

Chapter 2: Financial Statements and the Annual Report

Student: _____

1. 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

2. “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

3. 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.

4. 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

5. 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.

6. 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.

7. Schneider, 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 Schneider 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

8. 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

9. Cheile Transportation purchases many pieces of office furniture with an individual cost below \$200 each. Cheile 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 Cheile to expense the furniture?

- A. Conservatism
- B. Matching
- C. Materiality
- D. Verifiability

10. Crouse Company applies the consistency convention. What does this mean?

- A. Crouse Co. uses the same names for all its expenses as its competitors.
- B. Crouse Co. has selected certain accounting principles that can never be changed.
- C. Crouse Co. applies the same accounting principles each accounting period.
- D. Crouse Co. applies the same accounting principles as its competitors.

11. 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

12. 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

13. The qualitative characteristics of accounting data include

- A. Assets reported on the balance sheet
- B. All accounting information
- C. Cash flows
- D. Reliability

14. Which of the following is a **noncurrent** asset?

- A. Inventories
- B. Office supplies
- C. Land
- D. Accounts receivable

15. Which of the following is a current asset?

- A. Land
- B. Buildings
- C. Store fixtures
- D. Prepaid insurance

16. 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

17. 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

18. Wood Company

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

| | | | |
|-------------------|-----------|--------------------------|-----------|
| Cash | \$ 50,000 | Accounts receivable | \$ 40,000 |
| Inventory | 60,000 | Land | 75,000 |
| Accounts payable | 45,000 | Notes payable (due 2020) | 150,000 |
| Retained earnings | ? | | |

Read the information for Wood Corporation. What are Wood's current assets?

- A. \$ 90,000
- B. \$ 150,000
- C. \$ 195,000
- D. \$ 225,000

19. Read the information for Wood Company. What are Wood's current liabilities?

- A. \$ 45,000
- B. \$ 120,000
- C. \$ 195,000
- D. \$ 225,000

20. 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

21. The following information is given for Wagner 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

22. 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

23. 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

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

- A. Franchises
- B. Copyrights
- C. Investments
- D. Goodwill

25. 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.

26. 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

27. 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

28. 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

29. 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

30. For several years, Shaun Corporation has had a current ratio that was consistent with other companies in its industry. For the most recent year, Shaun'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. Shaun's liquidity has improved or is not leveraging financial resources effectively.
- C. Shaun has less property, plant and equipment than other companies.
- D. Shaun has too much debt.

31. **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 |

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

32. 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 |

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

33. 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 |

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 Nadia & Sisters nor its competitors is liquid.
- D. Nadia & Sisters is more profitable than its competitors.

34. Rosu Company has total current assets of \$120,000 and total current liabilities of \$50,000. What is the amount of working capital for Rosu Company?

- A. \$ 27,000
- B. \$ 67,000
- C. \$ 70,000
- D. \$ 91,000

35. 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

36. 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

37. 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 long-term debt
- C. An analysis of the return on stockholders' equity
- D. An analysis of retained earnings

38. 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

39. Use Rizwi Corporation's list of accounts at December 31, 2014 to answer the following question.

**Rizwi
Corp
oratio
n
List
of
Acco
unts
at
Dece
mber
31,
2014**

| | | | |
|-----------------------|----------|-------------------------------|-----------|
| 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 07/01/2015 | 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

40. If the current ratio is 3 to 1, net income is \$12,000, and current liabilities are \$24,000, how much is working capital?

- A. \$ 12,000
- B. \$ 36,000
- C. \$ 48,000
- D. \$ 72,000

41. 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 probability.

42. 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.

43. 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.

44. 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.

45. 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 |

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

46. 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 |

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

- A. \$58,440
- B. \$89,740
- C. \$84,040
- D. \$9,740

47. 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

48. 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

49. 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.

50. 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.

51. 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

52. 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
53. 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.
54. 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.
55. 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.
56. 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.
57. 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

58. 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 |

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

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

- A. \$ 1,600
- B. \$ 2,000
- C. \$ 2,200
- D. \$ 2,800

60. 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-

61. 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.

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

62. 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.

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

63. Dardenelle, Inc. earned \$600,000 profit during 2014. 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

64. 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.

65. 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

66. 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 |

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.

67. 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 |

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.

68. 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 |

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

69. 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

70. Garrison Industries

Garrison Industries began operations on January 2, 2014, with an investment of \$50,000 by each of its two stockholders. Net income for its first year of business was \$240,000. Garrison Industries paid a total of \$100,000 in dividends to its stockholders during the year.

Read the information about Garrison Industries. What is the company's retained earnings balance at December 31, 2014?

- A. \$140,000
- B. \$190,000
- C. \$240,000
- D. \$340,000

71. Garrison Industries

Garrison Industries began operations on January 2, 2014, with an investment of \$50,000 by each of its two stockholders. Net income for its first year of business was \$240,000. Garrison Industries paid a total of \$100,000 in dividends to its stockholders during the year.

Read the information about Garrison Industries. If the company's revenues were \$500,000 for the year ended December 31, 2014, how much were total expenses?

