**CHAPTER 2**

# A further look at FINANCIAL STATEMENTS

### Summary of Question TYPEs by LEARNING Objective, Level of difficulty, BLOOM’S TAXONOMY, CPA CODES, and AACSB Codes

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
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| **Item** | **LO** | **LOD** | **Bloom’s** | **CPA** | **AACSB** | **Item** | **LO** | **LOD** | **Bloom’s** | **CPA** | **AACSB** | **Item** | **LO** | **LOD** | **Bloom’s** | **CPA** | **AACSB** |
| **True-False Statements** |
| 1. | 1 | E | K | F | AN | 15. | 2 | M | C | F | AN | 29. | 3 | M | C | F | AN |
| 2. | 1 | E | K | F | AN | 16. | 2 | E | C | F | AN | 30. | 3 | M | K | F | AN |
| 3. | 1 | E | C | F | AN | 17. | 2 | E | C | F | AN | 31. | 3 | E | C | F | AN |
| 4. | 1 | M | K | F | AN | 18. | 2 | M | K | F | AN | 32. | 3 | M | K | F | AN |
| 5. | 1 | M | K | F | AN | 19. | 2 | E | K | F | AN | 33. | 3 | E | K | F | AN |
| 6. | 1 | M | K | F | AN | 20. | 2 | M | C | F | AN | 34. | 3 | M | C | F | AN |
| 7. | 1 | M | K | F | AN | 21. | 2 | E | K | F | AN | 35. | 3 | M | C | F | AN |
| 8. | 1 | M | K | F | AN | 22. | 2 | M | C | F | AN | 36. | 3 | E | K | F | AN |
| 9. | 1 | M | K | F | AN | 23. | 2 | M | K | F | AN | 37. | 3 | E | K | F | AN |
| 10. | 2 | E | K | F | AN | 24. | 3 | M | K | F | AN | 38. | 3 | M | K | F | AN |
| 11. | 2 | E | K | F | AN | 25. | 3 | M | C | F | AN | 39. | 3 | M | K | F | AN |
| 12. | 2 | M | K | F | AN | 26. | 3 | M | K | F | AN | 40. | 3 | E | K | F | AN |
| 13. | 2 | E | C | F | AN | 27. | 3 | E | K | F | AN | 41. | 3 | E | K | F | AN |
| 14. | 2 | M | K | F | AN | 28. | 3 | E | C | F | AN |  |  |  |  |  |  |

LOD: E = Easy M = Medium H = Hard

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### Summary of Question TYPEs by LEARNING Objective, Level of difficulty, BLOOM’S TAXONOMY, CPA CODES, and AACSB Codes

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| **Item** | **LO** | **LOD** | **Bloom’s** | **CPA** | **AACSB** | **Item** | **LO** | **LOD** | **Bloom’s** | **CPA** | **AACSB** | **Item** | **LO** | **LOD** | **Bloom’s** | **CPA** | **AACSB** |
| **Multiple Choice Questions** |
| 42. | 1 | M | C | F | AN | 72. | 2 | H | C | F | AN | 102. | 2 | M | C | F | AN |
| 43. | 1 | M | C | F | AN | 73. | 2 | M | C | F | AN | 103. | 3 | M | C | F | AN |
| 44. | 1 | H | C | F | AN | 74. | 2 | E | K | F | AN | 104. | 3 | M | C | F | AN |
| 45. | 1 | E | K | F | AN | 75. | 2 | M | K | F | AN | 105. | 3 | H | C | F | AN |
| 46. | 1 | M | K | F | AN | 76. | 2 | M | K | F | AN | 106. | 3 | M | C | F | AN |
| 47. | 1 | E | K | F | AN | 77. | 2 | E | K | F | AN | 107. | 3 | M | C | F | AN |
| 48. | 1 | E | C | F | AN | 78. | 2 | E | K | F | AN | 108. | 3 | M | C | F | AN |
| 49. | 1 | M | K | F | AN | 79. | 2 | E | K | F | AN | 109. | 3 | E | K | F | AN |
| 50. | 1 | E | K | F | AN | 80. | 2 | E | K | F | AN | 110. | 3 | E | K | F | AN |
| 51. | 1 | M | C | F | AN | 81. | 2 | M | K | F | AN | 111. | 3 | M | K | F | AN |
| 52. | 1 | E | K | F | AN | 82. | 2 | E | K | F | AN | 112. | 3 | M | K | F | AN |
| 53. | 1 | E | K | F | AN | 83. | 2 | M | C | F | AN | 113. | 3 | M | K | F | AN |
| 54. | 1 | E | K | F | AN | 84. | 2 | E | K | F | AN | 114. | 3 | E | K | F | AN |
| 55. | 1 | E | K | F | AN | 85. | 2 | M | K | F | AN | 115. | 3 | E | K | F | AN |
| 56. | 1 | E | K | F | AN | 86. | 2 | M | K | F | AN | 116. | 3 | E | K | F | AN |
| 57. | 1 | M | K | F | AN | 87. | 2 | E | AP | F | AN | 117. | 3 | M | K | F | AN |
| 58. | 1 | M | K | F | AN | 88. | 2 | E | AP | F | AN | 118. | 3 | H | K | F | AN |
| 59. | 1 | M | AP | F | AN | 89. | 2 | M | AP | F | AN | 119. | 3 | E | K | F | AN |
| 60. | 1 | M | AP | F | AN | 90. | 2 | M | AP | F | AN | 120. | 3 | E | K | F | AN |
| 61. | 1 | M | AP | F | AN | 91. | 2 | M | AP | F | AN | 121. | 3 | E | K | F | AN |
| 62. | 1 | M | AP | F | AN | 92. | 2 | E | K | F | AN | 122. | 3 | E | K | F | AN |
| 63. | 1 | H | AP | F | AN | 93. | 2 | M | K | F | AN | 123. | 3 | E | K | F | AN |
| 64. | 1 | M | AP | F | AN | 94. | 2 | E | K | F | AN | 124. | 3 | M | C | F | AN |
| 65. | 1 | M | AP | F | AN | 95. | 2 | H | C | F | AN | 125. | 3 | E | K | F | AN |
| 66. | 1 | E | AP | F | AN | 96. | 2 | H | C | F | AN | 126. | 3 | H | K | F | AN |
| 67. | 1 | H | AP | F | AN | 97. | 2 | M | AP | F | AN | 127. | 3 | E | K | F | AN |
| 68. | 1 | M | AP | F | AN | 98. | 2 | M | C | F | AN | 128. | 3 | E | K | F | AN |
| 69. | 1 | M | AP | F | AN | 99. | 2 | M | C | F | AN | 129. | 3 | E | K | F | AN |
| 70. | 2 | M | C | F | AN | 100. | 2 | H | C | F | AN |  |  |  |  |  |  |
| 71. | 2 | M | C | F | AN | 101. | 2 | M | C | F | AN |  |  |  |  |  |  |

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### Summary of Question TYPEs by LEARNING Objective, Level of difficulty, BLOOM’S TAXONOMY, CPA CODES, and AACSB Codes

### (Cont’d)

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
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| **Item** | **LO** | **LOD** | **Bloom’s** | **CPA** | **AACSB** | **Item** | **LO** | **LOD** | **Bloom’s** | **CPA** | **AACSB** | **Item** | **LO** | **LOD** | **Bloom’s** | **CPA** | **AACSB** |
| **Exercises** |
| 130. | 1 | M | K | F | AN | 138. | 2 | H | AP | F | AN | 146. | 2 | E | AP | F | AN |
| 131. | 1 | H | K | F | AN | 139. | 2 | H | AP | F | AN | 147. | 2 | E | AP | F | AN |
| 132. | 1 | M | C | F | AN | 140. | 2 | H | AP | F | AN | 148. | 3 | E | C | F | AN |
| 133. | 1 | E | AP | F | AN | 141. | 2 | E | AP | F | AN | 149. | 3 | M | K | F | AN |
| 134. | 1 | E | K | F | AN | 142. | 2 | M | AP | F | AN | 150. | 3 | E | C | F | AN |
| 135. | 1 | E | K | F | AN | 143. | 2 | E | K | F | AN | 151. | 3 | M | K | F | AN |
| 136. | 1,2 | M | AP | F | AN | 144. | 2 | H | AP | F | AN | 152. | 3 | H | C | F | AN |
| 137. | 1,2 | M | AP | F | AN | 145. | 2 | M | AP | F | AN |  |  |  |  |  |  |
| **Matching** |
| 153. | 1–3 | M | K | F | AN |  |  |  |  |  |  |  |  |  |  |  |  |
| **Short-Answer Essay** |
| 154. | 1,2 | E | K | F | AN | 156. | 3 | H | C | F | AN | 158. | 3 | E | K | F | AN |
| 155. | 2 | M | C | F,C | AN | 157. | 3 | M | C | F | AN |  |  |  |  |  |  |
| **CPA Questions** |
| 159. | 1 | M | AN | F | AN | 161. | 2 | M | AN | F | AN | 163. | 3 | M | K | F | AN |
| 160. | 2 | E | K | F | AN | 162. | 2 | H | AN | F | AN |  |  |  |  |  |  |

