

CHAPTER 2: BASIC ACCOUNTING CONCEPTS

1. The basic elements of a financial accounting system include a framework for preparing financial statements.
 - a. True
 - b. False

ANSWER: True

2. The accounting equation is expressed as follows: $\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$.
 - a. True
 - b. False

ANSWER: True

3. Any given transaction must affect at least two different parts of the accounting equation.
 - a. True
 - b. False

ANSWER: False

4. The accounting equation can be expressed as: $\text{Assets} - \text{Liabilities} = \text{Revenues}$.
 - a. True
 - b. False

ANSWER: False

5. A transaction can affect at most two elements of the accounting equation.
 - a. True
 - b. False

ANSWER: False

6. Equality of the accounting equation means that no errors have occurred.
 - a. True
 - b. False

ANSWER: False

7. Dividends are an example of an expense.
 - a. True
 - b. False

ANSWER: False

8. Retained earnings will be increased by the amount in the dividend account.
 - a. True
 - b. False

ANSWER: False

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9. By keeping a running total of the effects of transactions, the accounting equation provides a framework for summarizing the effects of a series of transactions.

- a. True
- b. False

ANSWER: True

10. A business receives \$10,000 cash for a sale of merchandise and records this receipt of cash as an increase in accounts receivable by mistake. The accounting equation is still in balance.

- a. True
- b. False

ANSWER: True

11. The effect of every transaction is an increase or a decrease in one or more of the accounting equation elements.

- a. True
- b. False

ANSWER: True

12. When a notes payable account is paid in cash, the stockholders' equity in the business increases.

- a. True
- b. False

ANSWER: False

13. When an account receivable is collected in cash, the total assets of the business increase.

- a. True
- b. False

ANSWER: False

14. It is possible for a transaction to change the makeup of assets, but to *not* affect assets in total.

- a. True
- b. False

ANSWER: True

15. When capital stock is issued by a corporation for cash, both the income statement and the balance sheet are affected.

- a. True
- b. False

ANSWER: False

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16. Fees earned and received in cash will increase cash flows from operating activity as well as retained earnings.
- a. True
 - b. False

ANSWER: True

17. Miscellaneous expenses are expenses that have an undetermined amount to be paid.
- a. True
 - b. False

ANSWER: False

18. The payment of utilities expense in cash would affect the operating activities in the statement of cash flows and the income statement but *not* the balance sheet.
- a. True
 - b. False

ANSWER: False

19. Revenues decrease stockholders' equity.
- a. True
 - b. False

ANSWER: False

20. The two sides of the accounting equation do *not* have to be equal.
- a. True
 - b. False

ANSWER: False

21. A common-sized income statement is prepared by expressing income statement amounts as a percent of purchases.
- a. True
 - b. False

ANSWER: False

22. The basic financial statements include the:
- a. trial balance.
 - b. bank reconciliation statement.
 - c. balance sheet.
 - d. ledger account.

ANSWER: c

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23. Which of the following is *not* an element of the financial accounting system?
- a. Rules for determining what, when and the amount that should be recorded
 - b. A framework for preparing financial statements
 - c. A set of rules for the stock exchange
 - d. Controls to determine whether errors occur during recording

ANSWER: c

24. If a \$15,000 purchase of equipment for cash is incorrectly recorded as an increase to equipment and as an increase to cash, at the end of the period assets will:
- a. exceed liabilities and stockholders' equity by \$15,000.
 - b. equal liabilities and stockholders' equity.
 - c. exceed liabilities and stockholders' equity by \$30,000.
 - d. exceed liabilities and stockholders' equity by \$40,000.

ANSWER: c

25. Which of the following is considered to be a liability?
- a. Prepaid expenses
 - b. Investments
 - c. Unearned revenues
 - d. Accrued revenues

ANSWER: c

26. Which of the following accounts is a stockholders' equity account?
- a. Cash
 - b. Capital Stock
 - c. Prepaid Insurance
 - d. Accounts Payable

ANSWER: b

27. Which of the following group of accounts are all assets?
- a. Cash, Accounts Payable, Buildings
 - b. Accounts Receivable, Revenue, Cash
 - c. Prepaid Expenses, Buildings, Patents
 - d. Unearned Revenues, Prepaid Expenses, Cash

ANSWER: c

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28. Expenses can be defined as:

- a. assets consumed.
- b. services used in the process of generating revenues.
- c. costs that have been incurred during the normal course of business.
- d. all of these.