- A. \$160,000
- B. \$260,000
- C. \$640,000
- D. \$740,000

72. Read the information about Garrison Industries. The company's dividends for the year

- A. Reduce the amount of capital stock reported by the company.
- B. Are part of Garrison Industries' operating costs.
- C. Are reported on the statement of retained earnings.
- D. Are an expense of Garrison Industries.

73. 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

74. In preparing the financial statements for December 31, 2014, 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, 2014
- B. Retained earnings, December 31, 2014
- C. Net income
- D. Total assets

75. 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

76. 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

77. 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

78. 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

79. 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.

80. 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

81. 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 |

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

82. 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 |

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

83. 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

84. 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

85. 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.

86. 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

87. 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

88. 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

89. 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.

90. 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
91. 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
92. 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
93. 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
94. 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.
95. 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

96. A discussion of the financial statements with explanations of certain amounts in the 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

97. 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

98. 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

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

True False

100. The Financial Accounting Standards Board created the objectives of financial reporting.

True False

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

True False

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

True False

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

True False

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

True False

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

True False

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

True False

107. 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.

True False

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

True False

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

True False

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

True False

111. 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.

True False

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

True False

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

True False

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

True False

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

True False

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

True False

117. 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.

True False

118. 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.

True False

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

True False

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

True False

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

True False

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

True False

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

True False

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

True False

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

True False

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

True False

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

True False

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

True False

129. 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.

True False

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

True False

131. 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.
True False

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

151. Match the following characteristics with the statements about each qualitative characteristic's importance.

- | | |
|--|-------------------------|
| 1. Those willing to spend the time should be provided with comprehensible accounting information. | Understandability _____ |
| 2. Accounting information must be verifiable and faithfully represent actual transactions. | Relevance _____ |
| 3. Users must be able to compare accounting information of a firm with its prior year information. | Conservatism _____ |
| 4. The accounting information must be information that could affect a decision. | Comparability _____ |
| 5. Accounting information should use the least optimistic estimate. | Consistency _____ |
| 6. This quality allows users to analyze two or more companies and look for similarities and differences. | Reliability _____ |
| 7. This quality refers to an amount large enough to affect a decision. | Materiality _____ |

152. Loren Corporation

Listed below is information from the financial records of Loren Corporation at December 31, 2014:

| | | | |
|--------------------------|----------|---------------------------------|----------|
| Retained earnings | \$37,000 | Notes payable--Due July 1, 2017 | \$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 |

Read the information about Loren Corporation.

Required:

Prepare the current liabilities section of the balance sheet for Loren Corp. at December 31, 2014. You may omit the heading. If the amount of current liabilities were larger, what effect would this have on the current ratio?

153. Loren Corporation

Listed below is information from the financial records of Loren Corporation at December 31, 2014:

| | | | |
|--------------------------|----------|---------------------------------|----------|
| Retained earnings | \$37,000 | Notes payable--Due July 1, 2017 | \$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 |

Read the information about Loren Corporation.

Required:

Prepare the long-term asset section of Loren Corp.'s balance sheet at December 31, 2014. You may omit the heading. Why are these amounts classified as "long-term"?

154. Loren Corporation

Listed below is information from the financial records of Loren Corporation at December 31, 2014:

| | | | |
|--------------------------|----------|---------------------------------|----------|
| Retained earnings | \$37,000 | Notes payable--Due July 1, 2017 | \$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 |

Read the information about Loren Corporation.

Required:

Prepare the current assets section of the balance sheet for Loren Corp. at December 31, 2014. You may omit the heading. How does the concept of liquidity apply?

155. Loren Corporation

Listed below is information from the financial records of Loren Corporation at December 31, 2014:

| | | | |
|--------------------------|----------|---------------------------------|----------|
| Retained earnings | \$37,000 | Notes payable--Due July 1, 2017 | \$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 |

Read the information about Loren Corporation.

Required:

Calculate Manus' current ratio at December 31, 2014. What does this ratio tell you about the "composition" of the current assets?

156. Loren Corporation

Listed below is information from the financial records of Loren Corporation at December 31, 2014:

| | | | |
|--------------------------|----------|---------------------------------|----------|
| Retained earnings | \$37,000 | Notes payable--Due July 1, 2017 | \$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 |

Read the information below about Loren Corporation.

Required:

Calculate the amount of working capital at December 31, 2014 for Loren Corp. What can you learn from the current ratio that you cannot learn from the amount of working capital?

157. Raponi, Inc.

The following balance sheet items from Raponi, Inc. are listed for December 31, 2014:

| | |
|--|-----------|
| 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, 2015 | 6,500 |
| Office supplies | 200 |
| Notes payable, due December 31, 2018 | 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 |

Read the information about Raponi, Inc.

Required:

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

158. Raponi, Inc.

The following balance sheet items from Raponi, Inc. are listed for December 31, 2014:

| | |
|--|-----------|
| 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, 2015 | 6,500 |
| Office supplies | 200 |
| Notes payable, due December 31, 2018 | 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 |

Read the information about Raponi, Inc.

Required:

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

159. Raponi, Inc.

The following balance sheet items from Raponi, Inc. are listed for December 31, 2014:

| | |
|--|-----------|
| 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, 2015 | 6,500 |
| Office supplies | 200 |
| Notes payable, due December 31, 2018 | 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 |

Read the information about Raponi, Inc.

