CHAPTER 2: FINANCIAL STATEMENTS AND THE ANNUAL REPORT

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

   ANSWER: d

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.

   ANSWER: b

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.

   ANSWER: d

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

   ANSWER: c

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.

   ANSWER: b

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.

   ANSWER: b

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

   ANSWER: a

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.

   ANSWER: a

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

   ANSWER: c

10. Madden Company applies the consistency convention. What does this mean?
    a. Madden Co. uses the same names for all its expenses as its competitors.
    b. Madden Co. has selected certain accounting principles that can never be changed.
    c. Madden Co. applies the same accounting principles each accounting period.
    d. Madden Co. applies the same accounting principles as it competitors.

    ANSWER: c

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.

    ANSWER: a

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

    ANSWER: b

13. The qualitative characteristics of accounting data include:
    a. assets reported on the balance sheet.
    b. all accounting information.
    c. cash flows.
    d. reliability.

    ANSWER: d

14. Which of the following is a noncurrent asset?
    a. Inventories
    b. Office supplies
    c. Land
    d. Accounts receivable

    ANSWER: c

15. Which of the following is a current asset?
    a. Land
    b. Buildings
    c. Store fixtures
    d. Prepaid insurance

    ANSWER: d

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

    ANSWER: a

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

    ANSWER: a

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

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

18. Read the information for Moss Corporation. What are Moss' current assets?
    a. $100,000
    b. $165,000
    c. $210,000
    d. $240,000

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

19. Read the information for Moss Company. What are Moss' current liabilities?
    a. $50,000
    b. $125,000
    c. $200,000
    d. $230,000

    ANSWER: a
    RATIONALE: ($50,000 Accounts Payable)

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

    ANSWER: a

21. The following information is given for Sego Company:

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

    What are the company's current assets?
    a. $220,000
    b. $155,000
    c. $130,000
    d. $ 95,000

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

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

    ANSWER: c

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

    ANSWER: c

24. Which of the following would **not** be considered to be an intangible asset?
    a. Franchises
    b. Copyrights
    c. Investments
    d. Goodwill

    ANSWER: c

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.

    ANSWER: b

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

    ANSWER: b

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

    ANSWER: a

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

    ANSWER: d

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

    ANSWER: b

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

    ANSWER: b

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

31. Read the information for Guinther & Sons. Calculate the total amount of current assets for Guinther & Sons.
    a. $100,000
    b. $147,000
    c. $150,000
    d. $249,000

    ANSWER: c

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

32. Read the information for Guinther & Sons, Inc. Calculate the current ratio for Guinther & Sons.
    a. 2.58 to 1
    b. 2.75 to 1
    c. 3.00 to 1
    d. 2.00 to 1

    ANSWER: c

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

33. Read the information for Guinther & Sons, Inc. The average current ratio for stores such as Guinther & Sons is 2.4 to 1. What does this comparison tell you about its liquidity?
    a. It is more liquid than its competitors
    b. It has more long-term assets than its competitors
    c. Since a rule of thumb for current ratios is 2 to 1, neither Guinther & Sons, Inc. nor its competitors is liquid.
    d. Guinther & Sons, Inc. is more profitable than its competitors.

    ANSWER: a

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

    ANSWER: b

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

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

    ANSWER: c

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

    ANSWER: a

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

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

   ANSWER: a

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

   ANSWER: b

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

Rizwi Corporation
List of Accounts at December 31, 2015

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

   What is Rizwi Corp.'s current ratio?
   a. 0.48 to 1
   b. 2.00 to 1
   c. 2.55 to 1
   d. 2.86 to 1

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

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

   ANSWER: c
   RATIONALE: ($18,000 Current Liabilities × 2.5 = $45,000 Current Assets; $45,000 - $18,000 = $27,000)

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 leverage.

    ANSWER: a

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.

    ANSWER: d

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.

    ANSWER: b

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.

    ANSWER: a

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

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

45. Read the information about Skyline, Inc. What is Skyline’s current ratio?
a. 0.8 to 1
b. 1.6 to 1
c. 1.2 to 1
d. 2.5 to 1

ANSWER: c

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

46. Read the information about Skyline, Inc. What is Skyline’s working capital?
a. $58,440
b. $89,740
c. $84,040
d. $9,740

ANSWER: d

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

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

ANSWER: d

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

    ANSWER: c

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.

    ANSWER: c

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.

    ANSWER: b

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

    ANSWER: b

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

    ANSWER: c

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.

    ANSWER: c

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.

    ANSWER: b

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.

    ANSWER: c

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.

    ANSWER: c

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

ANSWER: c

Webb Company

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

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

58. Read the information about Webb Company. What is Webb's income from operations?
a. $1,600
b. $2,000
c. $2,200
d. $2,800

ANSWER: b

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

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

ANSWER: c

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

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-

    ANSWER: d

Deal Mart

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

61. Read the information about Deal Mart. What is Deal Mart's net income?
    a. $80,000
    b. $92,190
    c. $130,800
    d. $46,470

    ANSWER: d
    RATIONALE: Net Income = $130,800 – $37,100 – $34,900 – $900 – $11,430 = $46,470

62. Read the information about Deal Mart. What is Deal Mart's profit margin (to the closest tenth of a percent)?
    a. 2.8
    b. 35.5
    c. 61.2
    d. 14.5

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

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

    ANSWER: d

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.