ANSWER: d

29. The gross increases in stockholders' equity attributable to business activities are called:

- a. assets.
- b. liabilities.
- c. revenues.
- d. net income.

ANSWER: c

30. The payment of \$20,000 for expenses was incorrectly recorded by Elite Co. as an increase in cash of \$20,000 and a decrease in retained earnings of \$20,000. What is the effect of this error on the accounting equation?

- a. Total assets will exceed total liabilities and stockholders' equity by \$20,000.
- b. Total assets will exceed total liabilities and stockholders' equity by \$40,000.
- c. Total assets will be less than total liabilities and stockholders' equity by \$40,000.
- d. The error will not affect the accounting equation.

ANSWER: b

31. Which of the following will increase stockholders' equity?

- a. Expenses > revenues
- b. Owners' investment
- c. Accounts payable
- d. Dividends paid

ANSWER: b

32. A _____ is an economic event that under generally accepted accounting principles affects an element of the financial statements and must be recorded.

- a. framework
- b. control
- c. set of rules
- d. transaction

ANSWER: d

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33. The statement of cash flows is integrated with the balance sheet because:

- a. the cash at the beginning of the period plus or minus the cash flows from operating, investing, and financing activities equals the end of period cash reported on the balance sheet.
- b. the cash at the beginning of the period plus or minus the net income equals the end of period cash reported on the balance sheet.
- c. the cash at the beginning of the period plus or minus assets and liabilities equals the end of period cash reported on the balance sheet.
- d. the cash at the beginning of the period plus or minus the cash flows from operating activities equals the end of period cash reported on the balance sheet.

ANSWER: a

34. Which of the following statements is true about liabilities?

- a. Liabilities include insurance premium paid in advance.
- b. Liabilities arise when a company sells goods on account.
- c. Liabilities equal assets plus stockholders' equity.
- d. Liabilities are the debt owed by a company.

ANSWER: d

35. Which of the following situations increase stockholders' equity?

- a. Supplies are purchased on account.
- b. Services are provided on account.
- c. Cash is received from customers.
- d. Utility bill will be paid next month.

ANSWER: b

36. Stockholders' equity will be increased by:

- a. increase in revenues.
- b. increase in expenses.
- c. payment of dividends.
- d. issuance of bonds.

ANSWER: a

37. Sunlight, Inc. had the following assets and liabilities as of September 30, 2016:

Assets	\$60,600
Liabilities	\$27,500

What is the stockholders' equity of Sunlight as of September 30, 2016?

- a. \$0
- b. \$33,100
- c. \$88,100
- d. Cannot be determined with this information

ANSWER: b

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38. Sunlight, Inc. had the following assets and liabilities as of September 30, 2016

Assets	\$60,600
Liabilities	\$27,500

If assets increased by \$4,350 and equity increased by \$2,900 during October, what is the increase or decrease in liabilities of Sunlight as of October 31, 2016?

- a. (\$1,450)
- b. \$1,450
- c. \$7,250
- d. (\$7,250)

ANSWER: b

39. Rush Corporation borrowed \$25,000 from the bank. Which of the following accurately shows the effects of the transaction?

- a. Increase cash \$25,000 and decrease notes payable \$25,000
- b. Increase cash \$25,000 and increase notes payable \$25,000
- c. Decrease cash \$25,000 and decrease notes payable \$25,000
- d. Decrease cash \$25,000 and increase notes payable \$25,000

ANSWER: b

40. Flow, Inc. received cash from fees earned. How does this transaction affect the Statement of Cash Flows?

- a. Increase cash from Operating Activities
- b. Increase cash from Investing Activities
- c. Increase cash from Financing Activities
- d. No effect on the Statement of Cash Flows

ANSWER: a

41. Philip Corporation purchased equipment on account. What is the effect of this transaction?

- a. Cash will decrease and equipment will increase.
- b. Total assets will remain unchanged.
- c. Cash flow from Investing Activities will decrease.
- d. Total assets and total liabilities will both increase.

ANSWER: d

42. Johnson, Inc. paid rent expense of \$3,500 for the month of October. How are the accounts affected due to this transaction?

- a. Increase in cash \$3,500 and increase in retained earnings \$3,500
- b. Increase in cash \$3,500 and decrease in retained earnings \$3,500
- c. Decrease in cash \$3,500 and decrease in retained earnings \$3,500
- d. Decrease in cash \$3,500 and increase in retained earnings \$3,500

ANSWER: c

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43. Johnson, Inc. purchased land for cash. What effect does this transaction have?