LOD: E = Easy M = Medium H = Hard

Bloom’s: AN = Analysis AP = Application C = Comprehension K = Knowledge

CPA: F = Financial Reporting C = Communication

AACSB: AN = Analytic

**SUMMARY OF LEARNING OBJECTIVES BY QUESTION TYPE**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Item** | **Type** | **Item** | **Type** | **Item** | **Type** | **Item** | **Type** | **Item** | **Type** | **Item** | **Type** | **Item** | **Type** |
| Learning Objective 1 |
| 1. | TF | 8. | TF | 47. | MC | 54. | MC | 61. | MC | 68. | MC | 135. | Ex |
| 2. | TF | 9. | TF | 48. | MC | 55. | MC | 62. | MC | 69. | MC | 136. | Ex |
| 3. | TF | 42. | MC | 49. | MC | 56. | MC | 63. | MC | 130. | Ex | 137. | Ex |
| 4. | TF | 43. | MC | 50. | MC | 57. | MC | 64. | MC | 131. | Ex | 153. | Ma |
| 5. | TF | 44. | MC | 51. | MC | 58. | MC | 65. | MC | 132. | Ex | 154. | SAE |
| 6. | TF | 45. | MC | 52. | MC | 59. | MC | 66. | MC | 133. | Ex | 159. | CP |
| 7. | TF | 46. | MC | 53. | MC | 60. | MC | 67. | MC | 134. | Ex |  |  |
| Learning Objective 2 |
| 10. | TF | 20. | TF | 76. | MC | 86. | MC | 96. | MC | 139. | Ex | 154. | SAE |
| 11. | TF | 21. | TF | 77. | MC | 87. | MC | 97. | MC | 140. | Ex | 155. | SAE |
| 12. | TF | 22. | TF | 78. | MC | 88. | MC | 98. | MC | 141. | Ex | 160. | CP |
| 13. | TF | 23. | TF | 79. | MC | 89. | MC | 99. | MC | 142. | Ex | 161. | CP |
| 14. | TF | 70. | MC | 80. | MC | 90. | MC | 100. | MC | 143. | Ex | 162. | CP |
| 15. | TF | 71. | MC | 81. | MC | 91. | MC | 101. | MC | 144. | Ex |  |  |
| 16. | TF | 72. | MC | 82. | MC | 92. | MC | 102. | MC | 145. | Ex |  |  |
| 17. | TF | 73. | MC | 83. | MC | 93. | MC | 136. | Ex | 146. | Ex |  |  |
| 18. | TF | 74. | MC | 84. | MC | 94. | MC | 137. | Ex | 147. | Ex |  |  |
| 19. | TF | 75. | MC | 85. | MC | 95. | MC | 138. | Ex | 153. | Ma |  |  |
| Learning Objective 3 |
| 24. | TF | 33. | TF | 41. | TF | 110. | MC | 118. | MC | 126. | MC | 152. | Ex |
| 25. | TF | 34. | TF | 103. | MC | 111. | MC | 119. | MC | 127. | MC | 153. | Ma |
| 26. | TF | 35. | TF | 104. | MC | 112. | MC | 120. | MC | 128. | MC | 156. | SAE |
| 27. | TF | 36. | TF | 105. | MC | 113. | MC | 121. | MC | 129. | MC | 157. | SAE |
| 29. | TF | 37. | TF | 106. | MC | 114. | MC | 122. | MC | 148. | Ex | 158. | SAE |
| 30. | TF | 38. | TF | 107. | MC | 115. | MC | 123. | MC | 149. | Ex | 163. | CP |
| 31. | TF | 39. | TF | 108. | MC | 116. | MC | 124. | MC | 150. | Ex |  |  |
| 32. | TF | 40. | TF | 109. | MC | 117. | MC | 125. | MC | 151. | Ex |  |  |

Note: TF = True/False MC = Multiple Choice Ma = Matching

 Ex = Exercise SAE = Short-Answer Essay CP = CPA

## CHAPTER LEARNING OBJECTIVES

**1. Identify the sections of a classified statement of financial position.** In a classified statement of financial position, assets are classified as current or non-current assets. In the non-current asset category, they are further classified as long-term investments; property, plant, and equipment; intangible assets and goodwill; or other assets. Liabilities are classified as either current or non-current. There is also a shareholders’ equity section, which shows share capital and retained earnings, among other equity items if any exist.

2. **Identify and calculate ratios for analyzing a company’s liquidity, solvency, and profitability.** Liquidity ratios, such as working capital and the current ratio, measure a company’s short-term ability to pay its maturing obligations and meet unexpected needs for cash. Solvency ratios, such as debt to total assets, measure a company’s ability to survive over a long period by having enough assets to settle its liabilities as they fall due. Profitability ratios, such as basic earnings per share and the price-earnings ratio, measure a company’s operating success for a specific period of time.

3. **Describe the framework for the preparation and presentation of financial statements.** The key components of the conceptual framework are (1) the objective of financial reporting; (2) qualitative characteristics of useful financial information, which include fundamental and enhancing characteristics and the cost constraint; (3) the going concern assumption underlying the accounting process; (4) elements of the financial statements; and (5) measurement of the elements of financial statements.

## TRUE-FALSE STATEMENTS

1. Long-term investments appear in the property, plant, and equipment section of the statement of financial position.

2. Special rights and privileges that provide a future economic benefit to the company are classified as intangible assets.

3. A liability is normally classified as a current liability if it is to be paid within the coming year.

4. Mortgages and pension liabilities are examples of non-current liabilities.

5. The investment classification on the statement of financial position normally includes investments that are intended to be held for a short period of time (less than one year).

6. The main difference between intangible assets and property, plant, and equipment is the length of the asset’s life.

7. Listing assets and liabilities in reverse order of liquidity is *not* permitted in Canada.

8. The statement of financial position is normally presented as follows, when ordered in order of liquidity: Current assets, current liabilities, non-current assets, non-current liabilities, and shareholders’ equity.

9. The statement of financial position is normally presented as follows, when ordered in order of *reverse* liquidity: Non-current assets, current assets, shareholders’ equity, non-current liabilities, and current liabilities.

10. Intracompany comparisons are based on comparisons with competitors in the same industry.

11. Calculating financial ratios can give clues to underlying conditions that may *not* be noticed by examining each financial statement item separately.

12. Liquidity ratios are concerned with the frequency and amounts of dividend payments.

13. Analysis of financial statements is enhanced with the use of comparative data.

14. Solvency ratios measure the entity’s ability to survive over a long period.

15. A single ratio by itself is *not* very meaningful.

16. Profitability means having enough funds on hand to pay debts when they fall due.

17. The most liquid resource is inventory.

18. Solvency ratios measure the short-term ability of the company to pay its maturing obligations.

19. The debt to total assets ratio measures the percentage of assets financed by creditors rather than shareholders.

20. From a creditor’s point of view, the higher the total debt to total assets ratio, the lower the risk that the company may be unable to pay its obligations.

21. The price-earnings ratio is a measure of liquidity.

22. The higher the price-earnings ratio, the higher are investors’ expectations of the company’s future profitability.

23. Companies using Accounting Standards for Private Enterprises (ASPE) are *not* required to present basic earnings per share information in their financial statements.

24. The conceptual framework is fundamentally similar for both Canadian publicly traded companies and Canadian private companies.

25. Faithful representation means that accounting information must be complete, neutral, and free from error.

26. Financial reporting does *not* have to present the economic substance of a transaction in order to provide a faithful representation of what really happened.

27. Materiality and relevance are both defined in terms of what influences or makes a difference to a decision maker.

28. Enhancing qualitative characteristics include timeliness and comparability.

29. Under the going concern assumption, reporting assets, such as land, at their cost may be more appropriate than reporting land at its current value.

30. In order for information to be relevant, it must be reported on a timely basis.

31. Consistency aids comparability when a company uses the same accounting principles and methods from year to year or when companies with similar circumstances use the same accounting principles.

32. Comparability in accounting means that a company uses the same generally accepted accounting principles from one accounting period to the next.

33. Comparability and understandability are examples of enhancing qualitative characteristics.

34. Information has verifiability if the information is comparable.

35. Using a simplified version of Canadian GAAP for small companies in order to reduce the cost of providing financial information is an example of the application of materiality.

36. Elements of financial statements include assets, equity, and expenses, but *not* liabilities.

37. Two measurement principles are historical cost and current value.

38. In general, standard setters require that most assets be recorded using historical cost because cost is representationally faithful.

39. The cost basis of accounting states that assets and liabilities should be recorded at their cost *not* only when originally acquired, but also during the time the entity holds them.

40. Qualitative characteristics help ensure that the information provided in financial statements is useful.

41. A conceptual framework is still under development for companies using International Financial Reporting Standards (IFRS).

#### Answers to True-False Statements

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
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| **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** |
| 1. | F | 7. | F | 13. | T | 19. | T | 25. | T | 31. | T | 37. | T |
| 2. | T | 8. | F | 14. | T | 20. | F | 26. | F | 32. | F | 38. | T |
| 3. | T | 9. | T | 15. | T | 21. | F | 27. | T | 33. | T | 39. | T |
| 4. | T | 10. | F | 16. | F | 22. | T | 28. | T | 34. | F | 40. | T |
| 5. | F | 11. | T | 17. | F | 23. | T | 29. | T | 35. | F | 41. | T |
| 6. | F | 12. | F | 18. | F | 24. | T | 30. | T | 36. | F |  |  |

## MULTIPLE CHOICE QUESTIONS

42. On a statement of financial position

(a) Cash and Office Supplies are both classified as current assets.

(b) Inventories and Prepaid Expenses are classified as long-term investments.

(c) Land and Buildings are classified as long-term investments.

(d) Depreciation Expense is classified as property, plant and equipment.

43. Shareholders’ equity

(a) is divided into at least two parts: share capital and retained earnings.

(b) consists of two parts: common and preferred shares.

(c) reflects two parts: dividends declared and share capital.

(d) reflects retained earnings only.

44. All property, plant and equipment

(a) including land have estimated useful lives over which they are expected to generate revenue.

(b) are depreciated over their estimated useful lives including land.

(c) with finite lives including land are depreciated.

(d) including land contributes to the generation of revenue.

45. On a classified statement of financial position, prepaid expenses are classified as

(a) a current liability.

(b) property, plant, and equipment.

(c) a current asset.

(d) a long-term investment.

46. A current asset is

(a) the last asset purchased by a business.

(b) an asset which is not currently being used to produce a product or service.

(c) usually found as a separate classification in the income statement.

(d) expected to be converted to cash or used in the business within a relatively short period of time.

47. Which of the following is *not* classified as a current asset?

(a) supplies

(b) short-term (trading) investments

(c) a fund to be used to purchase a building within the next year

(d) equipment with an estimated useful life of five years

48. An intangible asset

(a) derives its value from the rights and privileges it provides the company.

(b) is worthless because it has no physical substance.

(c) is converted into a tangible asset during the year.

(d) cannot be classified on the statement of financial position because it lacks physical substance.

49. Which of the following is *not* considered to be an asset?

(a) equipment

(b) dividends declared

(c) accounts receivable

(d) inventory

50. The difference between cost and accumulated depreciation is referred to as

(a) net depreciation.

(b) book amount.

(c) current value.

(d) cost value.

51. Trademarks would appear in which section of the statement of financial position?

(a) Shareholders’ equity

(b) Investments

(c) Intangible assets

(d) Current assets

52. Liabilities are generally classified on a statement of financial position as

(a) small liabilities and large liabilities.

(b) present liabilities and future liabilities.

(c) tangible liabilities and intangible liabilities.

(d) current liabilities and non-current liabilities.

53. Which of the following would *not* normally be classified as a non-current liability?

(a) current portion of non-current debt

(b) bonds payable

(c) mortgage payable

(d) lease liabilities

54. Which of the following is *not* normally a current liability?

(a) salaries payable

(b) accounts payable

(c) income tax payable

(d) bonds payable

55. Office equipment is classified on the statement of financial position as

(a) a current asset.

(b) property, plant, and equipment.

(c) shareholders’ equity.

(d) a long-term investment.

56. Current liabilities are expected to be

(a) converted to cash within one year.

