction Company
  - D) Wheat Farmer

Answer: A Difficulty: Medium

46. Identify which of the following is not considered a cost to ensure quality?
- A) Internal failure cost
  - B) Appraisal cost
  - C) Maintenance cost
  - D) Prevention cost

Answer: C Difficulty: Medium

47. Which of the following businesses would have the longest customer response time?
- A) Dell Computers
  - B) General Motors Company
  - C) Furniture Manufacturer
  - D) Apple Grower

Answer: D Difficulty: Medium

48. Internal failure cost occurs when:
- A) A company repairs a product before it is sold to the customer.
  - B) A company repairs a product after it is sold to the customer.
  - C) A company hires someone to inspect material before production takes place.
  - D) A company pays an engineer to insure the production line is free of faulty machines.

Answer: A Difficulty: Hard

49. The balanced scorecard approach has four perspectives, which of the following is not one of those perspectives?
- A) Financial perspective
  - B) Learning and growth perspective
  - C) Internal control perspective
  - D) Customer perspective

Answer: C Difficulty: Medium

50. The cost and effectiveness of research and development is part of which of the following balanced scorecard perspectives?
- A) Financial perspective
  - B) Learning and growth perspective
  - C) Customer perspective
  - D) Internal perspective

Answer: B Difficulty: Easy

51. Customer response time is part of which of the following balanced scorecard perspectives?
- A) Financial perspective
  - B) Learning and growth perspective
  - C) Customer perspective
  - D) Internal perspective
- Answer: D Difficulty: Hard
52. Which of the following is not part of an internal control system?
- A) Providing independent checks
  - B) Separating incompatible duties
  - C) Physically controlling assets
  - D) Designing produce that meet the customers' needs
- Answer: D Difficulty: Medium
53. Identifying incompatible duties is divided into four phases, which of the following is not one of the four phases?
- A) Scrutiny
  - B) Approval
  - C) Execution
  - D) Custody
- Answer: A Difficulty: Hard
54. The controller of Allitron, Inc. is one of two individuals in the company allowed to sign checks. This is an application of which of the following internal controls?
- A) Separating incompatible duties
  - B) Maintaining adequate documents and records
  - C) Requiring proper authorization
  - D) Physically controlling assets and documents
- Answer: C Difficulty: Medium
55. The bookkeeper who records cash receipts also deposits daily cash receipts at the bank on his way home from work. This is a violation of which of the following characteristics of good internal control?
- A) Requiring proper authorization
  - B) Maintaining adequate documents and records
  - C) Physically controlling assets and documents
  - D) Separating incompatible duties
- Answer: D Difficulty: Medium

56. All the checks used by Graphics, Inc. to pay its bills are prenumbered. This is an application of which of the following internal controls?
- A) Maintaining adequate documents and records
  - B) Physically controlling assets and documents
  - C) Requiring proper authorization
  - D) Separating incompatible duties
- Answer: A Difficulty: Medium
57. A burger shop requires employees to ring up sales and place all cash receipts in the cash register. This is an application of which of the following internal controls?
- A) Requiring proper authorization
  - B) Separating incompatible duties
  - C) Physically controlling assets and documents
  - D) Maintaining adequate documents and records
- Answer: C Difficulty: Medium
58. Which of the following is part of the operating process?
- A) Sale of a warehouse
  - B) Purchase of machinery
  - C) Purchase of inventory
  - D) Sale of common stock of another firm
- Answer: C Difficulty: Medium
59. Which of the following are the three phases of a business?
- A) Start-up, development and decline
  - B) Operating, investing and financing
  - C) Planning, performing and evaluating
  - D) Revenue, expenditure and conversion
- Answer: C Difficulty: Medium
60. Plans showing business activities intended to accomplish objectives during the next year are referred to as:
- A) operating plans.
  - B) strategic plans.
  - C) evaluating plans.
  - D) development plans.
- Answer: A Difficulty: Easy
61. Which of the following would not be part of the capital resources process?
- A) Collection of a loan
  - B) Acquisition of equipment
  - C) Purchase and sale of inventory
  - D) Sale of stock in another company
- Answer: C Difficulty: Medium

62. Which of the following would be part of the capital resources process?

- A) Issuance of stock
- B) Preparation of operating budget
- C) Calculating financial ratios
- D) Selling products on credit to customers

Answer: A Difficulty: Medium

63. Which is not part of the operating process?

- A) Purchase of a bulldozer by a construction company
- B) Purchase of a computer by an electronics store for resale
- C) Sale of stock by a stock broker
- D) Sale of merchandise