    ANSWER: b

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

    ANSWER: d

Hopper, Inc.

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

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

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

    ANSWER: a

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

    ANSWER: a

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

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

    ANSWER: a

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

    ANSWER: d

Bartlett Industries

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

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

    ANSWER: a

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

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

    ANSWER: b

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

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

    ANSWER: c

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.

    ANSWER: c

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

    ANSWER: a

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

    ANSWER: b

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

    ANSWER: c

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

    ANSWER: c

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

    ANSWER: b

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.

    ANSWER: d

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.

    ANSWER: a

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

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

a. $10,000 increase

b. $30,000 increase

c. $40,000 increase

d. $70,000 increase

ANSWER: a

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

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

a. $10,000

b. $30,000

c. $40,000

d. $70,000

ANSWER: c

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

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

ANSWER: d

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

    ANSWER: a

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

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.

    ANSWER: c

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.

    ANSWER: a

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

    ANSWER: d

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

    ANSWER: b

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.

    ANSWER: a

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

    ANSWER: c

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.

    ANSWER: a

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

    ANSWER: c

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.

    ANSWER: c

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.

    ANSWER: b

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

    ANSWER: b

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

    ANSWER: b

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

    ANSWER: d

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.

    ANSWER: d

99. Financial statements are intended to tell the reader the value of a company.
    a. True
    b. False

    ANSWER: False

100. Accountants are the main reason financial statements are prepared.
    a. True
    b. False

    ANSWER: False

101. The Financial Accounting Standards Board defined the objectives of financial reporting.
    a. True
    b. False

    ANSWER: True

102. The purpose of financial reporting is to provide economic information to external decision makers only.
    a. True
    b. False

    ANSWER: False

103. An objective of financial reporting is to reflect economic information concerning a company's cash flows.
    a. True
    b. False

    ANSWER: True

104. The concept of conservatism is the capacity of information to make a difference in a decision.
    a. True
    b. False

    ANSWER: False

105. Materiality deals with the size of an error in accounting information.
    a. True
    b. False

    ANSWER: True

106. Most businesses have an operating cycle of less than one year.
    a. True
    b. False

    ANSWER: True

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

    ANSWER: True

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

    ANSWER: True

109. The operating cycle for all businesses is one year.
    a. True
    b. False

    ANSWER: False

110. A construction company that builds skyscrapers is likely to have an operating cycle longer than one year.
    a. True
    b. False

    ANSWER: True

111. Three common categories of long-term assets are: 1) property, plant, and equipment, 2) investments, and 3) intangibles.
    a. True
    b. False

    ANSWER: True

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

    ANSWER: True

113. One primary purpose of a classified balance sheet is to help users evaluate the liquidity of a company.
    a. True
    b. False

    ANSWER: True

114. Companies prepare classified financial statements because they are required by international accounting principles.
    a. True
    b. False

    ANSWER: False

115. The current ratio is **irrelevant** in liquidity analysis for service companies because they do **not** have inventories among their current assets.
    a. True
    b. False

    ANSWER: False

116. An advantage of the current ratio is that it considers the makeup of the current assets.
    a. True
    b. False

    ANSWER: False

117. The excess of current assets over current liabilities is referred to as working capital.
    a. True
    b. False

    ANSWER: True

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

    ANSWER: True

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

    ANSWER: False

120. The purchase of inventory for cash will cause the current ratio to decrease.
    a. True
    b. False

    ANSWER: False

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

    ANSWER: True

122. A 12% change in sales will result in a 12% change in net income.
    a. True
    b. False

    ANSWER: False

123. Some analysts properly refer to a company’s profit margin as its return on assets.
    a. True
    b. False

    ANSWER: False

124. Dividends declared and paid reduce a company’s retained earnings balance.
    a. True
    b. False

    ANSWER: True

125. Dividends paid appears on both the income statement and the statement of retained earnings.
    a. True
    b. False

    ANSWER: False

126. Investing activities are needed to provide the funds to start a business.
    a. True
    b. False

    ANSWER: False

127. The statement of cash flows, like the income statement, reports only operating activities of a company.
    a. True
    b. False

    ANSWER: False

128. Funds raised from financing activities should be invested in assets that can be used to carry on business operations.
    a. True
    b. False

    ANSWER: True

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

    ANSWER: False

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

    ANSWER: True

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

    ANSWER: False

132. In the independent auditors' report included with the annual report, management discusses the financial statements and provides the shareholders with explanations for certain amounts reported in the statements.
    a. True
    b. False

    ANSWER: False

133. ____________________ and ____________________ have claims to an entity’s economic resources.

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

134. ____________________is the magnitude of an omission or misstatement in accounting information that will affect the judgment of someone relying on the information.