(b) paid within one year.

(c) used in the business within one year.

(d) acquired within one year.

57. On a classified statement of financial position, current assets are often listed

(a) in alphabetical order.

(b) with the largest dollar amounts first.

(c) in the order in which they are expected to be converted into cash.

(d) in the order of acquisition.

58. Long-lived assets without physical substance are

(a) listed directly under current assets on the statement of financial position.

(b) not listed on the statement of financial position because they do not have physical substance.

(c) intangible assets.

(d) listed as a long-term investment on the statement of financial position.

Use the following information to answer questions 59–63.

|  |
| --- |
| **HONEST RON’S FURNITURE OUTLET LTD.** |
| **Statement of Financial Position** |
| **December 31, 2018** |
| –––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––– |
| Cash |  | $ 5,000 | Accounts payable | $ 30,000 |  |
| Accounts receivable  |  | 20,000 | Salaries payable | 10,000 |  |
| Supplies |  | 1,000 | Mortgage payable |  130,000 |  |
| Inventory |  | 170,000 |  Total liabilities |  | $170,000 |
| Land |  | 100,000 | Shareholders’ equity |  |  |
| Building | $100,000 |  | Common shares | $140,000 |  |
| Less: Accum. Depreciation |  20,000 | 80,000 | Retained earnings |  96,000 |  |
| Trademark | $ 40,000 |  | Total shareholders’ equity |  |  236,000 |
| Less: Accum. Amortization |  10,000 |  30,000 |  |  |  |
| Total assets |  | $406,000  | Total liabilities and shareholders’ equity |  | $406,000 |

59. The dollar amount of current liabilities is

(a) $196,000.

(b) $170,000.

(c) $ 40,000.

(d) $ 30,000.

Solution: $30,000 + $10,000 = $40,000

60. The dollar amount of net property, plant and equipment is

(a) $ 80,000.

(b) $180,000.

(c) $210,000.

(d) $350,000.

61. The dollar amount of current assets is

(a) $ 26,000.

(b) $ 40,000.

(c) $ 25,000.

(d) $196,000.

Solution: $5,000 + $20,000 + $1,000+170,000 = $196,000

62. The dollar amount of share capital is

(a) $406,000.

(b) $236,000.

(c) $140,000.

(d) $ 96,000.

63. The total obligations that have resulted from past transactions are

(a) $ 20,000.

(b) $ 40,000.

(c) $ 96,000.

(d) $170,000.

Use the following information to answer questions 64–69.

**FRANKLIN LTD.**

**Statement of Financial Position**

**December 31, 2018**

Cash $ 65,000 Accounts payable $ 66,000

Prepaid insurance 15,000 Salaries payable 25,000

Accounts receivable 95,000 Bonds payable 225,000

Inventory 120,000 Total liabilities 316,000

Land 165,000

Building $235,000 Common shares 250,000

Less: Accumulated Retained earnings 146,000

 depreciation 70,500 164,500 Total shareholders’ equity 396,000

Trademark $ 125,000

Less: Accum. Amort. 37,500 87,500 Total liabilities and

Total assets $712,000 shareholders’ equity $712,000

64. The total dollar amount of assets to be classified as current assets is

(a) $295,000.

(b) $235,000.

(c) $175,000.

(d) $160,000.

Solution: $65,000 + $15,000 + $95,000+120,000 = $295,000

65. The total dollar amount of assets to be classified as net property, plant, and equipment is

(a) $329,500.

(b) $164,500.

(c) $252,000.

(d) $235,000.

Solution: $165,000 + $235,000 – 70,500 = $329,500

66. The total dollar amount of assets to be classified as investments is

(a) $ 0.

(b) $ 165,000.

(c) $ 525,000.

(d) $400,000.

67. The total amount in the contra asset accounts is

(a) $ 37,500.

(b) $ 108,000.

(c) $70,500.

(d) $252,000.

Solution: $70,500 – $37,500 = $108,000

68. Non-current liabilities total

(a) $712,000.

(b) $316,000.

(c) $225,000.

(d) $ 25,000.

Solution: Bonds payable $225,000

69. Net income retained for use in the business is

(a) $712,000.

(b) $396,000.

(c) $316,000.

(d) $146,000.

70. Working capital is

(a) the difference between total assets and current liabilities.

(b) the excess of current assets over current liabilities.

(c) the difference between current assets and total liabilities.

(d) the excess of total assets over total liabilities.

71. The current ratio

(a) is calculated by dividing total assets by total liabilities.

(b) takes into account the composition of current assets.

(c) takes into account the composition of current assets and current liabilities.

(d) is calculated by dividing current assets by current liabilities.

72. Which of the following statements is true?

(a) A current ratio of 1.2 to 1 indicates that a company’s current assets are less than its current liabilities.

(b) All companies, regardless of size, should have a current ratio of at least 2:1.

(c) The current ratio is a more dependable indicator of liquidity than working capital.

(d) The use of the current ratio does not make it possible to compare companies of different sizes.

73. Basic earnings per share

(a) is calculated by dividing income available to common shareholders for the period by the dollar value in the common shares account.

(b) is the only ratio that must be presented in the financial statements for publicly traded companies.

(c) is frequently compared across companies in the same industry.

(d) is the only ratio that must be presented in the financial statements for both publicly traded companies and privately held companies.

74. A measure of profitability is the

(a) current ratio.

(b) debt to total assets ratio.

(c) basic earnings per share.

(d) working capital.

75. Basic earnings per share is calculated by dividing

(a) revenue by weighted average shareholders’ equity.

(b) revenue by the weighted average number of common shares.

(c) income available to common shareholders by weighted average shareholders’ equity.

(d) income available to common shareholders by the weighted average number of common shares.

76. The price-earnings ratio is calculated by dividing

(a) the market price per share by basic earnings per share.

(b) basic earnings per share by the average number of shares.

(c) net income by the market price per share.

(d) basic earnings per share by the market price per share.

77. The relationship between current assets and current liabilities is important in evaluating a company’s

(a) profitability.

(b) liquidity.

(c) current value.

(d) solvency.

78. The most important information needed to determine if companies can pay their current obligations is the

(a) net income for this year.

(b) projected net income for next year.

(c) relationship between current assets and current liabilities.

(d) relationship between current and non-current liabilities.

79. A short-term creditor is primarily interested in the \_\_\_ of the borrower.

(a) liquidity

(b) profitability

(c) comparability

(d) solvency

80. The current ratio is calculated as

(a) current assets plus current liabilities.

(b) current assets minus current liabilities.

(c) current assets divided by current liabilities.

(d) current assets times current liabilities.

81. Working capital is calculated as

(a) current assets plus current liabilities.

(b) current assets minus current liabilities.

(c) current assets divided by current liabilities.

(d) current assets times current liabilities.

82. Working capital is a measure of

(a) comparability.

(b) liquidity.

(c) profitability.

(d) solvency.

83. Long-term creditors are usually most interested in evaluating

(a) liquidity and profitability.

(b) comparability and profitability.

(c) profitability and solvency.

(d) consistency and solvency.

84. A liquidity ratio measures the

(a) net income or operating success of a company over a period of time.

(b) ability of a company to survive over a long period of time.

(c) short-term ability of a company to pay its maturing obligations and to meet unexpected needs for cash.

(d) percentage of total financing provided by creditors.

85. Working capital is

(a) calculated by dividing current assets by current liabilities.

(b) used to evaluate a company’s liquidity and short-term debt-paying ability.

(c) used to evaluate a company’s solvency and long-term debt-paying ability.

(d) calculated by subtracting current liabilities from total assets.

86. The ability of a business to pay obligations that are expected to become due within the next year is called

(a) leverage.

(b) liquidity.

(c) profitability.

(d) solvency.

Use the following information to answer questions 87–91.

Current assets $18,000 Net sales $40,000

Current liabilities 8,000 Total liabilities 10,000

Average assets 80,000 Shareholders’ equity 50,000

Total assets 60,000 Market price of shares $4

Net income 18,000 Weighted average number

 of common shares 26,000

87. What is the total amount of working capital?

(a) $4,000

(b) $8,000

(c) $10,000

(d) $14,000

Solution: $18,000 - $8,000 = $10,000

88. What is the current ratio?

(a) 2.3:1

(b) 2.0:1

(c) 0.6:1

(d) 0.4:1

Solution: $18,000 / $8,000 = 2.3:1

89. What is the basic earnings per share?

(a) $0.44

(b) $0.69

(c) $1.92

(d) $1.54

Solution: $18,000 / 26,000 = $0.69

90. What is the price-earnings ratio?

(a) 9.1 times

(b) 5.8 times

(c) 2.1 times

(d) 1.7 times

Solution: $4 / $0.69 = 5.8 times

91. What is the debt to total assets?

(a) 12.5%

(b) 20.0%

(c) 75.0%

(d) 16.7%

Solution: $10,000 / $60,000 = 16.7%

92. The debt to total assets ratio is calculated by dividing

(a) non-current liabilities by total assets.

(b) non-current liabilities by average assets.

(c) total liabilities by total assets.

(d) total liabilities by average assets.

93. A useful measure of solvency is the

(a) current ratio.

(b) price-earnings ratio.

(c) basic earnings per share.

(d) debt to total assets.

94. Which of the following is *not* considered a measure of liquidity?

(a) current ratio

(b) working capital

(c) both current ratio and working capital

(d) debt to total assets

95. Investors are usually most interested in evaluating

(a) liquidity and solvency.

(b) solvency and marketability.

(c) liquidity and profitability.

(d) profitability and solvency.

96. Shareholders are most interested in evaluating

(a) liquidity and solvency.

(b) profitability and solvency.

(c) liquidity and profitability.

(d) marketability and solvency.

97. The current assets of Brothers Corporation are $615,000. The current liabilities are $512,500. The current ratio expressed as a ratio is

(a) 120%

(b) 1.2:1

(c) 0.8:1

(d) 80%

Solution: $615,000 / $512,500 = 1.2:1

98. A weakness of the current ratio is

(a) the difficulty of the calculation.

(b) that it doesn’t take into account the composition of the current assets.

(c) that it is rarely used by sophisticated analysts.

(d) that it can be expressed as a percentage, as a rate, or as a proportion.

99. A supplier to a company would probably be most interested in the

(a) debt to total assets.

(b) price-earnings ratio.

(c) current ratio.

(d) basic earnings per share.

Use the following information for questions 100–101.

Anson Corporation had $325,000 in current assets and $145,000 in current liabilities before borrowing $100,000 from the bank for a 6-month period.