- a. Increase in Cash and decrease in Land
- b. Decrease in Cash and decrease in Land
- c. Increase in Cash and increase in Land
- d. Decrease in Cash and increase in Land

ANSWER: d

44. Johnson, Inc. issued \$15,000 in capital stock in exchange for cash. What is the effect of this transaction?

- a. Total assets remain unchanged.
- b. Cash flow from Financing Activities will increase.
- c. Net Income will increase.
- d. Total Retained Earnings will increase.

ANSWER: b

45. Johnson, Inc. receives \$5,000 cash for fees earned. What is the effect of this transaction?

- a. Total assets remain unchanged.
- b. Cash flow from Financing Activities will increase.
- c. Net income will increase.
- d. Retained earnings will remain unchanged.

ANSWER: c

46. Stockholders' equity will be reduced by:

- a. payment of dividends.
- b. increase in revenues.
- c. owners' investments.
- d. issuance of bonds.

ANSWER: a

47. ABC Company deposited \$20,000 in a bank account in return for issuing shares in the corporation. This transaction would affect which two financial statement elements?

- a. Assets and stockholders' equity
- b. Assets and liabilities
- c. Liabilities and stockholders' equity
- d. None of these

ANSWER: a

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48. BNC Company earns revenues and as a result collects cash. Which of the following financial statement elements increased?
- a. Cash only
 - b. Stockholders' equity only
 - c. Liabilities
 - d. Cash and stockholders' equity

ANSWER: d

49. DAF Company paid a utility bill of \$300 and paid rent of \$700 in December. By how much would these events reduce stockholders' equity?
- a. \$300
 - b. \$1,000
 - c. \$400
 - d. \$700

ANSWER: b

50. Declaring and paying cash dividends affects which balance sheet accounts?
- a. Cash only
 - b. Stockholders' equity only
 - c. Cash and stockholders' equity
 - d. Cash and capital stock

ANSWER: c

51. Which of the following transactions changes the mix of assets only?
- a. Paid for supplies with cash.
 - b. Borrowed money from Second National Bank.
 - c. Received money for fees earned.
 - d. Received a utility bill.

ANSWER: a

52. If assets have a balance of \$80,000 and stockholders' equity has a balance of \$60,000, then liabilities must have a balance of:
- a. \$140,000.
 - b. \$60,000.
 - c. \$80,000.
 - d. \$20,000.

ANSWER: d

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53. If liabilities have a balance of \$10,000 and stockholders' equity has a balance of \$60,000, then assets must have a balance of:
- a. \$50,000.
 - b. \$60,000.
 - c. \$70,000.
 - d. \$10,000.

ANSWER: c

Exhibit 2-1

	Total Assets	Total Liabilities
Beginning of the year	\$300,000	\$130,000
End of the year	\$800,000	\$550,000

54. Refer to Exhibit 2-1. Determine the net income (or loss), assuming no stock was issued and no dividends were paid?
- a. \$420,000
 - b. \$250,000
 - c. \$80,000
 - d. \$170,000

ANSWER: c

55. Refer to Exhibit 2-1. Determine the net income (or loss), assuming no stock was issued and dividends of \$40,000 were paid?
- a. \$40,000
 - b. \$210,000
 - c. \$120,000
 - d. \$290,000

ANSWER: c

56. Refer to Exhibit 2-1. Determine the net income (or loss), assuming \$50,000 of stock was issued and no dividends were paid?
- a. \$130,000
 - b. \$30,000
 - c. \$80,000
 - d. \$220,000

ANSWER: b

57. Refer to Exhibit 2-1. Determine the net income (or loss), assuming \$50,000 of stock was issued and \$40,000 of dividends were paid?
- a. \$70,000
 - b. \$210,000
 - c. \$260,000
 - d. \$10,000

ANSWER: a

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58. Lewis Company has \$25,000 in retained earnings, \$40,000 in assets, and \$11,000 in liabilities. How much is in common stock?
- a. \$29,000
 - b. \$25,000
 - c. \$14,000
 - d. \$4,000

ANSWER: d

59. A to Z Corporation paid a \$10,000 cash dividend. On the Statement of Cash Flows, the transaction would be classified as:
- a. Cash Flows from Operating Activities.
 - b. Cash Flows from Investing Activities.
 - c. Cash Flows from Financing Activities.
 - d. Noncash transaction.