    ANSWER: Materiality

135. ____________________is the capacity of information to make a difference in a decision.

    ANSWER: Relevance

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

    ANSWER: Conservatism

137. ____________________is the quality of accounting information that makes it comprehensible to those willing to spend the necessary time.

ANSWER: Understandability

138. ____________________is the quality of accounting information that makes it dependable in representing the events that it purports to represent.

ANSWER: Reliability

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

ANSWER: Comparability

140. ____________________is the quality of accounting information that allows a user to compare two or more accounting periods for a single company.

ANSWER: Consistency

141. _____________________have claims to an entity's economic resources.

ANSWER: Creditors
Lenders
Investors
Stockholders

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

ANSWER: Current assets

143. Property, plant and equipment are classified as______________________assets on the balance sheet.

ANSWER: noncurrent

144. ____________________ is the process of writing off the cost of tangible assets and ____________________ is the process of writing off the cost of intangible assets.

ANSWER: Depreciation; amortization

145. _______________________________is a liquidity measure that is calculated by subtracting current assets from current liabilities.

ANSWER: Working capital

146. The ability of a company to pay its debt as it comes due relates to______________________.

ANSWER: liquidity

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

ANSWER: single

148. The statement of____________________explains changes in the components of owners' equity during the period.

ANSWER: stockholders' equity

149. On the statement of cash flows, the______________________________section involves the acquisition and sale of long-term assets.

ANSWER: Investing Activities

150. On the statement of cash flows, the______________________________section involves the purchase and sale of products and services.

ANSWER: Operating Activities

151. On the statement of cash flows, the______________________________section involves the issuance and repayment of long term liabilities and stock transactions.

ANSWER: Financing Activities

Cargo Corporation

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

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

152. Read the information about Cargo Corporation.

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

ANSWER:

Accounts payable	$36,000
Interest payable	1,000
Income taxes payable	24,000
Total	$61,000

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

153. Read the information about Cargo Corporation.

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

ANSWER:

Land		$50,000
Buildings	$48,000	
Less: Accumulated Depreciation	(13,000)	35,000
Total		$85,000

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. Read the information about Cargo Corporation.

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

ANSWER:

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

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. Read the information about Cargo Corporation.

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

ANSWER: Current Assets = $85,000
($11,000 Cash + $35,000 Accounts receivable + $33,000 Inventory + $4,000 Prepaid Rent + $2,000 Office Supplies = $85,000)
Current Liabilities = $61,000 ($36,000 Accounts Payable + $1,000 Interest Payable + $24,000 Income Taxes Payable =$61,000)
Current ratio = 1.39 to 1
($85,000 / $61,000)
The current ratio does not provide information about the composition of the current assets. Only totals are used to calculate the current ratio.

156. Read the information about Cargo Corporation.

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

ANSWER: Current Assets = $85,000
($11,000 Cash + $35,000 Accounts receivable + $33,000 Inventory + $4,000 Prepaid Rent + $2,000 Office Supplies = $85,000)
Current Liabilities = $61,000
($36,000 Accounts Payable + $1,000 Interest Payable + $24,000 Income Taxes Payable = $61,000)
Working Capital = $24,000
($85,000 - $61,000)
The current ratio indicates the number of times current assets is greater than current liabilities. It is based on a relative relationship, not total dollars, as the amount of working capital is.

Fasoli, Inc.

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

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

157. Read the information about Fasoli, Inc.

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

ANSWER: Current Assets:

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

158. Read the information about Fasoli, Inc.

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

ANSWER: **Stockholders' Equity**

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

159. Read the information about Fasoli, Inc.

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

ANSWER: Current liabilities:

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

160. Read the information about Fasoli, Inc.

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

ANSWER: Current Ratio = Current Assets/Current Liabilities

$219,390/$56,250 = 3.9 to 1

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

161. Read the information about Fasoli, Inc.

Required:
Prepare the Assets section of the classified balance sheet.

ANSWER: **Assets**

Current assets:		
Cash		$60,990
Marketable securities		15,000
Accounts receivable		26,500
Merchandise inventory		112,900
Prepaid rent		3,800
Office supplies		200
Total current assets		$219,390
Property, plant, and equipment:		
Land		$250,000
Buildings	$150,000	
Less: Accumulated depreciation	(40,000)	110,000
Equipment	$84,500	
Less: Accumulated depreciation	(12,500)	72,000
Total property, plant, and equipment		432,000
Intangible assets:		
Patents		45,000
Total assets		$696,390

162. Read the information about Fasoli, Inc.

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

ANSWER: **Liabilities**

Current liabilities:	
Accounts payable	$32,650
Income taxes payable	7,500
Interest payable	2,200
Notes payable, due April 15, 2016	6,500
Salaries payable	7,400
Total current liabilities	$56,250
Long-term debt:	
Notes payable, due December 31, 2019	251,630
Total liabilities	$307,880

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

	2015	**2014**
Current ratio	3.1 to 1	2.0 to 1
Profit margin	22 %	18%

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

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

164. Complete the December 31, 2015 (first year of operation) Balance sheet for Weglein Company using the following information:
(a) Retained earnings at December 31, 2015 was $51,000.
(b) Total stockholders' equity at January 1, 2015 was $139,000.
(c) On December 30, 2015, additional capital stock was sold for cash, $55,000
(d) The land and building were purchased on December 30, 2015 for $150,000.