100. What effect did the borrowing transaction have on the amount of Anson’s working capital?

(a) No effect

(b) $100,000 increase

(c) $145,000 increase

(d) $100,000 decrease

Solution: $325,000 – $145,000 = $180,000 versus ($325,000 – ($145,000 + $100,000)) = $80,000: $180,000 – $80,000 = $100,000 decrease

101. What effect did the borrowing transaction have on Anson’s current ratio?

(a) The ratio remained unchanged.

(b) The change in the current ratio cannot be determined.

(c) The ratio decreased.

(d) The ratio increased.

Solution: $325,000 / $145,000 = 2.2:1 versus $325,000 / ($145,000 + $100,000) = 1.3:1; ratio decreased

102. Marvel Inc. has $180,000 in current assets and $150,000 in current liabilities. When the company pays $35,000 owed to employees (salaries payable), what effect does this have on their current ratio?

(a) The ratio increases.

(b) The ratio decreases.

(c) The ratio stays the same.

(d) Cannot be determined.

Solution: $180,000 / $150,000 = 1.2:1 versus ($180,000-35,000) / ($145,000 - $35,000) = 1.3:1; ratio increased slightly

103. The key components of the conceptual framework include

(a) the objective of financial reporting, qualitative characteristics, the going concern assumption, elements of financial statements and the measurement of those elements.

(b) the objective of financial reporting, qualitative characteristics, the going concern assumption, and elements of financial statements.

(c) the objective of financial reporting, qualitative characteristics, the going concern assumption, and measurement of the elements of financial statements.

(d) the objective of financial reporting, qualitative characteristics and the going concern assumption.

104. The two fundamental qualitative characteristics are

(a) relevance and timeliness.

(b) faithful representation and relevance.

(c) comparability and relevance.

(d) understandability and relevance.

105. Information

(a) is relevant if it will make a difference in a user’s decision(s).

(b) has predictive value if it helps users confirm or correct their previous predictions.

(c) has confirmatory value if it helps users make predictions about the future.

(d) is not relevant if it will make a difference in a user’s decision(s).

106. The cost constraint ensures that

(a) the value of information provided is greater than the cost of providing it.

(b) that information costs less than budget.

(c) the value of information provided is less than the cost of providing it.

(d) that information costs more than budget.

107. Which of the following statements is false?

(a) The going concern assumption states that the business will continue in operation for the foreseeable future.

(b) If a company is *not* a going concern, the classification of its assets and liabilities does *not* matter.

(c) The going concern assumption underlies the preparation of financial statements.

(d) The going concern assumption does not create a foundation for the accounting process.

108. Which of the following statements is true?

(a) Two recognition principles are the current value basis of accounting and the going concern assumption.

(b) The current value basis of accounting states that all assets and liabilities can be reported at current value.

(c) Current values may *not* always be representationally faithful.

(d) Current value is fair value in use.

109. The conceptual framework of accounting helps to ensure that

(a) users with no accounting or business knowledge will understand financial statements.

(b) a rule will be in place for every possible situation.

(c) there are consistent standards prescribing the nature, functions and limits of financial statements.

(d) all countries have their own unique accounting standards.

110. The objective of financial reporting is to

(a) provide information to the Canada Revenue Agency.

(b) provide financial information that is useful to existing and potential investors, lenders and other creditors.

(c) comply with Accounting Standards for Private Enterprises.

(d) comply with International Financial Reporting Standards.

111. The conceptual framework of accounting begins with

(a) qualitative characteristics.

(b) the going concern assumption.

(c) the objective of financing reporting.

(d) elements of financial statements.

112. Which one of the following is *not* a qualitative characteristic of useful accounting information?

(a) relevance

(b) verifiability

(c) going concern

(d) comparability

113. Which one of the following is a fundamental qualitative characteristic?

(a) relevance

(b) timeliness

(c) understandability

(d) comparability

114. In order for accounting information to be relevant, it must

(a) have very little cost.

(b) help predict future events or confirm prior expectations.

(c) be verifiable.

(d) be used by a lot of different organizations.

115. If accounting information has relevance, it

(a) is not required to be complete.

(b) will not have predictive value.

(c) will only make a difference for internal stakeholders.

(d) will make a difference in users’ decisions.

116. The two qualitative characteristics that are defined in terms of what influences or makes a difference to a decision maker are

(a) faithful representation and materiality.

(b) comparability and timeliness.

(c) materiality and relevance.

(d) relevance and understandability.

117. Which of the following is *not* an enhancing qualitative characteristic?

(a) verifiability

(b) faithful representation

(c) comparability

(d) timeliness

118. Accounting information should be neutral in order to enhance

(a) faithful representation.

(b) materiality.

(c) comparability.

(d) understandability.

119. Which of the following is *not* a main section of the conceptual framework of accounting?

(a) the objective of financial reporting

(b) the going concern assumption

(c) financial analysis

(d) the elements of financial statements

120. Which of the following statements is *not* true?

(a) Comparability means using different accounting principles from year to year within a company.

(b) Faithful representation means information must be neutral, complete, and free from error.

(c) Relevant accounting information must be capable of making a difference in a user’s decision.

(d) For accounting information to be relevant, it must have timeliness.

121. A company can change to a new accounting principle if management can justify that the change will result in

(a) less likelihood of clerical errors.

(b) higher net income.

(c) lower net income for tax purposes.

(d) more relevant information for decision-making.

122. If accounting information has predictive value, it will help users

(a) prepare for future Canada Revenue Agency audits.

(b) make predictions about future events.

(c) make predictions about foreign currency exchange rates.

(d) confirm or correct previous predictions or expectations.

123. The going concern assumption assumes that the business

(a) will be liquidated in the near future.

(b) will be purchased by another business.

(c) is in a growth industry.

(d) will remain in operation for the foreseeable future.

124. The going concern assumption is inappropriate when

(a) the business is just starting up.

(b) liquidation appears likely.

(c) current values are higher than costs.

(d) the business is organized as a proprietorship.

125. Which of the following is a constraint in accounting?

(a) comparability

(b) cost

(c) faithful representation

(d) timeliness

126. In general, standard setters require that most assets be recorded using historical cost because

(a) current values may overstate assets and equity.

(b) current values may not always be representationally faithful.

(c) cost often cannot be verified.

(d) cost values may or may not be relevant.

127. Which of the following is *not* a financial statement element?

(a) Liabilities

(b) Equity

(c) Expenses

(d) Current value

128. The qualitative characteristic that says the value of information should exceed the cost of preparing it is called

(a) relevance.

(b) understandability.

(c) cost constraint.

(d) verifiability.

129. The measurement principle that says assets are reported at the price that would be received if the item were sold is called

(a) current value.

(b) historical cost.

(c) materiality.

(d) going concern.

#### Answers to Multiple Choice Questions

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** |
| 42. | a | 57. | c | 72. | c | 87. | c | 102. | a | 117. | b |
| 43. | a | 58. | c | 73. | b | 88. | a | 103. | a | 118. | a |
| 44. | d | 59. | c | 74. | c | 89. | b | 104. | b | 119. | c |
| 45. | c | 60. | b | 75. | d | 90. | b | 105. | a | 120. | a |
| 46. | d | 61. | d | 76. | a | 91. | d | 106. | a | 121. | d |
| 47. | d | 62. | c | 77. | b | 92. | c | 107. | d | 122. | b |
| 48. | a | 63. | d | 78. | c | 93. | d | 108. | c | 123. | d |
| 49. | b | 64. | a | 79. | a | 94. | d | 109. | c | 124. | b |
| 50. | b | 65. | a | 80. | c | 95. | d | 110. | b | 125. | b |
| 51. | c | 66. | a | 81. | b | 96. | b | 111. | c | 126. | b |
| 52. | d | 67. | b | 82. | b | 97. | b | 112. | c | 127. | d |
| 53. | a | 68. | c | 83. | c | 98. | b | 113. | a | 128. | c |
| 54. | d | 69. | d | 84. | c | 99. | c | 114. | b | 129. | a |
| 55. | b | 70. | b | 85. | b | 100. | d | 115. | d |  |  |
| 56. | b | 71. | d | 86. | b | 101. | c | 116. | c |  |  |

## Exercises

**Ex. 130**

Companies group similar types of assets and similar types of liabilities together. In the table below, the standard classifications on a statement of financial position are identified:

|  |  |
| --- | --- |
| Assets | Liabilities and Shareholders’ Equity |
| Retained earningsGoodwill | Non-current liabilitiesCurrent liabilities |
| Long-term investmentsShare capital | Shareholders’ equityIntangible assets |
| Property, plant, and equipment |  Current assets |

**Instructions**

Rearrange the table to reflect the general order in which the standard classifications should be presented on a statement of financial position.

##### Solution 130

|  |  |
| --- | --- |
| Assets | Liabilities and Shareholders’ Equity |
| Current assets | Current liabilities |
| Long-term investments | Non-current liabilities |
| Property, plant, and equipment | Shareholders’ equity |
| Intangible assets |  Share capital |
| Goodwill |  Retained earnings |

**Ex. 131**

The following descriptors relate to the order in which items on the statement of financial position may be presented:

(a) Order of liquidity

(b) No general prescribed order

(c) Order of permanency

(d) Reverse order of liquidity

(c) Largest to smallest

(f) Smallest to largest

**Instructions**

Assuming a firm uses the standard order used by North American companies (excluding real estate companies), match the key letter of the correct term above with the descriptive statement below. Please note: the above descriptors may be used more than once when assigned to the items below:

\_\_\_\_\_ 1. Current assets

\_\_\_\_\_ 2. Property, plant & equipment

\_\_\_\_\_ 3. Non-current liabilities

\_\_\_\_\_ 4. Current liabilities

\_\_\_\_\_ 5. Qualitative enhancing characteristics

##### Solution 131

\_\_a\_\_ 1. Current assets

\_\_c\_\_ 2. Property, plant & equipment

\_\_b\_\_ 3. Non-current liabilities

\_\_a\_\_ 4. Current liabilities

\_\_b\_\_ 5. Qualitative enhancing characteristics

##### Ex. 132

Identify the errors, corrections required, and corrected subtotals required in the following classified statement of financial position. Then prepare a corrected statement of financial position.

**RUMPBELL INC.**

**Statement of Financial Position**

**Year Ended December 31, 2018**

Assets

Current assets

Accounts receivable (net of accounts payable of $2,000) $12,000

Prepaid insurance 1,500

Goodwill 1,200

 14,700

Property, plant and equipment $4,300

Less: Accounted depreciation 1,100

Other assets (non-current) 1,720 4,920

Total assets $19,620

Liabilities

Bank loan payable (due in 6 months) $9,500

Long-term debt 6,700

Total liabilities 16,200

Shareholders’ equity

Retained earnings $2,460

Less: Dividends declared 150

Common shares 1,110 3,420

Total $19,620

##### Solution 132 (15 min.)

1. The date is not properly identified in the heading—it should be December 31, 2018, not year ended.

2. The accounts payable should not be netted against the receivables—accounts receivable should be $14,000 and accounts payable shown as a current liability of $2,000.