ANSWER: c

60. A to Z Corporation purchased a building for \$80,000 cash. On the Statement of Cash Flows, the transaction would be classified as:
- a. Cash Flows from Operating Activities.
 - b. Cash Flows from Investing Activities.
 - c. Cash Flows from Financing Activities.
 - d. Noncash transaction.

ANSWER: b

61. A to Z Corporation issued a \$30,000 note payable to borrow cash from the bank. On the Statement of Cash Flows, the transaction would be classified as:
- a. Cash Flows from Operating Activities.
 - b. Cash Flows from Investing Activities.
 - c. Cash Flows from Financing Activities.
 - d. Noncash transaction.

ANSWER: c

62. An increase in Stockholders' Equity from revenues earned will also result in an increase in:
- a. liabilities.
 - b. assets.
 - c. expenses.
 - d. cash flow from financing activities.

ANSWER: b

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63. For EFG Co., the transaction "payment to creditors" would:

- a. increase total assets.
- b. decrease total assets.
- c. have no effect on total assets.
- d. decrease stockholders' equity.

ANSWER: b

64. For EFG Co., the transaction "cash sales to customers at a profit" would:

- a. increase total assets.
- b. decrease total assets.
- c. have no effect on total assets.
- d. decrease stockholders' equity.

ANSWER: a

65. For EFG Co., the transaction "payment of interest expense" would:

- a. increase total assets.
- b. decrease total assets.
- c. have no effect on total assets.
- d. increase stockholders' equity.

ANSWER: b

66. For EFG Co., the transaction "purchase of store equipment with cash" would:

- a. increase total assets.
- b. decrease total assets.
- c. have no effect on total assets.
- d. decrease stockholders' equity.

ANSWER: c

67. For EFG Co., the transaction "payment of dividends" would:

- a. increase total assets.
- b. decrease total assets.
- c. have no effect on total assets.
- d. increase stockholders' equity.

ANSWER: b

68. For EFG Co., the transaction "purchase of store equipment with a note payable" would:

- a. increase total assets.
- b. decrease total assets.
- c. have no effect on total assets.
- d. decrease total liabilities.

ANSWER: a

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69. For EFG Co., the transaction "payment of quarterly taxes" would:

- a. increase total assets.
- b. decrease total assets.
- c. have no effect on total assets.
- d. increase stockholders' equity.

ANSWER: b

70. For EFG Co., the transaction "receipt of interest income" would:

- a. increase total assets.
- b. decrease total assets.
- c. have no effect on total assets.
- d. decrease total liabilities.

ANSWER: a

71. For EFG Co., the transaction "receipt of a utility bill" would:

- a. increase total assets.
- b. decrease total assets.
- c. have no effect on total assets.
- d. decrease total liabilities.

ANSWER: c

72. For EFG Co., the transaction "billed a customer for fees earned" would:

- a. increase total assets.
- b. decrease total assets.
- c. have no effect on total assets.
- d. increase total liabilities.

ANSWER: a

73. The income statement for August indicates net income of \$100,000. The corporation also paid \$25,000 in dividends during the same period. If the company is in operation for only one month and has no beginning balance in retained earnings, what is the ending balance in retained earnings?

- a. \$75,000
- b. \$100,000
- c. \$20,000
- d. \$125,000

ANSWER: a

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74. Anthony, Inc. buys land for \$50,000 cash. The net effect on assets is:

- a. \$50,000 increase.
- b. \$0.
- c. \$50,000 decrease.
- d. \$25,000 increase.

ANSWER: b

75. Declaring and paying cash dividends affects which account/ accounts?

- a. Cash only
- b. Capital stock only
- c. Cash and retained earnings
- d. Cash and capital stock

ANSWER: c

76. Buying equipment for cash affects which account/ accounts?

- a. Cash only
- b. Retained earnings only
- c. Equipment and retained earnings
- d. Cash and equipment

ANSWER: d

77. Cash receipts from cash sales affects which financial statement elements?

- a. Assets only
- b. Stockholders' equity only
- c. Assets and stockholders' equity
- d. Assets and liabilities

ANSWER: c

78. Paying expenses affects which financial statement elements?

- a. Assets only
- b. Stockholders' equity only
- c. Assets and stockholders' equity
- d. Assets and liabilities

ANSWER: c

79. The payment of a liability:

- a. decreases assets and stockholders' equity.
- b. increases assets and decreases liabilities.
- c. decreases assets and increases liabilities.
- d. decreases assets and decreases liabilities.