Weglein Company
Balance Sheet
December 31, 2015

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

ANSWER:

Weglein Company
Balance Sheet
December 31, 2015

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

Explanation of calculations:
Total assets must be equal to total liabilities & stockholders equity of $390,000.
$150,000 (cost of land and building) less $112,000 for land = $38,000 for building.
Accounts receivable must be $130,000 to achieve total assets of $390,000.
$139,000 (capital stock at January 1) plus $55,000 (additional investment).
Total liabilities must be $145,000 to achieve total liabilities & stockholders' equity of $390,000.
Notes payable must be $100,000 to achieve total liabilities of $145,000.

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

	2015	2014
Current ratio	3.1 to 1	2.0 to 1
Profit margin	22 %	18%

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

ANSWER: Since the current ratio increased from 2014 to 2015, the current assets other than cash would have had to increase substantially to offset the decline in cash. The decline in cash changes the liquidity somewhat, in that the other current assets must be converted to cash prior to paying the current period debt.

Fellsmere Corporation

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

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

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

ANSWER: (A) Current ratio for 2014 = 1.56 to 1
($2,228,186 Current Assets / $1,429,674 Current Liabilities)
Current Ratio for 2013 = 2.53 to 1
($2,544,683 Current Assets / $1,003,906 Current Liabilities)
This ratio is an indicator of the company's ability to pay its current debt when it is due. Felllsmere’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. Read the information about Fellsmere Corporation.
Required:
(A) Explain the change in Fellsmere’s working capital from 2013 to 2014. Why do users believe the current ratio provides more information than the dollar amount of working capital? Explain.
(B) Fellsmere Corporation's creditors need to know whether its working capital position improved during the year. How would you evaluate this?

ANSWER: (A) Working Capital, 2013 = $1,540,777
($2,544,683 Current Assets - $1,003,906 Current Liabilities = $1,540,777)
Working Capital, 2014 = $798,512
($2,228,186 Current Assets - $1,429,674 Current Liabilities = $798,512)
Decrease in Working Capital = $742,265
($1,540,777 Working Capital, 2013 - $798,512 Working Capital, 2014 = $742,265)
Working capital represents the excess of current assets over current liabilities in total dollars. The current ratio indicates the number of times that current assets exceed the current liabilities. It is possible that $742,265 could pay the current debts of one company easily, but pay for only a small portion of a larger company's debts.
(B) The amount of working capital and the current ratio are the best indicators of a company's working capital position. While the amount of working capital provides the dollar amount of current assets that exceed the company's current debt, the current ratio provides a relative indicator of how many times the dollar amount of current assets exceeds currently due debt. In 2013, Fellsmere Corporation’s working capital was $1,540,777. However, this figure declined in 2014 to $798,512. Less current assets are available to cover current liabilities.

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

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

ANSWER: Cash is the most liquid asset. Liquidity is an indicator of a company's ability to pay its current debts when they come due. A company without cash is most certainly not going to survive.

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

ANSWER: Retained earnings represents the company's cumulative profits since it began operations less the dividends it paid out. Since Crystal, Inc. has a positive balance in its retained earnings account, it has been profitable over the time it has been in business. Cumulative net income exceeds aggregate net loss and aggregate dividends paid.

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?

ANSWER: 1. Current Ratio = Current Assets/Current Liabilities
= ($21,500 + $12,400 + $45,300 + $1,800)/($49,000 + $1,625)
= $81,000/$50,625 = 1.6 to 1
Working Capital = Current Assets – Current Liabilities
= $81,000 – $50,625 = $30,375
2. One concern is the relatively large percentage of the current assets tied up in inventory. This asset accounts for $45,300/$81,000, or approximately 56% of the total current assets. What is the normal period of time it takes to sell inventory? Is any part of the inventory slow moving or obsolete?
3. On the basis of the current ratio alone, Evanston appears to be relatively liquid, although it would be important to compare the ratio with those of prior years and with those of other companies in the same industry.

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

171. Read the information about Eagle Corporation.
Required::
How much is net income for the year ended December 31, 2014? If Eagle Corporation had used a single-step statement, by how much would net income be different? Explain.

ANSWER: Net Income = $290,000
($2,300,000 Service Fees + $40,000 Other Income, net - $1,900,000 General and Administrative Expenses - $150,000 Income Taxes = $290,000)
Net income is the same under a single-step or a multiple-step income statement. Only subtotals and the order the amounts are listed differ.

172. Read the information about Eagle Corporation.
Required:
Compare the profit margins for 2014 and 2013. Is the company becoming more or less profitable or staying the same? What could be contributing to this?