3. Goodwill should not be a current asset. Goodwill is a type of intangible asset, shown separately. Current assets should be $15,500.

4. Other (non-current) assets should not be included with property, plant and equipment subtotal. The subtotal should be $3,200.

5. Accounted depreciation should be accumulated depreciation.

6. A heading “Liabilities and Shareholders’ Equity” should replace the “Liabilities” heading.

7. Liabilities should be classified as current and non-current.

8. Current liabilities should include accounts payable of $2,000 and note payable (due in 6 months) of $9,500—for total current liabilities of $11,500.

9. Common shares should be listed first under the shareholders’ equity heading.

10. Dividends declared should not be shown on the statement of financial position—only the ending amount of retained earnings of $2,310 ($2,460 – $150) should be shown.

Corrected statement of financial position:

**RUMPBELL INC.**

**Statement of Financial Position**

**December 31, 2018**

Assets

Current assets

 Accounts receivable $14,000

 Prepaid insurance 1,500

Total current assets 15,500

Property, plant and equipment $4,300

Less: Accumulated depreciation 1,100 3,200

Goodwill 1,200

Other assets (non-current) 1,720

Total assets $21,620

Liabilities and Shareholders’ Equity

Liabilities

Current liabilities

 Accounts payable $2,000

 Bank loan payable (due in 6 months) 9,500

Total current liabilities $11,500

Non-current liabilities

 Long-term debt 6,700

Total liabilities 18,200

Shareholders’ equity

 Common shares $1,110

 Retained earnings 2,310

Total shareholders’ equity 3,420

Total liabilities and shareholders’ equity $21,620

##### Ex. 133

##### The following information is available for Jordi Ltd. At December 31, 2018:

 Accounts payable $14,500

 Accounts receivable 2,500

 Accumulated amortization, patents 3,500

 Accumulated depreciation, equipment 3,000

 Retained earnings 6,400

 Cash 41,900

 Common shares 40,000

 Equipment 3,500

 Land 15,000

 Long-term investments 500

 Bank loan payable (due in 5 years) 4,200

 Patents 5,500

 Short-term (held for trading) investments 2,700

**Instructions**

Use the above information to prepare a classified statement of financial position at December 31, 2018.

##### Solution 133 (20 min.)

**JORDI LTD.**

**Statement of Financial Position**

**December 31, 2018**

Assets

Current assets

 Cash $41,900

 Short-term (trading) investments 2,700

 Accounts receivable 2,500

Total current assets $47,100

Long-term Investments 500

Property, plant, and equipment

 Land 15,000

 Equipment $3,500

 Less Accumulated depreciation, equipment 3,000 500

Intangible assets

 Patents $5,500

 Less: Accumulated amortization, patents 3,500 2,000

Total assets $65,100

###### Liabilities and Shareholders’ Equity

Current liabilities

 Accounts payable $14,500

Total current liabilities 14,500

Non-current liabilities

 Bank loan payable 4,200

Total liabilities 18,700

Shareholders’ equity

 Common shares $40,000

 Retained earnings 6,400

Total shareholders’ equity 46,400

Total liabilities and shareholders’ equity $65,100

##### Ex. 134

The following accounts were taken from a company’s statement of financial position:

 Account Classification

|  |  |
| --- | --- |
| Cash |  |
| Inventory |  |
| Held for Trading Investments |  |
| Building |  |
| Accounts Payable  |  |
| Trademarks |  |
| Equipment |  |
| Prepaid Insurance |  |
| Long-term Debt |  |
| Unearned Revenue |  |
| Mortgage Payable |  |
| Accounts Receivable |  |
| Accumulated Depreciation—Building |  |
| Land |  |
| Notes Receivable (due in 24 months) |  |

**Instructions**

Classify each of the above accounts as current assets (CA), non-current assets (NCA), current liabilities (CL), non- current liabilities (NCL), or shareholders’ equity (SE).

**Solution 134**

 Account Classification

|  |  |
| --- | --- |
| Cash | CA |
| Inventory | CA |
| Held for Trading Investments | CA |
| Building | NCA |
| Accounts Payable  | CL |
| Trademarks | NCA |
| Equipment | NCA |
| Prepaid Insurance | CA |
| Long-term Debt | NCL |
| Unearned Revenue | CL |
| Mortgage Payable | NCL |
| Accounts Receivable | CA |
| Accumulated Depreciation—Building | NCA |
| Land | NCA |
| Notes Receivable (due in 24 months) | NCA |

##### Ex. 135

Accounting standards do not prescribe the order in which items are presented in the statement of financial position. Below are various categories to the statement of financial position:

 Non-current assets

 Shareholders’ equity

 Current liabilities

 Current assets

 Non-current liabilities

**Instructions**

(a) Present each category in “Order of Liquidity”.

(b) Present each category in “Order of Reverse Liquidity”.

**Solution 135**

1. Order of Liquidity

 Current assets

 Non-current assets

 Current liabilities

 Non-current liabilities

 Shareholders’ equity

(b) Order of Reverse Liquidity

 Non-current assets

 Current assets

 Shareholders’ equity

 Non-current liabilities

 Current liabilities

##### Ex. 136

The following items are taken from the financial statements of La Brea Ltd. For the fiscal year ended December 31, 2018. Note they are in alphabetical order.

 Accounts payable $ 15,500

 Accounts receivable 18,000

 Accumulated depreciation—buildings 30,500

 Advertising expense 21,000

 Cash 15,000

 Common shares (10,000 shares) 90,000

 Depreciation expense 12,000

 Dividends declared 5,000

 Income tax expense 10,000

 Insurance expense 3,000

 Bank loan payable 70,000

 Prepaid insurance 6,000

 Rent expense 22,000

 Retained earnings, January 1, 2018 12,000

 Salaries expense 32,000

 Salaries payable 3,000

 Service revenue 143,000

 Supplies 4,000

 Supplies expense 6,000

 Buildings 210,000

**Instructions**

(a) Calculate the net income for the year.

(b) Calculate the balance of Retained Earnings that would appear on the statement of financial position at December 31, 2018.

(c) Prepare a classified statement of financial position for La Brea Ltd. At December 31, 2018, assuming the bank loan payable is a non-current liability.

(d) Calculate the current ratio, debt to total assets, and basic earnings per share. Assets at the beginning of 2018 totalled $183,000. No additional shares were issued or redeemed during the year.

##### Solution 136 (20 min.)

1. Net income is $143,000 – $21,000 – $12,000 – $3,000 – $22,000 – 32,000 – $6,000 – $10,000 = $37,000

(b) Retained earnings, January 1 $12,000

 Add: Net income 37,000

 49,000

 Less: Dividends declared 5,000

 Retained earnings, December 31 $44,000

(c)

**LA BREA LTD.**

**Statement of Financial Position**

**December 31, 2018**

Assets

Current assets

 Cash $ 15,000

 Accounts receivable 18,000

 Supplies 4,000

 Prepaid insurance 6,000

 Total current assets 43,000

Property, plant and equipment

 Buildings $210,000

 Less: Accumulated depreciation—buildings 30,500 179,500

 Total assets $222,500

Liabilities and Shareholders’ Equity

Current liabilities

 Accounts payable $ 15,500

 Salaries payable 3,000

 Total current liabilities 18,500

Non-current liabilities

 Bank loan payable 70,000

 Total liabilities 88,500

Shareholders’ equity

 Common shares $90,000

 Retained earnings 44,000 134,000

 Total liabilities and shareholders’ equity $222,500

(d) Current ratio: $43,000 ÷ $18,500 = 2.3:1

 Debt to total assets: $88,500 ÷ $222,500 = 39.8%

 Basic earnings per share: $37,000 ÷ 10,000 = $3.70

##### Ex. 137

The following items are taken from the financial statements of Pelle Ltd. For the year ended December 31, 2018:

 Accounts payable $31,300

 Accounts receivable 10,000

 Accumulated depreciation—equipment 8,400

 Bank loan payable 34,500

 Cash 38,500

 Common shares (4,375 shares issued) 43,750

 Depreciation expense 8,400

 Dividends declared 525

 Equipment 82,000

 Goodwill 12,300

 Income tax expense 1,750

 Interest expense 6,125

 Market price per common share $5.25

 Rent Expense 21,000

 Retained earnings, beginning 28,000

 Salaries expense 14,350

 Sales revenue 56,875

 Supplies 7,875

**Instructions**

(a) Prepare an income statement and a classified statement of financial position for Pelle for 2018.

(b) Calculate the following ratios:

 1. Current ratio

 2. Debt to total assets

 3. Basic earnings per share

 4. Price-earnings ratio

##### Solution 137 (25 min.)

(a)

**PELLE LTD.**

**Income Statement**

**Year Ended December 31, 2018**

Sales revenue $56,875

Operating expenses

 Rent expense $21,000

 Salaries expense 14,350

 Depreciation expense 8,400

 Interest expense 6,125 49,875

Income before income tax 7,000

Income tax expense 1,750

Net income $ 5,250

**PELLE LTD.**

**Statement of Financial Position**

**December 31, 2018**

Assets

Current assets

 Cash $38,500

 Accounts receivable 10,000

 Supplies 7,875

 Total current assets 56,375

Property, plant, and equipment

 Equipment $82,000

 Less: Accumulated depreciation—equipment 8,400 73,600

Goodwill 12,300

 Total assets $142,275

Liabilities and Shareholders’ Equity

Current liabilities

 Accounts payable $31,300

Non-current liabilities

 Bank loan payable 34,500

 Total liabilities 65,800

Shareholders’ equity

 Common shares $43,750

 Retained earnings 32,725\* 76,475

 Total liabilities and shareholders’ equity $142,275

\*Retained earnings = $32,725 ($28,000 + $5,250 – $525)

(b) 1. Current ratio: $56,375 ÷ $31,300 = 1.8:1

 2. Debt to total assets: $65,800 ÷ $142,275 = 46.2%

 3. Basic earnings per share: $5,250 ÷ 4,375 = $1.20

 4. Price-earnings ratio: $5.25 ÷ $1.20 = 37.7 times

**Ex. 138**

The following data have been selected from the annual report of Komark Corporation:

Market price per share $60

Price-Earnings ratio 20 times

Total Assets $450,000

Current Liabilities $180,000

Shareholders’ Equity $200,000

Current ratio 1.5:1

Weighted average number of shares 100,000

**Instructions**

Calculate the following:

