

1. United Airlines is an example of a:
- a. producer.
 - b. supplier.
 - c. retailer.
 - d. service provider.

ANSWER: d

2. All of the following are examples of retailers **except**:
- a. Sports Authority.
 - b. Boeing.
 - c. Home Depot.
 - d. Best Buy.

ANSWER: b

3. The three forms of business entities are:
- a. Government, cooperatives, and philanthropic organizations.
 - b. Financing, investing, and operating.
 - c. Sole proprietorships, partnerships, and corporations.
 - d. Wholesaler, manufacturer, and retailer.

ANSWER: c

4. Which of the following statements would be true if you own stock in a company?
- a. You are an owner of the retained earnings and capital stock of the company.
 - b. You have a claim to the assets of the business.
 - c. You have the right to receive interest on an annual basis.
 - d. You have the right to a portion of the company's revenues each accounting period.

ANSWER: b

5. Which of the following statements best describes the term "revenues"?
- a. Revenues represent an outflow of assets resulting from the sale of goods or services.
 - b. Revenues represent assets received from the sale of products or services.
 - c. Revenues represent assets used or consumed in the sale of products or services.
 - d. Revenues represent the dollar amount of bonds sold to the public.

ANSWER: b

Chapter 1: Accounting as a Form of Communication

6. Which one of the following events involves a liability for a business?

- a. Loans to be repaid to banks
- b. Inventories purchased for cash
- c. Amounts invested by the owners
- d. Stock sold to the general public

ANSWER: a

7. Which of the following best describes the term “expenses”?

- a. The amount of total profits earned by a business since it began operations.
- b. The amount of interest or claim that the owners have in the business.
- c. The future economic resources of a business entity.
- d. The outflow of assets resulting from the sale of goods and services.

ANSWER: d

8. The inflow of assets resulting from the sale of products and services is called a(n):

- a. asset.
- b. liability.
- c. revenue.
- d. expense.

ANSWER: c

9. The costs of doing business through the sale of goods and services are called:

- a. Net income.
- b. Expenses.
- c. Revenues.
- d. Dividends.

ANSWER: b

10. Which of the following best describes the term “assets”?

- a. The amount of total profits earned by a business since it began operations.
- b. The amount of interest or claim that the owners have in the business.
- c. The economic resources of a business entity.
- d. The cumulative profits earned by a business less any dividends distributed.

ANSWER: c

Chapter 1: Accounting as a Form of Communication

11. Which one of the following business decisions will **least** likely require financial information?
- a. The Gulf Coast Bank is reviewing the loan application from Tuo's Restaurant.
 - b. Tuo's Restaurant is attempting to sell its stock to the public.
 - c. The labor union representing Flaggler's Fitness Spa employees is negotiating a pay raise as part of a new labor agreement.
 - d. Tuo's Restaurant management is deciding whether to wash its catering vans today or tomorrow.

ANSWER: d

12. Which of the following would be internal users of accounting information?
- a. Customers and vendors
 - b. Employees and managers
 - c. Government and banks
 - d. Employees and customers

ANSWER: b

13. Which of the following would be classified as external users of financial statements?
- a. Stockholders and management of the company
 - b. The controller of the company and a company's stockholders
 - c. The company's marketing managers
 - d. The creditors and stockholders of the company

ANSWER: d

14. Which one of the following is **not** an external user of financial information?
- a. Company management
 - b. Internal Revenue Service
 - c. Creditors
 - d. Stockholders

ANSWER: a

15. Barton Building Company is ready to sell its bonds. Which one of the following financial questions is most relevant to the issue of the bonds and that investors will most likely want answered before they purchase the bonds?
- a. How many product lines did Barton Building Company have last year?
 - b. What will be Barton Building Company's cost to start operations in another city?
 - c. How much debt does Barton Building Company already have?
 - d. Will Barton Building Company pay dividends?

ANSWER: c

Chapter 1: Accounting as a Form of Communication

16. Is the name of the branch of accounting concerned with providing managers and administrators with information to facilitate the planning and control of business operations?
- a. Management accounting
 - b. Auditing
 - c. Financial accounting
 - d. Bookkeeping

ANSWER: a

17. Which of the following invests funds into a business and is considered an owner?
- a. Stockholders
 - b. Creditors
 - c. Bankers
 - d. Lenders

ANSWER: a

18. Which one of the following is **not** one of the three activities included in the definition of accounting?
- a. Communicating
 - b. Identifying
 - c. Measuring
 - d. Operating

ANSWER: d

19. Which one of the following is **not** an external user of financial statements?
- a. Suppliers
 - b. Creditors
 - c. Investors
 - d. The company's controller

ANSWER: d

20. Which one of the following is **least** likely to be a user of financial information of a grocery store?
- a. The manager of the grocery store.
 - b. The supplier of milk to the grocery store.
 - c. A stockbroker looking for a possible investment.
 - d. A customer at the grocery store.

ANSWER: d

Chapter 1: Accounting as a Form of Communication

21. Which one of the following groups is considered an internal user of financial statements?
- a. A bank reviewing a loan application from a corporation.
 - b. The labor union representing employees of a company that is involved in labor negotiations.
 - c. The financial analysts for a brokerage firm who are preparing recommendations for the firm's brokers on companies in a certain industry.
 - d. Factory managers that supervise production line workers.

ANSWER: d

22. Which of the following is an organization that lends funds to a business entity and expects repayment of the funds?
- a. A partner
 - b. A stockholder
 - c. An owner
 - d. A creditor

ANSWER: d

23. You are a potential stockholder and are concerned that a particular company you are ready to invest in might have too much debt. Which financial statement would provide you information needed in order to evaluate your concern?
- a. Balance sheet
 - b. Income statement
 - c. Statement of retained earnings
 - d. Statement of public accounting

ANSWER: a

24. Which financial statement would you analyze to determine if a company distributed any of its profits to its shareholders?
- a. Balance Sheet
 - b. Statement of Retained Earnings
 - c. Income Statement
 - d. Statement of Public Accounting

ANSWER: b

Chapter 1: Accounting as a Form of Communication

25. Which financial statement would you refer to in order to determine whether a company owed funds to creditors?
- a. Balance Sheet
 - b. Statement of Retained Earnings
 - c. Income Statement
 - d. Statement of Public Accounting

ANSWER: a

26. Which one of the following is an economic obligation for a business entity?
- a. Salaries paid to employees for services rendered
 - b. Amounts owed to creditors
 - c. Materials used in manufacturing products
 - d. Payment of rent for the next year

ANSWER: b

27. Which one of the following is a correct expression of the accounting equation?
- a. $\text{Assets} + \text{Liabilities} = \text{Owners' Equity}$
 - b. $\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$
 - c. $\text{Assets} + \text{Owners' Equity} = \text{Liabilities}$
 - d. $\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$

ANSWER: d

28. How is the balance sheet linked to the other financial statements?
- a. The amount of retained earnings reported on the balance sheet is equal to net income.
 - b. Retained earnings is added to total assets and reported on the balance sheet.
 - c. Net income increases retained earnings on the statement of retained earnings, which ultimately increases retained earnings on the balance sheet.
 - d. There is no link between the balance sheet and other statements, as each contains different accounts and provides different information.

ANSWER: c

29. Which of the following is the correct date format for the financial statement heading?
- a. Balance sheet for the year ended June 30, 2015
 - b. Income statement at December 31, 2015
 - c. Balance sheet at December 31, 2015
 - d. Statement of retained earnings at December 31, 2015

ANSWER: c

Chapter 1: Accounting as a Form of Communication

30. Which of the following best describes the term “retained earnings”?
- a. The amount of total profits earned by a business since it began operations.
 - b. The amount of interest or claim that the owners have on the assets of the business.
 - c. The future economic resources of a business entity.
 - d. The cumulative profits earned by the business less any dividends distributed.

ANSWER: d

31. Which one of the following items is correct concerning the time element of financial statements?
- a. The balance sheet covers a period of time.
 - b. The statement of retained earnings explains changes during a particular period.
 - c. An income statement lists amounts at a specific point in time.
 - d. Both the income statement and the balance sheet cover a period of time.

ANSWER: b

32. Which one of the following items appears on a balance sheet?
- a. Accounts payable
 - b. Sales revenue
 - c. Utilities expense
 - d. Cost of goods sold

ANSWER: a

33. Which one of the following financial statements reports an entity’s financial position at a specific date?
- a. Balance sheet
 - b. Statement of retained earnings
 - c. Income statement
 - d. Both the income statement and the balance sheet

ANSWER: a

34. Which one of the following correctly represents one of the basic financial statement models?
- a. $\text{Assets} - \text{Liabilities} = \text{Net Income}$
 - b. $\text{Assets} + \text{Liabilities} = \text{Owners' Equity}$
 - c. $\text{Revenues} + \text{Expenses} = \text{Net Income}$
 - d. $\text{Beginning Retained Earnings} + \text{Net Income} - \text{Dividends} = \text{Ending Retained Earnings}$

ANSWER: d

Chapter 1: Accounting as a Form of Communication

35. Which of the following statements is true?

- a. Profits distributed to the creditors are called dividends.
- b. The balance sheet shows the assets, liabilities, and profits of a company.
- c. Dividends are an expense, and are reported on the income statement as a deduction from net income.
- d. The income statement reports the revenues and expenses of a company.

ANSWER: d

36. Which of the following terms best describes a distribution of the net income of a business to its owners?

- a. Revenue
- b. Dividends
- c. Earnings
- d. Monetary unit

ANSWER: b

37. Which statement summarizes the income earned and the dividends paid?

- a. Statement of cash flows
- b. Statement of retained earnings
- c. Balance sheet
- d. Income statement

ANSWER: b

38. Sun City Corporation's endofyear balance sheet consisted of the following amounts:

Cash	\$ 25,000	Accounts receivable	\$ 70,000
Property, plant, and equipment	70,000	Long-term debt	40,000
Capital stock	100,000	Accounts payable	20,000
Retained earnings	?	Inventory	35,000

What amount should Sun City report on its balance sheet for **total assets**?

- a. \$100,000
- b. \$95,000
- c. \$165,000
- d. \$200,000

ANSWER: d

RATIONALE: $\$25,000 + \$70,000 + \$70,000 + \$35,000 = \$200,000$

Chapter 1: Accounting as a Form of Communication

39. Lawton Corporation's endofyear balance sheet consisted of the following amounts:

Cash	\$ 25,000	Accounts receivable	\$ 58,000
Property, plant, and equipment	69,000	Long-term debt	40,000
Capital stock	100,000	Accounts payable	20,000
Retained earnings	?	Inventory	43,000

What amount should Lawton report on its balance sheet for **total assets**?

- a. \$100,000
- b. \$161,000
- c. \$194,000
- d. \$195,000

ANSWER: d

RATIONALE: $\$25,000 + \$69,000 + \$58,000 + \$43,000 = \$195,000$

40. Harbor City Corporation's endofyear balance sheet consisted of the following amounts:

Cash	\$ 15,000	Accounts receivable	\$ 50,000
Property, plant, and equipment	70,000	Long-term debt	40,000
Capital stock	100,000	Accounts payable	20,000
Retained earnings	?	Inventory	35,000

What is Harbor City's **retained earnings** balance at the end of the current year?

- a. \$10,000
- b. \$110,000
- c. \$160,000
- d. \$170,000

ANSWER: a

RATIONALE: Assets: $\$15,000 + \$70,000 + \$50,000 + \$35,000 = \$170,000$

Liabilities: $\$40,000 + \$20,000 = \$60,000$

Owners' equity: $\$170,000 - \$60,000 = \$110,000$

Retained earnings: $\$110,000 - \$100,000 = \$10,000$

Chapter 1: Accounting as a Form of Communication

41. Lakeland Corporation's endofyear balance sheet consisted of the following amounts:

Cash	\$ 25,000	Accounts receivable	\$ 46,000
Property, plant, and equipment	69,000	Long-term debt	41,000
Capital stock	97,000	Accounts payable	22,000
Retained earnings	?	Inventory	33,000

What is Lakeland's **retained earnings** balance at the end of the current year?

- a. \$13,000
- b. \$34,000
- c. \$76,000
- d. \$173,000

ANSWER: a

RATIONALE: Assets: $\$25,000 + \$69,000 + \$46,000 + \$33,000 = \$173,000$

Liabilities: $\$41,000 + \$22,000 = \$63,000$

Owners' equity: $\$173,000 - \$63,000 = \$110,000$

Retained earnings: $\$110,000 - \$97,000 = \$13,000$

42. Brock Corporation's endofyear balance sheet consisted of the following amounts:

Cash	\$ 25,000	Accounts receivable	\$ 46,000
Property, plant & equipment	69,000	Long-term debt	41,000
Capital stock	100,000	Accounts payable	24,000
Retained earnings	?	Inventory	33,000

What is Brock's **total liabilities** balance at the end of the current year?

- a. \$8,000
- b. \$65,000
- c. \$108,000
- d. \$173,000

ANSWER: b

RATIONALE: Assets: $\$25,000 + \$69,000 + \$46,000 + \$33,000 = \$173,000$

Liabilities: $\$41,000 + \$24,000 = \$65,000$

Owners' equity: $\$173,000 - \$65,000 = \$108,000$

Retained earnings: $\$108,000 - \$100,000 = \$8,000$

Chapter 1: Accounting as a Form of Communication

43. Front Corporation's end-of-year balance sheet consisted of the following amounts:

Cash	\$ 25,000	Accounts receivable	\$ 46,000
Property, plant & equipment	69,000	Long-term debt	41,000
Capital stock	107,000	Accounts payable	22,000
Retained earnings	?	Inventory	33,000

What is Front's **owners' equity** balance at the end of the current year?

- a. \$3,000
- b. \$110,000
- c. \$63,000
- d. \$173,000

ANSWER: b

RATIONALE: Assets: $\$25,000 + \$69,000 + \$46,000 + \$33,000 = \$173,000$

Liabilities: $\$41,000 + \$22,000 = \$63,000$

Owners' equity: $\$173,000 - \$63,000 = \$110,000$

Retained earnings: $\$110,000 - \$107,000 = \$3,000$

44. Wei Company reported the following items on its financial statements for the year ending December 31, 2015:

Sales	\$ 560,000	Cost of goods sold	\$400,000
Salary expense	40,000	Interest expense	30,000
Dividends	20,000	Income tax expense	25,000

The income statement for Wei will report **net income** for the current year in the amount of

- a. \$ 45,000
- b. \$ 65,000
- c. \$ 85,000
- d. \$ 465,000

ANSWER: b

RATIONALE: $\$560,000 - \$400,000 - \$40,000 - \$30,000 - \$25,000 = \$65,000$

Chapter 1: Accounting as a Form of Communication

45. Marcos Company reported the following items on its financial statements for the year ending December 31, 2015:

Sales	\$ 560,000	Cost of goods sold	\$400,000
Salary expense	40,000	Interest expense	30,000
Dividends	20,000	Income tax expense	25,000

How much will be reported as **retained earnings** on Marcos' balance sheet at December 31, 2015, if this is the first year of operations?

- a. \$ 45,000
- b. \$ 65,000
- c. \$ 85,000
- d. Not enough information is provided.

ANSWER: a

RATIONALE: Net income: $\$560,000 - \$400,000 - \$40,000 - \$30,000 - \$25,000 = \$65,000$
Retained earnings: $\$65,000 - \$20,000 = \$45,000$

46. Morton Corporation reported the following information for the year ended December 31, 2015:

Net income	\$ 10,000
Dividends	6,000
Retained earnings at December 31, 2015	25,000

What was the balance of Morton's' retained earnings at January 1, 2015?

- a. \$21,000
- b. \$29,000
- c. \$31,000
- d. \$35,000

ANSWER: a

RATIONALE: $\$25,000 + \$6,000 - \$10,000 = \$21,000$ Lewis Corporation reported the following information for the year ended December 31, 2015:

Net income	\$ 10,000
Dividends	6,000
Retained earnings at December 31, 2015	25,000

What was the economic effect of the payment of Lewis' dividends?

- a. The dividend reduced net income for 2015.
- b. The dividend should be equal to net income if the company's accounting equation is in balance.
- c. The dividends reduce total retained earnings for the year.
- d. The dividends must be paid whenever Lewis Corp. reports net income.

ANSWER: c

Chapter 1: Accounting as a Form of Communication

Chapter 1: Accounting as a Form of Communication

47. Volt Corp. reported the following information for the year ended December 31, 2015:

Revenues	\$ 50,000
Expenses	20,000
Retained earnings at December 31, 2014	100,000
Retained earnings at December 31, 2015	105,000

How much was paid out in dividends by Volt in 2015?

- a. \$ 20,000
- b. \$ 25,000
- c. \$ 30,000
- d. \$ 50,000

ANSWER: b

RATIONALE: $\$100,000 + \$50,000 - \$20,000 - X = \$105,000$ $X = \$25,000$

48. Mobile Power Corp. reported the following information for the year ended December 31, 2015.

Revenue	\$ 40,000
Expenses	23,000
Dividends	10,000
Retained earnings at December 31, 2015	175,000

What was the retained earnings balance for Mobile Power at December 31, 2014?

- a. \$ 165,000
- b. \$ 168,000
- c. \$ 182,000
- d. \$ 192,000

ANSWER: b

RATIONALE: $X + \$17,000 - \$10,000 = \$175,000$ $X = \$168,000$

Chapter 1: Accounting as a Form of Communication

49. Native Mike's Consultants had the following balance sheet amounts at the beginning of the year:

Total assets	\$400,000
Total owner's equity	150,000

During the year, total assets increased by \$100,000 and total liabilities increased by \$40,000. The company also paid \$30,000 in dividends. No other transactions occurred except revenues and expenses. How much is net income for the year?

- a. \$30,000
- b. \$60,000
- c. \$70,000
- d. \$90,000

ANSWER: d

RATIONALE: Assets: \$400,000+\$100,000 \$500,000

Liabilities: (\$400,000-\$150,000)+\$40,000 = \$290,000

Owners' Equity at Year End: \$500,000-\$290,000 = \$210,000

Net Income: \$210,000-\$150,000+\$30,000 = \$90,000

50. On January 1, 2015, A-Best Company's balance in retained earnings was \$70,000. At the end of the year, December 31, 2015, the balance in retained earnings was \$94,000. During 2015, the company earned net income of \$40,000. How much were dividends?

- a. \$16,000
- b. \$24,000
- c. \$40,000
- d. \$64,000

ANSWER:

a

RATIONALE: \$70,000+\$40,000-\$94,000 = \$16,000

51. On January 1, 2015, Flaggler Company's balance in retained earnings was \$70,000. During 2015, the company earned net income of \$43,000 and paid \$15,000 in dividends. Calculate the retained earnings balance at December 31, 2015.

- a. \$42,000
- b. \$90,000
- c. \$98,000
- d. \$113,00

ANSWER: c

RATIONALE: \$70,000+\$43,000-\$15,000 = \$98,000

Chapter 1: Accounting as a Form of Communication

52. The following information is provided by the Centos Corporation:

Beginning retained earnings	\$ 50,000
Ending retained earnings	70,000
Dividends declared and paid	10,000
Revenue	50,000

What is the net income for Centos Corp.? a.

\$10,000

b. \$20,000

c. \$30,000

d. Unable to tell from the information provided.

ANSWER: c

RATIONALE: $\$50,000 + x - \$10,000 = \$70,000$ $x = \$30,000$

53. The following information is provided by the Ferrara Corporation:

Beginning retained earnings	\$ 50,000
Ending retained earnings	70,000
Dividends declared and paid	10,000
Revenue	50,000

Calculate Ferrara Corporation's expenses.

a. \$20,000

b. \$30,000

c. \$40,000

d. Cannot tell from the information provided.

ANSWER: a

RATIONALE: $\$50,000 + X - \$10,000 = \$70,000$

$X = \$30,000$ or Net Income $\$50,000$ (Revenue) - $\$30,000$ (Net Income) = $\$20,000$ Expenses

54. If a company has \$152,000 of revenues, declares and pays \$55,000 in dividends, and has net income of \$89,000, how much were expenses for the year?

a. \$ 8,000

b. \$ 63,000

c. \$144,000

d. Unable to determine the amount due to incomplete information.

ANSWER: b

RATIONALE: $\$152,000$ (Revenues) - $\$89,000$ (Net Income) = $\$63,000$ (Expenses)

Chapter 1: Accounting as a Form of Communication

55. Surge Company reports the following information at December 31, 2015:

Revenue	\$150,000
Cash	30,000
Accounts payable	40,000
Dividends	10,000
Expenses	85,000

What is Surge Company's net income?

- a. \$ 15,000
- b. \$ 45,000
- c. \$ 55,000
- d. \$ 65,000

ANSWER: d

RATIONALE: \$150,000 (Revenue) - \$85,000 (Expenses) = \$65,000 (Net Income)

56. Cerrato Company has assets of \$350,000, liabilities of \$130,000, and retained earnings of \$180,000. How much is total owners' equity?

- a. \$ 40,000
- b. \$ 170,000
- c. \$ 220,000
- d. \$ 350,000

ANSWER: c

RATIONALE: \$350,000 (Assets) - \$130,000 (Liabilities) = \$220,000 Owners' Equity

57. Gyro's Shop reported a net loss of \$15,000 and total expenses of \$80,000. How much are total revenues?

- a. \$ 15,000
- b. \$ 65,000
- c. \$ 95,000
- d. The answer cannot be determined from the information given.

ANSWER: b

RATIONALE: \$80,000 Total Expenses + (\$15,000) Net Loss = \$65,000 Total Revenues

58. Marcos Inc. had net income for 2014 of \$40,000. It declared and paid a \$3,500 cash dividend in 2014. If the company's retained earnings for the end of the year was \$38,200, what was the company's retained earnings balance at the beginning of 2014?

- a. \$81,700
- b. \$74,700
- c. \$5,300
- d. \$1,700

ANSWER: d

RATIONALE: (Beg. Retained Earnings + \$40,000) - \$3,500 = \$38,200; Beg. Retained Earnings = \$1,700

Chapter 1: Accounting as a Form of Communication

59. Global Inc. had net income for 2015 of \$24,000. It declared and paid a \$13,000 cash dividend in 2015. If the company's retained earnings for the end of the year was \$39,600, what was the company's retained earnings balance at the beginning of 2015?