Answer: A Difficulty: Hard

64. Which is an example of an event that takes place in the operating process?

- A) Purchase of a bulldozer by a construction company
- B) Purchase of a computer by an accounting firm
- C) Payment of dividends
- D) Payment of wages

Answer: D Difficulty: Hard

65. Which of the following is part of the conversion subprocess?

- A) Purchase of merchandise for resale
- B) Payment of wages to sales people
- C) Purchase of building
- D) Requisition of raw materials

Answer: D Difficulty: Medium

66. Billing customers is part of which of the following?

- A) Capital resources process
- B) Marketing/sales/collection/customer service subprocess
- C) Conversion subprocess
- D) Credit sales process

Answer: B Difficulty: Medium

67. At May 31, Allegro Company had a general ledger cash balance of \$7,400. At the end of May, the bank statement had a balance of \$7,500. Deposits in transit amounted to \$1,000 and there was a service charge of \$10. Outstanding checks totaled \$1,110. What is the correct amount of cash?

A) \$7,390  
B) \$7,000  
C) \$6,390  
D) \$6,380

Answer: A Difficulty: Medium

68. At July 31, Sonata Company had a general ledger cash balance of \$5,900. Deposits in transit amounted to \$1,200 and there was a service charge of \$20. Outstanding checks totaled \$1,500. What is the balance shown on the bank statement at the end of July?

A) \$5,580  
B) \$5,880  
C) \$6,180  
D) Unable to determine from the information given

Answer: C Difficulty: Hard

69. A bank reconciliation will identify all the following except

A) Unrecorded bank service charges  
B) Double payment of a bill  
C) Outstanding checks  
D) Deposits in transit

Answer: B Difficulty: Medium

70. Which of the following will required the cash on the books of the company to be adjusted?

A) Outstanding checks  
B) Deposits in transit  
C) Bank errors  
D) Bank service charges

Answer: D Difficulty: Medium

71. Which of the following bank reconciliation items would require the cash on the company's books to be reduced?

A) Outstanding checks  
B) Deposit in transit  
C) Nonsufficient funds check  
D) Bank error

Answer: C Difficulty: Medium

72. On a bank reconciliation, which of the following will reduce the bank's cash balance?
- A) Outstanding checks
  - B) Deposit in transit
  - C) Nonsufficient funds check
  - D) Failure of the company to record the correct amount of the check on the company's records.

Answer: A Difficulty: Hard

73. Which of the following will not require an adjustment to the company's cash balance?
- A) Bank service charge
  - B) Nonsufficient funds check
  - C) Bank recorded a check for the wrong amount
  - D) All will require the company's cash balance to be adjusted.

Answer: C Difficulty: Hard

74. On a bank reconciliation, which of the following will reduce the company's cash balance?
- A) Outstanding checks
  - B) Deposit in transit
  - C) Nonsufficient funds check
  - D) Bank error

Answer: C Difficulty: Hard

75. Which of the following reflects a weakness in the internal control for cash?
- A) The cash register generates a receipt that documents the cash sale, which is given to the customer.
  - B) Two employees have access to the same cash register in order to reduce chance of theft.
  - C) The person making out a check must get authorization before the check is sent.
  - D) The person receiving cash in the mail cannot make entries into the accounting records.

Answer: B Difficulty: Medium

76. Which of the following is not a factor in getting bank and book balances to reconcile?
- A) Outstanding checks
  - B) Deposits for cash
  - C) Deposits in transit
  - D) Bank service charges

Answer: B Difficulty: Medium



## ESSAYS

77. Scherzo Company purchased equipment from Rondo Corporation for \$20,000. Scherzo paid no cash at the time of purchase. Instead Rondo permitted Scherzo to pay for the equipment by making four annual payments of \$5,000. For Scherzo and for Rondo what processes are being used by these events? Explain your answer.

Answer:

For Scherzo, the capital resources process is being used. The purchase of equipment is an investing activity, whereas borrowing money is a financing activity. For Rondo, both the operating and capital resources processes are being impacted. The sale of the equipment is part of the operating process, whereas lending the money to Scherzo is part of the capital resources process.

78. For each of the items below, explain how it would be handled in preparing a bank statement reconciliation and why it would be handled in that way.

A) Deposits in transit

B) Outstanding checks

C) A check for \$300 was erroneously recorded in the accounts as \$500

Answer:

A) Deposits in transit are added to the bank statement balance because they are properly additions to the bank balance, but the bank has not yet recorded them.