(a) Basic earnings per share

(b) Net income

(c) Debt to Total Assets ratio

(d) Current assets

(e) Working capital

##### Solution 138

(a) Price-earnings = Market price per share ÷ Basic earnings per share

 20 = $60.00 ÷ Basic EPS

 Basic EPS = $3.00

(b) Basic earnings per share = Net income ÷ Weighted average number of shares

 $3.00 = Net income ÷ 100,000

 Net income = $300,000

(c) Assets = Liabilities + Shareholders’ Equity

 $450,000 = $180,000 + Non-Current Liabilities + $200,000

 Non-Current Liabilities = $70,000

 Debt to Total Assets = Total Liabilities ÷ Total Assets

 = ($180,000 + $70,000) ÷ $450,000

 = 55.6%

(d) Current ratio = Current assets ÷ Current liabilities

 1.5 = Current assets ÷ $180,000

 Current assets = $270,000

(e) Working capital = Current assets – Current liabilities

 = $270,000-180,000

 = $90,000

##### Ex. 139

Presented below is information on XBRL Ltd.:

 2018 2017

 Cash $ 15,000 $ 12,000

 Cash provided by financing activities 20,000 0

 Cash used in investing activities 18,000 7,000

 Common shares 30,000 30,000

 Current assets 85,000 75,000

 Current liabilities 60,000 45,000

 Dividends declared 11,000 15,000

 Long-term assets 125,000 110,000

 Price-earnings ratio 12 14

 Retained earnings 60,000 40,000

 Total liabilities 110,000 95,000

 Weighted average number of shares issued 1,000 1,000

**Instructions**

Calculate the following for 2018:

(a) Basic earnings per share

(b) Market price per common share

(c) Working capital

(d) Current ratio

(e) Debt to total assets

##### Solution 139 (15–20 min.)

(a) Basic earnings per share

 Calculate net income

 Retained earnings 2017 $40,000

 Less: Dividends declared 11,000

 Subtotal 29,000

 Net income X

 Retained earnings 2018 $60,000

 Solving for X, Net income = $31,000

 Basic earnings per share = Net income ÷ weighted average number of common shares

 = $31,000 ÷ 1,000 = $31

(b) Market price per common share

 Price-earnings ratio = Market price per share ÷ EPS

 Therefore Market price per share = Price-earnings ratio × EPS = 12 × $31 = $372

(c) Working capital = current assets – current liabilities

 = $85,000 – $60,000 = $25,000

(d) Current ratio = current assets ÷ current liabilities

 = $85,000 ÷ $60,000 = 1.4:1

(e) Debt to total assets = Total liabilities ÷ Total assets

 = $110,000 ÷ ($85,000 + $125,000) = 52%

##### Ex. 140

The following data are taken from the financial statements of Kamloops Inc.:

 Accounts payable $28,000

 Accounts receivable 56,000

 Cash 54,000

 Dividends declared 10,000

 Market price per share 12.75

 Other current liabilities 17,000

 Net income 44,000

 Wages payable 5,000

 Weighted average number of common shares 10,000

##### Instructions

Calculate the following ratios:

(a) Current ratio

(b) Working capital

(c) Basic earnings per share

(d) Price-earnings ratio

##### Solution 140 (10 min.)

Current assets = $56,000 + $54,000 = $110,000

Current liabilities = $28,000 + $17,000 + $5,000 = $50,000

(a) Current ratio = Current assets ÷ Current liabilities = $110,000 ÷ $50,000 = 2.2:1

(b) Working capital = Current assets – Current liabilities = $110,000 – $50,000 = $60,000

(c) Basic earnings per share = Net income ÷ Weighted average number of common shares

 = $44,000 ÷ 10,000 = $4.40

(d) Price-earnings ratio = Market price ÷ Basic earnings per share = $12.75 ÷ $4.40 = 2.9

##### Ex. 141

The following data are taken from the financial statements of Sannot Inc.:

 Current assets $225,000

 Current liabilities 140,625

 Dividends declared 6,000

 Market price per share 9

 Net sales 230,000

 Net income 48,000

 Total liabilities 153,125

 Total assets 218,750

 Weighted average number of common shares 8,000

**Instructions**

Calculate the following ratios:

(a) Current ratio

(b) Working capital

(c) Basic earnings per share

(d) Price-earnings ratio

(e) Debt to total assets

##### Solution 141 (15 min.)

(a) Current ratio = Current assets ÷ Current liabilities = $225,000 ÷ $140,625 = 1.6:1

1. Working capital = Current assets – Current liabilities = $225,000 – $140,625 = $84,375

(c) Basic earnings per share = Net income ÷ Weighted average number of common shares

 = $48,000 ÷ 8,000 = $6.00

(d) Price-earnings ratio = Market price per share ÷ Basic earnings per share

 = $9 ÷ $6.00 = 1.5

(e) Debt to total assets = Total debt ÷ Total assets = $153,125 ÷ $218,750 = 70%

##### Ex. 142

The following selected data are taken from the financial statements of Lincoln Inc. The data are in alphabetical order.

 Accounts payable $ 52,000

 Accounts receivable 84,500

 Average assets 520,000

 Cash 147,200

 Market price/share 65.00

 Net sales 590,000

 Other current liabilities 22,500

 Net income 174,000

 Salaries payable 19,600

 Shareholders’ equity 310,900

 Total assets 500,000

 Weighted average number of common shares 4,000

**Instructions**

Calculate the following ratios:

(a) Current ratio

(b) Working capital

(c) Basic earnings per share

(d) Price-earnings ratio

(e) Debt to total assets

##### Solution 142 (10 min.)

(a) Current ratio = Current assets ÷ Current liabilities

 = $231,700 ÷ $94,100 = 2.5:1

Current assets: $84,500 + $147,500 = $231,700

Current liabilities: $52,000 + $22,500 + $19,600 = $94,100

(b) Working capital = Current assets – Current liabilities

 = $231,700 – $94,100 = $137,600

(c) Basic earnings per share = Net income ÷ Weighted avg. number of common shares

 = $174,000 ÷ 4,000 = $43.50

(d) Price-earnings ratio = Market price per share ÷ Basic earnings per share

 = $65.00 ÷ $43.50= 1.5

(e) Debt to total assets = Total liabilities ÷ Total assets

 = $189,100 ÷ $500,000 = 37.8%

 (Total liabilities = Total assets – Shareholders’ equity = $500,000 – $310,900 = $189,100)

##### Ex. 143

For each of the ratios listed below, indicate by the appropriate code letter, whether it is a liquidity ratio, a profitability ratio, or a solvency ratio.

Code:

L = Liquidity ratio

P = Profitability ratio

S = Solvency ratio

 1. Basic earnings per share

 2. Debt to total assets

 3. Price-earnings ratio

 4. Current ratio

##### Solution 143 (5 min.)

 P 1. Basic earnings per share

 S 2. Debt to total assets

 P 3. Price-earnings ratio

 L 4. Current ratio

##### Ex. 144

The following information is available from the 2018 financial statements of Ying Corp. and Yang Inc.

 (amounts in millions, except share price)

 Ying Yang

 Beginning total assets $22,233 $43,069

 Current assets 15,225 36,981

 Current liabilities 9,958 18,688

 Ending total assets 28,715 47,015

 Net income 735 1,652

 Sales 31,812 41,415

 Share price $90 $130

 Total liabilities 20,170 39,028

 Weighted average number of common shares 25 44

**Instructions**

(a) For each company, calculate the following ratios:

 1. Current ratio

 2. Debt to total assets

 3. Basic earnings per share

 4. Price-earnings ratio

(b) Based on your calculations, discuss the relative liquidity, solvency, and profitability of the two companies.

##### Solution 144 (15 min.)

(a) Ying Yang.

1. Current ratio 1.5:1 ($15,225 ÷ $9,958) 2.0:1 ($36,981 ÷ $18,688)

2. Debt to total assets 70.2% ($20,170 ÷ $28,715) 83.0% ($39,028 ÷ $47,015)

3. Basic earnings per share $29.40 ($735 ÷ 25) $37.55 ($1,652 ÷ 44)

4. Price-earnings ratio 3.1 ($90 ÷ $29.40) 3.6 ($130 ÷ $37.55)

(b) Based on the current ratio, Yang is more liquid than Ying since its current ratio (2.0:1) is 27% higher than Ying’s ratio (1.5:1). However, Ying would be considered more solvent than Yang since its debt to total assets (70.2%) is lower than Yang’s debt to total assets ratio (83.0%). A lower debt to total assets ratio indicates a company is more solvent and better able to survive over a long period of time.

 Yang has a higher basic earnings per share and price-earnings ratio than Ying. Yang’s basic earnings per share ($37.55) is 27.7% higher than Ying’s basic earnings per share ($29.40); as well, Yang’s price-earnings ratio (3.6) is 11.4% higher than Ying’s ratio (3:1).

##### Ex. 145

Selected information from the comparative financial statements of National Falls Inc. for the year ended December 31 appears below:

 2018 2017

 Accounts receivable $ 142,000 $ 182,000

 Bank loan payable 490,000 390,000

 Cash 27,000 17,000

 Cost of goods sold 970,000 900,000

 Current liabilities 125,000 95,000

 Income tax expense 80,000 60,000

 Interest expense 40,000 15,000

 Inventory 136,000 154,000

 Net income 220,000 155,000

 Total assets 1,350,000 950,000

 Total revenues 2,100,000 1,100,000

 Weighted average number of common shares 15,000 7,000

**Instructions**

Calculate the following ratios for 2018:

(a). Current ratio.

(b) Working capital.

(c) Debt to total assets.

(d) Basic earnings per share.

##### Solution 145 (12 min.)

(a) Current ratio is 2.4:1.

 $27,000 + $142,000 + $136,000

 —————————–—————– = 2.4:1

 $125,000

(b) Working capital is $180,000.

 ($27,000 + $142,000 + $136,000) – $125,000 = $180,000

(c) Debt to total assets is 46%.

 $125,000 + $490,000

 ———————–——– = 46%

 $1,350,000

(d). Basic earnings per share is $15.

 $220,000

 ——–—— = $15

 15,000

##### Ex. 146

Channing Corporation reported the following current assets and current liabilities:

 Dec. 31, 2018 Dec. 31, 2017

Current assets

 Cash $ 40,000 $ 30,000

 Short-term investments 40,000 10,000

 Accounts receivable 55,000 95,000

 Inventory 110,000 90,000

 Prepaid insurance 35,000 20,000

 Total current assets $280,000 $245,000

Current liabilities

 Accounts payable $120,000 $110,000

 Salaries payable 40,000 30,000

 Income tax payable 20,000 15,000

 Total current liabilities $180,000 $155,000

**Instructions**

(a) Calculate the following ratios for 2018:

 1. Current ratio.

 2. Working capital.

(b) Explain the purpose of each ratio.