- a. \$28,600
- b. \$50,600
- c. \$76,600
- d. \$2,600

ANSWER: a

RATIONALE: (Beg. Retained Earnings + \$24,000) - \$13,000 = \$39,600; Beginning Retained Earnings = \$28,600

60. At December 31, 2015, the accounting records of Wyndam Corporation contain the following:

Accounts payable	\$16,000	Accounts receivable	\$40,000
Land	240,000	Cash	?
Capital stock	?	Equipment	120,000
Building	180,000	Notes payable	190,000
Retained earnings	160,000		

If capital stock is \$260,000, what is the December 31, 2015 cash balance?

- a. \$46,000
- b. \$506,000
- c. \$94,000
- d. \$86,000

ANSWER: a

RATIONALE: Cash + \$40,000 + \$120,000 + \$180,000 + \$240,000 = \$16,000 + \$260,000 + \$160,000 + \$190,000

61. At December 31, 2015, the accounting records of Farmer Corporation contain the following:

Accounts payable	\$16,000	Accounts receivable	\$40,000
Land	240,000	Cash	?
Capital stock	?	Equipment	120,000
Building	180,000	Notes payable	190,000
Retained earnings	160,000		

If Cash is \$26,000, what is the December 31, 2015 capital stock balance?

- a. \$272,000
- b. \$240,000
- c. \$220,000
- d. \$400,000

ANSWER: b

RATIONALE: \$26,000 + \$40,000 + \$120,000 + \$180,000 + \$240,000 = \$16,000 + \$160,000 + \$190,000 + Capital Stock

Chapter 1: Accounting as a Form of Communication

62. Sawaddee Enterprises began the year with total assets of \$450,000 and total liabilities of \$230,000. If Sawaddee's total assets increased by \$80,000 and its total liabilities increased by \$57,000 during the year, what is the amount of Sawaddee's owners' equity at the end of the year?
- a. \$197,000
 - b. \$543,000
 - c. \$243,000
 - d. \$220,000

ANSWER: c

RATIONALE: $(\$450,000 + \$80,000) = (\$230,000 + \$57,000) + \text{SE}$

63. Sawaddee Enterprises began the year with total assets of \$450,000 and total liabilities of \$230,000. If Sawaddee total liabilities increased by \$31,000 and its owners' equity decreased by \$53,000 during the year, what was the amount of its total assets at the end of the year?
- a. \$472,000
 - b. \$242,000
 - c. \$198,000
 - d. \$428,000

ANSWER: d

RATIONALE: $A = (\$230,000 + \$31,000) + (\$220,000^* - \$53,000) = \$428,000$ *Owners' equity = \$450,000 - \$230,000

64. The natural progression in items from one statement to another and preparation of financial statements is best represented by the following order:
- a. Balance sheet and statement of cash flows > statement of retained earnings > income statement
 - b. Balance sheet and statement of cash flows > income statement > statement of retained earnings
 - c. Statement of retained earnings > income statement > balance sheet and statement of cash flows
 - d. Income statement > statement of retained earnings > balance sheet and statement of cash flows

ANSWER: d

65. All of the following are different expressions for net income **except**:
- a. Profits
 - b. Excess of revenues over expenses
 - c. Capital
 - d. Earnings

ANSWER: c

Chapter 1: Accounting as a Form of Communication

66. Sawaddee Enterprises began the year with total assets of \$450,000 and total liabilities of \$230,000. If Sawaddee's total assets doubled to \$900,000 and its owners' equity remained the same during the year, what was the amount of its total liabilities at the end of the year?
- a. \$670,000
 - b. \$680,000
 - c. \$440,000
 - d. \$900,000

ANSWER: b

RATIONALE: $\$900,000 = L + \$220,000$

67. The statement of retained earnings accomplishes which of the following?
- a. It summarizes income earned and dividends paid over a single period of the business.
 - b. It accumulates all revenues for the year.
 - c. It summarizes the balance sheet accounts.
 - d. It summarizes the capital stock accounts over the life of the business.

ANSWER: a

68. Which concept is the reason the dollar is used in the preparation of financial statements?
- a. Going concern
 - b. Legal entity
 - c. Monetary unit
 - d. Time Period

ANSWER: c

69. Which one of the following is an assumption made in the preparation of financial statements?
- a. Financial statements are prepared for a specific entity that is distinct from the entity owners.
 - b. Financial statements are prepared assuming that inflation has a distinct effect on the monetary unit.
 - c. Preparation of financial statements for a specific time period assumes that the balance sheet covers a period of time.
 - d. Market values are always assumed to be irrelevant when preparing financial statements.

ANSWER: a

Chapter 1: Accounting as a Form of Communication

70. Why is the time period assumption required?

- a. Inflation exists
- b. External users of financial statements want statements that accurately reflect net income or earnings for a specific time period.
- c. The dollar is the monetary unit in the United States.
- d. The federal government requires it.

ANSWER: b

71. Which one of the following statements is true concerning assets?

- a. They are recorded at market value and then adjusted for inflation.
- b. They are recorded at market value for financial reporting purposes as historical cost may be arbitrary.
- c. Accountants use the term historical cost to refer to the original cost of an asset.
- d. Assets are measured using the time-period approach.

ANSWER: c

72. Macon Enterprises purchased land for \$2,000,000 in 2001. In 2015, an independent appraiser assessed the value at \$3,400,000. What amount should appear on the financial statements in 2015 with respect to the land? a. \$2,000,000

- b. \$1,400,000
- c. \$3,400,000
- d. Whatever amount the company believes is the best indicator of the true value of the land.

ANSWER: a

RATIONALE: The historical cost (purchase price of \$2,000,000) should appear on the balance sheet.

73. Which of the following is a five-member body that has the authority from Congress to set standards for conducting audits?

- a. FASB
- b. SEC
- c. PCAOB
- d. AICPA

ANSWER: c

74. Which the following organizations are primarily responsible for establishing GAAP today?

- a. Financial Accounting Standards Board (FASB)
- b. Securities and Exchange Commission (SEC)
- c. Internal Revenue Service (IRS)
- d. Federal Government

ANSWER: a

Chapter 1: Accounting as a Form of Communication

75. Which of the following organizations is responsible for setting auditing standards followed by public accounting firms in conducting independent audits of financial statements?
- a. Financial Accounting Standards Board (FASB)
 - b. Securities and Exchange Commission (SEC)
 - c. Public Company Accounting Oversight Board (PCAOB)
 - d. International Accounting Standards Board (IASB)

ANSWER: c

76. Which organization, in addition to the Financial Accounting Standards Board (FASB), occasionally issues authoritative rules for financial statements?
- a. The Accounting Profession
 - b. International Accounting Standards Board (IASB)
 - c. Securities and Exchange Commission (SEC)
 - d. Internal Revenue Service (IRS)

ANSWER: c

77. The Securities and Exchange Commission (SEC) is concerned with
- a. All companies in the United States regardless of size.
 - b. Companies that issue securities to the general public.
 - c. Accounting reports issued by government entities.
 - d. All domestic and international companies that issue accounting reports.

ANSWER: b

78. To which of the following entities must a company report if it sells its stock on the organized stock market?
- a. American Institute of Certified Public Accountants (AICPA)
 - b. American Accounting Association (AAA)
 - c. International Accounting Standards Board (IASB)
 - d. Securities and Exchange Commission (SEC)

ANSWER: d

79. The reliability of the information in a company's financial statements is the responsibility of which of the following?
- a. The Securities and Exchange Commission (SEC)
 - b. The Certified Public Accountant in charge of the audit of the company's financial statements
 - c. The company's management
 - d. The stockholders of the company

ANSWER: c

Chapter 1: Accounting as a Form of Communication

80. In order for accounting information to be useful in making informed decisions, it must be:
- relevant.
 - reliable.
 - both relevant and reliable.
 - neither relevant nor reliable.

ANSWER: c

81. The second step in the ethical decision-making model is to:
- list alternatives and evaluate the impact of each on those affected.
 - select the best alternative.
 - recognize an ethical dilemma.
 - analyze the key elements in the situation.

ANSWER: d

82. All of the following are important provisions of the Sarbanes-Oxley Act **except**:
- The establishment of a new Public Company Accounting Oversight Board.
 - The requirement to prepare both FASB and IASB financial statements.
 - A requirement that the external auditors report directly to the company's audit committee.
 - A clause to prohibit public accounting firms that audit a company from providing any other services that could impair their ability to act independently in the course of their audit.

ANSWER: b

83. When selecting between the best alternatives regarding an ethical dilemma in accounting all of the following should be considered **except**:
- which alternative provides the most relevant information.
 - which alternative provides the most accurate information.
 - which alternative provides the most neutral information.
 - which alternative provides the most profitable information.

ANSWER: d

84. *Under Armour* is an example of a service provider.
- True
 - False

ANSWER: False

Chapter 1: Accounting as a Form of Communication

85. A grocery store is an example of a wholesaler.

- a. True
- b. False

ANSWER: False

86. The Internal Revenue Service (IRS) recognizes the separate existence of a proprietorship from its owner.

- a. True
- b. False

ANSWER: False

87. A partnership is a business owned by two individuals; if three or more individuals organize a business, it must be established as a corporation.

- a. True
- b. False

ANSWER: False

88. Business entities and non-business entities are both organized to earn a profit.

- a. True
- b. False

ANSWER: False

89. Someone to whom a company has a debt is known as an investor.

- a. True
- b. False

ANSWER: False

90. All assets are tangible in nature.

- a. True
- b. False

ANSWER: False

91. A liability is a future economic benefit to a business.

- a. True
- b. False

ANSWER: False

92. An expense is an inflow of assets resulting from the sale of goods and services.

- a. True
- b. False

ANSWER: False

Chapter 1: Accounting as a Form of Communication

93. Capital stock indicates the owners' contributions to a partnership.

- a. True
- b. False

ANSWER: False

94. Financial accounting is the branch of accounting concerned with communication with internal management.

- a. True
- b. False

ANSWER: False

95. External users of accounting information include present and potential stockholders, bankers and other creditors, and management.

- a. True
- b. False

ANSWER: False

96. Bondholders are internal users of company's accounting information.

- a. True
- b. False

ANSWER: False

97. The income statement is sometimes called the statement of financial position.

- a. True
- b. False

ANSWER: False

98. The balance sheet is a statement that summarizes revenues and expenses for a period.

- a. True
- b. False

ANSWER: False

99. Assets may be used to satisfy business obligations and to carry on business operations.

- a. True
- b. False

ANSWER: True

Chapter 1: Accounting as a Form of Communication

100. The amount of earnings distributed to stockholders can be found in the income statement.

- a. True
- b. False

ANSWER: False

101. Profits from operating activities distributed to business owners are called dividends.

- a. True
- b. False

ANSWER: True

102. An entity's assets come from three primary sources: creditors, investors, and profits retained in the business.

- a. True
- b. False

ANSWER: True

103. The balance sheet is linked to the retained earnings statement by the ending retained earnings balance.

- a. True
- b. False

ANSWER: True

104. A balance sheet 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.

- a. True
- b. False

ANSWER: True

105. When an entity's revenues exceed its expenses for a period of time, the entity will report a net loss.

- a. True
- b. False

ANSWER: False

106. Owners' equity is the residual interest that remains after deducting liabilities from stockholders' equity.

- a. True
- b. False

ANSWER: False

107. If a company prepares a statement of retained earnings, net income plus dividends are added to beginning retained earnings on this statement.

- a. True
- b. False

ANSWER: False

Chapter 1: Accounting as a Form of Communication

108. Stockholders' equity is owners' equity in a corporation.

- a. True
- b. False

ANSWER: True

109. The time period assumption assumes a company prepares financial statements every month.

- a. True
- b. False

ANSWER: False

110. GAAP stands for Generally Accepted Auditing Procedures.

- a. True
- b. False

ANSWER: False

111. Because market values are subjective, many assets are carried on the balance sheet at their acquisition cost.

- a. True
- b. False

ANSWER: True

112. The term used to refer to an asset's original cost is "historical cost."

- a. True
- b. False

ANSWER: True

113. The going concern assumption infers that a company will continue to operate indefinitely.

- a. True
- b. False

ANSWER: True

114. A company in the process of liquidation meets the requirements under the going concern assumption.

- a. True
- b. False

ANSWER: False

115. The International Accounting Standards Board (IASB) was created in order to develop worldwide accounting standards that must be used for all financial statements prepared regardless of country.

- a. True
- b. False

ANSWER: False

Chapter 1: Accounting as a Form of Communication

116. The primary objective of external auditors is to provide assurance to stockholders and other users that the statements are fairly presented.
- a. True
 - b. False

ANSWER: True

117. The independent auditor's report conveys whether or not the business is a good investment.
- a. True
 - b. False

ANSWER: False

118. The IASB is a branch of the FASB.
- a. True
 - b. False

ANSWER: False

119. Information must be timely to be relevant.
- a. True
 - b. False

ANSWER: True

120. According to the accounting profession, the purpose of financial reporting is to provide information about a company that investors, lenders, and other creditors can use when deciding whether to provide resources to the entity.
- a. True
 - b. False

ANSWER: True

121. _____ consists of all activities necessary to provide the members of an economic system with goods and services.

ANSWER: Business

122. A _____ is a certificate that represents a corporation's promise to repay a certain amount of money and interest in the future.

ANSWER: bond

123. _____ is the type of accounting used by nonbusiness entities.

ANSWER: Fund accounting

124. Owners of corporations are called _____.

ANSWER: stockholders

Chapter 1: Accounting as a Form of Communication

125. The three types of business activities in which all corporations engage are _____, _____, and _____.

ANSWER: financing, investing, operating

126. The process of identifying, measuring, and communicating economic information to various users is called _____.

ANSWER: accounting

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

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

128. Another name for profits or earnings of a business is _____.

ANSWER: net income

129. The various methods, rules, practices, and other procedures that have evolved over time in response to the need to regulate the preparation of financial statements are called _____.

ANSWER: generally accepted accounting principles

130. The concept that assumes that assets are recorded at the amount to acquire them is called the _____.

ANSWER: cost principle (historical cost)

131. The concept that assumes that an entity is **not** in the process of liquidation is _____.

ANSWER: going concern

132. The federal government agency with the ultimate authority to determine the rules in preparing statements for companies whose stock is sold to the public is the _____.

ANSWER: Securities and Exchange Commission

133. The private sector group with authority to set accounting standards is the _____.

ANSWER: Financial Accounting Standards Board

134. _____ means the presentation of information is free from bias toward a particular result.

ANSWER: Neutrality

135. In 2002, Congress passed the _____ Act to bring reform to corporate accountability and stewardship in the wake of a number of major corporate scandals.

Chapter 1: Accounting as a Form of Communication

ANSWER: Sarbanes-Oxley

136. Good quality information should be both _____ and present a _____.

ANSWER: relevant faithful representation

137. Choose the user group that is most likely to have the need listed below. (Select all that apply.)

The ability of the company to pay its debts as they become due.

- a. Stockholder
- b. Company management
- c. Supplier
- d. Banker
- e. Internal Revenue Service
- f. Securities and Exchange Commission
- g. Labor union

ANSWER: c, d

Chapter 1: Accounting as a Form of Communication

138. Meredith Corporation is in the business of providing dog and cat grooming services to customers within the city of New York. The following information concerning financial activities during 2014 is available at December 31, 2014:

Grooming revenue	\$130,000	Salary and wage expense	\$44,000
Dividends declared and paid	13,000	Rent expense	24,000
Equipment	40,000	Furniture	60,000
Accounts payable	30,000	Accounts receivable	23,000
Capital stock	22,000	Retained earnings, Jan. 1, 2014	21,000
Utilities expense	10,000	Notes payable	88,000
Cash	33,000	Income tax expense	7,000

- A. Calculate net income for 2014
- B. Prepare a statement of retained earnings for the year ended December 31, 2014.
- C. What information can you derive from the statement of retained earning concerning this company? Explain.

ANSWER:

A. $\$130,000 - \$10,000 - \$44,000 - \$24,000 - \$7,000 = \$45,000$

B.

Meredith Corporation
Statement of Retained Earnings
For the Year Ended December 31, 2014

Beginning balance	\$21,000
Add: Net income for the year	45,000
Less: Dividends for the year	<u>(13,000)</u>
Ending balance	<u>\$53,000</u>

- C. The statement of retained earnings provides information on the changes in retained earnings during 2014. Net income causes retained earnings to increase, and dividends cause it to decrease. Since net income exceeded dividends paid, the ending balance is larger than the beginning balance.

Chapter 1: Accounting as a Form of Communication

139. South Corporation has been in the business of delivering small packages for local companies within the city of Atlanta, Georgia, since 1960. The following information concerning financial activities during 2015 is available at December 31, 2015:

Delivery revenue	\$280,000	Salary and wage expense	\$82,000
Dividends declared and paid	85,000	Rent expense	43,000
Buildings	140,000	Land	60,000
Accounts payable	30,000	Accounts payable	30,000
Capital stock	105,000	Retained earnings, January 1, 2015	42,000
Water, gas, and electricity	28,000	Notes payable	34,000
Cash	56,000	Income tax expense	18,000

- Prepare an income statement for the year ended December 31, 2015.
- If you were a bank loan officer and South Corporation wanted to borrow \$100,000 from your bank, would you lend the money? Explain.
- Calculate retained earnings at December 31, 2015.

ANSWER: A.

South Corporation		
Income Statement		
Year Ended December 31, 2015		
Revenues:		
Delivery revenue		\$280,000
Expenses:		
Salary and wage expense	\$82,000	
Rent expense	43,000	
Water, gas, and electricity	28,000	
Income tax expense	<u>18,000</u>	<u>171,000</u>
Net income		<u><u>\$109,000</u></u>

- The company appears profitable. Basing the decision solely on profitability, it appears the company can generate operating income to enable it to repay the loan. But the company also had accounts payable and notes payable of \$30,000 and \$34,000, respectively, for which cash may not be available to pay when these amounts become due.
- $\$42,000 + \$109,000 - \$85,000 = \$66,000$

Chapter 1: Accounting as a Form of Communication

140. Here is a list of accounts and their balances that appear on the Thomas Company's income statement and balance sheet.

Accounts payable	\$ 800
Accounts receivable	500
Building	2,000
Cash	3,300
Gas, utilities, and other expenses	300
Land	4,000
Lawn-care revenue	1,500
Notes payable	6,000
Salaries and wages expense	900
Tools	800
Tree-trimming revenue	500
Truck	2,000

REQUIRED:

Identify which of these are:

- (a) Assets
- (b) Liabilities
- (c) Expenses
- (d) Revenues

ANSWER: (a) Assets: Accounts receivable, Building, Cash, Land, Tools, Truck
(b) Liabilities: Accounts payable, Notes payable
(c) Expenses: Gas, utilities, and other expenses, Salaries and wages expense
(d) Revenues: Lawn-care revenue, Tree-trimming revenue

Chapter 1: Accounting as a Form of Communication

Taryn Corporation

The accountant for Taryn Corporation prepared the following list of account balances from the company's records for the year ended December 31, 2014:

Sales revenue	\$165,000	Cash	\$30,000
Accounts receivable	14,000	Selling expenses	44,000
Equipment	42,000	Common stock	41,000
Accounts payable	12,000	Interest income	3,000
Salaries and wages expense	40,000	Cost of sales	51,000
Inventories	22,000	Prepaid expenses	2,000
Income taxes payable	5,000	Income taxes expense	18,000
Notes payable	20,000	Retained earnings	?

141. Read the information for Taryn Corporation. Determine the following amounts for Taryn Corp.

- A) Total assets at the end of 2014 _____
- B) Total liabilities at the end of 2014 _____
- C) What parties have a claim on Taryn Corporation's assets? Explain your answer in the terms of the accounting equation.

- ANSWER:* A) \$110,000
(\$30,000 Cash + \$14,000 Accounts Receivable + \$42,000 Equipment + \$22,000 Inventories + 2,000 Prepaid Expenses = \$110,000)
- B) \$37,000
(\$12,000 Accounts Payable + \$5,000 Income Taxes Payable + \$20,000 Notes Payable = \$37,000)
- 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 owners' (or stockholders') equity.

Chapter 1: Accounting as a Form of Communication

142. Read the information for Taryn Corporation. Determine the following amounts for Taryn Corporation.

- A) The balance of retained earnings at the end of 2014. _____
- B) The total stockholders' equity at the end of 2014. _____
- C) Name the two events that might cause stockholders' equity to increase.

ANSWER: A) \$32,000
(\$110,000 Total Assets - \$37,000 Total Liabilities - \$41,000 Common Stock = \$32,000)

B) \$73,000
(\$110,000 Total Assets - \$37,000 Total Liabilities = \$73,000; OR \$41,000 Common Stock + \$32,000 Retained Earnings = \$73,000)

C) Stockholders equity can increase when common (or capital) stock is issued to investors. It also can increase through increases to retained earnings when the net income of the business is greater than any dividends paid to the shareholders.

Chapter 1: Accounting as a Form of Communication

143. Read the information for Taryn Corporation. Prepare an income statement for Taryn Corporation in good form.

ANSWER:

Taryn Corporation			
Income Statement			
For the Year Ended December 31, 2014			
Revenues:			
	Sales revenue	\$165,000	
	Interest income	<u>3,000</u>	\$168,000
Expenses:			
	Cost of sales	\$51,000	
	Salaries and wages expense	40,000	
	Selling expenses	44,000	
	Income taxes expense	<u>18,000</u>	<u>153,000</u>
Net income			<u>\$ 15,000</u>

144. Read the information for Taryn Corporation. Prepare a balance sheet for Taryn Corporation in good form.

ANSWER:

Taryn Corporation			
Balance Sheet			
December 31, 2014			
<u>Assets</u>		<u>Liabilities & Owners' Equity</u>	
Cash	\$ 30,000	Accounts payable	\$ 12,000
Accounts receivable	14,000	Income taxes payable	5,000
Inventories	22,000	Notes payable	20,000
Prepaid expenses	2,000	Common stock	41,000
Equipment	<u>42,000</u>	Retained Earnings	<u>32,000</u>
Total assets	<u>\$110,000</u>	Total liabilities and owners' equity	<u>\$110,000</u>

Chapter 1: Accounting as a Form of Communication

145. Read the information for Taryn Corporation. Determine the following amounts for Taryn Corporation:

- A) Total revenues for 2014. _____
- B) Total expenses for 2014. _____
- C) What is the purpose of the income statement?
- D) Is Taryn Corp. profitable? Explain your answer.
- E) Is this the first year of operations for Taryn Corp.? Explain your answer.