Required:

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

160. Raponi, Inc.

The following balance sheet items from Raponi, Inc. are listed for December 31, 2014:

| | |
|--|-----------|
| 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, 2015 | 6,500 |
| Office supplies | 200 |
| Notes payable, due December 31, 2018 | 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 |

Read the information about Raponi, Inc.

Required:

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

161. Raponi, Inc.

The following balance sheet items from Raponi, Inc. are listed for December 31, 2014:

| | |
|--|-----------|
| 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, 2015 | 6,500 |
| Office supplies | 200 |
| Notes payable, due December 31, 2018 | 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 |

Read the information about Raponi, Inc.

Required:

Prepare the Assets section of the classified balance sheet.

162. Read the information about Raponi, Inc.

Required:

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

163. Complete the December 31, 2014 (first year of operation) Balance sheet for Weglein Company using the following information:

- (a) Retained earnings at December 31, 2014 was \$51,000.
- (b) Total stockholders' equity at January 1, 2014 was \$139,000.
- (c) On December 30, 2014, additional capital stock was sold for cash, \$55,000
- (d) The land and building were purchased on December 30, 2014 for \$150,000.

**Weglein Company
Balance Sheet
December 31, 2014**

| Assets | | Liabilities & Stockholders' Equity |
|---------------------|-----------|---|
| Cash | \$ 80,000 | Liabilities: |
| Accounts receivable | | \$ |
| Land | 112,000 | Not payable |
| | | 45,000 |
| Buildings | | Accounts payable |
| | | \$ |
| | | Total liabilities |

Equipment

30,000

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Total assets

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164. Ficus Company calculated the following amounts concerning its financial information for the years ending December 31, 2014 and 2013:

| | <u>2014</u> | <u>2013</u> |
|---------------|-------------|-------------|
| Current ratio | 3.1 to 1 | 2.0 to 1 |
| Profit margin | 22 % | 18% |

REQUIRED:

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

165. Ficus Company calculated the following amounts concerning its financial information for the years ending December 31, 2014 and 2013:

| | <u>2014</u> | <u>2013</u> |
|---------------|-------------|-------------|
| Current ratio | 3.1 to 1 | 2.0 to 1 |
| Profit margin | 22 % | 18% |

REQUIRED:

Suppose Ficus Company had a decrease in its cash account from 2013 to 2014. Would the other current asset amounts have increased or decreased? Explain.

166. 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>Dec</u> <u>emb</u> <u>er</u> <u>31,</u> <u>201</u> <u>4</u> | <u>December 31, 2013</u> | |
|-------|---|--------------------------|-------------------|
| C | \$2,228,186 | | \$2,544,68 |
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| P | 530,589 | | 376,647 |
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| Tota | <u>\$2,889,981</u> | | <u>\$3,039.45</u> |
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| | | | |
|---|--------------------|--|--------------------|
| C u r r e n t l i a b i l i t i e s | \$1,429,674 | | \$1,003,906 |
| L o n g - t e r m o b l i g a t i o n s | 3,360 | | 7,240 |
| W a r r a n t y a n d o t h e r l i a b i l i t i e s | <u>112,971</u> | | <u>98,081</u> |
| Tota | <u>\$1,546,605</u> | | <u>\$1,109,227</u> |
| l i a b i l i t i e s | | | <u>7</u> |
| S t o c k h o l d e r s' e q u i t y | | | |
| : Com mon stoc k | \$ 1,566 | | \$ 501,631 |

| | |
|----------------------------|-------------------|
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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.

167. 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>Dec</u> <u>emb</u> <u>er</u> <u>31,</u> <u>201</u> <u>4</u> | <u>December 31, 2013</u> | |
|-------|---|--------------------------|-------------------|
| C | \$2,228,186 | | \$2,544,68 |
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| C u r r e n t l i a b i l i t i e s | \$1,429,674 | | \$1,003,906 |
| L o n g - t e r m o b l i g a t i o n s | 3,360 | | 7,240 |
| W a r r a n t y a n d o t h e r l i a b i l i t i e s | <u>112,971</u> | | <u>98,081</u> |
| Tota | <u>\$1,546,605</u> | | <u>\$1,109,227</u> |
| l i a b i l i t i e s | | | <u>7</u> |
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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?

168. 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 |

Read the information about Crystal, Inc. Which item is most "liquid"? Why is liquidity important?

169. 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 |

Read the information about Crystal, Inc. Has Crystal been profitable since it began operations? How do you know?

170. 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?

171. Eagle Corporation

Presented below are all of the items from Eagle Corporation's income statement for the years ending December 31, 2014 and 2013.

| | December 31, 2014 | December 31, 2013 |
|-------------------------------------|-------------------|-------------------|
| 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 |

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.

172. Eagle Corporation

Presented below are all of the items from Eagle Corporation's income statement for the years ending December 31, 2014 and 2013.

| | December 31, 2014 | December 31, 2013 |
|-------------------------------------|-------------------|-------------------|
| 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 |

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?

173. 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 |

Read the information about Burke Company.