##### Solution 146 (10–15 min.)

(a)

1. Current ratio = Current assets ÷ Current liabilities

 = $280,000 ÷ $180,000

 = 1.56:1

 2. Working capital = $280,000 – $180,000

 = $100,000

(b) The purpose of each ratio:

 1. The current ratio is a measure of liquidity. For example, for every dollar of current liabilities, the corporation has $1.56 of current assets.

 2. Working capital is a measure of liquidity. When working capital is positive, there is a greater likelihood that the company can pay its liabilities.

##### Ex. 147

Selected data from Lift-Off Ltd. are presented below:

 Net sales $3,425,000

 Net income 315,000

 Share price 14.45

 Weighted average number of common shares 185,000

**Instructions**

(a) Based on the above information, calculate two profitability ratios.

(b) Explain the purpose of each ratio.

##### Solution 147 (10–15 min.)

(a) With the information provided, the profitability ratios that can be calculated are as follows:

 1. Basic earnings per share = Net income ÷ Weighted average number of shares

 = $315,000 ÷ 185,000 = $1.70

 2. Price-earnings = Market price per share ÷ Basic earnings per share

 = $14.45 ÷ $1.70 = 8.50

(b) The purpose of each ratio:

 1. Basic earnings per share measures the net income for each common share.

 2. The price-earnings ratio measures the ratio of the market price of each common share to its basic earnings per share. It reflects the investors’ assessment of the company’s future net income expectations.

##### Ex. 148

Insert the characteristics listed below that are associated with relevance and faithful representation:

 Confirmatory value Materiality

 Completeness Free from errors

 Neutral Predictive value

 RELEVANCE FAITHFUL REPRESENTATION

 1. 1.

 2. 2.

 3. 3.

##### Solution 148 (5 min.)

 RELEVANCE FAITHFUL REPRESENTATION

 1. Confirmatory value 1. Free from errors

 2. Predictive value 2. Completeness

 3. Materiality 3. Neutral

##### Ex. 149

The following terms relate to the characteristics of useful information. Match the key letter of the correct term with the descriptive statement below:

(a) Confirmatory value

(b) Neutral

(c) Predictive value

(d) Relevance

(e) Faithful representation

(f) Timeliness

(g) Verifiability

\_\_\_\_\_ 1. Accounting information cannot be selected, prepared, or presented to favour one set of interested users over another.

\_\_\_\_\_ 2. Providing information in time to make decisions

\_\_\_\_\_ 3. Providing information that can be confirmed or duplicated by independent parties

\_\_\_\_\_ 4. Providing information that would make a difference in a business decision

\_\_\_\_\_ 5. Providing information that represents economic reality

\_\_\_\_\_ 6. Helping evaluate prior decisions

##### Solution 149 (5 min.)

1. (b)

2. (f)

3. (g)

4. (d)

5. (e)

6. (a)

##### Ex. 150

For each of the independent situations described below, list the fundamental or enhancing qualitative characteristic that has been violated, if any. List only one term for each case.

(a) Brunswick Corporation is in its third year of operations and has yet to issue financial statements.

(b) Ontario Corporation has used different methods for recording the cost of inventory. In the current year, the cost of goods sold is calculated based on the average cost of inventory. Last year, the cost of inventory was calculated based on the actual cost of each item sold. Next year, the company plans to change back to average cost.

(c) Manitoba Inc. is carrying inventory at its current cost of $110,000. The inventory has a current value of $135,000.

(d) Saskatchewan Corporation expenses some inexpensive office equipment even though it has a useful life of more than one year.

##### Solution 150 (5 min.)

(a) Timeliness

(b) Comparability (consistency)

(c) No violation

(d) No violation (materiality)

**Ex. 151**

Identify whether the following statements are true or false.

\_\_\_\_\_ 1. The conceptual framework of accounting guides decisions about what to present in financial statements, alternative ways of reporting economic events, and inappropriate ways of communication this information.

\_\_\_\_\_ 2. The users identified in the conceptual framework are all external users and, and as such, do not have access to the same financial information as internal users do.

\_\_\_\_\_ 3. The conceptual framework is fundamentally similar for publicly traded companies in Canada reporting under IFRS and private companies reporting under ASPE.

\_\_\_\_\_ 4. Two major economies, the United States and China, have yet to adopt IFRS.

\_\_\_\_\_ 5. All countries use the same conceptual framework or set of accounting standards.

##### Solution 151

\_\_F\_\_ 1. The conceptual framework of accounting guides decisions about what to present in financial statements, alternative ways of reporting economic events, and inappropriate ways of communication this information.

\_\_T\_\_ 2. The users identified in the conceptual framework are all external users and, as such, do not have access to the same financial information as internal users do.

\_\_T\_\_ 3. The conceptual framework is fundamentally similar for publicly traded companies in Canada reporting under IFRS and private companies reporting under ASPE.

\_\_F\_\_ 4. Two major economies, the United Kingdom and China, have yet to adopt IFRS.

\_\_F\_\_ 5. All countries use the same conceptual framework or set of accounting standards.

**Ex. 152**

Identify which qualitative characteristic is being violated in each of the situations below:

(a) Valeem Industries has its financial statements audited on an as needed basis, usually every other year.

(b) Over & Out Communications Inc. did not issue its 2015 financial statements until the end of F2016.

(c) On the statement of financial position, Faithfully Yours reported the cost of machinery equipment used in the manufacturing of the company product in the inventory account.

(d) Oriole Enterprises is the only company in the industry who uses straight-line method of depreciation.

(e) The Controller for Paws Inc. prepares the financial statements with as few classifications and descriptions to make it easier on the reader.

##### Solution 152

(a) Verifiability

(b) Timeliness

1. Faithful representation
2. Comparability
3. Understandability

## MATCHING QUESTIONS

153. Match the items below by entering the appropriate code letter in the space provided.

 A. Relevance G. Working capital

 B. Liquidity ratios H. Current ratio

 C. Comparability I. Basic earnings per share

 D. Liabilities J. Solvency ratios

 E. Intangible assets K. Price-earnings ratio

 F. Timeliness L. Materiality

 1. Measures of the ability of an entity to survive over a long period of time

 2. Current assets divided by current liabilities

 3. Knowledge that will influence a user’s decision

 4. Market price per share divided by basic earnings per share

 5. An omission or statement that could influence the decisions of users

 6. Obligations that result from past transactions

 7. Non-current assets that do not have physical substance

 8. Income available to common shareholders divided by the weighted average number of common shares

 9. Different companies using the same accounting principles

 10. Measures of the short-term ability of the company to pay its maturing obligations

 11. The excess of current assets over current liabilities

 12. Information is available to stakeholders before it loses its ability to influence decisions

#### Answers to Matching

1. J

2. H

3. A

4. K

1. L
2. D

7. E

8. I

9. C

10. B

11. G

12. F

## SHORT-ANSWER ESSAY QUESTIONS

##### S-A E 154

Give the definition of current assets, current liabilities and the current ratio.

##### Solution 154

Current assets are cash or other resources that are reasonably expected to be realized in cash or sold or consumed in the business within one year or the operating cycle, if longer. Current liabilities are obligations reasonably expected to be paid from the existing current assets or through the creation of other current liabilities within the next year, or the operating cycle. The current ratio is a measure used to evaluate a company’s liquidity and short-term debt-paying ability, calculated by dividing current assets by current liabilities.

##### S-A E 155

Fast Express specializes in overnight transportation of medical equipment and laboratory specimens. The company has selected the following information from its most recent annual report to be the subject of an immediate press release.

* The financial statements are being released.
* Net income this year was $2.1 million. Last year, net income was $1.8 million.
* The current ratio has changed to 2:1 from last year’s 1.5:1.
* The debt to total assets ratio has changed to 4:5 from last year’s 3:5.
* The company expanded its truck fleet substantially by purchasing ten new delivery vans.
* The company already had twelve delivery vans. The company is now the largest medical courier in the Northern Ontario region.

**Instructions**

Prepare a brief press release incorporating the information above. Include all information. Think carefully which information (if any) is good news for the company, and which (if any) is bad news.

##### Solution 155

Fast Express released its financial statements today, disclosing a 17% increase in net income, to $2.1 million from $1.8 million last year. The company also improved its short-term liquidity. Its current ratio improved to 2:1 from last year’s 1.5:1. Part of the improved performance is no doubt due to the addition of ten new delivery vans to its fleet, allowing it to become the largest medical courier in the Northern Ontario region. The purchase of the vans, however, caused the debt to total assets ratio to increase. There are now $4 of debt for every $5 in assets, while last year, there were only $3 of debt to $5 in assets.

##### SA-E 156

Comparability is an enhancing qualitative characteristic that makes accounting information useful for decision-making purposes. Briefly explain how comparability affects financial reporting and if comparability would be easier when accounting policies are used consistently.

##### Solution 156

Comparability results when a specific company, and similar companies, use the same accounting principles and methods, so that users can identify and understand similarities and differences among items on the financial reports. Using the same accounting policies from year to year would make comparability easier as meaningful trends could be identified company to company.

##### S-A E 157

Marberry Inc. has hired a new controller who has prepared the company’s annual financial statements. The company president, who has been in business for over 25 years, has reviewed the statements and comments that there are little to no classifications and that some of the descriptions are not ones that have been used in the past and appear complicated.

**Instructions**

Have any of the qualitative characteristics of useful financial information been violated? If so, which one and why.

##### Solution 157

To be useful for decision-making, information should be understandable which means that users with a reasonable knowledge of business can interpret the information and comprehend its meaning. The fact that the president, who we can assume is this type of user given his 25 years of business experience, is having difficulty with the financial statements indicates that the understandability enhancing characteristic has been violated.

##### S-A E 158

Identify *and describe* the three characteristics information must have in order to provide a faithful representation of economic reality.

##### Solution 158

In order to achieve faithful representation, information must be complete, neutral and free from error. Neutral information is free of bias and does not intentionally favour one set of stakeholders over another. Completeness means that all the information that is needed to faithfully represent economic reality must be included, and nothing important is omitted. The statements should be, as far as possible, free from error. However, this does not mean that there is necessarily 100% accuracy at all times. This is basically impossible given the fact that accounting estimates are frequently necessary.