ANSWER: Profit Margin for 2014 = 12.61%
($290,000 Net Income / $2,300,000 Service Fees = 12.61%)
Profit Margin for 2013 = 20.95%
($440,000 Net Income / $2,100,000 Service Fees = 20.95%)
The decrease in profit margin is unfavorable and indicates that the company is becoming less profitable. A significant increase in general and administrative expenses seems to be the cause of the decline.

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

173. Read the information about Burke Company.

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

ANSWER:

BURKE COMPANY
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2014

Sales			$50,300
Cost of goods sold			29,200
Gross profit			$21,100
Operating expenses:			
Selling expenses:			
Advertising	$2,600		
Commissions	3,515		
Insurance - salesperson's auto	3,350		
Total selling expenses		$9,465	
General and administrative expenses:			
Depreciation—office building	$4,000		
Salaries and wages—office	13,660		
Supplies—office	1,990		
Total general and administrative expenses		19,650	
Total operating expenses			29,115
Loss from operations			$(8,015)
Other revenues and expenses:			
Interest expense		$(1,400)	
Interest revenue		2,340	
Rent revenue		7,700	
Excess of other revenues over other expenses			8,640
Income before taxes			$625
Income tax expense			190
Net income			$ 435

174. Read the information about Burke Company

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

ANSWER:

BURKE COMPANY
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2014

Revenues:		
Sales	$50,300	
Interest revenue	2,340	
Rent revenue	7,700	
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	1,990	
Total expenses		59,905
Net income		$435

175. The 2015 income statement of Cigmar Enterprises shows operating revenues of $120,500, selling expenses of $35,200, general and administrative expenses of $29,900, interest expense of $1,500, and income tax expense of $10,520. Cigmar's stockholders' equity was $280,000 at the beginning of the year and $320,000 at the end of the year. The company has 20,000 shares of stock outstanding at December 31, 2015.

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

ANSWER: Profit margin:
Net Income/Revenues = $43,380*/$120,500 = 36.0%
*$120,500 – $35,200 – $29,900 – $1,500 – $10,520 = $43,380
A profit margin of 36% indicates that for every dollar of sales, Cigmar Enterprises has $0.36 in net income. It would be beneficial to compare the company's profit margin with some of its competitors and with previous years.

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?

ANSWER: **Profit margin:**

Net Income/Revenues = $47,530*/$135,800 = 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. Hammar Corporation's partial income statement is as follows:

Sales	$2,400,000
Cost of sales	900,000
Selling expenses	121,600
General and admin. expenses	150,000

Required

Determine the profit margin. Would you invest in Hammar Corporation? Explain your answer.

ANSWER: **Profit margin:**

Net Income/Sales = $1,228,400*/$2,400,000 = 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

Hammar Corporation has been very profitable on the basis of its very high profit margin of 51.2%. Before making an investment, however, you would want to consider how this ratio compares with that of prior years and with that of other companies in the same line of business.

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.

ANSWER: **Profit margin:**

Net Income/Sales = $640,000*/$1,300,000 = 49.2%

$1,300,000 – $300,000 – $210,000 – $150,000 = $640,000

Sales	$1,300,000
– Cost of sales	300,000
= Gross profit	$1,000,000
– Total operating expenses	360,000**
= Net income	$640,000*

**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. Powder Corporation began operations on January 2, 2013, with a total investment of $150,000 by its stockholders. Net income for its first year of business was $90,000. During 2014 and 2015, net income increased to $188,000 and to $217,000, respectively. Powder paid $85,000 in dividends to its shareholders in each of the three years.

A) In good form, prepare a statement of retained earnings for the year ended December 31, 2014.

B) How much is total retained earnings on December 31, 2015?

C) Explain the link between the statement of retained earnings and the balance sheet.

ANSWER: A)

Powder Corporation
Statement of Retained Earnings
for the Year Ended December 31, 2014

Beginning balance, January 1, 2014	$5,000*
Add: Net income for 2014	188,000
Less: Dividends paid during the year	(85,000)
Ending balance, December 31, 2014	$108,000

* $90,000 Net Income for 2013 - $85,000 Dividends paid = $5,000 Balance, January 1, 2014

B) Retained earnings at December 31, 2015 = $240,000
($108,000 Beginning Balance, January 1, 2015 + $217,000 Net Income for 2015 - $85,000 Dividends paid during the year =$240,000)

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?

ANSWER: A) $30,000
($7,000 Accounts Payable +$23,000 Bond Payable)

B) The primary source for seeing whether any stock was issued during the year would be the Statement of Stockholders' Equity. While the Balance Sheet may show an amount for "Capital Stock," this amount is an ending balance, and would not show the results of any transactions involving new issuances of stock during the period.

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 access Coglin's liquidity?

ANSWER: A) Current ratio: 1.44 to 1
($23,000 Cash + $13,000 Accounts receivable + $45,000 Inventory + $1,000 Prepaid insurance) / ($55,000 Accounts payable + $2,000 Salaries payable) = 1.44 to 1
Working capital: $25,000
($82,000 Total Current Assets - $57,000 Total Current Liabilities = $25,000)

B) The closer an asset is to being converted to cash, the more liquid the asset is. Some assets, like inventory, take much longer to turn into cash because they must be sold before collection of the cash can be made. Prepaid insurance is not as liquid as accounts receivable since it will be consumed as time passes. Receivables are more liquid than inventory because a sale has already occurred

C) The statement of cash flows would be helpful to determine the cash inflows and outflows that occurred during the year. The balance sheet represents only the ending balance of the cash account. The statement of cash flows also identifies the sources and uses of cash by business activity and the nature of each particular cash flow

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?