Required:

Prepare a multiple-step income statement for the year ended December 31, 2014.

174. 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 |

Read the information about Burke Company

Required:

Prepare a single-step income statement for the year ended December 31, 2014.

175. The 2014 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, 2014.

REQUIRED: Compute Cigmar's profit margin. What other information would you need in order to comment on whether this ratio is favorable?

176. 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?

177. Heidi 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 Heidi Corporation? Explain your answer.

178. 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.

179. Posey Corporation began operations on January 2, 2012, with a total investment of \$150,000 by its stockholders. Net income for its first year of business was \$90,000. During 2013 and 2014, net income increased to \$188,000 and to \$217,000, respectively. Posey 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, 2013.
- B) How much is total retained earnings on December 31, 2014?
- C) Explain the link between the statement of retained earnings and the balance sheet.

180. 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?

181. 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?

182. 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?

183. 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?

184. 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?

185. 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?

186. 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?

187. 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 (+). If the item is an outflow, please indicate by a (-)

- _____ (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.

188. 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 | | |

189. Comparative income statements for Gregson Inc. are as follows:

| | 2014 | 2013 |
|----------------------------|------------------|----------------|
| Sales | \$2,000,000 | \$600,000 |
| Cost of sales | <u>800,000</u> | <u>400,000</u> |
| Gross profit | \$1,200,000 | \$200,000 |
| Operating expenses | <u>520,000</u> | <u>120,000</u> |
| Operating income | \$ 680,000 | \$ 80,000 |
| Loss on sale of subsidiary | <u>(800,000)</u> | <u>0</u> |
| Net income (loss) | \$ (120,000) | \$ 80,000 |

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.

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

191. 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?

192. 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.

193. 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.

194. What is the difference between comparability and consistency?

195. What is conservatism and why is it important in accounting?

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

197. What is the operating cycle of a business? How does this impact the classification of assets into current and noncurrent categories?

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

199. 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
Cash
Common stock
Retained earnings
Office supplies
Unearned revenue

Accounts payable
Depreciation expense
Land held for future expansion
Loss on the sale of equipment
Patent amortization expense
Utilities expense

Advertising expense
Income taxes
Dividends
Service revenue
Sales

- A) List the two items from above in which stockholders would be most interested. 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.

200. What is the purpose of a statement of stockholders' equity? How does it differ from the statement of retained earnings? Which statement is required?

201. What is the purpose of a statement of cash flows? Give an example of one of each of the three activities.

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

Chapter 2: Financial Statements and the Annual Report **Key**

1. 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

2. “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

3. 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.

4. 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

5. 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.

6. 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.

7. Schneider, 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 Schneider 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

8. 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

9. Cheile Transportation purchases many pieces of office furniture with an individual cost below \$200 each. Cheile 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 Cheile to expense the furniture?

- A. Conservatism
- B. Matching
- C.** Materiality
- D. Verifiability

10. Crouse Company applies the consistency convention. What does this mean?

- A. Crouse Co. uses the same names for all its expenses as its competitors.
- B. Crouse Co. has selected certain accounting principles that can never be changed.
- C.** Crouse Co. applies the same accounting principles each accounting period.
- D. Crouse Co. applies the same accounting principles as its competitors.

11. 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

12. 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

13. The qualitative characteristics of accounting data include

- A. Assets reported on the balance sheet
- B. All accounting information
- C. Cash flows
- D.** Reliability

14. Which of the following is a **noncurrent** asset?

- A. Inventories
- B. Office supplies
- C.** Land
- D. Accounts receivable

15. Which of the following is a current asset?

- A. Land
- B. Buildings
- C. Store fixtures
- D.** Prepaid insurance

16. 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

17. 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

18. Wood Company

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

| | | | |
|-------------------|-----------|--------------------------|-----------|
| Cash | \$ 50,000 | Accounts receivable | \$ 40,000 |
| Inventory | 60,000 | Land | 75,000 |
| Accounts payable | 45,000 | Notes payable (due 2020) | 150,000 |
| Retained earnings | ? | | |

Read the information for Wood Corporation. What are Wood's current assets?

- A. \$ 90,000
- B.** \$ 150,000
- C. \$ 195,000
- D. \$ 225,000

19. Read the information for Wood Company. What are Wood's current liabilities?

- A.** \$ 45,000
- B. \$ 120,000
- C. \$ 195,000
- D. \$ 225,000

20. 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

21. The following information is given for Wagner 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

22. 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

23. 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

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

- A. Franchises
- B. Copyrights
- C.** Investments
- D. Goodwill

25. 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.

26. 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

27. 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

28. 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

29. 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

30. For several years, Shaun Corporation has had a current ratio that was consistent with other companies in its industry. For the most recent year, Shaun'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.** Shaun's liquidity has improved or is not leveraging financial resources effectively.
- C. Shaun has less property, plant and equipment than other companies.
- D. Shaun has too much debt.

31. **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 |

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

32. 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 |

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

33. 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 |

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 Nadia & Sisters nor its competitors is liquid.
- D. Nadia & Sisters is more profitable than its competitors.

34. Rosu Company has total current assets of \$120,000 and total current liabilities of \$50,000. What is the amount of working capital for Rosu Company?