**OBJECTIVE FORMAT QUESTIONS**

159. The following balances were taken from the statement of financial position for Guardian Ltd. at December 31, 2018:

|  |  |
| --- | --- |
| Accounts payable |  $24,500  |
| Total current assets |  28,500  |
| Current portion of bank loan payable |  30,500  |
| Land |  58,000  |
| Buildings |  475,000  |
| Accumulated depreciation, buildings |  95,000  |
| Mortgage payable |  113,700  |
| Total long term investments |  47,850  |
| Interest payable  |  17,500  |
| Net equipment |  37,680  |
| Unearned revenue |  1,500  |
| Bank loan payable |  91,500  |
| Current portion of mortgage payable |  22,800  |
| Accumulated depreciation, equipment |  9,420  |
| Common shares |  125,000  |
| Goodwill |  12,500  |
| Salaries payable |  6,500  |
| Retained earnings | ? |

Indicate all of the following statements that are correct.

(a) Total assets for Guardian Ltd. at Dec. 31 2018 are $556,994.

(b) Total retained earnings cannot be determined from the information given.

(c) Total current liabilities are $103,300.

(d) Total retained earnings are $131,030.

(e) Total property, plant and equipment is $468,144.

(f) Total non-current liabilities are $205,200.

(g) Total liabilities and shareholder’s equity is $564,030.

(h) The current liabilities are $101,800.

**Solution 159**

Statements (c), (d), and (f) are correct; (a), (b), (e), (g), and (h) are incorrect.

The following is a completed statement of financial position for Guardian Ltd., which indicates the correct values.

Guardian Ltd.

Statement of Financial Position

December 31, 2018

Assets

Current assets

 Total current assets $ 28,500

Long term investments 47,850

Property, plant, and equipment

 Land $ 58,000

 Buildings $475,000

 Less: Accumulated depreciation 95,000 380,000

 Equipment $ 47,100

 Less: Accumulated depreciation 9,420 37,680

 Total property, plant, and equipment 475,680

Goodwill 12,500

Total assets $564,530

Liabilities and Shareholders' Equity

Current liabilities

 Accounts payable $ 24,500

 Salaries payable 6,500

 Interest payable 17,500

 Unearned revenue 1,500

 Current portion of bank loan 30,500

 Current portion of mortgage payable 22,800

 Total current liabilities $103,300

Non-current liabilities

 Bank loan payable $ 91,500

 Mortgage payable 113,700 205,200

 Total liabilities 308,500

Shareholders' equity

 Common shares $125,000

 Retained earnings 131,030

 Total shareholders’ equity 256,030

Total liabilities and shareholders' equity $564,530

160. Choose whether the item is describing liquidity, profitability or leverage ratios:

(a) Total liabilities divided by total assets

(b) The difference between current assets and current liabilities

(c) The market price per share divided by basic earnings per share

(d) Measures a company’s operating success for a specific period of time

(e) Current assets divided by current liabilities

(f) Measures a company’s ability to survive over the long term by having enough assets to settle its liabilities as they fall due

(g) Measures a company’s short-term ability to pay its maturing obligations

(h) Income available to common shareholders divided by the weighted average number of common shares

(i) Uses net income from the income statement.

**Solution 160**

(a) **Solvency.** This describing the *debt to total assets* ratio, which is a solvency ratio and measures long-term debt-paying ability.

(b) **Liquidity**. This is describing *working capital* which is a liquidity ratio and measures a company’s ability to pay its current obligations.

(c) **Profitability**. This is describing the *price-earnings* ratio which is a profitability ratio that measures the ratio of the stock market price of each common share to its basic earnings per share.

(d) **Profitability**. Profitability ratios such as *price-earnings* and *basic earnings per share* measure a company’s earnings for a specific period of time.

(e) **Liquidity.** This is describing the *current ratio* which is a measure of a company’s liquidity.

1. **Solvency.** Solvency ratios such as *debt to total assets* measure a company’s long-term debt-paying ability.
2. **Liquidity**. Liquidity ratios such as *working capital* and the *current ratio* measure a company’s short-term debt-paying ability.
3. **Profitability.** This is describing the *basic earnings per share* ratio which measures the income earned on each common share.

(i) **Profitability.** Net income from the income statement is used to calculate profitability ratios such *as basic earnings per share* and *price-earning*.

161. The following was reported for Grand Enterprises Corporation for the last two years:

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2018 |  | 2017 |
| Current assets |  $58,000  |  |  $45,000  |
| Total assets |  358,000  |  |  321,000  |
| Current liabilities |  62,000  |  |  40,000  |
| Total liabilities |  88,000  |  |  101,000  |
| Net income |  108,000  |  |  92,000  |
| Weighted average number of common shares |  55,000  |  |  45,000  |
| Market price per share |  $18.25  |  |  $15.17  |
| Industry average price earnings ratio |  13.50  |  times  |

Based on the above information, indicate all of the following statements that are correct:

(a) The price-earnings ratio for 2018 is 4.2 times lower than the industry average.

(b) The company’s overall liquidity has improved.

(c) The current ratio for 2017 is 1.125.

(d) The company’s ability to pay long-term debt obligations has improved in 2018.

(e) The basic earnings per share is $1.96 for 2018.

(f) The current ratio for 2018 indicates the company may not be able to cover its long-term debt obligations.

(g) Investors will likely consider that Grand Enterprises’ stock is overpriced given its price-earnings ratio for 2018.

**Solution 161**

(a) and (e) are correct. The price-earnings ratio for 2018 is 4.2 times (13.5 – 9.3 times = 4.2 times) lower.

 1. Basic earnings per share = Net income ÷ Weighted average number of shares

 = $108,000 ÷ 55,000 = $1.96

 2. Price-earnings = Market price per share ÷ Basic earnings per share

 = $18.25 ÷ $1.96 = 9.31 times

(c) is correct.

 Current ratio 2018 = Current assets ÷ current liabilities

 = $58,000 ÷ $62,000 = .935

 Current ratio 2017 = Current assets ÷ current liabilities

 = $45,000 ÷ $40,000 = 1.125

(d) is correct. Debt to total assets ratio has improved from 31.5% to 24.6%

 Debt to total assets 2018 = Total liabilities ÷ Total assets

 = $88,000 ÷ $358,000 = 24.6%

 Debt to total assets 2017 = Total liabilities ÷ Total assets

 = $101,000 ÷ $321,000 = 31.5%

(b), (f), and (g) are incorrect.

(b) The overall liquidity has declined. – Refer to current ratio in part (c) above.

(f) The current ratio for 2018 indicates the company may not be able to cover its short-term debt obligations. - Refer to current ratio for 2018 in part (c) above which has fallen below 1.

(g) Investors will likely consider that Grand Enterprises’ shares are under priced given that the price-earnings ratio for 2018 as it is below the industry average. For 2018 the price-earnings ratio is 9.31 (18.25/1.96) which is lower than the industry average of 13.5 times.

162. The following data has been provided for Luna Industries Ltd.:



Using the above information, identify all of the following statements that are correct.

(a) Total current liabilities are $810,000

(b) Luna’s working capital is negative.

(c) The market price per common share cannot be determined from the information given.

(d) Total assets are $1,250,000.

(e) Net income is $650,000.

(f) Total current liabilities are $250,000.

(g) The market price per common shares is $195.

(h) Total assets are $188,180.

**Solution 162**

(d), (e), (f), and (g) are correct; (a), (b), (c), and (h) are incorrect.

(a) Total liabilities are $250,000.

$$Current liabilities= \frac{Current assets}{Current ratio}$$

$$Current liabilities=\frac{\$450,000}{1.8} =\$250,000$$

(b) Luna’s working capital is positive

 Working capital = Current assets less current liabilities

 = $450,000 - $250,000 [taken from (a) above] = $200,000

(c) The market price per share can be determined from the prices earnings ratio and the basic earnings per share.

$$Market price per share=price earnings ratio ×basic earnings per share$$

$$Market price per share=15 × \$13=\$195$$

(h) Total assets are $1,250,000:

$$Total assets= \frac{Total liabilities}{Debt to total assets}$$

$$Total assets=\frac{\$485,000}{0.388} =\$1,250,000$$

163. Choose the qualitative characteristic of financial information being described and whether it is a fundamental (F) or enhancing (E) characteristic.

Note: a characteristic may be used more than once.

|  |  |
| --- | --- |
| (a) Accounting information represents economic reality. | Relevance, Faithful Representation, Comparability, Verifiability, Timeliness, or Understandability |
| (b) Users can identify and understand similarities in, and differences among, items. | Relevance, Faithful Representation, Comparability, Verifiability, Timeliness, or Understandability |
| (c) Accounting information influences a user’s decision.  | Relevance, Faithful Representation, Comparability, Verifiability, Timeliness, or Understandability |
| (d) Different knowledgeable and independent users can reach consensus that the accounting information is faithfully represented. | Relevance, Faithful Representation, Comparability, Verifiability, Timeliness, or Understandability |
| (e) Accounting information has three characteristics: **complete** (nothing important was omitted), **neutral** (not biased toward one position or another), and **free from error** (it provides an accurate description and no errors were made in the process used to determine it).  | Relevance, Faithful Representation, Comparability, Verifiability, Timeliness, or Understandability |
| (f) Accounting information is made available to decision makers before it loses its ability to influence decisions. | Relevance, Faithful Representation, Comparability, Verifiability, Timeliness, or Understandability |
| (g) Accounting information is classified, characterized, and presented clearly and concisely. | Relevance, Faithful Representation, Comparability, Verifiability, Timeliness, or Understandability |

**Solution163**

(a) **Faithful representation (F).** For accounting information to be useful, it should report the economic substance of an event. If the substance of the transaction is different from its legal form, the transaction should be accounted for based on its economic reality. For example, if a company knew they were not going to be able to collect an accounts receivable from a customer because the customer went out of business, excluding this loss in their determination of income would not be a faithful representation of the economic reality.

(b) **Comparability (E)**. Comparability means that users can compare results from the same company from one period to the next or compare results across different companies.

(c) **Relevance (F)**. Accounting information is relevant when it impacts a user’s decision. For example, if a manager is deciding whether to purchase a new machine, the cost of the new machine is relevant but the cost of old machine that is being replaced is not. The purchase of the old machine was a historical event that will not change whether or not they decide to purchase the new machine.

(d) **Verifiability (E)**. Accounting results are verifiable when those results can be reproduced. Accounting information is verifiable if the same data and assumptions are provided to an independent accountant and they produce the same result. Auditors provide a key role in ensuring accounting information if verifiable.

(e) **Faithful representation (F).** A transaction is faithfully represented if information regarding the transaction is complete, accurate and not misleading to users.

(f) **Timeliness (E).** Financial information should be provided to users in time to make decisions. For instance, stock exchange regulators require annual financial statements to be made available to users within 90 days of a company’s year end.

(g) **Understandability (E)**. Users with a reasonable knowledge of business should be able to interpret financial information and comprehend its meaning

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