- ANSWER:*
- A) \$168,000
(\$165,000 Sales Revenue + \$3,000 Interest Income = \$168,000)
 - B) \$153,000
(\$51,000 Cost of Sales + \$40,000 Salaries & Wages Expense + \$44,000 Selling Expenses + \$18,000 Income Taxes Expense = \$153,000)
 - 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) Taryn Corporation had net income for the period of \$15,000. Since revenues exceeded expenses for the period, the company would be considered profitable.
 - E) This would not be the first year of operations for Taryn Corporation. The reasons for this are that the ending Retained Earnings balance is greater than the net income of \$15,000. Since the ending balance of Retained Earnings is \$32,000, and Net Income for the period was \$15,000 as well as apparently no dividends declared and paid to the stockholders during the year, Taryn Corporation began the year with a balance of \$17,000 (\$32,000 - \$15,000) in Retained Earnings.

Chapter 1: Accounting as a Form of Communication

Canyon Corporation

The accountant for the Canyon Corporation prepared the following list from the company's accounting records for the year ended December 31, 2014:

Retained earnings	?	Prepaid expenses	\$3,000
Cash	\$7,000	Common stock	40,000
Accounts payable	15,000	Accounts receivable	17,000
Sales revenue	125,000	Interest income	500
Cost of sales	70,000	Salary expense	4,000
Land	75,000	Income tax expense	200
Notes payable	15,000	Selling expense	45,000
Inventory	20,000	Salaries payable	5,000

146. Read the information for Canyon Corporation. Determine the following amounts for Canyon Corporation.

- A) Total assets at the end of 2014. _____
- B) Total liabilities at the end of 2014. _____
- C) Total equity at the end of 2014. _____

ANSWER: A) \$122,000
(\$3,000 Prepaid Expenses + \$7,000 Cash + \$17,000 Accounts Receivable + \$75,000 Land + \$20,000 Inventory = \$122,000)

B) \$35,000
(\$15,000 Accounts Payable + \$15,000 Notes Payable + \$5,000 Salaries Payable = \$35,000)

C) \$87,000
(\$122,000 Total Assets - \$35,000 Total Liabilities = \$87,000)

147. Read the information for Canyon Corporation. Determine the following amounts for Canyon Corporation:

- A) Total revenues for 2014. _____
- B) Total expenses for 2014. _____
- C) Net income for 2014. _____

ANSWER: A) \$125,500
(\$125,000 Sales Revenue + \$500 Interest Income = \$125,500)

B) \$119,200
(\$70,000 Cost of Sales + \$4,000 Salary Expense + \$200 Income Tax Expense + \$45,000 Selling Expense = \$119,200)

C) \$6,300
(\$125,500 Total Revenue - \$119,200 Total Expenses = \$6,300)

Chapter 1: Accounting as a Form of Communication

148. Read the information for Canyon Corporation. Determine the following amounts for Canyon Corporation:

- A) Stockholders' equity at the end of 2014. _____
- B) Retained earnings at the end of 2014. _____
- C) Name two events that might cause stockholders' equity to decrease.

ANSWER: A) \$87,000
(\$122,000 Total Assets - \$35,000 Total Liabilities = \$87,000)
B) \$47,000
(\$87,000 Total Stockholders' Equity \$40,000 Common Stock = \$47,000)
C) Stockholders' equity is decreased when dividends are declared and paid. Expenses or net losses also reduce stockholders' equity.

149. Read the information for Canyon Corporation. Using good form, prepare an income statement for Canyon Corporation.

ANSWER:

Canyon Corporation		
Income Statement		
For the Year Ended December 31, 2014		
Revenues:		
Sales Revenue	\$125,000	
Interest Income	<u>500</u>	\$125,500
Expenses:		
Cost of Sales	\$ 70,000	
Selling Expense	45,000	
Salary Expense	4,000	
Income tax Expense	<u>200</u>	<u>119,200</u>
Net Income		<u>\$6,300</u>

150. Read the information for Canyon Corporation. Using good form, prepare a Balance Sheet for the Canyon Corporation.

ANSWER:

Canyon Corporation			
Balance Sheet			
December 31, 2014			
<u>Assets</u>		<u>Liabilities and Owners' Equity</u>	
Cash	\$7,000	Accounts payable	\$15,000
Accounts receivable	17,000	Salaries payable	5,000
Inventory	20,000	Notes payable	15,000
Prepaid expenses	3,000	Common stock	40,000
Land	<u>75,000</u>	Retained earnings	<u>47,000</u>
Total assets	<u>\$122,000</u>	Total liabilities and owners' equity	<u>\$122,000</u>

Chapter 1: Accounting as a Form of Communication

151. Assume that you have received copies of the financial statements for PepsiCo for the years ending December 31, 2014 and 2013. Answer the following questions:

- A) If you were a banker, why would you need information from PepsiCo's financial statements?
- B) If you were a potential investor in PepsiCo stock, what information would you want from their financial statements?
- C) If you were a labor negotiator for a union that represents a group of PepsiCo's employees, which financial statement would provide you with the most useful information?

ANSWER:

- 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.
- B) Investors want to know whether they should make an investment in the company's stock, 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 declared and paid in dividends.
- C) A labor negotiator needs to know how much profit the company has made. This information is found on the Income Statement.

152. Target, Inc., started the year with total assets of \$400,000 and total liabilities of \$240,000. Net income for the year is \$120,000 and dividends declared and paid during the year are \$90,000.

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

- ANSWER:*
- A) \$190,000
(\$400,000 Total Assets at the beginning of the year - \$240,000 Total Liabilities at the beginning of the year = \$160,000 Total Equity at the beginning of the year)
(\$160,000 Total Equity at the beginning of the year + \$120,000 Net Income for the year - \$90,000 Dividends declared and paid during the year = \$190,000)
 - B) Yes. Assuming the company has enough cash to do so, dividends can be paid. Net income exceeded the amount of dividends paid by \$30,000 (\$120,000 - \$90,000), so the amount paid could have been increased. Also the company has total positive retained earnings.

Chapter 1: Accounting as a Form of Communication

153. Ramos Corp. started business at the beginning of the year, with assets of \$600,000 and stockholders' equity of \$240,000. By the end of the year, assets increased by \$80,000 and liabilities increased by \$60,000. Other than net income or loss, the only change in stockholders' equity was dividends declared and paid of \$55,000.

- A) What was the amount of Ramos Corp. stockholders' equity at the end of the year?
 B) What was the amount of Ramos Corp. net income or net loss for the year?

ANSWER: A)

	Assets	Liabilities	Stockholders' Equity
Beginning of year	\$600,000	\$360,000	\$240,000
Change during year	<u>+80,000</u>	<u>+60,000</u>	<u>+20,000</u>
End of year	\$680,000 =	\$420,000	\$260,000

B)

Change in equity	\$20,000
Add: Dividends	<u>55,000</u>
Net Income	<u>\$75,000</u>

154. Presented below are selected data from the balance sheet of Farmer Company for 2014. The figures are expressed in millions.

Total Current assets	\$5,572
Property, plant, and equipment	16,325
Other assets	?
Total Current liabilities	3,274
Total Long-term debt	5,632
Total Stockholders' equity	19,639

- A) Determine the amount of "Other assets" for Farmer's 2014 balance sheet. (HINT: you must use the accounting equation concept to determine your answer.)
 B) How much of Farmer Company is financed by creditors? How much is financed by the owners?

ANSWER:

- A) \$6,648
 (\$3,274 Current liabilities + \$5,632 Longterm debt + \$19,639 Stockholders' equity = \$28,545 Total Assets)
 (\$28,545 Total Assets - \$5,572 Current assets - 16,325 Property, plant & equipment = \$6,648)
 B) Amount of financing by creditors: \$8,906 or 31.2%
 (\$3,274 Current liabilities + \$5,632 Long-term debt = \$8,906) Amount of financing by owners: \$19,639 or 68.8%
 (\$19,639 Stockholders' equity)

Chapter 1: Accounting as a Form of Communication

155. Presented below are selected data from the accounting records for Micco's Gift Store for 2014.

Net sales	\$190,000
Income taxes	30,000
Cost of sales	80,000
Operating expenses	45,000
Dividends	12,000

- A) Calculate the net income or loss for 2014.
- B) Explain how the amount from part "A" will affect the financial position of Micco's Gift Store.
- C) Is the company profitable? Explain your answer.

ANSWER: A) \$35,000
(\$190,000 Net sales - \$30,000 Income taxes - \$80,000 Cost of sales - \$45,000 Operating expenses = \$35,000)

B) Net income will improve the company's financial position.

C) Yes. The amount of revenues exceeds the amount of expenses by \$35,000.

D)

156. The following information comes from the records of Morton Corporation. Assume no additional investment by owners when answering the following questions:

	<u>Assets</u>	<u>Liabilities</u>	<u>Owners' Equity</u>
January 1, 2014	\$98,000	\$54,000	\$
December 31, 2014	131,000		84,000

- A) What is the amount of owners' equity at January 1, 2014? _____
- B) What is the amount of liabilities at December 31, 2014? _____
- C) Assume that the company declared and paid dividends of \$22,000 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?

ANSWER: A) \$44,000
(\$98,000 Assets - \$54,000 Liabilities = \$44,000)

B) \$47,000
(\$131,000 Assets - \$84,000 Owners' Equity = \$47,000)

C) \$62,000
(\$44,000 Beginning Owners' Equity + X - \$22,000 Dividend = \$84,000 Ending Owners' Equity)
(X = \$106,000 - 44,000 = \$62,000)

D) Assuming that the increase in owners' 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 owners' equity

Chapter 1: Accounting as a Form of Communication

157. Carroll Corporation began the year with total assets of \$800,000 and total liabilities of \$620,000. Use the accounting equation to answer the following questions. Assume no additional investment by owners when answering these questions.

- A) What was the amount of Carroll's total assets at the end of the year if liabilities decreased by \$60,000 and owners' equity increased by \$90,000?
- B) Was the company profitable? Explain your answer.

ANSWER: A) \$830,000

	<u>Assets</u>	<u>Liabilities</u>	<u>Owners' Equity</u>
Beginning of the year	\$800,000	\$620,000	\$180,000
Change during the year	<u>30,000</u>	<u>(60,000)</u>	<u>90,000</u>
End of the year	\$830,000	\$560,000	\$270,000

- B) The company was profitable because the owners' equity increased from the beginning of the year to the end of the year.

158. The beginning balance of retained earnings was \$630,000, and the ending balance was \$650,000. The company declared and paid dividends of \$60,000.

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

ANSWER: A) \$80,000
(\$650,000 Ending Retained Earnings - \$630,000 Beginning Retained Earnings = \$20,000)
(\$20,000 + \$60,000 Dividends = \$80,000)

- 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.

Chapter 1: Accounting as a Form of Communication

159. The Space Corporation began 2015 with \$390,000 in assets, \$140,000 in liabilities, and \$170,000 of retained earnings the year was \$120,000, and dividends of \$110,000 were declared and paid.

- A) Prepare a statement of retained earnings for 2015.
- B) What is the nature or purpose of the statement of retained earnings?
- C) What was the amount of capital stock for Space Corporation at the beginning of 2015?
- D) Identify what business events might occur in Space Corp.'s business operations that would cause the two stock equity items to increase.
- E) How do you identify whether Space was profitable during 2015 by examining the statement of retained earnings?

ANSWER: A)

Space Corporation	
Statement of Retained Earnings	
For the Year Ended December 31, 2015	
Beginning balance	\$170,000
Add: Net income for the year	120,000
Deduct: Dividends for the year	<u>(110,000)</u>
Ending balance	<u>\$180,000</u>

- B) The statement of retained earnings explains the change in retained earnings during a period.
- C) \$80,000 (\$390,000 Total Assets - \$140,000 Total Liabilities - \$170,000 Beginning Retained Earnings = \$80,000)
- D) One way that the company can increase stockholders' equity is to sell additional shares of stock. Retained earnings will increase 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.

Chapter 1: Accounting as a Form of Communication

160. Below are several accounts from Costello Company's accounting records. Answer the questions that follow.

Total liabilities, end of the year	\$92,000	Total assets, end of the year	\$143,000
Capital stock, end of the year	16,000	Retained earnings, beginning of the year	15,000
Dividends declared and paid for the period	20,000	Net income	40,000

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

ANSWER: A) \$35,000
(\$15,000 Retained earnings, beginning of the year + \$40,000 Net income - \$20,000 Dividends for the period = \$35,000) OR
(\$143,000 Total assets, end of the year - \$92,000 Total liabilities, end of the year - \$16,000 Capital stock, end of the year = \$35,000)

B) \$143,000 Total assets, end of the year = \$92,000 Total liabilities, end of the year + \$51,000 Owners' Equity, end of the year (\$16,000 Capital stock, end of the year + \$35,000 Retained earnings, end of the year)

C) This would depend upon what causes the stockholders' 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 capital stock issued, this would not be a measure of profitability.

Chapter 1: Accounting as a Form of Communication

161. Classify the following items according to the financial statement on which each belongs, either the income statement (IS) or the balance sheet (BS). Also indicate whether each is a revenue (R), expense (E), asset (A), liability (L), or owners' equity (OE) item.

	Appears on Which Statement?	Type of Account
1. Retained earnings	_____	_____
2. Buildings	_____	_____
3. Common stock	_____	_____
4. Accounts payable	_____	_____
5. Football ticket sales	_____	_____
6. Salaries expense	_____	_____
7. Accounts receivable	_____	_____

ANSWER:

1.	BS	OE
2.	BS	A
3.	BS	OE
4.	BS	L
5.	IS	R
6.	IS	E
7.	BS	A

Chapter 1: Accounting as a Form of Communication

162. Several amounts from Duggard Company at December 31, 2014 are listed below. Answer the questions.

Service revenue	\$245,000	Salaries expense	\$109,000
Dividends declared and paid	15,000	Rent expense	36,000
Buildings	110,000	Land	100,000
Accounts payable	40,000	Accounts receivable	28,000
Capital stock	60,000	Retained earnings, Jan. 1, 2014	40,000
Utilities expense	19,000	Notes payable	30,000
Income tax payable	4,000	Income tax expense	11,000

A) Calculate net income for 2014.

B) How much is Duggard Company's retained earnings at the end of 2014?

C) What primary asset account is missing?

- ANSWER:* A) \$70,000
(\$245,000 Service Revenue - \$109,000 Salaries Expense - \$36,000 Rent Expense - \$19,000 Utilities Expense - \$11,000 Income Tax Expense = \$70,000)
- B) \$95,000
(\$40,000 Retained Earnings, Jan 1, 2014 + \$70,000 Net Income - \$15,000 Dividends Paid = \$95,000)
- C) The Cash account is missing.

163. Gym Corporation reported the following information at December 31, 2014:

Accounts payable	\$40,000	Dividends declared and paid	\$10,000
Cash	75,000	Expenses	60,000
Inventories	18,000	Revenue	75,000

A) Calculate Gym Corporation's total assets.

B) Calculate Gym Corporation's net income for 2014.

C) Calculate Gym Corporation's total stockholders' equity at the end of 2014.

- ANSWER:* A) \$93,000
(\$75,000 Cash + \$18,000 Inventories = \$93,000)
- B) \$15,000
(\$75,000 Revenue - \$60,000 Expenses = \$15,000)
- C) \$53,000
(\$93,000 Total Assets - \$40,000 Accounts Payable = \$53,000)

Chapter 1: Accounting as a Form of Communication

164. Joseph is the president of Sunshine Enterprises. Sunshine Enterprises began business on January 1, 2014. The company's controller is out of the country on business. Joseph needs a copy of the company's balance sheet for a meeting tomorrow and asks his assistant to obtain the required information from the company's records. She presents Joseph with the following balance sheet. He asks you to review it for accuracy.

Sunshine Enterprises Balance Sheet For Year Ended December 31, 2014			
ASSETS		LIABILITIES & STOCKHOLDERS'	
Accounts payable		Accounts receivable	\$24,200
Building and equipment	177,30	Supplies	12,200
Cash	14,70	Capital stock	100,000
Cash dividends declared and	16,00	Net income for 2014	113,800

Required

1. Prepare a corrected balance sheet.
2. Draft a memo explaining the major differences between the balance sheet Joseph's assistant prepared and the one you prepared.

ANSWER: 1.

Sunshine Enterprises Balance Sheet December 31, 2014			
ASSETS		LIABILITIES & STOCKHOLDERS'	
Cash	\$ 14,700	Accounts payable	\$
Accounts receivable	24,200	Capital stock	100,00
Supplies	12,200	Retained earnings	97,800
Building and	177,300		
Total assets	<u>\$228,400</u>	Total liabilities and stockholders' equity	<u>\$228,400</u>

* \$113,800 - \$16,000

Chapter 1: Accounting as a Form of Communication

2. Memorandum to the company president:

TO: Company president

FROM: Your name

DATE: January 1, 2015

SUBJECT: Corrected balance sheet

Attached please find the original balance sheet your assistant prepared, along with a corrected version of that same statement. The differences can be explained as follows:

1. The balance sheet is always as of a certain date, in this case, December 31, 2014, rather than a period of time, such as a year.
2. Accounts payable should be classified as a liability.
3. Cash dividends declared and paid do not belong on the balance sheet; this amount should appear instead on the statement of retained earnings for the year.
4. Accounts receivable should be classified as an asset.
5. Net income for 2014 does not belong on the balance sheet; this amount should appear instead on the statement of retained earnings for the year.
6. Supplies should be classified as an asset.
7. Retained earnings should appear with capital stock as a component of stockholders' equity on the balance sheet. Since this is the first year of operations, the retained earnings balance comprises the net income for the year less the cash dividends declared and paid.
8. Totals were added as necessary to provide summary information.

Chapter 1: Accounting as a Form of Communication

165. The following items are available from the records of Ramos Corporation at the end of its fiscal year, June 30, 2014:

Accounts payable	\$17,000
Advertising expense	4,600
Accounts receivable	5,700
Notes payable	50,000
Buildings	35,000
Office equipment	12,000
Inventory	12,100
Retained earnings (end of year)	26,300
Capital stock	25,000
Salary and wage expense	8,230
Cash	21,900
Sales revenue	14,220
Computerized grinders	25,800
Hand Tools	5,800

Required

- (1) Prepare a balance sheet.
- (2) For each non-balance-sheet item, indicate where it should appear.

ANSWER: (1)

RAMOS CORPORATION BALANCE SHEET JUNE 30, 2014

Assets		Liabilities and Stockholders' Equity	
Cash	\$21,900	Accounts payable	\$17,000
Accounts receivable	5,700	Notes payable	50,000
Inventory	12,100	Capital stock	25,000
Computerized grinders	25,800	Retained earnings	26,300
Office equipment	12,000		
Buildings	35,000		
Hand tools	<u>5,800</u>		
Total assets	<u>\$118,300</u>	Total liabilities and stockholders' equity	<u>\$118,300</u>

(2) Items not shown on a balance sheet and where they would appear:

Advertising expense—income statement
Salary and wage expense—income statement
Sales revenue—income statement

Chapter 1: Accounting as a Form of Communication

166. **Tentco** reported the following amounts in various statements included in its 2014 annual report. (All amounts are stated in millions of dollars.)

Net income for 2014	\$142
Cash dividends declared in 2014	15
Retained earnings, December 31, 2013	\$ 95

REQUIRED:

- (1) Prepare a Statement of retained earnings for the year ended December 31, 2014.
- (2) Assume that Tentco presents a statement of stockholders' equity rather than a statement of retained earnings in its annual report. Explain how the information differs between the two statements.

ANSWER: (1)

Tentco
Statement of Retained Earnings
For the Year Ended December 31, 2014
(amounts in millions)

Retained earnings, beginning of year	\$95
Add: Net income for the year	142
Deduct: Dividends for the year	<u>(15)</u>
Retained earnings, end of year	<u>\$222</u>

- (2)** The statement of stockholders' equity would include all changes in stockholders' equity such as issuances and retirements of stock in addition to the information normally provided in a retained earnings statement.

Chapter 1: Accounting as a Form of Communication

167. The following information is available from the records of Focus Seascapes, Inc. at the end of the 2014 calendar year:

Accounts payable	\$4,700
Service revenues	28,000
Accounts receivable	3,600
Office equipment	9,200
Capital stock	?
Rent expense	2,500
Cash	13,200
Retained earnings, beginning of year	10,500
Dividends declared and paid during the year	3,800
Salary and wage expense	14,000

Required:

(1) What is Focus' net income for the year ended December 31, 2014?

(2) What is Focus' retained earnings balance for the year ended December 31, 2014?

ANSWER:

1. Revenue – Expenses = Net Income

$\$28,000 - (\$2,500 + \$14,000) = \$11,500$

2. Retained Earnings + Net Income - Dividends = Retained Earnings

(Beginning) (Ending)

$\$10,500 + \$11,500 - \$3,800 = \$18,200$

Chapter 1: Accounting as a Form of Communication

168. The following information is available from the records of Focus Seascapes, Inc. at the end of the 2014 calendar year:

Accounts payable	\$4,700
Service revenues	28,000
Accounts receivable	3,600
Office equipment	9,200
Capital stock	?
Rent expense	2,500
Cash	13,200
Retained earnings, beginning of year	10,500
Dividends declared and paid during the year	3,800
Salary and wage expense	14,000

Required:

1. What is the total amount of Focus' assets at December 31, 2014?
2. What is the total amount of Owners' Equity at December 31, 2014?
3. What is the capital stock balance at December 31, 2014?

ANSWER:

1. Total Assets:

Cash	\$13,200
Accounts receivable	3,600
Office equipment	<u>9,200</u>
Total assets	<u>\$26,000</u>

2. $\$26,000 - \$4,700 = \$21,300$

3. $\$21,300 - \$18,200 = \$3,100$

169. Rogers Corporation starts the year with a Retained Earnings balance of \$55,000. Net income for the year is \$27,000. The ending balance in Retained Earnings is \$70,000. What was the amount of dividends declared and paid for the year?

ANSWER: If Rogers has \$55,000 in Retained Earnings to begin the year and net income for the year of \$27,000, the ending balance in Retained Earnings would be \$82,000 if no dividends were declared and paid during the year. Because the ending balance in Retained Earnings is \$70,000, the company must have declared and paid \$12,000 in dividends.

170. List the names of three companies with which you are familiar that are manufacturers or producers. Also list the names of three companies that are retailers. Finally, provide the names of three service providers.

ANSWER: Answers will vary. Students will provide a number of different examples of real companies that are manufacturers, retailers, and service providers.

Chapter 1: Accounting as a Form of Communication

171. Presented below are condensed data from the financial statements of Unique Factory for 2015 and 2014. The figures are expressed in thousands. Use this information to answer the questions that follow.