- A. \$ 27,000
- B. \$ 67,000
- C.** \$ 70,000
- D. \$ 91,000

35. 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

36. 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

37. 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 long-term debt
- C. An analysis of the return on stockholders' equity
- D. An analysis of retained earnings

38. 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

39. Use Rizwi Corporation's list of accounts at December 31, 2014 to answer the following question.

**Rizwi
Corp
oratio
n
List
of
Acco
unts
at
Dece
mber
31,
2014**

| | | | |
|-----------------------|----------|-------------------------------|-----------|
| 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 07/01/2015 | 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

40. If the current ratio is 3 to 1, net income is \$12,000, and current liabilities are \$24,000, how much is working capital?

- A. \$ 12,000
- B. \$ 36,000
- C. \$ 48,000**
- D. \$ 72,000

41. 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 probability.

42. 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.**

43. 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.

44. 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.

45. 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 |

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

46. 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 |

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

- A. \$58,440
- B. \$89,740
- C. \$84,040
- D. \$9,740**

47. 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**

48. 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

49. 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.

50. 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.

51. 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

52. 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

53. 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.

54. 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.

55. 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.

56. 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.

57. 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

58. 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 |

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

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

- A. \$ 1,600
- B. \$ 2,000
- C.** \$ 2,200
- D. \$ 2,800

60. 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-

61. 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.

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**

62. 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.

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

63. Dardenelle, Inc. earned \$600,000 profit during 2014. 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**

64. 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.

65. 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**

66. 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 |

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.

67. 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 |

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.

68. 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 |

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

69. 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

70. Garrison Industries

Garrison Industries began operations on January 2, 2014, with an investment of \$50,000 by each of its two stockholders. Net income for its first year of business was \$240,000. Garrison Industries paid a total of \$100,000 in dividends to its stockholders during the year.

Read the information about Garrison Industries. What is the company's retained earnings balance at December 31, 2014?

- A.** \$140,000
- B. \$190,000
- C. \$240,000
- D. \$340,000

71. Garrison Industries

Garrison Industries began operations on January 2, 2014, with an investment of \$50,000 by each of its two stockholders. Net income for its first year of business was \$240,000. Garrison Industries paid a total of \$100,000 in dividends to its stockholders during the year.

Read the information about Garrison Industries. If the company's revenues were \$500,000 for the year ended December 31, 2014, how much were total expenses?

- A. \$160,000
- B. \$260,000**
- C. \$640,000
- D. \$740,000

72. Read the information about Garrison Industries. The company's dividends for the year

- A. Reduce the amount of capital stock reported by the company.
- B. Are part of Garrison Industries' operating costs.
- C. Are reported on the statement of retained earnings.**
- D. Are an expense of Garrison Industries.

73. 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

74. In preparing the financial statements for December 31, 2014, 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, 2014**
- B. Retained earnings, December 31, 2014
- C. Net income
- D. Total assets

75. 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

76. 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

77. 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

78. 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

79. 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.**

80. 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

81. 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 |

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

82. 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 |

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

83. 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

84. 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

85. 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.

86. 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

87. 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

88. 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

89. 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.

90. 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
91. 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
92. 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
93. 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
94. 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.
95. 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

96. A discussion of the financial statements with explanations of certain amounts in the 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

97. 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**

98. 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**

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

FALSE

100. The Financial Accounting Standards Board created the objectives of financial reporting.

TRUE

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

FALSE

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

TRUE

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

FALSE

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

TRUE

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

TRUE

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

TRUE

107. 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.

TRUE

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

FALSE

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

TRUE

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

TRUE

111. 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.

TRUE

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

TRUE

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

FALSE

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

FALSE

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

FALSE

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

TRUE

117. 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.

TRUE

118. 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.

FALSE

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

FALSE

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

TRUE

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

FALSE

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

FALSE

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

TRUE

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

FALSE

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

FALSE

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

FALSE

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

TRUE

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

FALSE

129. 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.

TRUE

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

FALSE

131. 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.

FALSE

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

Creditors, Investors *or*

investors, creditors *or*

Lenders, Stockholders *or*

stockholders, lenders

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

Materiality

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

Relevance

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

Conservatism

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

Understandability

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

Reliability

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

Comparability

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

Consistency

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

Creditors *or*

Lenders *or*

Investors *or*

Stockholders

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

Current assets

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

noncurrent

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

Depreciation, amortization

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

Working capital

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

liquidity

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

single

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

stockholders' equity

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

Investing Activities

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

Operating Activities

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

Financing Activities

151. *Match the following characteristics with the statements about each qualitative characteristic's importance.*

- | | |
|--|-----------------------------------|
| 1. Those willing to spend the time should be provided with comprehensible accounting information. | Understandability <u>1</u> |
| 2. Accounting information must be verifiable and faithfully represent actual transactions. | Relevance <u>4</u> |
| 3. Users must be able to compare accounting information of a firm with its prior year information. | Conservatism <u>5</u> |
| 4. The accounting information must be information that could affect a decision. | Comparability <u>6</u> |
| 5. Accounting information should use the least optimistic estimate. | Consistency <u>3</u> |
| 6. This quality allows users to analyze two or more companies and look for similarities and differences. | Reliability <u>2</u> |
| 7. This quality refers to an amount large enough to affect a decision. | Materiality <u>7</u> |

152. Loren Corporation

Listed below is information from the financial records of Loren Corporation at December 31, 2014:

| | | | |
|--------------------------|----------|---------------------------------|----------|
| Retained earnings | \$37,000 | Notes payable--Due July 1, 2017 | \$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 |

Read the information about Loren Corporation.