B) Outstanding checks are subtracted from the bank statement balance because they are reductions in the amount of cash in the bank, but the bank has not yet recorded them.

C) Two hundred dollars would be added to the cash account in the general ledger because too much was subtracted from cash when initially recording the check.

79. Toccata Corporation purchased raw materials, transformed them into finished goods, and sold these goods to customers on account. Describe how the subprocesses of the operating process are impacted by these events.

Answer:

The purchase of raw materials and the acquisition of goods or services from external parties are part of the purchasing/human resources/payment subprocess. The conversion of raw materials into finished goods is part of the conversion process. The sale of goods to customers is part of the marketing/sales/collection/customer service subprocess.

80. Ethan Fromme is the purchaser for Hardware Hut, a company with several hardware stores. He prepares purchase orders for merchandise and places the orders with manufacturers. Although he does not physically receive the merchandise, he is responsible for checking the invoice against the purchase order and authorizing payment of the invoice. Describe internal control problems this arrangement causes.

Answer:

Because Mr. Fromme is responsible for both ordering the merchandise and checking the invoice, he could place fictitious orders and authorize payment for them. If he worked

out an "arrangement" with a supplier, it would be possible for him to divert part of an order and sell it. He could submit fictitious invoices and authorize their payment. He could, through collusion with a supplier, overpay invoices and pocket the excess.

81. Give the formula for each of the following ratios and then explain what each ratio measures.

- A) Return on Investment
- B) Quick Ratio
- C) Gross Margin Ratio
- D) Return on Owners' Equity

Answer:

$$\text{A) Return on Investment} = \frac{\text{Net Income}}{\text{Average Total Assets}}$$

Describes the percentage return on the dollars invested in the assets of the company.

$$\text{B) Quick Ratio} = \frac{\text{Cash} + \text{Temporary Investments} + \text{Receivables}}{\text{Current Liabilities}}$$

Describes a company's ability to meet its current obligations as they become due.

$$\text{C) Gross Margin Ratio} = \frac{\text{Gross Margin}}{\text{Sales}}$$

Describes the percentage of each dollar sales that is available to cover operating and other costs.

$$\text{D) Return on Owners' Equity} = \frac{\text{Net Income}}{\text{Average Owners' Equity}}$$

Measures the profitability of the company as a percent of the owners' equity. It describes the rate of return owners earned on their investment.

## PROBLEMS

82. Using the financial statements from the (*instructor supplies the income statement and balance sheet of a company and insert name here*), calculate each of the following ratios and briefly describe what the results indicate.

- A) Return on Investment

- B) Quick Ratio
- C) Gross Margin Ratio
- D) Current Ratio
- E) Return on Sales Ratio
- F) Debt to Equity Ratio
- G) Return on Owners' Equity

Answer will depend on the company selected.

82. (Note to the Instructor: This problem combines the ratios from Chapters 1 and 2)  
Using the financial statements from the (*instructor supplies the income statement and balance sheet of a company and insert name here*), calculate each of the following ratios and briefly describe what the results indicate.

- A) Current Ratio
- B) Quick Ratio
- C) Gross Margin Ratio
- D) Return on Sales Ratio
- E) Debt to Equity Ratio
- F) Return on Investment Ratio
- G) Return on Owners' Equity
- H) Accounts Receivable turnover
- I) Inventory turnover
- J) Accounts Payable turnover

Answer will depend on the company selected.

83. Using the financial statements below, calculate each of the following ratios and briefly describe what the results of each indicate.

- A) Return on Investment
- B) Quick Ratio
- C) Debt to Equity Ratio
- D) Return on Owners' Equity
- E) Accounts Receivable Turnover
- F) Inventory Turnover

Banner Corporation  
Balance Sheet  
December 31, 2008

**Current Assets**

**Current Liabilities**

Cash	\$ 20,000	Accounts Payable	\$ 140,000
Accounts Receivable	100,000	Wages Payable	<u>200,000</u>
Inventory	<u>300,000</u>	Total Current Liabilities	\$ 340,000
Total Current Assets	\$420,000		
		<b><u>Long-Term Liabilities</u></b>	
<i>Property, Plant &amp; Equipment</i>		Long-Term Notes Payable	\$1,000,000
Land	\$300,000	Total Liabilities	\$1,340,000
Buildings	800,000		
Equipment	<u>90,000</u>		
Total Property Plant & Equipment	<u>\$1,190,000</u>	Owners' Equity	<u>\$ 270,000</u>
Total Assets	\$1,610,000	Total Liabilities and Owners' Equity	\$1,610,000
Total Assets 12/31/07	1,400,000	Accts Rec 12/31/07	\$75,000
Total Owners' Equity 12/31/07	\$250,000	Accts Pay 12/31/07	\$100,000