Statement A	<u>2015</u>	<u>2014</u>
Total current assets	\$82,309	\$80,080
Property, plant & equipment (net of accumulated depreciation)	63,451	62,724
Investments	303	1,061
Other assets	<u>3,438</u>	<u>2,606</u>
Total assets	<u>\$149,501</u>	<u>\$146,471</u>
Total current liabilities	\$33,928	\$28,668
Long-term debt	20,491	25,676
Deferred income taxes and contingencies	<u>4,174</u>	<u>5,208</u>
Total liabilities	\$58,593	\$59,552
Total stockholders' equity	<u>90,908</u>	<u>86,919</u>
Total liabilities & stockholders' equity	<u>\$149,501</u>	<u>\$146,471</u>

Statement B	<u>2015</u>	<u>2014</u>
Net sales	\$209,203	\$174,206
Cost of sales	<u>136,225</u>	<u>114,284</u>
Gross profit	72,978	59,922
Selling, general and administrative expenses	63,895	53,520
Other income (expense)	<u>693</u>	<u>(118)</u>
Income (loss) before income taxes	9,776	6,284
Income tax expense	<u>3,534</u>	<u>2,388</u>
Net income (loss)	<u>\$6,242</u>	<u>\$3,896</u>

Required: Based on the information provided, is Unique Factory considered a business or non-business entity? How do you know by examining the financial statements?

ANSWER: Unique Factory is a business entity, because its purpose is to make a profit, not simply provide a service. Non-business entities have no owners, and Unique Factory has owners, as evidenced by examining the stockholders' equity section of the balance sheet.

Chapter 1: Accounting as a Form of Communication

172. In 2014, you invested \$12,000 along with 5 other investors in a new theatre, Rock-On, that offers Broadway play productions. Because you live out of state, you have **not** been actively involved in the daily affairs of the theatre. On January 10, 2015, you are excited because you received \$12,000 as a dividend after the end of the 1st year of the theatre's existence. Included with your \$12,000 check are financial statements and some supplemental information regarding the accounting. The supplemental information explains:

(1) During the last three months of 2014, an aggressive advertising campaign resulted in the sale of 600 season tickets for the 2015 productions. Each season ticket cost \$120 and the resulting \$72,000 was included in 2014 income.

(2) Along with the advertising campaign, the general manager was able to secure pledges of \$7,500 for advertising by local merchants in the playbills for the first two productions for 2015. This amount is included as advertising revenue in the 2014 financial statements.

REQUIRED:

Are there any problems related to the supplementary disclosures? If so, explain and indicate what effects (over- or understatements) these items will have on the financial statements.

ANSWER: The recognition of the 2015 season ticket sales as revenue in 2014 should not be recognized as revenue in the current year, because Rock-On has not provided these ticketholders with any service yet.

The recognition of \$7,500 in advertising revenue is currently just a pledge for 2015 playbills. It is not clear whether a contract has been signed with the advertisers and it sounds as if no money has changed hands. In any event, this revenue will need to be matched with the period in which the playbills are used (or 2015) rather than the current year of 2014.

As a result, the 2014 net income will be overstated by \$79,500 and the 2015 net income will be understated by \$79,500.

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

ANSWER: The groups and their decisions are:

Stockholders:	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?)

174. What is the purpose of an income statement?

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

Chapter 1: Accounting as a Form of Communication

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

ANSWER: 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 ending balance in the statement of retained earnings goes to the balance sheet. Finally, the net increase in cash at the bottom of the statement of cash flows equals the amount shown in cash on the balance sheet.

Chapter 1: Accounting as a Form of Communication

176. Presented below are condensed data from the financial statements of Faux Factory for 2015 and 2014. The figures are expressed in thousands. Use this information to answer the questions that follow.

Statement A	<u>2015</u>	<u>2014</u>
Total current assets		
Property, plant & equipment (net of accumulated depreciation)	\$82,309	\$80,080
	63,451	62,724
Investments	303	1,061
Other assets	<u>3,438</u>	<u>2,606</u>
Total assets	<u>\$149,501</u>	<u>\$146,471</u>
Total current liabilities	\$33,928	\$28,668
Long-term debt	20,491	25,676
Deferred income taxes and contingencies	<u>4,174</u>	<u>5,208</u>
Total liabilities	\$58,593	\$59,552
Total stockholders' equity	<u>90,908</u>	<u>86,919</u>
Total liabilities & stockholders' equity	<u>\$149,501</u>	<u>\$146,471</u>

Statement B	<u>2015</u>	<u>2014</u>
Net sales	\$209,203	\$174,206
Cost of sales	<u>136,225</u>	<u>114,284</u>
Gross profit	72,978	59,922
Selling, general and administrative expenses	63,895	53,520
Other income (expense)	<u>693</u>	<u>(118)</u>
Income (loss) before income taxes	9,776	6,284
Income tax expense	<u>3,534</u>	<u>2,388</u>
Net income (loss)	<u>\$6,242</u>	<u>\$3,896</u>

REQUIRED:

- What is the name of Statement A? _____
- What is the name of Statement B? _____

ANSWER: 1. Statement A is the Balance Sheet
2. Statement B is the Income Statement

Chapter 1: Accounting as a Form of Communication

177. Presented below are condensed data from the financial statements of Toro Factory for 2015 and 2014. The figures are expressed in thousands. Use this information to answer the questions that follow.

Statement A	<u>2015</u>	<u>2014</u>
Total current assets	\$82,309	\$80,080
Property, plant & equipment (net of accumulated depreciation)	63,451	62,724
Investments	303	1,061
Other assets	<u>3,438</u>	<u>2,606</u>
Total assets	<u>\$149,501</u>	<u>\$146,471</u>
Total current liabilities	\$ 33,928	\$ 28,668
Long-term debt	20,491	25,676
Deferred income taxes and contingencies	<u>4,174</u>	<u>5,208</u>
Total liabilities	\$ 58,593	\$ 59,552
Total stockholders' equity	<u>90,908</u>	<u>86,919</u>
Total liabilities & stockholders' equity	<u>\$149,501</u>	<u>\$146,471</u>

Statement B	<u>2015</u>	<u>2014</u>
Net sales	\$209,203	\$174,206
Cost of sales	<u>136,225</u>	<u>114,284</u>
Gross profit	72,978	59,922
Selling, general and administrative expenses	63,895	53,520
Other income (expense)	<u>693</u>	<u>(118)</u>
Income (loss) before income taxes	9,776	6,284
Income tax expense	<u>3,534</u>	<u>2,388</u>
Net income (loss)	<u>\$6,242</u>	<u>\$3,896</u>

Required: 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.

ANSWER: The balance sheet, Statement A, 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 owners' or stockholders' equity. This amount represents net worth or the financial position of a company at the balance sheet date.

Chapter 1: Accounting as a Form of Communication

178. Presented below are condensed data from the financial statements of Laugh Factory for 2015 and 2014. The figures are expressed in thousands. Use this information to answer the questions that follow.

Statement A	<u>2015</u>	<u>2014</u>
Total current assets	\$82,309	\$80,080
Property, plant & equipment (net of accumulated depreciation)	63,451	62,724
Investments	303	1,061
Other assets	<u>3,438</u>	<u>2,606</u>
Total assets	<u>\$149,501</u>	<u>\$146,471</u>
Total current liabilities	\$ 33,928	\$ 28,668
Long-term debt	20,491	25,676
Deferred income taxes and contingencies	<u>4,174</u>	<u>5,208</u>
Total liabilities	\$58,593	\$59,552
Total stockholders' equity	<u>90,908</u>	<u>86,919</u>
Total liabilities & stockholders' equity	<u>\$149,501</u>	<u>\$146,471</u>

Statement B	<u>2015</u>	<u>2014</u>
Net sales	\$209,203	\$174,206
Cost of sales	<u>136,225</u>	<u>114,284</u>
Gross profit	72,978	59,922
Selling, general and administrative expenses	63,895	53,520
Other income (expense)	<u>693</u>	<u>(118)</u>
Income (loss) before income taxes	9,776	6,284
Income tax expense	<u>3,534</u>	<u>2,388</u>
Net income (loss)	<u>\$6,242</u>	<u>\$3,896</u>

Required: Was Laugh Factory profitable both years? What are the amounts of the total revenues and total expenses, respectively, for 2015? Which financial statement provides this information to you?

ANSWER: The company was profitable in both 2015 and 2014. For 2015, total revenues include net sales of \$209,203, and other income, \$693, for a total of \$209,896. Total expenses are cost of sales of \$136,225, selling, general and administrative expenses of \$63,895, and income tax expense of \$3,534, or a total of \$203,654. This information is reported on the income statement, Statement B.

Chapter 1: Accounting as a Form of Communication

179. Presented below are condensed data from the financial statements of Snap Factory for 2015 and 2014. The figures are expressed in thousands. Use this information to answer the questions that follow.

Statement A	<u>2015</u>	<u>2014</u>
Total current assets	\$82,309	\$80,080
Property, plant & equipment (net of accumulated depreciation)	63,451	62,724
Investments	303	1,061
Other assets	<u>3,438</u>	<u>2,606</u>
Total assets	<u>\$149,501</u>	<u>\$146,471</u>
Total current liabilities	\$33,928	\$28,668
Long-term debt	20,491	25,676
Deferred income taxes and contingencies	<u>4,174</u>	<u>5,208</u>
Total liabilities	\$58,593	\$59,552
Total stockholders' equity	<u>90,908</u>	<u>86,919</u>
Total liabilities & stockholders' equity	<u>\$149,501</u>	<u>\$146,471</u>
Statement B	<u>2015</u>	<u>2014</u>
Net sales	\$209,203	\$174,206
Cost of sales	<u>136,225</u>	<u>114,284</u>
Gross profit	72,978	59,922
Selling, general and administrative expenses	63,895	53,520
Other income (expense)	<u>693</u>	<u>(118)</u>
Income (loss) before income taxes	9,776	6,284
Income tax expense	<u>3,534</u>	<u>2,388</u>
Net income (loss)	<u>\$6,242</u>	<u>\$3,896</u>

Required: How much of Snap Factory is financed by owners at the end of December of 2015?

ANSWER: The financing by owners for 2015 is the amount of stockholders' equity, \$90,908. Over time, sales of stock and earnings of the company cause this amount to increase.

Chapter 1: Accounting as a Form of Communication

180. Presented below are condensed data from the financial statements of Gallo Factory for 2015 and 2014. The figures are expressed in thousands. Use this information to answer the questions that follow.

Statement A	<u>2015</u>	<u>2014</u>
Total current assets	\$82,309	\$80,080
Property, plant & equipment (net of accumulated depreciation)	63,451	62,724
Investments	303	1,061
Other assets	<u>3,438</u>	<u>2,606</u>
Total assets	<u>\$149,501</u>	<u>\$146,471</u>
Total current liabilities	\$33,928	\$28,668
Long-term debt	20,491	25,676
Deferred income taxes and contingencies	<u>4,174</u>	<u>5,208</u>
Total liabilities	\$ 58,593	\$ 59,552
Total stockholders' equity	<u>90,908</u>	<u>86,919</u>
Total liabilities & stockholders' equity	<u>\$149,501</u>	<u>\$146,471</u>

Statement B	<u>2015</u>	<u>2014</u>
Net sales	\$209,203	\$174,206
Cost of sales	<u>136,225</u>	<u>114,284</u>
Gross profit	72,978	59,922
Selling, general and administrative expenses	63,895	53,520
Other income (expense)	<u>693</u>	<u>(118)</u>
Income (loss) before income taxes	9,776	6,284
Income tax expense	<u>3,534</u>	<u>2,388</u>
Net income (loss)	<u>\$6,242</u>	<u>\$3,896</u>

Required: How much of Gallo Factory is financed by creditors at the end of December of 2015? Evaluate the change from 2014 to 2015.

ANSWER: The amount of financing by creditors for 2015 is the amount of liabilities reported on the balance sheet, \$58,593. For 2014, the amount was \$59,552. Total liabilities decreased by \$959, or about 1.6%. The company must be keeping its debt at a steady position as stockholders' equity and assets have increased. The change must be examined relative to the entire financial position.

Chapter 1: Accounting as a Form of Communication

181. The following accounting principles and assumptions are included in the conceptual framework of accounting:

Economic entity Going concern Cost principle

Monetary unit Time period

For each situation in A through C below, identify which assumption or principle applies by selecting from the list pro why that assumption or principle applies.

- A) Global Corp. has divisions in several countries around the world. Each of these countries has a currency different from the U.S.dollar. Global Corp. is a U.S. company and must include the financial data of its worldwide divisions in its financial stat
- B) Steve and Mike operate a security business as a partnership. They are considering the advantages of changing over to the corporate form of business.
- C) Island Pasta is a locally owned and operated fast-food business. The owners have decided to expand into nearby cities. Expansion will require more capital, but management does **not** expect it will stay in business for more than a year or so regardless if it expands or not.

ANSWER:

- A) Monetary unit. Financial statements must be denominated in one currency--the standard monetary unit. United States, this unit is the dollar.
- B) Economic entity. A business can take three forms. Regardless of form, however, the unit itself is distinct from other units.
- C) Going concern. A business is assumed to continue indefinitely to more accurately reflect the valuation of assets and appropriately allocate costs to accounting periods.

182. What is meant by generally accepted accounting principles?

ANSWER: Generally accepted accounting principles (GAAP) are a set of guidelines that are based on a conceptual framework. They represent the various rules, practices, and other procedures used as a basis for accounting principles. GAAP was created in response to the need for some form of regulation over the preparation of financial statements.

Chapter 1: Accounting as a Form of Communication

183. Discuss the four steps in the ethical decision model used by accountants. Expand the discussion to include questions that you would ask to analyze the key elements in the situation.

ANSWER: The four steps in the ethical decision model include:

1. Identification: Recognize an ethical dilemma.
2. Analysis: Analyze the key elements in the situation.
3. Alternatives and Evaluation : List alternatives and evaluate the impact of each on those affected.
4. Resolution: Select the best alternative.

During the analysis phase, analyze the key elements in the situation by answering these questions in sequence:

- a. Who may benefit or be harmed?
- b. How are they likely to benefit or be harmed?
- c. What rights or claims may be violated?
- d. What specific interests are in conflict?
- e. What are my responsibilities and obligations?

184. From an ethical standpoint, if various alternatives are available to report a transaction, what are some of the questions an accountant should ask about the alternatives?

ANSWER: As the text points out, when determining alternative methods for reporting transactions, situations, or events, an accountant should answer the following questions:

- a. Which of the alternatives is most relevant and a faithful representation? Timeliness should be considered; potential bias must be identified.
- b. Does the report accurately represent the situation it claims to describe?
- c. Is the information free from bias?

185. Develop an ethical dilemma scenario that an accountant may face and give examples of key elements (listed below) that should be considered when analyzing the decision:

1. Those who may benefit or be harmed
2. What potential benefits or harm could result from the situation
3. The rights or claims violated
4. The specific interests in conflict
5. The responsibilities and obligations

ANSWER: Student answers will vary but may include some of the following:

1. Players in the scenario: Management, shareholders, potential investors, the auditor, creditors, and employees may benefit or be harmed.
2. Benefits including higher pay, promotion, increased status in the community and harm including loss of job, bankruptcy, customer's failure to pay debt.
3. Rights or claims including payments to creditors and obligations to customers.
4. Conflicting interests including a member of the board of directors who is also a company employee or a manager whose bonus is based on the manipulation of sales and/or other reporting.
5. Responsibility of the accountant to provide the most accurate information and report fraud.

Chapter 1: Accounting as a Form of Communication

Match the following business forms with their characteristics below.

- a. Sole proprietorship
- b. Partnership
- c. Corporation

186. Must file articles of incorporation with the state

ANSWER: c

187. Easy to raise large sums of money

ANSWER: c

188. Single owner

ANSWER: a

189. Need an agreement about contributions to the business

ANSWER: b

190. Usually owned and operated by the same person

ANSWER: a

191. Owned by two or more individuals

ANSWER: b

192. Control most private resources in the U.S.

ANSWER: c

193. A share of stock acts as evidence of ownership

ANSWER: c

Chapter 1: Accounting as a Form of Communication

Provided below is a list of important users of accounting information. Below the list are descriptions of a major need of each of the various users. Fill in the blank with the one user group that is most likely to have the need described to the right of the blank. Some user groups may be used more than once or not at all.

- a. Stockholder
- b. Company management
- c. Supplier
- d. Banker
- e. Internal Revenue Service
- f. Securities and Exchange Commission
- g. Labor union

194. The prospects for future dividend payments.

ANSWER: a

195. The financial status of a company issuing securities to the public for the first time.

ANSWER: f

196. The profitability of the company based upon the Internal Revenue Code.

ANSWER: e

197. The profitability of each division of the company.

ANSWER: b

198. The exact amount of profit on each product of the company.

ANSWER: b

199. The company's profitability since the last work force contract was signed.

ANSWER: g

Chapter 1: Accounting as a Form of Communication

For each statement provided, choose the letter of the appropriate term from the list that each statement best describes. Some terms may be used more than once, while others are not used at all.

- a. Capital stock
- b. Asset
- c. Owners' equity
- d. Time period
- e. Dividends
- f. Economic entity concept
- g. Expense
- h. Retained earnings
- i. Cost principle
- j. Creditor
- k. Liability
- l. Revenue
- m. Going concern
- n. Monetary unit
- o. Corporation

200. The portion of owner's equity that represents the net income less any dividends paid over the life of the entity.

ANSWER: h

201. The owners' claims on the assets of an entity.

ANSWER: c

202. A distribution of the net income of a business to its owners.

ANSWER: e

203. The sale of goods or the performance of services.

ANSWER: l

204. A category on the balance sheet to indicate the owners' direct investment in a corporation.

ANSWER: a

205. The cost of doing business that results from the process of generating revenues.

ANSWER: g

206. A future benefit.

ANSWER: b

207. An artificial segment on the calendar used as a basis for preparing financial statements.

ANSWER: d

208. The assumption that an entity is **not** in the process of liquidation and that it will continue indefinitely.

ANSWER: m

Chapter 1: Accounting as a Form of Communication

209. The principle or rule that specifies the amount recorded for an asset upon acquisition.

ANSWER: i

210. An entity that lends a company money with the expectation of repayment.

ANSWER: j

211. Claims of the creditors against the assets of a company.

ANSWER: k

Several items from the financial statements of Standard Tires are listed below. Use the following answer choices to identify the type of account for each item listed. Place your answers in the space provided.

- a. Assets
- b. Liabilities
- c. Revenues
- d. Expenses
- e. Owners' equity

212. Property, plant, and equipment

ANSWER: a

213. Sale of tires

ANSWER: c

214. Accounts payable

ANSWER: b

215. Interest income

ANSWER: c

216. Selling expenses

ANSWER: d

217. Accounts receivable

ANSWER: a

218. Capital stock

ANSWER: e

219. Long-term debt

ANSWER: b

Chapter 1: Accounting as a Form of Communication

220. Cash

ANSWER: a

221. Retained earnings

ANSWER: e

222. Inventories

ANSWER: a

Three organizations important to accounting are listed below. Select the organization that most closely achieves the role described.

- a. American Institute of Certified Public Accountants (AICPA)
- b. Financial Accounting Standards Board (FASB)
- c. Securities and Exchange Commission (SEC)

223. Issues financial accounting concepts that are used as a guide to accounting standard setting.

ANSWER: b

224. Has the ultimate authority to set accounting standards, but has allowed the profession to do so.

ANSWER: c

225. Prepares and grades the Uniform CPA Examination.

ANSWER: a

226. An agency of the federal government.

ANSWER: c

227. Is a professional organization of certified public accountants.

ANSWER: a

228. Primarily responsible for setting accounting standards today.

ANSWER: b

229. Requires that publicly traded companies file annual and quarterly financial statements on a timely basis.

ANSWER: c

Chapter 1: Accounting as a Form of Communication

230. Since there is a lack of a profit motive in nonbusiness entities, they do **not** need information provided by an accounting system.

- a. True
- b. False

ANSWER: False

231. Drew Mellow, owner of Mellow's Melodies, also owns a personal residence that costs \$400,000. The market value of his residence is \$600,000. During preparation of the financial statements for Mellow's Melodies, the accounting concept most relevant to the presentation of Drew's home is:

- a. monetary unit.
- b. a going concern entity.
- c. the economic entity concept.
- d. the time period assumption.

ANSWER: c

232. Which of the following statements is true regarding a bond?

- a. A bond is a certificate that acts as evidence of ownership in a corporation.
- b. A bond is a certificate that represents a corporation's promise to repay a certain amount of money and interest in the future.
- c. If you buy a bond from a company, you are borrowing money from the company.
- d. Bondholders receive dividends semiannually.

ANSWER: b

233. All of the following are the types of activities that businesses engage in **except**:

- a. financing activities.
- b. investing activities.
- c. operating activities.
- d. organizational activities.

ANSWER: d

Chapter 1: Accounting as a Form of Communication

234. Which of the following represents the proper order of the financial decision framework?
- a. Analyze the information, formulate the question, gather information from financial statements, monitor your decision, make the decision.
 - b. Formulate the question, Analyze the information, gather information from financial statements, monitor your decision, make the decision.
 - c. Formulate the question, Gather information from financial statements, Analyze the information, Make the decision, Monitor your decision
 - d. Analyze the information, monitor your decision, make the decision, formulate the question, gather information from financial statements.

ANSWER: c

235. Which one of the following items does **not** accurately describe stockholders' equity?
- a. Stockholders' equity is created when a company issues stock to an investor.
 - b. Total stockholders' equity should be equal to Assets in an publicly held entity.
 - c. Stockholders' equity represents amounts contributed by the owners to the company.
 - d. As owners of shares in a corporation, stockholders have claims on the assets of a business when it is profitable.

ANSWER: b

236. Sawyer Corporation purchased land in 2009 for \$490,000. In 2015, it purchased a nearly identical parcel of land for \$660,000. In its 2015 balance sheet, Sawyer valued these two parcels of land at a combined value of \$1,320,000. By reporting the land in this manner, Sawyer Corporation has violated which of the following?
- a. Going concern assumption
 - b. Cost principle
 - c. Monetary unit measure
 - d. Time Period assumption

ANSWER: b

237. Which one of the following best describes the external auditor's report?
- a. The external auditor's report is an opinion.
 - b. The external auditor's report is a statement of fact.
 - c. The external auditor's report must comply with both FASB and IASB standards.
 - d. The firms that provide external audit reports are restricted to 20 partners, based on authoritative standards issued by the PCAOB.