Required:

Prepare the current liabilities section of the balance sheet for Loren Corp. at December 31, 2014. You may omit the heading. If the amount of current liabilities were larger, what effect would this have on the current ratio?

| | | |
|----------------------|---------------|------------------|
| 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.

153. Loren Corporation

Listed below is information from the financial records of Loren Corporation at December 31, 2014:

| | | | |
|--------------------------|----------|---------------------------------|----------|
| Retained earnings | \$37,000 | Notes payable--Due July 1, 2017 | \$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 |

Read the information about Loren Corporation.

Required:

Prepare the long-term asset section of Loren Corp.'s balance sheet at December 31, 2014. You may omit the heading. Why are these amounts classified as "long-term"?

| | | |
|--------------------------|------------------|------------------|
| Land | | \$ 50,000 |
| Buildings | \$ 48,000 | |
| Less: | <u>(13,000)</u> | <u>35,000</u> |
| Accumulated Depreciation | | |
| 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.

154. Loren Corporation

Listed below is information from the financial records of Loren Corporation at December 31, 2014:

| | | | |
|--------------------------|----------|---------------------------------|----------|
| Retained earnings | \$37,000 | Notes payable--Due July 1, 2017 | \$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 |

Read the information about Loren Corporation.

Required:

Prepare the current assets section of the balance sheet for Loren Corp. at December 31, 2014. You may omit the heading. How does the concept of liquidity apply?

| | | |
|----------------------|--------------|-----------------|
| 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.

155. Loren Corporation

Listed below is information from the financial records of Loren Corporation at December 31, 2014:

| | | | |
|--------------------------|----------|---------------------------------|----------|
| Retained earnings | \$37,000 | Notes payable--Due July 1, 2017 | \$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 |

Read the information about Loren Corporation.

Required:

Calculate Manus' current ratio at December 31, 2014. What does this ratio tell you about the "composition" of the current assets?

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

156. Loren Corporation

Listed below is information from the financial records of Loren Corporation at December 31, 2014:

| | | | |
|--------------------------|----------|---------------------------------|----------|
| Retained earnings | \$37,000 | Notes payable--Due July 1, 2017 | \$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 |

Read the information below about Loren Corporation.

Required:

Calculate the amount of working capital at December 31, 2014 for Loren Corp. What can you learn from the current ratio that you cannot learn from the amount of working capital?

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.

157. Raponi, Inc.

The following balance sheet items from Raponi, Inc. are listed for December 31, 2014:

| | |
|--|-----------|
| 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, 2015 | 6,500 |
| Office supplies | 200 |
| Notes payable, due December 31, 2018 | 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 |

Read the information about Raponi, Inc.

Required:

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

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 |

158. Raponi, Inc.

The following balance sheet items from Raponi, Inc. are listed for December 31, 2014:

| | |
|--|-----------|
| 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, 2015 | 6,500 |
| Office supplies | 200 |
| Notes payable, due December 31, 2018 | 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 |

Read the information about Raponi, Inc.

Required:

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

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 | 388,510 |

159. Raponi, Inc.

The following balance sheet items from Raponi, Inc. are listed for December 31, 2014:

| | |
|--|-----------|
| 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, 2015 | 6,500 |
| Office supplies | 200 |
| Notes payable, due December 31, 2018 | 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 |

Read the information about Raponi, Inc.

Required:

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

Current liabilities:

| | | | |
|-----------------------------------|----|--------------|--------|
| Accounts payable | \$ | 32,650 | |
| Income taxes payable | | 7,500 | |
| Interest payable | | 2,200 | |
| Notes payable, due April 15, 2015 | | | 6,500 |
| Salaries payable | | <u>7,400</u> | |
| Total current liabilities | \$ | | 56,250 |

160. Raponi, Inc.

The following balance sheet items from Raponi, Inc. are listed for December 31, 2014:

| | | |
|--|----|---------|
| 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, 2015 | | 6,500 |
| Office supplies | | 200 |
| Notes payable, due December 31, 2018 | | 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 |

Read the information about Raponi, Inc.

Required:

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

Current Ratio = Current Assets/Current Liabilities

$\$219,390/\$56,250 = \underline{3.9}$ to 1

From the current ratio alone, Raponi appears to be relatively liquid. In fact, Raponi may be too liquid, because its cash balance is greater than its total current liabilities. This indicates that Raponi 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 Raponi's current ratio at the end of this period with prior periods, and with the current ratio for companies in the same industry.

161. Raponi, Inc.

The following balance sheet items from Raponi, Inc. are listed for December 31, 2014:

| | |
|--|-----------|
| 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, 2015 | 6,500 |
| Office supplies | 200 |
| Notes payable, due December 31, 2018 | 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 |

Read the information about Raponi, Inc.