ANSWER: d

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80. The first month of operation showed the net cash from operating activities to be \$1,850, the net cash from investing activities to be (\$3,000), and the ending cash balance to be \$1,600. The net cash from financing activities must be:
- a. \$450.
 - b. \$2,750.
 - c. \$3,250.
 - d. \$6,450.

ANSWER: b

81. A common-sized income statement is prepared by expressing income statement amounts as a percent of _____.
- a. sales
 - b. purchases
 - c. total assets
 - d. profit

ANSWER: a

82. A common-sized balance sheet is prepared by expressing each liability item as a percent of:
- a. total sales.
 - b. total stockholders' equity.
 - c. total liabilities.
 - d. total liabilities plus stockholders' equity.

ANSWER: d

83. A commonsized balance sheet is prepared by expressing each stockholders' equity item as a percent of:
- a. total sales.
 - b. total liabilities plus stockholders' equity.
 - c. total stockholders' equity.
 - d. total liabilities.

ANSWER: b

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84.

	Year 2	Year 1
Sales	\$170,000	\$130,000
Cost of sales	<u>135,000</u>	<u>105,000</u>
Gross profit	<u>\$ 35,000</u>	<u>\$ 25,000</u>

Using the above information, calculate the percentage increase or decrease in cost of sales from Year 1 to Year 2?

- a. Increase of 2.1%
- b. Decrease of 1.4%
- c. Increase of 1.4%
- d. Decrease of 2.1%

ANSWER: b

85. What are the basic elements of a financial accounting system?

ANSWER: A financial accounting system is designed to produce financial statements. The basic elements of a financial accounting system include:

- (1) A set of rules for determining what, when, and the amount that should be recorded
- (2) A framework for preparing financial statements
- (3) One or more controls to determine whether errors may have arisen in the recording process.

86. Calculate the following:

- (a) Determine the cash receipts for May based on the following data:

Cash payments during May	\$42,500
Cash account balance, May 1	3,750
Cash account balance, May 31	6,000
- (b) Determine the cash received from customers on account during May based on the following data:

Accounts receivable account balance, May 1	\$11,500
Accounts receivable account balance, May 31	8,250
Fees billed to customers during May	28,000

ANSWER: (a) \$44,750 (\$6,000 + \$42,500 - \$3,750)

(b) \$31,250 (\$11,500 + \$28,000 - \$8,250)

87. The accounting equation "Assets = Liabilities + Stockholders' Equity" is affected by transactions. Is it possible to have a transaction that only impacts one financial element of the equation? Can a transaction impact two elements of the equation? Give examples.

ANSWER: Yes to both questions. Examples include: (1) increase cash and decrease equipment; (2) increase cash and increase stockholders' equity.

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88. Letty's Laundry and Dry Cleaning incorporated and started business on January 1, 2016.

1. Letty's Laundry and Dry Cleaning began business by depositing \$30,000 in a checking account in the name of Letty's Laundry and Dry Cleaning, Inc. for which capital stock is issued.
2. Borrowed \$6,000 from City Bank.
3. Purchased equipment from Washers Wholesale, \$16,200.
4. Purchased supplies costing \$3,000 from Suds 'n Stuff for cash.
5. Paid one month's rent for business space in Pine Plaza, \$1,000.
6. Services provided to customers during January totaled \$13,400. All services were paid for in cash.
7. Paid employees for January, \$2,240.
8. Received and paid the utility bill, \$500.
9. Received and paid the telephone bill, \$250.
10. Paid dividends to the stockholders, \$2,140.

Indicate the effect of each transaction on the accounting equation by listing the numbers identifying the transactions, (1) through (10) in a vertical column, and inserting at the right of each number the appropriate letter from the following list:

a	Increase in an asset, decrease in another asset.
b	Increase in an asset, increase in a liability.
c	Increase in an asset, increase in stockholders' equity.
d	Decrease in an asset, decrease in a liability.
e	Decrease in an asset, decrease in stockholders' equity

ANSWER:

1.	c
2.	b
3.	b
4.	a
5.	e
6.	c
7.	e
8.	e
9.	e
10.	e

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89. Part A

Indicate the effect of each transaction during the month of October 2016 and the balances for the accounting equation after all transactions have been recorded. No beginning balances exist in the accounts. An accounting equation has been provided.