ANSWER: a

Chapter 1: Accounting as a Form of Communication

238. For each of the following, explain a transaction that will have the following stated effects on the accounting equation elements.

- A) Increase one asset, decrease one asset, and increase a liability.
- B) Increase an asset and increase stockholders' equity.
- C) Decrease an asset and decrease a liability.
- D) Increase an asset and increase a liability.
- E) Increase one asset and decrease another asset.

ANSWER: (Answers may vary, but here are a few examples.)

- A) Buy equipment with a cash down payment with the remainder financed by a note payable.
- B) Issued common stock in exchange for cash.
Provided services on account (or for cash).
- C) Pay cash to reduce accounts payable.
Pay cash to reduce a note payable.
- D) Purchase supplies on account.
Purchase equipment and signed a note payable.
- E) Receive cash from customers on account.
Purchase supplies for cash.

Chapter 1: Accounting as a Form of Communication

239. Calvin Corp. was organized on January 1 to operate a taxi service. For each of the following business activities, please indicate whether it is a financing (F), investing (I) or operating (O) activity.

- A. Issued shares of stock to each of the five owners.
- B. Purchased five automobiles to use as taxis.
- C. Paid the first month's rent for a garage.
- D. Obtained a loan from the bank.
- E. Received cash from a customer for a 10-mile taxi ride.
- F. Paid the drivers wages for the first week.
- G. Purchased a fueling station to install at the garage (includes a 500 gallon tank).
- H. Declared and paid cash dividends to the owners after the first month's operations.
- I. Paid cash to repair the brakes on one of the taxis.
- J. Bought land for a future taxi office.

ANSWER:

- A. F Issued shares of stock to each of the five owners.
- B. I Purchased five automobiles to use as taxis.
- C. O Paid the first month's rent for a garage.
- D. F Obtained a loan from the bank.
- E. O Received cash from a customer for a 10-mile taxi ride.
- F. O Paid the drivers wages for the first week.
- G. I Purchased a fueling station to install at the garage (includes a 500 gallon tank).
- H. F Declared and paid cash dividends to the owners after the first month's operations.
- I. O Paid cash to repair the brakes on one of the taxis.
- J. I Purchased land for cash for a future taxi office.

Chapter 1: Accounting as a Form of Communication

240. 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

ANSWER: d

241. "Claims to economic resources" are known as:
- a. assets and liabilities.
 - b. liabilities and stockholders' equity.
 - c. owners' equity and stockholders' equity.
 - d. retained earnings and revenues.

ANSWER: b

Chapter 1: Accounting as a Form of Communication

242. Which of the following is **not** an objective of financial reporting?

- a. To reflect prospective cash receipts to investors and creditors.
- b. To reflect prospective cash flows to an enterprise.
- c. To reflect resources and claim to resources.
- d. To reflect current stock prices and information concerning stock markets.

ANSWER: d

243. Which of the following statements is true concerning external users of financial information?

- a. External users need detailed records of the business to make informed decisions.
- b. External users are primarily responsible for the preparation of financial statements.
- c. External users rely on the financial statements to help make informed decisions.
- d. External users rely on management to tell them whether the company is a good investment

ANSWER: c

244. Relevant information can be quantitative or qualitative. In deciding whether to go to college part-time or full-time, which of the following is a qualitative factor for a student?

- a. The cost of tuition
- b. The opportunity to make friends
- c. The price of football tickets
- d. "Good Student" discounts on auto insurance rates.

ANSWER: b

245. The preparation of financial statements requires that the information be understandable:

- a. only to CPAs.
- b. to those willing to spend the time to understand it.
- c. only to those who take an accounting course.
- d. only to financial analysts and brokers.

ANSWER: b

246. Cook, Inc., a manufacturer of tires, has given you its most recent annual report in an effort to obtain a sizable loan. The company is very profitable and appears to have a sound financial position. Based on a report presented on prime-time television last night, you are aware that Cook is a defendant in several lawsuits related to its defective tires that cause vehicles to overturn. The information presented on television is an example of financial information that is:

- a. Relevant.
- b. Consistent.
- c. Predictable.
- d. Comparable.

ANSWER: a

Chapter 1: Accounting as a Form of Communication

247. If an investor can use accounting information for two different companies to evaluate the types and amounts of expenses, the information is said to have the quality of:

- a. Comparability.
- b. Consistency.
- c. Neutrality.
- d. Understandability.

ANSWER: a

248. Button Transportation purchases many pieces of office furniture with an individual cost below \$200 each. Button chooses to account for these expenditures as expenses when acquired rather than reporting them as property, plant, and equipment on its balance sheet. The company's accountant and independent CPA agree that no accounting principle has been violated. What accounting justification allows Button to expense the furniture?

- a. Conservatism
- b. Matching
- c. Materiality
- d. Verifiability

ANSWER: c

249. Madden Company applies the consistency convention. What does this mean?

- a. Madden Co. uses the same names for all its expenses as its competitors.
- b. Madden Co. has selected certain accounting principles that can never be changed.
- c. Madden Co. applies the same accounting principles each accounting period.
- d. Madden Co. applies the same accounting principles as its competitors.

ANSWER: c

250. Information that is material means that an error or alternative method of handling a transaction:

- a. would possibly affect the judgment of someone relying on the financial statements.
- b. would not affect the decisions of users.
- c. might cause a company to understate its earnings for the accounting period.
- d. could increase the profitability of a company.

ANSWER: a

251. An accountant is uncertain about the best estimate of an amount for a business transaction. If two amounts are about equally likely, the amount **least** likely to overstate assets and income is selected. Which of the following qualities is characterized by this action?

- a. Comparability
- b. Conservatism
- c. Materiality
- d. Neutrality

ANSWER: b

Chapter 1: Accounting as a Form of Communication

252. The qualitative characteristics of accounting data include:

- a. assets reported on the balance sheet.
- b. all accounting information.
- c. cash flows.
- d. reliability.

ANSWER: d

253. Which of the following is a noncurrent asset?

- a. Inventories
- b. Office supplies
- c. Land
- d. Accounts receivable

ANSWER: c

254. Which of the following is a current asset?

- a. Land
- b. Buildings
- c. Store fixtures
- d. Prepaid insurance

ANSWER: d

255. Which of the following include only current assets?

- a. Accounts receivable, cash, inventory, office supplies
- b. Cash, accounts payable, inventory, office supplies
- c. Cash, land, accounts receivable, inventory
- d. Accounts receivable, cash, furniture, office supplies

ANSWER: a

256. To determine the source of a company's assets, on which financial statement will you look?

- a. Balance sheet only
- b. Income statement only
- c. Both the balance sheet and the income statement
- d. Both the income statement and the statement of retained earnings

ANSWER: a

Chapter 1: Accounting as a Form of Communication

Moss Company

Moss Company has provided the following information from its accounting records for the current year:

Cash	\$55,000	Accounts receivable	\$45,000
Inventory	65,000	Land	75,000
Accounts payable	50,000	Notes payable (due 2020)	150,000
Retained earnings	?	Capital stock	20,000

257. Read the information for Moss Corporation. What are Moss' current assets?

- a. \$ 100,000
- b. \$ 165,000
- c. \$ 210,000
- d. \$ 240,000

ANSWER: b

RATIONALE: (\$55,000 Cash + \$45,000 Accounts Receivable + \$65,000 Inventory = \$165,000)

258. Read the information for Moss Company. What are Moss' current liabilities?

- a. \$ 50,000
- b. \$ 125,000
- c. \$ 200,000
- d. \$ 230,000

ANSWER: a

RATIONALE: (\$50,000 Accounts Payable)

259. Which one of the following items is reported as a current asset on a classified balance sheet?

- a. Inventory
- b. Accounts payable
- c. Land
- d. Common stock

ANSWER: a

Chapter 1: Accounting as a Form of Communication

260. The following information is given for Sego Company:

Cash	\$50,000	Inventory	\$45,000
Land	75,000	Accumulated Depreciation	40,000
Plant & Equipment	150,000	Accounts Payable	60,000

What are the company's current assets?

- a. \$220,000
- b. \$155,000
- c. \$130,000
- d. \$ 95,000

ANSWER: d

RATIONALE: (\$50,000 Cash + \$45,000 Inventory = \$95,000)

261. Which of the following accounts are normally reported as current liabilities on a classified balance sheet?

- a. Accounts payable and bonds payable
- b. Interest payable and mortgage payable
- c. Income taxes payable and salaries payable
- d. Capital stock and accounts payable

ANSWER: c

262. Which one of the following is **not** a major category for long-term assets?

- a. Intangibles
- b. Property, plant, and equipment
- c. Receivables
- d. Goodwill

ANSWER: c

263. Which of the following would **not** be considered to be an intangible asset?

- a. Franchises
- b. Copyrights
- c. Investments
- d. Goodwill

ANSWER: c

264. Which of the following statements is true concerning intangible assets?

- a. Intangible assets have no economic substance.
- b. Intangible assets lack physical existence.
- c. Intangible assets are listed in the stockholders' equity section of the balance sheet.
- d. Intangible assets appear in the current assets section of the balance sheet.

ANSWER: b

Chapter 1: Accounting as a Form of Communication

265. How are assets which 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) reported on a classified balance sheet?
- a. Property, plant, and equipment
 - b. Current assets
 - c. Intangible assets
 - d. Current liabilities

ANSWER: b

266. Which of the following terms characterizes the time period between the investment of cash in merchandise and the collection of cash from the sale of that merchandise?
- a. Operating cycle
 - b. Natural business year
 - c. Accounting period
 - d. Fiscal period

ANSWER: a

267. Which set of items below are current assets?
- a. Accounts receivable, net income, inventory, and dividends
 - b. Cash, accounts receivable, capital stock, and sales
 - c. Net income, cash, office supplies, and inventory
 - d. Cash, accounts receivable, inventory, and office supplies

ANSWER: d

268. One significant difference between a classified and a non-classified balance sheet is the distinction between which of the following items?
- a. Assets and liabilities
 - b. Current and noncurrent items
 - c. Liabilities and owners' equity
 - d. Resources invested by the owners and amounts borrowed from creditors

ANSWER: b

269. For several years, Flame Corporation has had a current ratio that was consistent with other companies in its industry. For the most recent year, Flame's current ratio was significantly higher than that for the industry. What is the best possible explanation for this situation?
- a. The other companies in the industry were not as profitable.
 - b. Flame's liquidity has improved or is not leveraging financial resources effectively.
 - c. Flame has less property, plant and equipment than other companies.
 - d. Flame has too much debt.

ANSWER: b

Chapter 1: Accounting as a Form of Communication

Guinther & Sons, Inc.

Guinther & Sons, Inc. a retailer of men's clothing, earned a net profit of \$77,000 for 2014. The balance sheet for Guinther & Sons includes the following items:

Cash	\$29,000	Accounts receivable	\$39,000
Inventory	79,000	Prepaid insurance	3,000
Land	90,000	Accounts payable	21,000
Taxes payable	29,000	Capital stock	50,000
Retained earnings	97,000	Long-term notes payable	43,000

270. Read the information for Guinther & Sons. Calculate the total amount of current assets for Guinther & Sons.

- a. \$ 100,000
- b. \$ 147,000
- c. \$ 150,000
- d. \$ 249,000

ANSWER: c

RATIONALE: (\$29,000 Cash + \$39,000 Accounts Receivable + \$79,000 Inventory + \$3,000 Prepaid Insurance = \$150,000)

271. Read the information for Guinther & Sons, Inc. Calculate the current ratio for Guinther & Sons. a. 2.58 to 1

- b. 2.75 to 1
- c. 3.00 to 1
- d. 2.00 to 1

ANSWER: c

RATIONALE: $(\$29,000 \text{ Cash} + \$39,000 \text{ Accounts Receivable} + \$79,000 \text{ Inventory} + \$3,000 \text{ Prepaid Insurance}) / (\$21,000 \text{ Accounts Payable} + \$29,000 \text{ Taxes Payable}) = 3.00 \text{ to } 1$

272. Read the information for Guinther & Sons, Inc. The average current ratio for stores such as Guinther & Sons is 2.4 to 1. What does this comparison tell you about its liquidity?

- a. It is more liquid than its competitors
- b. It has more long-term assets than its competitors
- c. Since a rule of thumb for current ratios is 2 to 1, neither Guinther & Sons, Inc. nor its competitors is liquid.
- d. Guinther & Sons, Inc. is more profitable than its competitors.

ANSWER: a

Chapter 1: Accounting as a Form of Communication

273. Lamar Company has total current assets of \$122,000 and total current liabilities of \$57,000. What is the amount of working capital for Lamar Company?
- a. \$ 57,000
 - b. \$ 65,000
 - c. \$ 122,000
 - d. \$ 179,000

ANSWER: b

RATIONALE: $\$122,000 - \$57,000 = \$65,000$

274. What is the correct method for calculating working capital?
- a. Total Assets minus Total Liabilities
 - b. Current Assets minus Total Liabilities
 - c. Current Assets minus Current Liabilities
 - d. Current Assets plus Current Liabilities

ANSWER: c

275. Oreo Company has current assets of \$20,000, current liabilities of \$8,000, and long-term liabilities of \$3,000. Oreo wants to buy new equipment. How much of its existing cash can Oreo use to acquire equipment without allowing its current ratio to decline below 2.0 to 1?
- a. \$ 4,000
 - b. \$ 8,000
 - c. \$ 10,000
 - d. \$ 12,000

ANSWER: a

RATIONALE: $(\$16,000 / \$8,000 = 2.0 \text{ to } 1; \$20,000 - \$16,000 = \$4,000)$

276. Excursion Corp. increased its dollar amount of working capital over the past several years. To further evaluate the company's short-run liquidity, which one of the following measures should be used?
- a. The current ratio
 - b. An analysis of the company's longterm debt
 - c. An analysis of the return on stockholders' equity
 - d. An analysis of retained earnings

ANSWER: a

277. Which financial statement reports information helpful in assessing working capital?
- a. Income statement
 - b. Balance sheet
 - c. Statement of retained earnings
 - d. Statement of cash flows

ANSWER: b

Chapter 1: Accounting as a Form of Communication

278. Use Rizwi Corporation's list of accounts at December 31, 2015 to answer the following question.

Rizwi Corporation
List of Accounts at December 31, 2015

Cash	\$30,000	Accumulated depreciation	\$ 12,000
Merchandise inventory	21,000	Notes payable--Due 12/31/2022	120,000
Land	40,000	Accounts payable	14,000
Buildings	80,000	Equipment	33,000
Accounts receivable	25,000	Notes Payable--Due 07/01/2016	24,000

What is Rizwi Corp.'s current ratio?

- a. 0.48 to 1
- b. 2.00 to 1
- c. 2.55 to 1
- d. 2.86 to 1

ANSWER: b

RATIONALE: $(\$30,000 \text{ Cash} + \$21,000 \text{ Merchandise Inventory} + \$25,000 \text{ Accounts Receivable}) / (\$14,000 \text{ Accounts Payable} + \$24,000 \text{ Notes Payable--Due 07/01/2015}) = 2.00 \text{ to } 1$

279. If the current ratio is 2.5 to 1, net income is \$6,000, and current liabilities are \$18,000, how much is working capital?
- a. \$ 6,000
 - b. \$ 24,000
 - c. \$ 27,000
 - d. \$ 45,000

ANSWER: c

RATIONALE: $(\$18,000 \text{ Current Liabilities} \times 2.5 = \$45,000 \text{ Current Assets}; \$45,000 - \$18,000 = \$27,000)$

280. For which of the following is the current ratio most useful?

- a. In evaluating a company's liquidity.
- b. In evaluating a company's solvency.
- c. In evaluating a company's profitability.
- d. In evaluating a company's leverage.

ANSWER: a

281. Which of the following events will cause a company's current ratio to decrease?

- a. The sale of inventory for cash.
- b. The sale of inventory for credit (accounts receivable).
- c. Issuing stock for cash.
- d. Paying off long-term debt with cash.

ANSWER: d

Chapter 1: Accounting as a Form of Communication

282. Which of the following events will cause a company's current ratio to increase?

- a. The collection of an account receivable.
- b. Selling land for cash at a loss.
- c. The discharge of an account payable by signing a short-term note payable.
- d. Paying off a long-term loan.

ANSWER: b

283. Liquidity relates to a company's ability to do which of the following?

- a. The ability to pay its financial obligations as they become due.
- b. The ability to stay in business over the long run.
- c. The ability to pay dividends to its stockholders.
- d. The ability to collect the amount their customers owe the company.

ANSWER: a

Skyline, Inc.

The balance sheet of Skyline Inc. includes the following items:

Cash	\$ 22,400
Accounts receivable	11,700
Inventory	23,300
Prepaid insurance	1,040
Land	80,000
Accounts payable	47,500
Salaries payable	1,200
Capital stock	84,040
Retained earnings	5,700

284. Read the information about Skyline, Inc. What is Skyline's current ratio?

- a. 0.8 to 1
- b. 1.6 to 1
- c. 1.2 to 1
- d. 2.5 to 1

ANSWER: c

RATIONALE: Current Ratio = Current Assets/Current Liabilities = $(\$22,400 + \$11,700 + \$23,300 + \$1,040)/(\$47,500 + \$1,200) = \$58,440/48,700 = 1.2$ to 1

Chapter 1: Accounting as a Form of Communication

285. Read the information about Skyline, Inc. What is Skyline's working capital?

- a. \$58,440
- b. \$89,740
- c. \$84,040
- d. \$9,740

ANSWER: d

RATIONALE: Current Ratio = Current Assets/Current Liabilities = $(\$22,400 + \$11,700 + \$23,300 + \$1,040)/(\$47,500 + \$1,200) = \$58,440/\$48,700 = 1.2$ to 1 Working Capital = Current Assets – Current Liabilities = $\$58,440 - \$48,700 = \$9,740$

286. Which of the following would appear on a multiple-step income statement but **not** on a single-step income statement?

- a. Net income
- b. Total expenses
- c. Total revenues
- d. Income before income taxes

ANSWER: d

287. Which of the following would **not** appear on an income statement?

- a. Sales revenue
- b. Cost of goods sold
- c. Accounts receivable
- d. Insurance expense

ANSWER: c

288. Which statement is true concerning an income statement?

- a. The income statement shows how much profit the company has earned since it began operations.
- b. Net income on the income statement should be equal to the amount of cash on the balance sheet.
- c. The income statement summarizes the results of operations for a period of time.
- d. The income statement indicates the liquidity of the company on an annual basis.

ANSWER: c

289. Which statement is true concerning gains and losses?

- a. Gains and losses are reported on the balance sheet in the Assets and Liabilities sections, respectively.
- b. Gains and losses are special types of revenues and expenses that are reported on the income statement.
- c. The amounts of gains and losses are included in the calculation of the current ratio, in the numerator and denominator, respectively.
- d. Gains and losses are reported only on a multi-step income statement.

ANSWER: b

Chapter 1: Accounting as a Form of Communication

290. Which one of the following subtotals or totals would appear in a multiple-step, but **not** a single-step income statement?

- a. Income tax expense
- b. Income from operations
- c. Cost of goods sold
- d. Net income

ANSWER: b

291. What are the two subtotals that distinguish the multi-step income statement from the single-step income statement?

- a. Income before taxes and income taxes
- b. Total operating revenues and total operating expenses
- c. Income from operations and income before taxes
- d. Total revenues and total expenses

ANSWER: c

292. A question asked by stockholders is, "How much profit did the company make?" What should the stockholder examine to get the most information that will help evaluate the answer to this question?

- a. The balance sheet, because retained earnings represents current profits.
- b. The statement of cash flows, as cash inflows and outflows represents current profits.
- c. The income statement, since it shows the revenues and expenses for the period.
- d. The economic resources of the company.

ANSWER: c

293. Under current accounting principles, how is net income on the income statement measured?

- a. Net change in owners' equity during the period.
- b. Excess of revenues over expenses during the period.
- c. Net change in the cash balance during the period.
- d. Excess of revenues over expenses less any dividends paid during the period.

ANSWER: b

294. Which of the following statements is true regarding the multiple-step income statement?

- a. The multiple-step income statement is used only by companies that sell products, not those that provide services.
- b. The multiple-step income statement is helpful in determining a company's working capital.
- c. The multiple-step income statement reports the same net income as the single-step income statement.
- d. The multiple-step income statement is required under generally accepted accounting principles.

ANSWER: c

Chapter 1: Accounting as a Form of Communication

295. How is income from operations determined?

- a. By subtracting the cost of goods sold from sales.
- b. By subtracting the total operating expenses from sales
- c. By subtracting the total operating expenses from gross profit.
- d. By subtracting selling expenses from operating revenues.

ANSWER: c

296. The following list contains several items that appear on an income statement.

1.	Other revenue and expenses	5.	Net Income
2.	Income before taxes	6.	Operating revenues
3.	Income taxes	7.	Income from operations
4.	Operating expenses		

Select the choice that lists the items in the order they would appear on a multi-step income statement

- a. 6, 1, 7, 4, 2, 3, 5
- b. 7, 6, 1, 4, 2, 3, 5
- c. 6, 4, 7, 1, 2, 3, 5
- d. 6, 7, 4, 1, 2, 3, 5

ANSWER: c

Webb Company

Selected data from the accounting records of Webb Company are listed below:

General & administrative expenses	\$2,200	Operating revenues	\$6,000
Selling expenses	1,800	Income taxes	600
Other revenues (expenses)	800	Dividends paid	1,200

297. Read the information about Webb Company. What is Webb's income from operations?

- a. \$ 1,600
- b. \$ 2,000
- c. \$ 2,200
- d. \$ 2,800

ANSWER: b

RATIONALE: (\$6,000 Operating Revenues - \$2,200 General & Administrative Expenses - \$1,800 Selling Expenses =\$2,000)

Chapter 1: Accounting as a Form of Communication

298. Read the information about Webb Company. What is Webb's net income?

- a. \$ 1,600
- b. \$ 2,000
- c. \$ 2,200
- d. \$ 2,800

ANSWER: c

RATIONALE: (\$6,000 Operating Revenues - \$2,200 General & Administrative Expenses - \$1,800 Selling Expenses = \$2,000 + \$800 Other Revenues (Expenses) - \$600 Income Taxes = \$2,200)

299. Read the information about Webb Company. By what amount will net income on a single-step income statement differ from net income on a multi-step income statement if Webb Company prepares both formats?