Required:

Prepare the Assets section of the classified balance sheet.

| 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> | |

162. Read the information about Raponi, Inc.

Required:

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

| Liabilities | | | |
|--------------------------------------|----|--------------|----------------|
| Current liabilities: | | | |
| Accounts payable | \$ | 32,650 | |
| Income taxes payable | | 7,500 | |
| Interest payable | | 2,200 | |
| Notes payable, due April 15, 2015 | | | 6,500 |
| Salaries payable | | <u>7,400</u> | |
| Total current liabilities | \$ | 56,250 | |
| Long-term debt: | | | |
| Notes payable, due December 31, 2018 | | | <u>251,630</u> |
| Total liabilities | | \$307,880 | |

163. Complete the December 31, 2014 (first year of operation) Balance sheet for Weglein Company using the following information:

- (a) Retained earnings at December 31, 2014 was \$51,000.
- (b) Total stockholders' equity at January 1, 2014 was \$139,000.
- (c) On December 30, 2014, additional capital stock was sold for cash, \$55,000
- (d) The land and building were purchased on December 30, 2014 for \$150,000.

**Weglein Company
Balance Sheet
December 31, 2014**

| Assets | | Liabilities & Stockholders' Equity |
|---------------------|-----------|---|
| Cash | \$ 80,000 | Liabilities: |
| Accounts receivable | | \$ |
| Land | 112,000 | Not payable |
| | | 45,000 |
| Buildings | | Accounts payable |
| | | \$ |
| | | Total liabilities |

Equipment

30,000

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Total assets

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164. Ficus Company calculated the following amounts concerning its financial information for the years ending December 31, 2014 and 2013:

| | <u>2014</u> | <u>2013</u> |
|---------------|-------------|-------------|
| Current ratio | 3.1 to 1 | 2.0 to 1 |
| Profit margin | 22 % | 18% |

REQUIRED:

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

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.

165. Ficus Company calculated the following amounts concerning its financial information for the years ending December 31, 2014 and 2013:

| | <u>2014</u> | <u>2013</u> |
|---------------|-------------|-------------|
| Current ratio | 3.1 to 1 | 2.0 to 1 |
| Profit margin | 22 % | 18% |

REQUIRED:

Suppose Ficus Company had a decrease in its cash account from 2013 to 2014. Would the other current asset amounts have increased or decreased? Explain.

Since the current ratio increased from 2013 to 2014, 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.

166. 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>Dec</u> <u>emb</u> <u>er</u> <u>31,</u> <u>201</u> <u>4</u> | <u>December 31, 2013</u> | |
|-------|---|--------------------------|-------------------|
| C | \$2,228,186 | | \$2,544,68 |
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|---|--------------------|--|--------------------|
| C u r r e n t l i a b i l i t i e s | \$1,429,674 | | \$1,003,906 |
| L o n g - t e r m o b l i g a t i o n s | 3,360 | | 7,240 |
| W a r r a n t y a n d o t h e r l i a b i l i t i e s | <u>112,971</u> | | <u>98,081</u> |
| Tota | <u>\$1,546,605</u> | | <u>\$1,109,227</u> |
| l i a b i l i t i e s | | | |
| S t o c k h o l d e r s' e q u i t y : | | | |
| Com mon stoc k | \$ 1,566 | | \$ 501,631 |

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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.

(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.

167. 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>Dec</u> <u>emb</u> <u>er</u> <u>31,</u> <u>201</u> <u>4</u> | <u>December 31, 2013</u> | |
|-------|---|--------------------------|-------------------|
| C | \$2,228,186 | | \$2,544,68 |
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| P | 530,589 | | 376,647 |
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| C u r r e n t l i a b i l i t i e s | \$1,429,674 | | \$1,003,906 |
| L o n g - t e r m o b l i g a t i o n s | 3,360 | | 7,240 |
| W a r r a n t y a n d o t h e r l i a b i l i t i e s | <u>112,971</u> | | <u>98,081</u> |
| Tota | <u>\$1,546,605</u> | | <u>\$1,109,227</u> |
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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?

(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.

168. 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 |

Read the information about Crystal, Inc. Which item is most "liquid"? Why is liquidity important?

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.

169. 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 |

Read the information about Crystal, Inc. Has Crystal been profitable since it began operations? How do you know?

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.

170. 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?

$$\begin{aligned} 1. \text{ Current Ratio} &= \text{Current Assets/Current Liabilities} \\ &= (\$21,500 + \$12,400 + \$45,300 + \$1,800)/(\$49,000 + \$1,625) \\ &= \$81,000/\$50,625 = 1.6 \text{ to } 1 \\ \text{Working Capital} &= \text{Current Assets} - \text{Current Liabilities} \\ &= \$81,000 - \$50,625 = \$30,375 \end{aligned}$$

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.

171. Eagle Corporation

Presented below are all of the items from Eagle Corporation's income statement for the years ending December 31, 2014 and 2013.

| | December 31, 2014 | December 31, 2013 |
|-------------------------------------|-------------------|-------------------|
| 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 |

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.

$$\begin{aligned} \text{Net Income} &= \$290,000 \\ &(\$2,300,000 \text{ Service Fees} + \$40,000 \text{ Other Income, net} - \$1,900,000 \text{ General and} \\ &\quad \text{Administrative Expenses} - \$150,000 \text{ Income Taxes} = \$290,000) \end{aligned}$$

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.