Banner Corporation  
Income Statement  
For the year ended Dec 31, 2008

Sales	\$4,200,000
Cost of Goods Sold	<u>1,800,000</u>
Gross Margin	\$2,400,000
Operating Expenses	<u>1,800,000</u>
Operating Income	\$ 600,000
Tax Expense	<u>180,000</u>
Net Income	\$ 420,000

Answer:

A) Return on Investment =

$$\frac{\$420,000}{(1,400,000 + \$1,610,000) \div 2} = 0.279 \text{ or } 28\%$$

B) Quick Ratio =

$$\frac{\$20,000 + \$100,000}{\$340,000} = 0.353$$

C) Debt to Equity =

$$\frac{\$1,340,000}{\$270,000} = 4.963$$

D) Return on Equity =

$$\frac{\$420,000}{(250,000 + \$270,000) \div 2} = 1.615 \text{ or } 161.5\%$$

E) Accounts Receivable Turnover =

$$\frac{\$4,200,000}{(75,000 + \$100,000) \div 2} = 48 \quad 365/48 = 7.6042 \text{ Days}$$

F) Inventory Turnover =

$$\frac{\$1,800,000}{(350,000 + \$300,000) \div 2} = 5.53 \quad 365/5.53 = 66.0036 \text{ Days}$$

84. From the information below create a two-column bank reconciliation for the month of November 2008 for the Purinton Corporation.

A) Nov 30, 2008 cash balance per book is \$35,152.22

B) Bank statement balance at Nov 30, 2008 is \$32,450.78

C) The following checks are outstanding.

Check No.	Amount of Check
2156	\$528.34
2175	378.00
2199	185.22

D) A memo included in the bank statement indicates that Dan Short had a NSF check for \$933.

E) The bank service charge for the month is \$38.

F) Cash receipts of \$2,300 deposited Nov 30, 2008 were not included in the bank statement.

G) A check for \$483 was deposited and correctly recorded by the bank but the company incorrectly recorded the deposit for \$438 on their books.

H) A check for \$567 written by another company was incorrectly deducted from the Purinton checking account.

Answer:

Purinton Company  
Bank Reconciliation  
for the Month of Nov. 2008

Balance Per Bank 11/30/08	\$32,450.78
Add: Deposits In Transit	2,300.00
Bank Error	567.00
Less: Outstanding Checks	<u>(1,091.56)</u>
Adjusted Bank Balance	\$34,226.22

Balance Per Book 11/30/08	\$35,152.22
Less: NSF Dan Short	(933.00)
Bank Service Charge	( 38.00)
Add: Recording Error per Book	<u>45.00</u>
Adjusted Book Balance	\$34,226.22

85. The Ogallah Corporation wants its bank reconciliation for March 2008 prepared and has gathered the following information.

Balance per bank statement 3/31/08	\$52,894.33
Balance per book 3/31/08	\$49,667.29

Outstanding Checks:	<u>Check Number</u>	<u>Check Amount</u>
	2380	\$3,122.47
	2391	2,145.00
	2392	754.89

Bank Service Charge for March 2008 \$46

Ogallah wrote check number 2347 for \$679.23 but the check was recorded as \$769.23 on Ogallah's books.

The bank statement contained a NSF check that totaled \$566 and the \$35 charge to process the NSF check.

Interest earned on checking account during March 2008 \$216.39.

Deposits in Transit \$2,567.23.

Required: Using a two-column bank reconciliation, determine the dollar amount of the error the bank made in March 2008. Assume that all adjustments to the cash per book are correct and complete.

Answer:

Balance per Bank	\$52,894.33
Less: Outstanding Checks	(6,022.36)
Bank Error	?
Add: Deposits in transit	<u>2,567.23</u>
Adjusted Balance per Bank	\$49,326.68

Balance per Book	\$49,667.29
Less: Bank Service Charge	(46.00)
NSF Check	(566.00)
NSF Check Charge	(35.00)
Add: Error in Recording Check Amount	90.00
Interest Earned on Checking Account	<u>216.39</u>
Adjusted Balance per Book	\$49,326.68

Students must first determine the adjusted Balance per Book and then use it to calculate the bank error.

$$(\$52,894.33 - 6,022.36 + 2,567.23) - \$49,326.68 = \$112.52$$