- a. \$ 800
- b. \$ 600
- c. \$ 200
- d. \$ -0-

ANSWER: d

Deal Mart

The 2014 income statement of Deal Mart shows operating revenues of \$130,800, selling expenses of \$37,100, general and administrative expenses of \$34,900, interest expense of \$900, and income tax expense of \$11,430. Deal Mart's stockholders' equity was \$280,000 at the beginning of the year and \$320,000 at the end of the year. The company has 20,000 shares of stock outstanding at December 31, 2014.

300. Read the information about Deal Mart. What is Deal Mart's net income?

- a. \$80,000
- b. \$92,190
- c. \$130,800
- d. \$46,470

ANSWER: d

RATIONALE: Net Income = \$130,800 - \$37,100 - \$34,900 - \$900 - \$11,430 = \$46,470

301. Read the information about Deal Mart. What is Deal Mart's profit margin (to the closest tenth of a percent)?

- a. 2.8
- b. 35.5
- c. 61.2
- d. 14.5

ANSWER: b

RATIONALE: Profit margin: Net Income/Revenues = \$46,470*/\$130,800 = 35.5%
*\$130,800 - \$37,100 - \$34,900 - \$900 - \$11,430 = \$46,470

Chapter 1: Accounting as a Form of Communication

302. Forman, Inc. earned \$600,000 profit during 2015. On which financial statement(s) will you find the dollar amount of the profit earned by the company?
- a. Balance sheet and income statement
 - b. Income statement only
 - c. Statement of retained earnings only
 - d. Income statement and statement of retained earnings

ANSWER: d

303. Grand Stores, Inc. is concerned about its profitability for the current year, since its profit margin has dropped 10% since last year. Which of the following is the **least** useful comparison in evaluating the drop in Grand Stores' profit margin?
- a. Comparison with the industry average for the current year.
 - b. Comparison with its current ratio for the current year
 - c. Comparison with the profit margins for its major competitors for the current year.
 - d. Comparison with its profit margins for the past five years.

ANSWER: b

304. Assume that you want to determine the profit margin for a company. Which one of the following financial statements is the best source of this information?
- a. Statement of retained earnings
 - b. Statement of cash flows
 - c. Statement of stockholders' equity
 - d. Income statement

ANSWER: d

Hopper, Inc.

Use the information from Hopper Inc. to answer the following question(s).

	2014	2013
Operating revenues	\$1,900,000	\$1,600,000
Operating expenses	1,400,000	1,100,000
Income taxes	200,000	200,000

305. Read the information about Hopper, Inc. Which statement best represents Hopper's performance?
- a. Hopper's profit margin ratio decreased.
 - b. Hopper has become more profitable.
 - c. Hopper's increase in operating revenues increased the company's net income.
 - d. Hopper's operating expenses as a percentage of operating revenues remained the same.

ANSWER: a

Chapter 1: Accounting as a Form of Communication

306. Read the information about Hopper, Inc. Which of the following statements is the best answer regarding the company's profit margin?
- a. The profit margin was 15.8% in 2014.
 - b. The profit margin was 15.8% in 2013.
 - c. The profit margin was 31.5% in 2014.
 - d. The profit margin was 31.5% in 2013.

ANSWER: a

RATIONALE: $(\$300,000 \text{ (or } \$1,900,000 \text{ Operating revenues} - \$1,400,000 \text{ Operating expenses} - \$200,000 \text{ Income taxes)} / \$1,900,000 = 15.8\%)$

307. Read the information about Hopper, Inc. Which ratio are you able to calculate given only the information provided by Hopper?
- a. Profit margin
 - b. Current ratio
 - c. Working capital
 - d. Gross profit percentage

ANSWER: a

308. Which one of the following equations represents retained earnings activity?
- a. Beginning balance + net income + dividends = profits for the year
 - b. Beginning balance + cash inflows - cash outflows = ending balance
 - c. Beginning balance + dividends - net income = ending balance
 - d. Beginning balance + net income - dividends = ending balance

ANSWER: d

Bartlett Industries

Bartlett Industries began operations on January 2, 2015, with an investment of \$50,000 by each of its two stockholders. Net income for its first year of business was \$240,000. Bartlett Industries paid a total of \$100,000 in dividends to its stockholders during the year.

309. Read the information about Bartlett Industries. What is the company's retained earnings balance at December 31, 2015?
- a. \$140,000
 - b. \$190,000
 - c. \$240,000
 - d. \$340,000

ANSWER: a

RATIONALE: $(\$ -0- \text{ Beginning Balance} + \$240,000 \text{ Net Income} - \$100,000 \text{ Dividends} = \$140,000)$

Chapter 1: Accounting as a Form of Communication

310. Read the information about Bartlett Industries. If the company's revenues were \$500,000 for the year ended December 31, 2015, how much were total expenses?
- a. \$160,000
 - b. \$260,000
 - c. \$640,000
 - d. \$740,000

ANSWER: b

RATIONALE: (\$500,000 Revenues - \$240,000 Net Income \$260,000)

311. Read the information about Bartlett Industries. The company's dividends for the year:
- a. reduce the amount of capital stock reported by the company.
 - b. are part of Bartlett Industries' operating costs.
 - c. are reported on the statement of retained earnings.
 - d. are an expense of Bartlett Industries.

ANSWER: c

312. A company is **not** required to prepare both a(n):
- a. income statement and statement of stockholders' equity.
 - b. income statement and statement of retained earnings.
 - c. statement of stockholders' equity and statement of retained earnings.
 - d. statement of cash flows and statement of retained earnings.

ANSWER: c

313. In preparing the financial statements for December 31, 2015, an accountant improperly classified the payment of prepaid rent as rent expense. Which of the following amounts would **not** be affected by this improper classification?
- a. Retained earnings, January 1, 2015
 - b. Retained earnings, December 31, 2015
 - c. Net income
 - d. Total assets

ANSWER: a

314. Carnival Bakery borrowed \$500,000 from Front Street Bank. Carnival then hired a contractor to build a new cookie distribution outlet. In which section of Carnival's statement of cash flows would you find information that indicated that Carnival acquired the new cookie distribution outlet?
- a. Operating Activities
 - b. Investing Activities
 - c. Financing Activities
 - d. Profit Activities

ANSWER: b

Chapter 1: Accounting as a Form of Communication

315. A bank loaned \$62 million to Apex Corporation to finance the construction of a new distribution warehouse. In which section of Apex's statement of cash flows would you be able to determine whether the company repaid any portion of the debt during the year?
- a. Operating Activities
 - b. Investing Activities
 - c. Financing Activities
 - d. Profit Activities

ANSWER: c

316. Which of the following categories on a statement of cash flows is used to report the cash flow effects of transactions involving a company's stock?
- a. Operating Activities
 - b. Investing Activities
 - c. Financing Activities
 - d. Profit Activities

ANSWER: c

317. Which one of the following categories on a statement of cash flows is used to report the cash flow effects of buying and selling property, plant, and equipment?
- a. Operating Activities
 - b. Investing Activities
 - c. Financing Activities
 - d. Profit Activities

ANSWER: b

318. Which one of the following is considered a financing activity?
- a. The payment of interest on a note payable to the bank.
 - b. Selling products to customers
 - c. Paying wages to employees
 - d. The payment of a cash dividend.

ANSWER: d

319. Which one of the following statements is true?
- a. The two primary sources of financing available to corporations are borrowed funds and funds invested by owners.
 - b. Financing activities involve the acquisition of property, plant and equipment.
 - c. Borrowed funds are a more permanent source of financing than funds invested by owners.
 - d. Investing activities involve the selling of products or services and the incurring of expenses related to selling these products and services.

ANSWER: a

Chapter 1: Accounting as a Form of Communication

Marvel Shoes

Marvel Shoes reported the following items on its statement of cash flows for the current year:

Net cash inflows from operating activities	\$70,000
Net cash outflows from investing activities	(20,000)
Net cash outflows from financing activities	(40,000)
Cash balance at the beginning of the year	30,000

320. Read the information about Marvel Shoes. What was the amount of net increase or decrease in the cash balance for Marvel Shoes for the current year?

- a. \$ 10,000 increase
- b. \$ 30,000 increase
- c. \$ 40,000 increase
- d. \$ 70,000 increase

ANSWER: a

RATIONALE: (\$70,000 Operating Activities - \$20,000 Investing Activities - \$40,000 Financing Activities = \$10,000)

321. Read the information about Marvel Shoes. What was the cash balance for Marvel Shoes at the end of the current year?

- a. \$ 10,000
- b. \$ 30,000
- c. \$ 40,000
- d. \$ 70,000

ANSWER: c

RATIONALE: (\$30,000 Beginning Balance + \$10,000 Increase in Cash = \$40,000)

322. Which financial statement reports the sources and uses of an entity's cash resources?

- a. Income statement
- b. Statement of retained earnings
- c. Balance sheet
- d. Statement of cash flows

ANSWER: d

Chapter 1: Accounting as a Form of Communication

323. During its fifth year of operations, Bright Creations Company reports a beginning cash balance of \$132,000, cash inflows from investing activities of \$210,000, cash outflows for financing activities of \$79,000, and cash outflows for operating activities of \$13,000. What was Bright Creations' cash balance at the end of the fifth year?
- a. \$ 250,000
 - b. \$ 434,000
 - c. \$ 276,000
 - d. \$ 132,000

ANSWER: a

RATIONALE: (\$132,000 Beginning Balance - \$13,000 Cash Flow from Operating Activities + \$210,000 Cash Flows from Investing Activities - \$79,000 Cash Flows from Financing Activities = \$250,000)

324. Which of the following best describes a company's financing activities?
- a. Financing activities focus on the sale of products and services.
 - b. Financing activities include selling products.
 - c. Financing activities enable a company to acquire assets needed to run a business.
 - d. Financing activities are represented by the revenues and expenses on the income statement.

ANSWER: c

325. Which of the following best describes a company's operating activities?
- a. Operating activities focus on the sale of products and services.
 - b. Operating activities are necessary to provide the money to start a business.
 - c. Operating activities are needed to provide the valuable assets required to run a business.
 - d. Operating activities represent the right to receive a benefit in the future.

ANSWER: a

326. Which one of the following is an investing activity of a business?
- a. Paying for purchases of inventory
 - b. Issuing stock for cash
 - c. Borrowing money from a bank.
 - d. Purchasing a manufacturing plant for cash

ANSWER: d

327. Which one of the following is a financing activity of a business?
- a. Paying for purchases of inventory
 - b. Issuing stock for cash
 - c. Paying salaries
 - d. Purchasing a manufacturing plant

ANSWER: b

Chapter 1: Accounting as a Form of Communication

328. Which one of the following is an operating activity of a business?

- a. Paying for purchases of inventory
- b. Issuing stock for cash
- c. Borrowing money from a bank
- d. Purchasing a manufacturing plant.

ANSWER: a

329. Which of the following represents the correct sequence of the three business activities on the Statement of Cash Flows?

- a. Financing - Operating - Investing
- b. Investing - Operating - Financing
- c. Operating - Investing - Financing
- d. Financing - Investing - Operating

ANSWER: c

330. Business entities generally carry on:

- a. operating, investing, and financing activities.
- b. operating activities, but only corporations engage in financing and investing activities.
- c. investing and operating activities, but only corporations engage in financing activities.
- d. either investing or financing activities, but not both.

ANSWER: a

331. Although businesses engage in a wide variety of activities, all of these activities can be categorized into three types. Which of the following choices best reflects these three types of business activities?

- a. Operating, financing, reporting
- b. Investing, reporting, financing
- c. Operating, financing, investing
- d. Investing, reporting, operating

ANSWER: c

332. As used in accounting, the “Notes to the Financial Statements” should be:

- a. listed with the liabilities on the balance sheet.
- b. omitted at the option of the company.
- c. included as an integral part of the financial statements.
- d. reported as expenses on the Income Statement.

ANSWER: c

Chapter 1: Accounting as a Form of Communication

333. Which of the following items will be found in a corporate annual report?
- a. Company budgets
 - b. Notes to the financial statements
 - c. Selected financial data from competitor companies
 - d. Management's statement that the auditors are responsible for the financial statements.

ANSWER: b

334. Which one of the following sections is **least** likely to be found in a corporate annual report?
- a. Notes to the Financial Statements
 - b. Forecasts of Cash Flows and Earnings
 - c. Report of the Independent Accountants
 - d. Management's Discussion and Analysis

ANSWER: b

335. Supplementary disclosures required by GAAP that help explain detail behind the accounting treatment of certain items in the financial statements is most likely found in which of the following sections of a corporate annual report?
- a. Report of the Independent Accountants
 - b. Notes to the Financial Statements
 - c. Management's Discussion and Analysis
 - d. Balance Sheet

ANSWER: b

336. An investor found the following in an annual report: "The financial statements, in our opinion, present fairly the financial position, operating results, and cash flows, in conformity with accounting principles generally accepted in the United States." In which section of the annual report did the investor find this?
- a. Balance Sheet
 - b. Notes to the Financial Statements
 - c. Management's Discussion and Analysis
 - d. Report of the Independent Accountants

ANSWER: d

337. Which of the following represents one of the purposes of the notes to financial statements?
- 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 CPA'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.

ANSWER: d

Chapter 1: Accounting as a Form of Communication

338. Financial statements are intended to tell the reader the value of a company.

- a. True
- b. False

ANSWER: False

339. Accountants are the main reason financial statements are prepared.

- a. True
- b. False

ANSWER: False

340. The Financial Accounting Standards Board defined the objectives of financial reporting.

- a. True
- b. False

ANSWER: True

341. The purpose of financial reporting is to provide economic information to external decision makers only.

- a. True
- b. False

ANSWER: False

342. An objective of financial reporting is to reflect economic information concerning a company's cash flows.

- a. True
- b. False

ANSWER: True

343. The concept of conservatism is the capacity of information to make a difference in a decision.

- a. True
- b. False

ANSWER: False

344. Materiality deals with the size of an error in accounting information.

- a. True
- b. False

ANSWER: True

345. Most businesses have an operating cycle of less than one year.

- a. True
- b. False

ANSWER: True

Chapter 1: Accounting as a Form of Communication

346. Current assets, other than cash, are expected to be sold or consumed during a company's normal operating cycle.

- a. True
- b. False

ANSWER: True

347. Obligations related to operating activities that will be paid within the company's operating cycle must be reported as current liabilities on a classified balance sheet.

- a. True
- b. False

ANSWER: True

348. The operating cycle for all businesses is one year.

- a. True
- b. False

ANSWER: False

349. A construction company that builds skyscrapers is likely to have an operating cycle longer than one year.

- a. True
- b. False

ANSWER: True

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

- a. True
- b. False

ANSWER: True

351. In the stockholders' equity section of a classified balance sheet, a distinction is made between amounts invested by owners and amounts accumulated from business earnings.

- a. True
- b. False

ANSWER: True

352. One primary purpose of a classified balance sheet is to help users evaluate the liquidity of a company.

- a. True
- b. False

ANSWER: True

353. Companies prepare classified financial statements because they are required by international accounting principles.

- a. True
- b. False

ANSWER: False

Chapter 1: Accounting as a Form of Communication

354. The current ratio is **irrelevant** in liquidity analysis for service companies because they do **not** have inventories among their current assets.

- a. True
- b. False

ANSWER: False

355. An advantage of the current ratio is that it considers the makeup of the current assets.

- a. True
- b. False

ANSWER: False

356. The excess of current assets over current liabilities is referred to as working capital.

- a. True
- b. False

ANSWER: True

357. A balance sheet shows cash, \$75,000; marketable securities, \$115,000; accounts receivable, \$150,000 and \$222,500 of inventories. Current liabilities are \$225,000. The current ratio is 2.5 to 1.

- a. True
- b. False

ANSWER: True

358. If a firm has a current ratio of 2, the subsequent receipt of a 60-day note receivable to settle an open account will cause the ratio to decrease.

- a. True
- b. False

ANSWER: False

359. The purchase of inventory for cash will cause the current ratio to decrease.

- a. True
- b. False

ANSWER: False

360. Income from operations does **not** include interest revenue and interest expense because these items are considered to be non-operating in nature.

- a. True
- b. False

ANSWER: True

361. A 12% change in sales will result in a 12% change in net income.

- a. True
- b. False

ANSWER: False

Chapter 1: Accounting as a Form of Communication

362. Some analysts properly refer to a company's profit margin as its return on assets.

- a. True
- b. False

ANSWER: False

363. Dividends declared and paid reduce a company's retained earnings balance.

- a. True
- b. False

ANSWER: True

364. Dividends paid appears on both the income statement and the statement of retained earnings.

- a. True
- b. False

ANSWER: False

365. Investing activities are needed to provide the funds to start a business.

- a. True
- b. False

ANSWER: False

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

- a. True
- b. False

ANSWER: False

367. Funds raised from financing activities should be invested in assets that can be used to carry on business operations.

- a. True
- b. False

ANSWER: True

368. The primary responsibility for the preparation and integrity of the financial statements in an annual report belongs to the company's independent accountants (CPAs).

- a. True
- b. False

ANSWER: False

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

- a. True
- b. False

ANSWER: True

Chapter 1: Accounting as a Form of Communication

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

- a. True
- b. False

ANSWER: False

371. 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.

- a. True
- b. False

ANSWER: False

372. _____ and _____ have claims to an entity's economic resources.

ANSWER: Creditors; investors
Investors; creditors
Lenders; stockholders
Stockholders; lenders

373. _____ is the magnitude of an omission or misstatement in accounting information that will affect the judgment of someone relying on the information.

ANSWER: Materiality

374. _____ is the capacity of information to make a difference in a decision.

ANSWER: Relevance

375. _____ is the practice of using the **least** optimistic estimate when two estimates of amounts are about equally likely.

ANSWER: Conservatism

376. _____ is the quality of accounting information that makes it comprehensible to those willing to spend the necessary time.

ANSWER: Understandability

377. _____ is the quality of accounting information that makes it dependable in representing the events that it purports to represent.

ANSWER: Reliability

378. _____ is the quality of accounting information that allows a user to analyze two or more companies and look for similarities and differences.

ANSWER: Comparability

379. _____ is the quality of accounting information that allows a user to compare two or more accounting periods for a single company.

ANSWER: Consistency

Chapter 1: Accounting as a Form of Communication

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

ANSWER: Creditors
Lenders
Investors
Stockholders

381. _____ are cash and other assets that are reasonably expected to be realized in cash during the normal operating cycle of the business.

ANSWER: Current assets

382. Property, plant and equipment are classified as _____ assets on the balance sheet.

ANSWER: noncurrent

383. _____ is the process of writing off the cost of tangible assets and _____ is the process of writing off the cost of intangible assets.

ANSWER: Depreciation; amortization

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

ANSWER: Working capital

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

ANSWER: liquidity

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

ANSWER: single

387. The statement of _____ explains changes in the components of owners' equity during the period.

ANSWER: stockholders' equity

388. On the statement of cash flows, the _____ section involves the acquisition and sale of long-term assets.

ANSWER: Investing Activities

389. On the statement of cash flows, the _____ section involves the purchase and sale of products and services.

ANSWER: Operating Activities

390. On the statement of cash flows, the _____ section involves the issuance and repayment of long term liabilities and stock transactions.

ANSWER: Financing Activities

Chapter 1: Accounting as a Form of Communication

Cargo Corporation

Listed below is information from the financial records of Cargo Corporation at December 31, 2015:

Retained earnings	\$37,000	Notes payable--Due July 1, 2018	\$12,000
Accumulated depreciation	13,000	Interest payable	1,000
Income taxes payable	24,000	Office supplies	2,000
Buildings	48,000	Accounts payable	36,000
Cash	11,000	Inventory	33,000
Accounts receivable	35,000	Land	50,000
Capital stock	60,000	Prepaid rent	4,000

391. Read the information about Cargo Corporation.

Required:

Prepare the current liabilities section of the balance sheet for Cargo Corp. at December 31, 2015. You may omit the heading. If the amount of current liabilities were larger, what effect would this have on the current ratio?

ANSWER:

Accounts payable	\$36,000
Interest payable	1,000
Income taxes payable	<u>24,000</u>
Total	<u>\$ 61,000</u>

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

392. Read the information about Cargo Corporation.

Required:

Prepare the long-term asset section of Cargo Corp.'s balance sheet at December 31, 2015. You may omit the heading. Why are these amounts classified as "long-term"?

ANSWER:

Land		\$50,000
Buildings	\$48,000	
Less: Accumulated Depreciation	(<u>13,000</u>)	<u>35,000</u>
Total		<u>\$85,000</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 building's benefit used up.

Chapter 1: Accounting as a Form of Communication

393. Read the information about Cargo Corporation.

Required:

Prepare the current assets section of the balance sheet for Cargo Corp. at December 31, 2015. You may omit the heading. How does the concept of liquidity apply?

ANSWER:

Cash	\$11,000
Accounts receivable	35,000
Inventory	33,000
Prepaid rent	4,000
Office supplies	<u>2,000</u>
Total current assets	<u>\$85,000</u>

Liquidity is an indicator of how close to cash the company's assets are. Those assets that are most liquid are listed first. Current assets are expected to be converted into cash or used up within the next accounting period.

394. Read the information about Cargo Corporation.

Required:

Calculate Cargo's current ratio at December 31, 2015. What does this ratio tell you about the "composition" of the current assets?

ANSWER: Current Assets = \$85,000
(\$11,000 Cash + \$35,000 Accounts receivable + \$33,000 Inventory + \$4,000 Prepaid Rent +
\$2,000 Office Supplies = \$85,000)
Current Liabilities = \$61,000
(\$36,000 Accounts Payable + \$1,000 Interest Payable + \$24,000 Income Taxes Payable =
\$61,000)
Current ratio = 1.39 to 1
(\$85,000 / \$61,000)

The current ratio does not provide information about the composition of the current assets. Only totals are used to calculate the current ratio.

Chapter 1: Accounting as a Form of Communication

395. Read the information about Cargo Corporation.

Required:

Calculate the amount of working capital at December 31, 2015 for Cargo Corp. What can you learn from the current ratio that you **cannot** learn from the amount of working capital?

ANSWER: Current Assets = \$85,000

(\$11,000 Cash + \$35,000 Accounts receivable + \$33,000 Inventory + \$4,000 Prepaid Rent + \$2,000 Office Supplies = \$85,000)

Current Liabilities = \$61,000

(\$36,000 Accounts Payable + \$1,000 Interest Payable + \$24,000 Income Taxes Payable = \$61,000)

Working Capital = \$24,000

(\$85,000 - \$61,000)

The current ratio indicates the number of times current assets is greater than current liabilities. It is based on a relative relationship, not total dollars, as the amount of working capital is.