172. Eagle Corporation

Presented below are all of the items from Eagle Corporation's income statement for the years ending December 31, 2014 and 2013.

| | December 31, 2014 | December 31, 2013 |
|-------------------------------------|-------------------|-------------------|
| 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 |

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?

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.

173. 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 |

Read the information about Burke Company.

Required:

Prepare a multiple-step income statement for the year ended December 31, 2014.

**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> |

174. 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 |

Read the information about Burke Company

Required:

Prepare a single-step income statement for the year ended December 31, 2014.

**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>\$ 435</u> |

175. The 2014 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, 2014.

REQUIRED: Compute Cigmar's profit margin. What other information would you need in order to comment on whether this ratio is favorable?

Profit margin:

$$\text{Net Income/Revenues} = \$43,380 / \$120,500 = 36.0\%$$

$$*\$120,500 - \$35,200 - \$29,900 - \$1,500 - \$10,520 = \$43,380$$

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.

176. 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?

Profit margin:

$$\text{Net Income/Revenues} = \$47,530 / \$135,800 = \underline{35.0\%}$$

$$*\$135,800 - \$40,310 - \$33,990 - \$880 - \$13,090 = \$47,530$$

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.

177. Heidi 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 Heidi Corporation? Explain your answer.

Profit margin:

$$\text{Net Income/Sales} = \$1,228,400 / \$2,400,000 = \underline{51.2\%}$$

$$*\$2,400,000 - \$900,000 - \$121,600 - \$150,000 = \$1,228,400*$$

| | |
|----------------------------|----------------|
| Sales | \$ 2,400,000 |
| - Cost of sales | 900,000 |
| = Gross profit | \$ 1,500,000 |
| - Total operating expenses | 271,600** |
| = Net income | \$ 1,228,400 * |

**Total Operating Expenses = Selling Expenses (\$121,600) + General and Administrative Expenses (\$150,000) = \$271,600

Heidi 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.

178. 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.

Profit margin:

$$\text{Net Income/Sales} = \$640,000^*/\$1,300,000 = \underline{49.2\%}$$

$$*\$1,300,000 - \$300,000 - \$210,000 - \$150,000 = \$640,000^*$$

| | |
|----------------------------|--------------------|
| 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>\$ 640,000*</u> |

**Total Operating Expenses = Selling Expenses (\$210,000) + 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.

179. Posey Corporation began operations on January 2, 2012, with a total investment of \$150,000 by its stockholders. Net income for its first year of business was \$90,000. During 2013 and 2014, net income increased to \$188,000 and to \$217,000, respectively. Posey 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, 2013.
- B) How much is total retained earnings on December 31, 2014?
- C) Explain the link between the statement of retained earnings and the balance sheet.

A)
Posey Corporation
Statement of Retained Earnings
for the Year Ended December 31, 2013

B \$ 5,000*

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* \$ 9,000 Net Income for 2012 - \$ 85,000 Dividend s paid = \$ 5,000 Balance, January 1, 2013

- B) Retained earnings at December 31, 2014 = \$240,000
 (\$108,000 Beginning Balance, January 1, 2014 + \$217,000 Net Income for 2014 - \$85,000 Dividends paid during the year = \$240,000)
- C) The ending balance of the retained earnings statement represents the cumulative earnings less all the dividends declared and paid for the life of the business. This amount appears on the balance sheet as a component of owners' equity.

180. 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?
- 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.

181. 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?

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

182. 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?

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 | <u>(30,000)</u> |
| 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>\$125,000</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

183. 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?

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 increase in cash for 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.

184. 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?

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)

185. 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?

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

186. 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?

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.

187. 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 (+). If the item is an outflow, please indicate by a (-)

- _____ (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.

a. -O b. +O c. -F d. -O e. -F f. N g. -I

188. 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 | | |

| 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 |

189. Comparative income statements for Gregson Inc. are as follows:

| | 2014 | 2013 |
|----------------------------|--------------|-----------|
| 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) | \$ (120,000) | \$ 80,000 |

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.

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.

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

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.

191. 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?

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.

192. 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.

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.

193. 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.

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.

194. What is the difference between comparability and consistency?

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.

195. What is conservatism and why is it important in accounting?

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.

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

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.

197. What is the operating cycle of a business? How does this impact the classification of assets into current and noncurrent categories?

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.

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

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

199. 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
Cash
Common stock
Retained earnings
Office supplies
Unearned revenue

Accounts payable
Depreciation expense
Land held for future expansion
Loss on the sale of equipment
Patent amortization expense
Utilities expense

Advertising expense
Income taxes
Dividends
Service revenue
Sales

- A) List the two items from above in which stockholders would be most interested. 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.
-
- 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.

200. What is the purpose of a statement of stockholders' equity? How does it differ from the statement of retained earnings? Which statement is required?

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.

201. What is the purpose of a statement of cash flows? Give an example of one of each of the three activities.

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

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

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.