ANSWER: A)

Wimbrow Images
Statement of Cash Flows
for the Year Ended December 31, 2014

Cash flows from operating activities	$80,000
Cash flows from investing activities:	
Purchase of new truck	(15,000)
Cash flows from financing activities:	
Proceeds from loan made by bank	40,000
Cash dividends paid	(30,000)
Increase (Decrease) in cash	$75,000
Cash at the beginning of the year	50,000
Cash at the end of the year	$125,000

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**?

ANSWER: A)

Tradewinds Corporation
Statement of Cash Flows
for the Year Ended December 31, 2014

Cash flows from operating activities		$35,000
Cash flows from investing activities		
Purchase office building		(800,000)
Cash flows from financing activities		
Investment by owners	500,000	
Loan from bank	300,000	
Payment of dividends	(30,000)	
Net cash provided by financing activities		770,000
Net increase in cash for the year		$5,000
Cash at the beginning of the year		--0--
Cash at the end of the year		$5,000

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?

ANSWER: A) Financing Cash Flows = $9,000
($24,000 Cash borrowed from bank - $15,000 Cash dividends paid = $9,000)
Investing Cash Flows = ($30,000)
(Purchase of new equipment)
Operating Cash Flows = $40,000
(Cash generated by operations)

B) Yes. The total of investing and financing activities is an outflow of $21,000. The $40,000 generated from operating activities is sufficient

C) $19,000 Increase
($40,000 Cash flow from operations - $30,000 Cash flow from investing + $9,000 Cash flow from financing = $19,000)

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?

ANSWER: A) $90,000 increase
($75,000 Cash flows provided by operating activities- $100,000 Cash flows used by investing activities + $115,000 Cash flows provided by financing activities = $90,000 increase)

B) $150,000 ($60,000 Cash at the beginning of the year + $90,000 increase = $150,000)

C) A statement of cash flows summarizes the operating, financing, and investing activities of a company for a period of time

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?

ANSWER:

Mill Valley Corporation
Statement of Cash Flows
For the Year Ended December 31, 2014

Cash flows from operating activities:		
Cash collected from customers	$93,000	
Cash paid for inventory	(60,600)	
Cash paid in salaries and wages	(22,400)	
Cash paid in taxes	(5,100)	
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	(5,300)	
Net cash provided by financing activities		269,700
Net increase in cash		$ 73,600
Cash at beginning of year		0
Cash at end of year		$73,600

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 (+), (e.g. O+, I+ or F+). If the item is an outflow, please indicate by brackets, (e.g., <O> for operating outflow, <I> for investing outflow, and <F> for financing outflow:

____(a) Paid an account payable for inventory purchased in the previous accounting period.
____(b) Amortization of debt issuance costs
____(c) Paid a dividend to stockholders.
____(d) Paid the interest on a note payable to National Street Bank.
____(e) Paid the principal amount due on the note payable to National Street Bank.
____(f) Transferred cash from a checking account into a money market fund.
____(g) Purchased equipment for cash.

ANSWER: a. <O> b. O+ c. <F> d. <O> e. <F> f. N g. <I>

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		

ANSWER:

Elements	**Prepared By**	**Information Provided**
Management Discussion & Analysis	Mgmt.	Discussion of financial statements and explanations
Financial Statements	Mgmt.	Income statement, balance sheet, statement of cash flows, statement of retained earnings
Notes to Financial Statements	Mgmt.	Accounting policies and other disclosures
Report of Independent Accountants	CPA firm.	Opinion that statements are presented fairly

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.

ANSWER: **Letter from the President to Stockholders of Gregson Inc.:**

On the surface, 2014 does not appear to have been a successful year for Gregson Inc. However, it was primarily one specific event that caused the net loss we experienced for the year. The sale of a subsidiary resulted in a loss of $800,000. We believe that the sale of this unprofitable unit of the business will allow us to concentrate our future attention on our successful businesses and clear the way for a return to overall profitability in 2013.

Aside from the loss experienced on the sale of the subsidiary, 2014 was a really great year for the company. We were able to control our operating expenses, resulting in operating income as a percentage of sales that increased from 13% to 34%. These are clear signals that Gregson Inc. is moving in the right direction and should have a very solid year of operations in 2013.

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

ANSWER: Investors are most interested in cash receipts from dividends and the cash they can receive upon selling their stock. Creditors are most interested in cash to be received for interest payments and the repayment of the principal. If a company does not have sufficient cash flows, investors and creditors could suffer as a result. The financial position, shown on the balance sheet, is also a concern for both investors and creditors because even though a company may have what appears to be sufficient cash flows for the current period, the long-run solvency picture could be weak.