- Opened a business bank account for Jones, Inc., with an initial deposit of \$45,000 in exchange for capital stock.
- Paid rent on the office building for the month, \$2,000.
- Received cash for fees earned of \$5,000.
- Purchased equipment, \$7,000.
- Borrowed \$20,000 by issuing a note payable.
- Paid salaries for the month, \$1,000.
- Received cash for fees earned of \$8,000.
- Paid dividends, \$3,000.
- Paid interest on the note, \$100.

Assets =			Liabilities + Stockholders' Equity		
	Cash	Equipment	Notes Payable	Capital Stock	Retained Earnings
a					
b					
c					
d					
e					
f					
g					
h					
i					
Bal.					

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Part B

Using the information from Part A, prepare (1) an income statement, (2) a statement of retained earnings, (3) a balance sheet, and (4) a statement of cash flows for the month of October.

Jones, Inc. Income Statement For the Month Ended October 31, 2016		

Jones, Inc. Retained Earnings Statement For the Month Ended October 31, 2016		

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[illegible]

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Jones, Inc.
Statement of Cash Flows
For the Month Ended October 31, 2016

[illegible]

ANSWER: Part A

Assets =		Liabilities + Stockholders' Equity			
	Cash	Equipment	Notes Payable	Capital Stock	Retained Earnings
a.	45,000			45,000	
b.	-2,000				-2,000 Rent Expense
c.	5,000				5,000 Fees Earned
d.	-7,000	7,000			
e.	20,000		20,000		
f.	-1,000				-1,000 Salaries Expense
g.	8,000				8,000 Fees Earned
h.	-3,000				-3,000 Dividends
i.	-100				-100 Interest Expense
Bal.	64,900	7,000	20,000	45,000	6,900

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Part B

Jones, Inc. Income Statement For the Month Ended October 31, 2016		
Revenues:		
Fees Earned		\$13,000
Expenses:		
Rent Expense	\$2,000	
Salaries Expense	1,000	
Interest Expense	<u>100</u>	
Total Expenses		<u>3,100</u>
Net Income		<u>\$ 9,900</u>

Jones, Inc. Retained Earnings Statement For the Month Ended October 31, 2016		
Retained Earnings, October 1, 2016		\$ 0
Add: Net Income		9,900
Less: Dividends		<u>(3,000)</u>
Retained Earnings, October 31, 2016		<u>\$ 6,900</u>

Jones, Inc. Balance Sheet October 31, 2016		
Assets		
Cash	\$64,900	
Equipment	<u>7,000</u>	
Total Assets		<u>\$71,900</u>
Liabilities		
Notes Payable		\$20,000
Stockholders' Equity		
Capital Stock	\$45,000	
Retained Earnings	<u>6,900</u>	<u>51,900</u>
Total Liabilities and Stockholders' Equity		<u>\$71,900</u>

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Jones, Inc. Statement of Cash Flows For the Month Ended October 31, 2016		
Cash flows from operating activities:		
Cash receipts from operating activities	\$13,000	
Cash payments for operating activities	<u>(3,100)</u>	
Net cash flows from operating activities		\$ 9,900
Cash flows from investing activities:		
Cash payments for equipment		(7,000)
Cash flows from financing activities:		
Cash receipts from issuing capital stock	\$45,000	
Cash receipts from note payable	20,000	
Cash payments for dividends	<u>(3,000)</u>	
Net cash flows from financing activities		<u>62,000</u>
Cash as of October 31, 2016		<u>\$64,900</u>

90. Explain how the four financial statements are linked.

ANSWER: A financial accounting system is designed to produce four financial statements. The income statement, statement of retained earnings, and statement of cash flows are linked to an element of the balance sheet.

- (1) The income statement shows the net effects of revenues and expenses, which affects the retained earnings on the balance sheet.
- (2) The statement of retained earnings reflects the net income and dividends paid and shows how retained earnings in the balance sheet moves from the beginning balance to the ending balance.
- (3) The statement of cash flows explains how the cash balance in the balance sheet moves from the beginning balance to the ending balance by looking at the cash effects of operating, investing, and financing activities.

91. How can a company earn a large net income and have a small balance in retained earnings?

ANSWER: The company may pay out most of its earnings in dividends.