Chapter 1: Accounting as a Form of Communication

Fasoli, Inc.

The following balance sheet items from Fasoli, Inc. are listed for December 31, 2015:

Accounts payable	\$ 32,650
Interest payable	2,200
Accounts receivable	26,500
Land	250,000
Accumulated depreciation—buildings	40,000
Marketable securities	15,000
Merchandise inventory	112,900
Accumulated depreciation—equipment	12,500
Notes payable, due April 15, 2016	6,500
Office supplies	200
Notes payable, due December 31, 2019	251,630
Paid-in capital in excess of par value	75,000
Buildings	150,000
Patents	45,000
Capital stock, \$1 par value	200,000
Prepaid rent	3,800
Cash	60,990
Retained earnings	113,510
Equipment	84,500
Salaries payable	7,400
Income taxes payable	7,500

396. Read the information about Fasoli, Inc.

Required:

Present the Current Assets section (including the total) of a classified balance sheet.

<i>ANSWER:</i> Current Assets:	
Cash	\$ 60,990
Marketable securities	15,000
Accounts receivable	26,500
Merchandise inventory	112,900
Prepaid rent	3,800
Office supplies	200
Total current assets	<u>\$ 219,390</u>

Chapter 1: Accounting as a Form of Communication

397. Read the information about Fasoli, Inc.

Required:

Prepare the Stockholders' Equity section of the classified balance sheet, including the total stockholders' equity amount.

ANSWER:

Stockholders' Equity	
Contributed capital:	
Capital stock, \$1 par value, 200,000 shares issued and outstanding	\$ 200,000
Paid-in capital in excess of par value	<u>75,000</u>
Total contributed capital	\$ 275,000
Retained earnings	<u>113,510</u>
Total stockholders' equity	<u>\$ 388,510</u>

398. Read the information about Fasoli, Inc.

Required:

Present the current liabilities section (including the total) of a classified balance sheet.

ANSWER:

Current liabilities:	
Accounts payable	\$ 32,650
Income taxes payable	7,500
Interest payable	2,200
Notes payable, due April 15, 2016	6,500
Salaries payable	<u>7,400</u>
Total current liabilities	<u>\$ 56,250</u>

399. Read the information about Fasoli, Inc.

Required:

Compute Fasoli's current ratio. On the basis of your answer, does Fasoli appear to be liquid? What other information do you need to fully answer that question?

ANSWER: Current Ratio = Current Assets/Current Liabilities $\$219,390/\$56,250 = 3.9$ to 1

From the current ratio alone, Fasoli appears to be relatively liquid. In fact, Fasoli may be too liquid, because its cash balance is greater than its total current liabilities. This indicates that Fasoli may be missing significant investment opportunities by maintaining such a large cash balance. To fully assess its liquidity, you would need to look more specifically at the activity in accounts receivable and merchandise inventory. In other words, how long does it take to collect an account receivable or how long does it take to sell inventory? Also, you would want to compare Fasoli's current ratio at the end of this period with prior periods, and with the current ratio for companies in the same industry.

Chapter 1: Accounting as a Form of Communication

400. Read the information about Fasoli, Inc.

Required:

Prepare the Assets section of the classified balance sheet.

ANSWER: Assets

Current assets:

Cash		\$ 60,990
Marketable securities		15,000
Accounts receivable		26,500
Merchandise inventory		112,900
Prepaid rent		3,800
Office supplies		<u>200</u>
Total current assets		\$219,390

Property, plant, and equipment:

Land		\$250,000
Buildings	\$150,000	
Less: Accumulated depreciation	<u>(40,000)</u>	110,000
Equipment	\$ 84,500	
Less: Accumulated depreciation	<u>(12,500)</u>	<u>72,000</u>
Total property, plant, and equipment		432,000

Intangible assets:

Patents		<u>45,000</u>
Total assets		<u>\$696,390</u>

401. Read the information about Fasoli, Inc.

Required:

Prepare the Liabilities section of the classified balance sheet, including total liabilities balance.

ANSWER: Liabilities

Current liabilities:

Accounts payable	\$ 32,650
Income taxes payable	7,500
Interest payable	2,200
Notes payable, due April 15, 2016	6,500
Salaries payable	<u>7,400</u>
Total current liabilities	\$ 56,250

Long-term debt:

Notes payable, due December 31, 2019	<u>251,630</u>
Total liabilities	<u>\$307,880</u>

Chapter 1: Accounting as a Form of Communication

402. Harrison Company calculated the following amounts concerning its financial information for the years ending December 31, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Current ratio	3.1 to 1	2.0 to 1
Profit margin	22 %	18%

Required:

Examine Harrison's ratios. Is the change in the current ratio favorable or not? Explain.

ANSWER: The current ratio increased from 2.0 to 1 to 3.1 to 1. This is an unusually large increase for most companies. A larger current ratio means a company is more liquid. This increase is favorable, although care must be taken that the current ratio does not become too large which may indicate an inefficient cash management system.

Chapter 1: Accounting as a Form of Communication

403. Complete the December 31, 2015 (first year of operation) Balance sheet for Weglein Company using the following information:

- (a) Retained earnings at December 31, 2015 was \$51,000.
- (b) Total stockholders' equity at January 1, 2015 was \$139,000.
- (c) On December 30, 2015, additional capital stock was sold for cash, \$55,000
- (d) The land and building were purchased on December 30, 2015 for \$150,000.

Weglein Company Balance Sheet December 31, 2015

Assets		Liabilities & Stockholders' Equity	
Cash	\$ 80,000	Liabilities:	
Accounts receivable	<u>?</u>	Notes payable	<u>?</u>
Land	112,000	Accounts payable	<u>45,000</u>
Buildings	<u>?</u>	Total liabilities	<u>?</u>
Equipment	30,000	Stockholders' equity:	
		Capital Stock	<u>?</u>
		Retained earnings	<u>?</u>
		Total liabilities and	
Total assets	<u>\$</u>	stockholders' equity	<u>\$390,000</u>

ANSWER:

Weglein Company Balance Sheet December 31, 2015

Assets		Liabilities & Stockholders' Equity	
Cash	\$ 80,000	Liabilities:	
Accounts receivable	130,000	Notes payable	\$100,000
Land	112,000	Accounts payable	<u>45,000</u>
Building	38,000	Total liabilities	<u>\$145,000</u>
Equipment	30,000	Stockholders' equity:	
		Capital Stock	\$194,000
		Retained earnings	<u>51,000</u>
			<u>245,000</u>
Total assets	<u>\$390,000</u>	Total liabilities and	
		stockholders' equity	<u>\$390,000</u>

Explanation of calculations:

Total assets must be equal to total liabilities & stockholders equity of \$390,000.

\$150,000 (cost of land and building) less \$112,000 for land = \$38,000 for building.

Accounts receivable must be \$130,000 to achieve total assets of \$390,000.

\$139,000 (capital stock at January 1) plus \$55,000 (additional investment).

Total liabilities must be \$145,000 to achieve total liabilities & stockholders' equity of \$390,000.

Notes payable must be \$100,000 to achieve total liabilities of \$145,000.

Chapter 1: Accounting as a Form of Communication

404. Harrison Company calculated the following amounts concerning its financial information for the years ending December 31, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Current ratio	3.1 to 1	2.0 to 1
Profit margin	22 %	18%

Required:

Suppose Harrison Company had a decrease in its cash account from 2014 to 2015. Would the other current asset amounts have increased or decreased? Explain.

ANSWER: Since the current ratio increased from 2014 to 2015, the current assets other than cash would have had to increase substantially to offset the decline in cash. 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.

Fellsmere Corporation

Presented below are the condensed balance sheets of Fellsmere Corporation at December 31, 2014 and 2013. Net income for the years ending December 31, 2014 and 2013 is \$346,000 and \$109,000, respectively.

	<u>December 31, 2014</u>	<u>December 31, 2013</u>
Current assets	\$2,228,186	\$2,544,683
Property, plant, & equipment (net)	530,589	376,647
Intangibles and other assets	<u>131,206</u>	<u>118,121</u>
Total assets	<u>\$2,889,981</u>	<u>\$3,039,451</u>
Current liabilities	\$1,429,674	\$1,003,906
Long-term obligations	3,360	7,240
Warranty and other liabilities	<u>112,971</u>	<u>98,081</u>
Total liabilities	<u>\$1,546,605</u>	<u>\$1,109,227</u>
Stockholders' equity:		
Common stock	\$ 1,566	\$ 501,631
Additional paid-in capital	365,986	799,483
Retained earnings	980,509	634,509
Accumulated other comprehensive loss	(4,085)	(5,489)
Total stockholders' equity	<u>\$1,343,976</u>	<u>\$1,930,224</u>
Total liabilities and stockholders' equity	<u>\$2,889,981</u>	<u>\$3,039,451</u>

Chapter 1: Accounting as a Form of Communication

405. Read the information about Fellsmere Corporation.

Required:

- (A) Did Fellsmere's current ratio increase or decrease from 2013 to 2014? Make any necessary calculations and explain your answer. Which financial statement users are most concerned with this ratio?
- (B) The balance sheets show a large increase in retained earnings during 2014. Identify the possible reason(s) for this increase.

ANSWER: (A) Current ratio for 2014 = 1.56 to 1

(\$2,228,186 Current Assets / \$1,429,674 Current Liabilities)

Current Ratio for 2013 = 2.53 to 1

(\$2,544,683 Current Assets / \$1,003,906 Current Liabilities)

This ratio is an indicator of the company's ability to pay its current debt when it is due. Fellsmere's current ratio has declined significantly. A company with decreasing liquidity ratios is not appealing to bankers and creditors, and it may have trouble trying to borrow money, since the decrease indicates the company is less likely able to repay its debts.

(B) The amount of retained earnings increases primarily because of net income for a period. A company that has a positive balance in retained earnings over time has cumulative profits in excess of cumulative dividends paid.

406. Read the information about Fellsmere Corporation.

Required:

- (A) Explain the change in Fellsmere's working capital from 2013 to 2014. Why do users believe the current ratio provides more information than the dollar amount of working capital? Explain.
- (B) Fellsmere Corporation's creditors need to know whether its working capital position improved during the year. How would you evaluate this?

ANSWER: (A) Working Capital, 2013 = \$1,540,777

(\$2,544,683 Current Assets - \$1,003,906 Current Liabilities = \$1,540,777)

Working Capital, 2014 = \$798,512

(\$2,228,186 Current Assets - \$1,429,674 Current Liabilities = \$798,512)

Decrease in Working Capital = \$742,265

(\$1,540,777 Working Capital, 2013 - \$798,512 Working Capital, 2014 = \$742,265)

Working capital represents the excess of current assets over current liabilities in total dollars. The current ratio indicates the number of times that current assets exceed the current liabilities. It is possible that \$742,265 could pay the current debts of one company easily, but pay for only a small portion of a larger company's debts.

(B) The amount of working capital and the current ratio are the best indicators of a company's working capital position. While the amount of working capital provides the dollar amount of current assets that exceed the company's current debt, the current ratio provides a relative indicator of how many times the dollar amount of current assets exceeds currently due debt. In 2013, Fellsmere Corporation's working capital was \$1,540,777. However, this figure declined in 2014 to \$798,512. Less current assets are available to cover current liabilities.

Chapter 1: Accounting as a Form of Communication

Crystal, Inc.

Crystal, Inc. reported \$52,000 of net income for 2014. Crystal's balance sheet at December 31, 2014 includes the following amounts:

Wages payable	\$ 1,000	Inventory	\$26,000
Prepaid rent	3,000	Land	40,000
Cash	15,000	Accounts receivable	22,000
Accounts payable	25,000	Capital stock	40,000
Retained earnings	29,000	Income taxes payable	11,000

407. Read the information about Crystal, Inc. Which item is most "liquid"? Why is liquidity important?

ANSWER: Cash is the most liquid asset. Liquidity is an indicator of a company's ability to pay its current debts when they come due. A company without cash is most certainly not going to survive.

408. Read the information about Crystal, Inc. Has Crystal been profitable since it began operations? How do you know?

ANSWER: Retained earnings represents the company's cumulative profits since it began operations less the dividends it paid out. Since Crystal, Inc. has a positive balance in its retained earnings account, it has been profitable over the time it has been in business. Cumulative net income exceeds aggregate net loss and aggregate dividends paid.

409. The balance sheet of Evanston Inc. includes the following items:

Cash	\$ 21,500
Accounts receivable	12,400
Inventory	45,300
Prepaid insurance	1,800
Land	80,000
Accounts payable	49,000
Salaries payable	1,625
Capital stock	105,100
Retained earnings	5,700

Required:

- (1) Determine the current ratio and working capital.
- (2) What does the composition of the current assets tell you about Evanston's liquidity?
- (3) What other information do you need to fully assess Evanston's liquidity?

ANSWER: 1. Current Ratio = Current Assets/Current Liabilities
= $(\$21,500 + \$12,400 + \$45,300 + \$1,800)/(\$49,000 + \$1,625)$
= $\$81,000/\$50,625 = 1.6$ to 1
Working Capital = Current Assets – Current Liabilities
= $\$81,000 - \$50,625 = \$30,375$

2. One concern is the relatively large percentage of the current assets tied up in inventory. This asset accounts for $\$45,300/\$81,000$, or approximately 56% of the total current assets. What is the normal period of time it takes to sell inventory? Is any part of the inventory slow moving or obsolete?

3. On the basis of the current ratio alone, Evanston appears to be relatively liquid, although it would be important to compare the ratio with those of prior years and with those of other companies in the same industry.

Chapter 1: Accounting as a Form of Communication

Eagle Corporation

Presented below are all of the items from Eagle Corporation's income statement for the years ending December 31, 2014 and 2013.

	<u>December 31, 2014</u>	<u>December 31, 2013</u>
Service fees	\$2,300,000	\$2,100,000
General and administrative expenses	1,900,000	1,500,000
Other income, net	40,000	20,000
Income taxes	150,000	180,000

410. Read the information about Eagle Corporation.

Required:

How much is net income for the year ended December 31, 2014? If Eagle Corporation had used a single-step statement, by how much would net income be different? Explain.

ANSWER: Net Income = \$290,000

(\$2,300,000 Service Fees + \$40,000 Other Income, net - \$1,900,000 General and Administrative Expenses - \$150,000 Income Taxes = \$290,000)

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.

411. Read the information about Eagle Corporation.

Required:

Compare the profit margins for 2014 and 2013. Is the company becoming more or less profitable or staying the same? What could be contributing to this?

ANSWER: Profit Margin for 2014 = 12.61%

(\$290,000 Net Income / \$2,300,000 Service Fees = 12.61%)

Profit Margin for 2013 = 20.95%

(\$440,000 Net Income / \$2,100,000 Service Fees = 20.95%)

The decrease in profit margin is unfavorable and indicates that the company is becoming less profitable. A significant increase in general and administrative expenses seems to be the cause of the decline.

Chapter 1: Accounting as a Form of Communication

Burke Company

The following income statement items are taken from the records of Burke Company for the year ended December 31, 2014:

Advertising expense	\$2,600
Commission expense	3,515
Cost of goods sold	29,200
Depreciation expense - Office Building	4,000
Income tax expense	190
Insurance expense sales person's auto	3,350
Interest expense	1,400
Interest revenue	2,340
Rent revenue	7,700
Salaries and wages expense - Office	13,660
Sales Revenue	50,300
Supplies expense - Office	1,990

412. Read the information about Burke Company.

Required:

Prepare a multiple-step income statement for the year ended December 31, 2014.

ANSWER:

BURKE COMPANY
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2014

Sales		\$50,300
Cost of goods sold		<u>29,200</u>
Gross profit		\$21,100
Operating expenses:		
Selling expenses:		
Advertising	\$2,600	
Commissions	3,515	
Insurance - salesperson's auto	<u>3,350</u>	
Total selling expenses		\$9,465
General and administrative expenses:		
Depreciation—office building	\$4,000	
Salaries and wages—office	13,660	
Supplies—office	<u>1,990</u>	
Total general and administrative expenses		<u>19,650</u>
Total operating expenses		<u>29,115</u>
Loss from operations		\$(8,015)
Other revenues and expenses:		
Interest expense	\$(1,400)	
Interest revenue	2,340	
Rent revenue	<u>7,700</u>	
Excess of other revenues over other expenses		<u>8,640</u>
Income before taxes		\$625
Income tax expense		<u>190</u>
Net income		<u>\$ 435</u>

Chapter 1: Accounting as a Form of Communication

413. Read the information about Burke Company

Required:

Prepare a single-step income statement for the year ended December 31, 2014.

ANSWER:

BURKE COMPANY		
INCOME STATEMENT		
FOR THE YEAR ENDED DECEMBER 31, 2014		
Revenues:		
Sales	\$50,300	
Interest revenue	2,340	
Rent revenue	<u>7,700</u>	
Total Revenues		\$60,340
Expenses:		
Advertising	\$2,600	
Commissions	3,515	
Cost of goods sold	29,200	
Depreciation—office building	4,000	
Income tax expense	190	
Insurance - salesperson's auto	3,350	
Interest expense	1,400	
Salaries and wages—office	13,660	
Supplies—office	<u>1,990</u>	
Total expenses		<u>59,905</u>
Net income		<u><u>\$ 435</u></u>

414. The 2015 income statement of Cigmar Enterprises shows operating revenues of \$120,500, selling expenses of \$35,200, general and administrative expenses of \$29,900, interest expense of \$1,500, and income tax expense of \$10,520. Cigmar's stockholders' equity was \$280,000 at the beginning of the year and \$320,000 at the end of the year. The company has 20,000 shares of stock outstanding at December 31, 2015.

Required:

Compute Cigmar's profit margin. What other information would you need in order to comment on whether this ratio is favorable?

ANSWER: Profit margin:

Net Income/Revenues = $\$43,380 / \$120,500 = 36.0\%$

$\$120,500 - \$35,200 - \$29,900 - \$1,500 - \$10,520 = \$43,380$

A profit margin of 36% indicates that for every dollar of sales, Cigmar Enterprises has \$0.36 in net income. It would be beneficial to compare the company's profit margin with some of its competitors and with previous years.

Chapter 1: Accounting as a Form of Communication

415. The 2014 income statement of Nasir Inc. shows operating revenues of \$135,800, selling expenses of \$40,310, general and administrative expenses of \$33,990, interest expense of \$880, and income tax expense of \$13,090. Nasir's stockholders' equity was \$250,000 at the beginning of the year and \$345,000 at the end of the year. The company has 10,000 shares of stock outstanding at December 31, 2014.

Required:

Compute Nasir's profit margin. What other information would you need in order to comment on whether this ratio is favorable?

ANSWER:

Profit margin:

$$\text{Net Income/Revenues} = \$47,530 / \$135,800 = \underline{\underline{35.0\%}}$$

$$*\$135,800 - \$40,310 - \$33,990 - \$880 - \$13,090 = \$47,530$$

A profit margin of 35% indicates that for every dollar of sales, Nasir Inc. has \$0.35 in net income. It would be beneficial to compare the company's profit margin with some of its competitors and with previous years.

416. Hammar Corporation's partial income statement is as follows:

Sales	\$2,400,000
Cost of sales	900,000
Selling expenses	121,600
General and admin. expenses	150,000

Required:

Determine the profit margin. Would you invest in Hammar Corporation? Explain your answer.

ANSWER: **Profit margin:**

$$\text{Net Income/Sales} = \$1,228,400 / \$2,400,000 = \underline{\underline{51.2\%}}$$

$$*\$2,400,000 - \$900,000 - \$121,600 - \$150,000 = \$1,228,400*$$

Sales	\$ 2,400,000
– Cost of sales	<u>900,000</u>
= Gross profit	\$ 1,500,000
– Total operating expenses	<u>271,600**</u>
= Net income	<u>\$ 1,228,400*</u>

**Total Operating Expenses = Selling Expenses (\$121,600) + General and Administrative Expenses (\$150,000) = \$271,600

Hammar Corporation has been very profitable on the basis of its very high profit margin of 51.2%. Before making an investment, however, you would want to consider how this ratio compares with that of prior years and with that of other companies in the same line of business.

Chapter 1: Accounting as a Form of Communication

417. Peterson Corporation's partial income statement is as follows:

Sales	\$1,300,000
Cost of sales	300,000
Selling expenses	210,000
General and admin. expenses	150,000

Required:

Determine the profit margin. Would you invest in Peterson Corporation? Explain your answer.

ANSWER: **Profit margin:**

$$\text{Net Income/Sales} = \$640,000 / \$1,300,000 = \underline{\underline{49.2\%}}$$

$$*\$1,300,000 - \$300,000 - \$210,000 - \$150,000 = \$640,000*$$

Sales	\$1,300,000
– Cost of sales	<u>300,000</u>
= Gross profit	\$1,000,000
– Total operating expenses	<u>360,000**</u>
= Net income	<u><u>\$ 640,000*</u></u>

$$**\text{Total Operating Expenses} = \text{Selling Expenses } (\$210,000) + \text{General and Administrative Expenses } (\$150,000) = \$360,000$$

Peterson Corporation has been very profitable on the basis of its very high profit margin of 49.2%. Before making an investment, however, you would want to consider how this ratio compares with that of prior years and with that of other companies in the same line of business.

Chapter 1: Accounting as a Form of Communication

418. Powder Corporation began operations on January 2, 2013, with a total investment of \$150,000 by its stockholders. Net income for its first year of business was \$90,000. During 2014 and 2015, net income increased to \$188,000 and to \$217,000, respectively. Powder paid \$85,000 in dividends to its shareholders in each of the three years.

- A) In good form, prepare a statement of retained earnings for the year ended December 31, 2014.
- B) How much is total retained earnings on December 31, 2015?
- C) Explain the link between the statement of retained earnings and the balance sheet.

ANSWER: A)

Powder Corporation	
Statement of Retained Earnings	
for the Year Ended December 31, 2014	
Beginning balance, January 1, 2014	\$ 5,000*
Add: Net income for 2014	188,000
Less: Dividends paid during the year	(85,000)
Ending balance, December 31, 2014	<u>\$108,000</u>

* \$90,000 Net Income for 2013 - \$85,000 Dividends paid = \$5,000 Balance, January 1, 2014

- B) Retained earnings at December 31, 2015 = \$240,000
(\$108,000 Beginning Balance, January 1, 2015 + \$217,000 Net Income for 2015 - \$85,000 Dividends paid during the year = \$240,000)
The ending balance of the retained earnings statement represents the cumulative earnings
- C) less all the dividends declared and paid for the life of the business. This amount appears on the balance sheet as a component of owners' equity.