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?

ANSWER: Companies provide information to users to make decisions. The primary decision makers external to the business are creditors, bankers, stockholders, and potential stockholders. These users need to know that the company can repay its debts, earn a profit, and pay dividends. The cost by month for each item of office supplies does not provide any additional information that would be helpful for any external users. In addition, the time and expense necessary to create the additional detail would outweigh the benefits of the final product. The amounts involved are probably immaterial.

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.

ANSWER: Because service-oriented companies do not sell a tangible product, they instead must sell their professional expertise and rely on alternative measures of their efficiency in marketing their services. For example, an law firm would keep detailed records of the hours worked on each client's case, monthly billings to each client, and the ratio of these billings to the average costs incurred on each case. Therefore, ratios like inventory turnover would be meaningless to a service business, like a law firm or a public accounting firm.

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.

ANSWER: To be useful, accounting information must be relevant and reliable. Relevant information has the capacity to make a difference in a decision. Reliable information can be depended on to represent the economic events that it purports to represent.

194. What is the difference between comparability and consistency?

ANSWER: Comparability allows comparisons to be made between or among companies. Even though a certain amount of freedom exists in selecting accounting principles, when this information is disclosed in the financial statements, users can still compare the information when they know what principle is used. Consistency involves the relationship between a set of numbers over several periods, but within one company only, unlike comparability that can be between or among companies.

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

ANSWER: Conservatism is taking the route that will be least likely to overstate assets or income. It is used in situations in which there is uncertainty about how to account for a particular item. In accounting, it is used in the balance sheet and income statement in an effort to provide the least optimistic amount.

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

ANSWER: A classified balance sheet helps evaluate the liquidity of a company by separating the current assets from long-term assets and current liabilities from long-term liabilities. The user can then determine the amount of working capital and the current ratio, which are both useful measures of liquidity.

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

ANSWER: The operating cycle depends on the nature of a company's business. It encompasses the period of time from the investment of cash in inventory to the collection of account receivables from the sale of products. This can take a long time, like the production of a cruise ship, or a very short time, like the preparation of restaurant food. Current assets are realized in cash, or sold, or consumed during the operating cycle or within one year if the cycle is shorter than one year.

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

ANSWER: Current assets will be realized in cash, or sold, or consumed during the operating cycle or within one year if the cycle is shorter than one year. Current liabilities are obligations that will be satisfied within the operating cycle or within one year if the cycle is shorter. For most companies, both current assets and liabilities are reported on the balance sheet using a one-year time period

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	Accounts payable	Advertising expense
Cash	Depreciation expense	Income taxes
Common stock	Land held for future expansion	Dividends
Retained earnings	Loss on the sale of equipment	Service revenue
Office supplies	Patent amortization expense	Sales
Unearned revenue	Utilities expense	

A) Which two items would stockholders be most interested in that can either be computed from the above data or are included in the items listed above? Explain why the two you selected are important to stockholders.
B) In which one item would lenders be most interested? Explain why this item is important.

ANSWER:

A) Stockholders are interested in net income and dividends. They want to make sure the company is profitable. If a company is incurring losses, it may not pay dividends.
B) Lenders are most interested in the company's ability to pay bills when they become due. Cash can be a big problem if a company does not have enough to pay its bills. This includes the company's ability to repay the lender.

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?

ANSWER: A statement of stockholders' equity summarizes the changes in all owners' equity amounts during the period. If there are no changes in capital stock during the period, a company can prepare a statement of retained earnings that explains only the changes in the retained earnings account. A company has an option to present either statement.

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

ANSWER: A statement of cash flows summarizes the operating, financing, and investing activities of a company for a period of time. Some examples are:
Operating: Collections of cash from customers; Payments to suppliers; Payments for wages
Investing: Purchases or sales of plant assets; Purchases or sales of investments
Financing: Payment of dividends; Issuance of stock to investors

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

ANSWER: An annual report contains the reports of management, the auditor's report, management's discussion and analysis of the amounts appearing in the statements, footnotes to the financial statements, and a summary of selected financial data over a period of years.

Identify whether the following investor questions are associated with (a) primary or (b) secondary financial reporting objectives.

a. primary financial reporting objective

b. secondary financial reporting objective

203. How much has Apple invested in research and development projects?

ANSWER: b

204. Based on the financial information, should I buy shares of Apple?

ANSWER: a

205. If I buy 50 shares of Apple, how much cash will I receive in dividends each year?

ANSWER: b

206. How much revenue will Apple generate during the time period in which I own the shares?

ANSWER: b

207. Based on the financial information, should I sell my shares of Apple next quarter?

ANSWER: a

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

a. Consistency

b. Materiality

c. Conservatism

d. Comparability

e. Reliability

f. Relevance

g. Understandability

208. Those willing to spend the time should be provided with comprehensible accounting information.

ANSWER: g

209. The accounting information must be information that could affect a decision.

ANSWER: f

210. Accounting information should use the least optimistic estimate.

ANSWER: c

211. This quality allows users to analyze two or more companies and look for similarities and differences.

ANSWER: d

212. Users must be able to compare accounting information of a firm with its prior year information.

ANSWER: a

213. Accounting information must be verifiable and faithfully represent actual transactions.

ANSWER: e

214. This quality refers to an amount large enough to affect a decision.

ANSWER: b

For each item listed, select the section of the balance sheet in which the item would be reported.