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92. The following are included in Ace Auto Parts, Inc.'s December 31, 2015 balance sheet:

Accounts Receivable	\$ 50,000
Building	100,000
Cash	60,000
Land	130,000
Accounts Payable	40,000
Notes Payable	70,000
Stockholders' Equity	?

Below are the balances for December 31, 2015:

Accounts Receivable	\$ 90,000
Building	100,000
Cash	150,000
Land	130,000
Accounts Payable	60,000
Notes Payable	50,000
Stockholders' Equity	?

Analyze the changes in these balances and determine net income for 2016, assuming that the only change to stockholders' equity is from net income.

ANSWER:

	Assets	=	Liabilities	+	Stockholder's Equity
	50,000				
	100,000				
	60,000		40,000		
	<u>130,000</u>		<u>70,000</u>		
Bal. 12/31/2015	<u>340,000</u>		<u>110,000</u>		<u>230,000</u>

	Assets	=	Liabilities	+	Stockholder's Equity
	90,000				
	100,000				
	150,000		60,000		
	<u>130,000</u>		<u>50,000</u>		
Bal. 12/31/2016	<u>470,000</u>		<u>110,000</u>		<u>360,000</u>

Stockholders' Equity ending balance	\$360,000
Stockholders' Equity beginning balance	<u>230,000</u>
Change - Net income	<u>\$130,000</u>

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THE COCA-COLA COMPANY AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

December 31, (In millions except par value)	2008	2007
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 4,701	\$ 4,093
Marketable securities	278	215
Trade accounts receivable, less allowances of \$51 and \$56, respectively	3,090	3,317
Inventories	2,187	2,220
Prepaid expenses and other assets	1,920	2,260
TOTAL CURRENT ASSETS	12,176	12,105
INVESTMENTS		
Equity method investments:		
Coca-Cola Hellenic Bottling Company S.A.	1,487	1,549
Coca-Cola FEMSA, S.A.B. de C.V.	877	996
Coca-Cola Amatil Limited	638	806
Coca-Cola Enterprises Inc.	—	1,637
Other, principally bottling companies and joint ventures	2,314	2,301
Other investments, principally bottling companies	463	488
TOTAL INVESTMENTS	5,779	7,777
OTHER ASSETS	1,733	2,675
PROPERTY, PLANT AND EQUIPMENT — net	8,326	8,493
TRADEMARKS WITH INDEFINITE LIVES	6,059	5,153
GOODWILL	4,029	4,256
OTHER INTANGIBLE ASSETS	2,417	2,810
TOTAL ASSETS	\$ 40,519	\$ 43,269
LIABILITIES AND SHAREOWNERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 6,205	\$ 6,915
Loans and notes payable	6,066	5,919
Current maturities of long-term debt	465	133
Accrued income taxes	252	258
TOTAL CURRENT LIABILITIES	12,988	13,225
LONG-TERM DEBT	2,781	3,277
OTHER LIABILITIES	3,401	3,133
DEFERRED INCOME TAXES	877	1,890
SHAREOWNERS' EQUITY		
Common stock, \$0.25 par value; Authorized — 5,600 shares;		
Issued — 3,519 and 3,519 shares, respectively	880	880
Capital surplus	7,966	7,378
Reinvested earnings	38,513	36,235
Accumulated other comprehensive income (loss)	(2,674)	626
Treasury stock, at cost — 1,207 and 1,201 shares, respectively	(24,213)	(23,375)
TOTAL SHAREOWNERS' EQUITY	20,472	21,744
TOTAL LIABILITIES AND SHAREOWNERS' EQUITY	\$ 40,519	\$ 43,269

Refer to Notes to Consolidated Financial Statements.

93. Refer to Coke's balance sheet and answer the following questions:

- Did Coke issue any stock in 2008? If so, how many shares were issued and where might this information be found?
- Did Coke repurchase any common stock in 2008? If so, how many shares were repurchased and where might this information be found?

ANSWER:

- No, for both 2008 and 2007, Coke had 3,519,000,000 shares issued. The information is in the Shareowners' Equity section of the Balance Sheet.
- Yes, Coke repurchased 6,000,000 shares of its common stock. The information is in the Shareowners' Equity section of the Balance Sheet.

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94. On May 1, the cash account balance was \$72,600. During May, cash receipts totaled \$345,600 and the May 31 balance was \$95,230. Determine the cash payments made during May.

ANSWER: $\$95,230 = \$72,600 + \$345,600 - ?$

Cash payments = \$322,970