Chapter 1: Accounting as a Form of Communication

419. The following information is taken from Harvey Company's balance sheet at December 31, 2014:

Cash	\$ 24,000
Retained earnings	14,000
Inventory	8,000
Equipment	38,000
Accounts payable	7,000
Bonds payable	23,000
Capital stock	26,000

Required:

Using the information provided for Harvey Company, answer the following questions:

- A) How much did creditors provide to Harvey Company?
- B) On which financial statement would an investor look to see if any stock was issued during the year?

ANSWER: A) \$30,000
(\$7,000 Accounts Payable + \$23,000 Bond Payable)

- B) The primary source for seeing whether any stock was issued during the year would be the Statement of Stockholders' Equity. While the Balance Sheet may show an amount for "Capital Stock," this amount is an ending balance, and would not show the results of any transactions involving new issuances of stock during the period.

Chapter 1: Accounting as a Form of Communication

420. Coglin, Inc. incurred a net loss of \$20,000 for 2014. The balance sheet at December 31, 2014, for Coglin, Inc., includes the following items:

Cash	\$ 23,000
Accounts receivable	13,000
Inventory	45,000
Prepaid insurance	1,000
Land	21,000
Building	80,000
Accounts payable	55,000
Salaries payable	2,000
Capital stock	100,000
Retained earnings	25,000

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

ANSWER: A) Current ratio: 1.44 to 1
(\$23,000 Cash + \$13,000 Accounts receivable + \$45,000 Inventory + \$1,000 Prepaid insurance) / (\$55,000 Accounts payable + \$2,000 Salaries payable) = 1.44 to 1
Working capital: \$25,000
(\$82,000 Total Current Assets - \$57,000 Total Current Liabilities = \$25,000)

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 business activity and the nature of each particular cash flow

Chapter 1: Accounting as a Form of Communication

421. During 2014, Wimbrow Images reported \$60,000 of net income and generated \$80,000 of cash from operations. During the year, Wimbrow Images paid \$15,000 to purchase a new delivery truck and also paid dividends in the amount of \$30,000. Wimbrow Images borrowed \$40,000 cash from the bank. At the beginning of the year, cash amounted to \$50,000.

- A) Prepare a statement of cash flows for the year ended December 31, 2014.
- B) How much more cash does Wimbrow Images have available at the end of the year than at the beginning?
- C) Why is there a difference between net income and cash flows from operations?

ANSWER: A)

Wimbrow Images
Statement of Cash Flows
for the Year Ended December 31, 2014

Cash flows from operating activities	\$ 80,000
Cash flows from investing activities:	
Purchase of new truck	(15,000)
Cash flows from financing activities:	
Proceeds from loan made by bank	40,000
Cash dividends paid	(30,000)
Increase (Decrease) in cash	\$ 75,000
Cash at the beginning of the year	<u>50,000</u>
Cash at the end of the year	<u><u>\$125,000</u></u>

- B) The company has \$75,000 more at the end of the year compared to the beginning of the year
- C) Net income is calculated using the accrual basis of accounting, whereas cash flows from operating activities represent the net amount of cash flows from operations of the business

Chapter 1: Accounting as a Form of Communication

422. Tradewinds Corporation was organized on January 1, 2014, with the investment of \$500,000 in cash by its stockholders. Tradewinds signed a ten-year, \$300,000 promissory note at a local bank during 2014 and received cash in the same amount. The company immediately purchased an office building for \$800,000, paying in cash. During its first year, Tradewinds generated \$35,000 in cash from operations and paid \$30,000 in cash dividends.

A) In good form, prepare a statement of cash flows for the year ended December 31, 2014.

B) What does this statement tell you that an income statement does **not**?

ANSWER: A)

Tradewinds Corporation
Statement of Cash Flows
for the Year Ended December 31, 2014

Cash flows from operating activities		\$ 35,000
Cash flows from investing activities		
Purchase office building		(800,000)
Cash flows from financing activities		
Investment by owners	500,000	
Loan from bank	300,000	
Payment of dividends	(30,000)	
Net cash provided by financing activities		<u>770,000</u>
Net increase in cash for the year		\$ 5,000
Cash at the beginning of the year		<u>--0--</u>
Cash at the end of the year		<u>\$5,000</u>

B) This statement provides information on the cash inflows and outflows by activity: operating, investing, and financing. The income statement is prepared on the accrual basis that provides information on the revenues earned and the expenses incurred during the period, which may or may not involve cash. The income statement shows the profitability of a company for a period of time. Furthermore, the income statement does not present information regarding all the sources and uses of cash.

Chapter 1: Accounting as a Form of Communication

423. Hindsville Company reported revenues of \$165,000 and net income of \$20,000 for 2014. Cash generated by operations was \$40,000. In addition, Hindsville Company borrowed \$24,000 from a bank. During 2014, Hindsville purchased new equipment for \$30,000 cash and paid cash dividends of \$15,000 to stockholders. Hindsville's cash balance at the beginning of 2014 was \$22,000.

- A) Identify the amount of cash flows for financing, investing, and operating activities for 2014 by filling in the amounts below.
- | | |
|-----------------------|-------|
| Financing Cash Flows: | _____ |
| Investing Cash Flows: | _____ |
| Operating Cash Flows: | _____ |
- B) Did Hindsville Company's operating activities generate enough cash to cover its investing and financing activities? Explain. _____
- C) How much did Hindsville Company's cash balance increase or decrease during 2014?

ANSWER: A) Financing Cash Flows = \$9,000
 (\$24,000 Cash borrowed from bank - \$15,000 Cash dividends paid = \$9,000)
 Investing Cash Flows = (\$30,000)
 (Purchase of new equipment)
 Operating Cash Flows = \$40,000
 (Cash generated by operations)

B) Yes. The total of investing and financing activities is an outflow of \$21,000. The \$40,000 generated from operating activities is sufficient

C) \$19,000 Increase
 (\$40,000 Cash flow from operations - \$30,000 Cash flow from investing + \$9,000 Cash flow from financing = \$19,000)

Chapter 1: Accounting as a Form of Communication

424. Presented below are items from Joplin Shoes statement of cash flows for 2014.

Cash flows provided by operating activities	\$ 75,000
Cash flows provided by financing activities	115,000
Cash at the beginning of the year	60,000
Cash flows used by investing activities	(100,000)

A) Determine whether Joplin Shoes' cash increased or decreased during the year.

B) How much cash does Joplin Shoes have at the end of 2014?

C) What is the purpose of the statement of cash flows?

- ANSWER:*
- A) \$90,000 increase
(\$75,000 Cash flows provided by operating activities- \$100,000 Cash flows used by investing activities + \$115,000 Cash flows provided by financing activities = \$90,000 increase)
 - B) \$150,000
(\$60,000 Cash at the beginning of the year + \$90,000 increase = \$150,000)
 - C) A statement of cash flows summarizes the operating, financing, and investing activities of a company for a period of time

Chapter 1: Accounting as a Form of Communication

425. Mill Valley Corporation was organized on January 1, 2014, with the investment of \$225,000 in cash by its stockholders. The company immediately purchased an office building for \$300,000, paying \$201,000 in cash and signing a three-year promissory note for the balance. Mill Valley signed a five-year, \$50,000 promissory note at a local bank during 2014 and received cash in the same amount. During its first year, Mill Valley collected \$93,000 from its customers. It paid \$60,600 for inventory, \$22,400 in salaries and wages, and another \$5,100 in taxes. Mill Valley paid \$5,300 in cash dividends.

Required

1. Prepare a statement of cash flows for the year ended December 31, 2014.
2. What does this statement tell you that an income statement does not?

ANSWER:

Mill Valley Corporation
Statement of Cash Flows
For the Year Ended December 31, 2014

Cash flows from operating activities:		
Cash collected from customers	\$ 93,000	
Cash paid for inventory	(60,600)	
Cash paid in salaries and wages	(22,400)	
Cash paid in taxes	<u>(5,100)</u>	
Net cash provided by operating activities		\$ 4,900
Cash flows from investing activities:		
Payment on office building		(201,000)
Cash flows from financing activities		
Proceeds from issuance of stock	\$225,000	
Proceeds from long-term note	50,000	
Dividends declared and paid	<u>(5,300)</u>	
Net cash provided by financing activities		<u>269,700</u>
Net increase in cash		\$ 73,600
Cash at beginning of year		<u>0</u>
Cash at end of year		<u>\$ 73,600</u>

Note: Mill Valley should report one significant noncash activity as supplementary information to its statement of cash flows: the three-year, \$99,000 note signed to finance the purchase of the office building.

2. First, the statement of cash flows reports on operations on a cash basis, as opposed to the income statement which is prepared on an accrual basis. Second, investing and financing activities are also reported on a statement of cash flows. For example, information about dividends paid during the year is shown on a statement of cash flows but not on an income statement. It is interesting to note that Mill Valley paid more in dividends, \$5,300, than the amount of cash it generated from operations, \$4,900.

Chapter 1: Accounting as a Form of Communication

426. Identify each of the following items as operating (O), investing (I), or financing (F) activities on the statement of cash flows (assuming the indirect method). If an item is not on the statement, please mark it as none of these (N). If the item is an inflow, please indicate by a (+), (e.g. O+, I+ or F+). If the item is an outflow, please indicate by brackets, (e.g., <O> for operating outflow, <I> for investing outflow, and <F> for financing outflow:

- ____ (a) Paid an account payable for inventory purchased in the previous accounting period.
- ____ (b) Amortization of debt issuance costs
- ____ (c) Paid a dividend to stockholders.
- ____ (d) Paid the interest on a note payable to National Street Bank.
- ____ (e) Paid the principal amount due on the note payable to National Street Bank.
- ____ (f) Transferred cash from a checking account into a money market fund.
- ____ (g) Purchased equipment for cash.

ANSWER: a. <O> b. O+ c. <F> d. <O> e. <F> f. N g. <I>

427. Most financial 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.

Elements	Prepared By	Information Provided
Management Discussion & Analysis		
Financial Statements		
Notes to Financial Statements		
Report of Independent Accountants		

ANSWER:

Elements	Prepared By	Information Provided
Management Discussion & Analysis	Mgmt.	Discussion of financial statements and explanations
Financial Statements	Mgmt.	Income statement, balance sheet, statement of cash flows, statement of retained earnings
Notes to Financial Statements	Mgmt.	Accounting policies and other disclosures
Report of Independent Accountants	CPA firm.	Opinion that statements are presented fairly

Chapter 1: Accounting as a Form of Communication

428. Comparative income statements for Gregson Inc. are as follows:

	<u>2014</u>	<u>2013</u>
Sales	\$2,000,000	\$600,000
Cost of sales	800,000	400,000
Gross profit	\$1,200,000	\$200,000
Operating expenses	520,000	120,000
Operating income	\$ 680,000	\$ 80,000
Loss on sale of subsidiary	(800,000)	0
Net income (loss)	<u>\$</u>	<u>\$</u>

Required:

The president and management believe that the company performed better in 2014 than it did in 2013. Write the president's letter to be included in the 2014 annual report. Explain why the company is financially sound and why shareholders should not be alarmed by the \$120,000 loss in a year when gross profit increased significantly.

ANSWER: Letter from the President to Stockholders of Gregson Inc.:

On the surface, 2014 does not appear to have been a successful year for Gregson Inc. However, it was primarily one specific event that caused the net loss we experienced for the year. The sale of a subsidiary resulted in a loss of \$800,000. We believe that the sale of this unprofitable unit of the business will allow us to concentrate our future attention on our successful businesses and clear the way for a return to overall profitability in 2013.

Aside from the loss experienced on the sale of the subsidiary, 2014 was a really great year for the company. We were able to control our operating expenses, resulting in operating income as a percentage of sales that increased from 13% to 34%. These are clear signals that Gregson Inc. is moving in the right direction and should have a very solid year of operations in 2013.

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

ANSWER: Investors are most interested in cash receipts from dividends and the cash they can receive upon selling their stock. 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 balance sheet, is also a concern for both investors and creditors because even though a company may have what appears to be sufficient cash flows for the current period, the long-run solvency picture could be weak.

430. Cory Harper, a newly hired accountant, wanted to impress his boss, so he stayed late one night to analyze the office supplies expense account. He determined the cost by month, for the past 12 months, of each of the following: computer paper, copy paper, fax paper, pencils and pens, note pads, postage, corrections supplies, stationery, and miscellaneous items. Why do companies **not** include information of this nature in published financial statements?

ANSWER: Companies provide information to users to make decisions. The primary decision makers external to the business are creditors, bankers, stockholders, and potential stockholders. These users need to know that the company can repay its debts, earn a profit, and pay dividends. The cost by month for each item of office supplies does not provide any additional information that would be helpful for any external users. In addition, the time and expense necessary to create the additional detail would outweigh the benefits of the final product. The amounts involved are probably immaterial.

Chapter 1: Accounting as a Form of Communication

431. Service-oriented companies have different needs than product-oriented companies when analyzing financial statements.

REQUIRED: Why is this true? Give an example of a financial ratio that is meaningless to a service business.

ANSWER: Because service-oriented companies do not sell a tangible product, they instead must sell their professional expertise and rely on alternative measures of their efficiency in marketing their services. For example, an law firm would keep detailed records of the hours worked on each client's case, monthly billings to each client, and the ratio of these billings to the average costs incurred on each case. Therefore, ratios like inventory turnover would be meaningless to a service business, like a law firm or a public accounting firm.

432. Ginger Company claims its financial information is useful. What two qualities must be present in order to have "useful" accounting information? Explain these two qualities.

ANSWER: To be useful, accounting information must be relevant and reliable. Relevant information has the capacity to make a difference in a decision. Reliable information can be depended on to represent the economic events that it purports to represent.

433. What is the difference between comparability and consistency?

ANSWER: Comparability allows comparisons to be made between or among companies. Even though a certain amount of freedom exists in selecting accounting principles, when this information is disclosed in the financial statements, users can still compare the information when they know what principle is used. Consistency involves the relationship between a set of numbers over several periods, but within one company only, unlike comparability that can be between or among companies.

434. What is conservatism and why is it important in accounting?

ANSWER: Conservatism is taking the route that will be least likely to overstate assets or income. It is used in situations in which there is uncertainty about how to account for a particular item. In accounting, it is used in the balance sheet and income statement in an effort to provide the least optimistic amount.

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

ANSWER: A classified balance sheet helps evaluate the liquidity of a company by separating the current assets from long-term assets and 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.

436. What is the operating cycle of a business? How does this impact the classification of assets into current and noncurrent categories?

ANSWER: The operating cycle depends on the nature of a company's business. It encompasses the period of time from the investment of cash in inventory to the collection of account receivables from the sale of products. This can take a long time, like the production of a cruise ship, or a very short time, like the preparation of restaurant food. Current assets are realized in cash, or sold, or consumed during the operating cycle or within one year if the cycle is shorter than one year.

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

ANSWER: Current assets will be realized in cash, or sold, or consumed during the operating cycle or within one year if the cycle is shorter than one year. Current liabilities are obligations that will be satisfied within 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

Chapter 1: Accounting as a Form of Communication

438. Potential stockholders 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 stock	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) Which two items would stockholders be most interested in that can either be computed from the above data or are included in the items listed above? Explain why the two you selected are important to stockholders.
- B) In which one item would lenders be most interested? Explain why this item is important.

ANSWER:

- A) Stockholders 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.

439. What is the purpose of a statement of stockholders' equity? How does it differ from the statement of retained earnings? Which statement is required?

ANSWER: A statement of stockholders' equity summarizes the changes in all owners' equity amounts during the period. If there are no changes in capital stock during the period, a company can prepare a statement of retained earnings that explains only the changes in the retained earnings account. A company has an option to present either statement.

440. What is the purpose of a statement of cash flows? Give an example of one of each of the three activities.

ANSWER: A statement of cash flows summarizes the operating, financing, and investing activities of a company for a period of time. Some examples are:
Operating: Collections of cash from customers; Payments to suppliers; Payments for wages
Investing: Purchases or sales of plant assets; Purchases or sales of investments
Financing: Payment of dividends; Issuance of stock to investors

Chapter 1: Accounting as a Form of Communication

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

ANSWER: 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.

Identify whether the following investor questions are associated with (a) primary or (b) secondary financial reporting objectives.

- a. primary financial reporting objective
- b. secondary financial reporting objective

442. How much has Apple invested in research and development projects?

ANSWER: b

443. Based on the financial information, should I buy shares of Apple?

ANSWER: a

444. If I buy 50 shares of Apple, how much cash will I receive in dividends each year?

ANSWER: b

445. How much revenue will Apple generate during the time period in which I own the shares?

ANSWER: b

446. Based on the financial information, should I sell my shares of Apple next quarter?

ANSWER: a

Match the following characteristics with the statements about each qualitative characteristic's importance.

- a. Consistency
- b. Materiality
- c. Conservatism
- d. Comparability
- e. Reliability
- f. Relevance
- g. Understandability

447. Those willing to spend the time should be provided with comprehensible accounting information.

ANSWER: g

448. The accounting information must be information that could affect a decision.

ANSWER: f

449. Accounting information should use the least optimistic estimate.

ANSWER: c

Chapter 1: Accounting as a Form of Communication

450. This quality allows users to analyze two or more companies and look for similarities and differences.

ANSWER: d

451. Users must be able to compare accounting information of a firm with its prior year information.

ANSWER: a

452. Accounting information must be verifiable and faithfully represent actual transactions.

ANSWER: e

453. This quality refers to an amount large enough to affect a decision.

ANSWER: b

For each item listed, select the section of the balance sheet in which the item would be reported.

- a. Current Assets
- b. Property, Plant, and Equipment
- c. Current Liabilities
- d. Long-term Liabilities
- e. Stockholders' Equity

454. Cash

ANSWER: a

455. Accounts payable

ANSWER: c

456. Retained earnings

ANSWER: e

457. Land

ANSWER: b

458. Capital stock

ANSWER: e

459. Accounts receivable

ANSWER: a

460. Equipment

ANSWER: b

461. Notes payable--due within one year

ANSWER: c

462. Interest payable

ANSWER: c

Chapter 1: Accounting as a Form of Communication

463. Bonds payable

ANSWER: d

464. Computer used within the business

ANSWER: b

465. Computer available for resale

ANSWER: a

Match the selected items from a classified balance sheet and multiple-step income statement to the section in which they would appear on the classified balance sheet or the income statement.

- a. Current Assets (balance sheet)
- b. Property, Plant, & Equipment (balance sheet)
- c. Current Liabilities (balance sheet)
- d. Long-term Liabilities (balance sheet)
- e. Stockholders' Equity (balance sheet)
- f. Operating Revenue (income statement)
- g. Operating Expenses (income statement)
- h. Other Revenue & Expenses (income statement)
- i. Income Taxes (income statement)

466. Accounts receivable

ANSWER: a

467. Consulting revenues

ANSWER: f

468. Buildings

ANSWER: b

469. Interest expense

ANSWER: h

470. Capital stock

ANSWER: e

471. Land

ANSWER: b

472. Bonds payable

ANSWER: d

473. Income taxes payable

ANSWER: c

Chapter 1: Accounting as a Form of Communication

474. Service revenues

ANSWER: f

475. Wages payable

ANSWER: c

476. Cost of goods
sold

ANSWER: g

From the following choices, select the answer that describes the effect on working capital as a result of the transaction.

- a. Working capital will increase
- b. Working capital will decrease
- c. Working capital will **not** change

477. Paid cash for supplies

ANSWER: c

478. Purchased inventory on account

ANSWER: c

479. Purchased land for cash

ANSWER: b

480. Borrowed cash using a long-term note

ANSWER: a

481. Borrowed cash using a six-month note

ANSWER: c

482. Collected an account receivable

ANSWER: c

From the following list, select the proper section from the statement of cash flows in which it would be classified.

- a. Operating Activities
- b. Investing Activities
- c. Financing Activities

483. Purchased equipment for cash

ANSWER: b

Chapter 1: Accounting as a Form of Communication

484. Received cash from the sale of a building

ANSWER: b

485. Paid a cash dividend on capital stock

ANSWER: c

486. Received cash from bond issuance

ANSWER: c

487. Paid income taxes

ANSWER: a

488. Received cash from selling goods to customers

ANSWER: a

489. Sold equipment **no** longer used in the business

ANSWER: b

490. Paid suppliers cash for inventory purchased

ANSWER: a

491. In preparing financial statements, accountants should consider all of the following **except**:

- a. the objectives of financial reporting.
- b. the characteristics that make accounting information useful.
- c. the most useful way to display the information found on the financial statements.
- d. the presentation of the value of a company.

ANSWER: d

492. Which of the following is the best description of the purpose of financial reporting?

- a. To allow users to access to the daily detailed records of a business.
- b. To help the users reach their decisions in an informed manner.
- c. To provide users with an assessment of how long the company will continue as a going concern.
- d. To allow users access to a list of all the individuals who owe the company money.

ANSWER: b

493. The quality of accounting information that allows a user to analyze two or more companies and look for similarities and differences is known as understandability.

- a. True
- b. False

ANSWER: False

Chapter 1: Accounting as a Form of Communication

494. The quality of accounting information that makes it comprehensible to those willing to spend the necessary time is consistency.
- a. True
 - b. False

ANSWER: False

495. The quality of accounting information that allows a user to compare two or more accounting periods for a single company is known as consistency.
- a. True
 - b. False

ANSWER: True

496. You are comparing three companies that use different depreciation methods. Which of the following would help you the most in making a comparison of the companies?
- a. The average earnings per share for the quarter.
 - b. Prospective cash receipts.
 - c. Claims to resources.
 - d. Disclosure of accounting policies.

ANSWER: d

497. There is a standard threshold for materiality set by the Financial Accounting Standards Board for all companies.
- a. True
 - b. False

ANSWER: False

498. The **lack** of a common depreciation method makes it impossible to compare the performance companies using different methods.
- a. True
 - b. False

ANSWER: False

499. The amount of a transaction may be **immaterial** by company standards but still be considered significant by financial statement users.
- a. True
 - b. False

ANSWER: True

Chapter 1: Accounting as a Form of Communication

500. Which of the following are generally supplementary information required by GAAP concerning the accounting treatments used by a company?
- a. A Year-End Worksheet
 - b. Management's Discussion and Analysis
 - c. The Report of Independent Accountants
 - d. Notes to the Consolidated Financial Statements

ANSWER: d