a. Current Assets
b. Property. Plant, and Equipment
c. Current Liabilities
d. Long-term Liabilities
e. Stockholders' Equity

215. Cash

ANSWER: a

216. Accounts payable

ANSWER: c

217. Retained earnings

ANSWER: e

218. Land

ANSWER: b

219. Capital stock

ANSWER: e

220. Accounts receivable

ANSWER: a

221. Equipment

ANSWER: b

222. Notes payable--due within one year

ANSWER: c

223. Interest payable

ANSWER: c

224. Bonds payable

ANSWER: d

225. Computer used within the business

ANSWER: b

226. Computer available for resale

ANSWER: a

Match the selected items from a classified balance sheet and multiple-step income statement to the section in which they would appear on the classified balance sheet or the income statement.

a. Current Assets (balance sheet)
b. Property, Plant, & Equipment (balance sheet)
c. Current Liabilities (balance sheet)
d. Long-term Liabilities (balance sheet)
e. Stockholders' Equity (balance sheet)
f. Operating Revenue (income statement)
g. Operating Expenses (income statement)
h. Other Revenue & Expenses (income statement)
i. Income Taxes (income statement)

227. Accounts receivable

ANSWER: a

228. Consulting revenues

ANSWER: f

229. Buildings

ANSWER: b

230. Interest expense

ANSWER: h

231. Capital stock

ANSWER: e

232. Land

ANSWER: b

233. Bonds payable

ANSWER: d

234. Income taxes payable

ANSWER: c

235. Service revenues

ANSWER: f

236. Wages payable

ANSWER: c

237. Cost of goods sold

ANSWER: g

From the following choices, select the answer that describes the effect on working capital as a result of the transaction.

a. Working capital will increase

b. Working capital will decrease

c. Working capital will **not** change

238. Paid cash for supplies

ANSWER: c

239. Purchased inventory on account

ANSWER: c

240. Purchased land for cash

ANSWER: b

241. Borrowed cash using a long-term note

ANSWER: a

242. Borrowed cash using a six-month note

ANSWER: c

243. Collected an account receivable

ANSWER: c

From the following list, select the proper section from the statement of cash flows in which it would be classified.

a. Operating Activities
b. Investing Activities
c. Financing Activities

244. Purchased equipment for cash

ANSWER: b

245. Received cash from the sale of a building

ANSWER: b

246. Paid a cash dividend on capital stock

ANSWER: c

247. Received cash from bond issuance

ANSWER: c

248. Paid income taxes

ANSWER: a

249. Received cash from selling goods to customers

ANSWER: a

250. Sold equipment **no** longer used in the business

ANSWER: b

251. Paid suppliers cash for inventory purchased

ANSWER: a

252. In preparing financial statements, accountants should consider all of the following **except**:
    a. the objectives of financial reporting.
    b. the characteristics that make accounting information useful.
    c. the most useful way to display the information found on the financial statements.
    d. the presentation of the value of a company.

    ANSWER: d

253. Which of the following is the best description of the purpose of financial reporting?
    a. To allow users to access to the daily detailed records of a business.
    b. To help the users reach their decisions in an informed manner.
    c. To provide users with an assessment of how long the company will continue as a going concern.
    d. To allow users access to a list of all the individuals who owe the company money.

    ANSWER: b

254. The quality of accounting information that allows a user to analyze two or more companies and look for similarities and differences is known as understandability.
    a. True
    b. False

    ANSWER: False

255. The quality of accounting information that makes it comprehensible to those willing to spend the necessary time is consistency.
    a. True
    b. False

    ANSWER: False

256. The quality of accounting information that allows a user to compare two or more accounting periods for a single company is known as consistency.
    a. True
    b. False

    ANSWER: True

257. You are comparing three companies that use different depreciation methods. Which of the following would help you the most in making a comparison of the companies?
    a. The average earnings per share for the quarter.
    b. Prospective cash receipts.
    c. Claims to resources.
    d. Disclosure of accounting policies.

    ANSWER: d

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258. There is a standard threshold for materiality set by the Financial Accounting Standards Board for all companies.
    a. True
    b. False

    ANSWER: False

259. The **lack** of a common depreciation method makes it impossible to compare the performance companies using different methods.
    a. True
    b. False

    ANSWER: False

260. The amount of a transaction may be **immaterial** by company standards but still be considered significant by financial statement users.
    a. True
    b. False

    ANSWER: True

261. Which of the following are generally supplementary information required by GAAP concerning the accounting treatments used by a company?
    a. A Year-End Worksheet
    b. Management's Discussion and Analysis
    c. The Report of Independent Accountants
    d. Notes to the Consolidated Financial Statements

    ANSWER: d