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## Chapter 1 - Financial Statements and Decision Making

1. The majority of business in Canada is conducted by corporations.

- a. True
- b. False

ANSWER: True

2. The three main business activities are financing, operating, and investing.

- a. True
- b. False

ANSWER: True

3. Internal users of accounting information include present creditors and management.

- a. True
- b. False

ANSWER: False

4. The statement of earnings summarizes the assets, liabilities, and shareholders' equity for a period of time.

- a. True
- b. False

ANSWER: False

5. The four basic financial statements prepared by private companies are the statement of earnings, statement of retained earnings, statement of financial position (or statement of financial position), and statement of cash flows.

- a. True
- b. False

ANSWER: True

6. The amount of earnings distributed to shareholders can be found in the statement of earnings as an expense.

- a. True
- b. False

ANSWER: False

7. Shareholders' equity is composed of two main sources: liabilities and contributed capital.

- a. True
- b. False

ANSWER: False

8. Accounting standards require that the statement of financial position be prepared on a classified basis.

- a. True
- b. False

ANSWER: True

9. For a private company, the only financial statement that reports the retained earnings balance at the end of the period is the statement of retained earnings.

- a. True
- b. False

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ANSWER: False

10. A statement of earnings provides information at one specific point in time, while the other basic financial statements provide information on activities that occur over a period of time.

- a. True
- b. False

ANSWER: False

11. When an entity's share issuances exceed its expenses for a period of time, the entity will report net income.

- a. True
- b. False

ANSWER: False

12. Contributed capital is the residual interest that remains after deducting liabilities from shareholders' equity.

- a. True
- b. False

ANSWER: False

13. Preparing a statement of earnings includes (1) preparing a heading; (2) listing the revenues of the company; (3) listing the expenses of the company; and (4) listing the dividends of the company.

- a. True
- b. False

ANSWER: False

14. Shareholders' equity arises primarily from contributed capital and retained earnings.

- a. True
- b. False

ANSWER: True

15. A company can rely on its internal auditors, who are employees of the company, to provide assurance to the company's shareholders that the financial statements are fairly presented.

- a. True
- b. False

ANSWER: False

16. In order to provide assurance to users that the financial statements are a fair presentation of the company's financial health, auditors retrace all transactions of the company for the entire accounting period.

- a. True
- b. False

ANSWER: False

17. The statement of cash flows shows cash inflows and cash outflows for a period of time.

- a. True
- b. False

ANSWER: True

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18. Because the four financial statements are interrelated (i.e., there is a natural progression from one financial statement to another), the statement of financial position should be prepared first.

a. True

b. False

ANSWER: False

19. A publicly traded company's annual report generally includes audited financial statements (with auditor's report), notes to the financial statements, and management's discussion and analysis.

a. True

b. False

ANSWER: True

20. A company will classify the purchase of new equipment as a financing activity.

a. True

b. False

ANSWER: False

21. In comparing sole proprietorships, partnerships, and corporations, the sole proprietorship provides an owner with the most decision-making control and the least liability.

a. True

b. False

ANSWER: False

22. The purpose of financial reporting is to provide economic information to investors, creditors, and other financial statement users.

a. True

b. False

ANSWER: True

23. External users of accounting information are most interested in whether or not the company will be able to pay them back their original investment.

a. True

b. False

ANSWER: False

24. Current assets include all of the following: cash, inventory, equipment, supplies, and accounts receivable.

a. True

b. False

ANSWER: False

25. Current liabilities should be typically listed in the order of increasing order of maturity (due date).

a. True

b. False

ANSWER: True

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26. Three common categories of noncurrent assets are (1) property, plant, and equipment; (2) long-term investments; and (3) intangibles.

a. True

b. False

ANSWER: True

27. In the shareholders' equity section of a classified statement of financial position, a distinction is made between amounts invested by owners and amounts financed by creditors.

a. True

b. False

ANSWER: False

28. One primary purpose of a classified statement of financial position is to help users evaluate the working capital of a company.

a. True

b. False

ANSWER: True

29. A classified statement of financial position helps users determine how a company obtained its resources.

a. True

b. False

ANSWER: True

30. The current ratio is useful in determining a company's ability to pay obligations when they become due.

a. True

b. False

ANSWER: True

31. Net income is the bottom line on every statement of earnings, regardless of whether the statement is presented as a single-step or multiple-step version.

a. True

b. False

ANSWER: True

32. When expenses exceed revenues, a company's retained earnings balance will decrease.

a. True

b. False

ANSWER: True

33. For a private company, the amount of dividends declared during a period appears on the statement of retained earnings.

a. True

b. False

ANSWER: True

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34. The statement of cash flows, like the statement of earnings, reports only operating activities of a company.

- a. True
- b. False

ANSWER: False

35. For a private company, the ending cash balance is shown on both the statement of financial position and the statement of retained earnings.

- a. True
- b. False

ANSWER: False

36. Information contained in the notes to the financial statements can be either quantitative (numerical) or qualitative (non-numerical).

- a. True
- b. False

ANSWER: True

37. Independent auditors may provide an opinion that the financial statements do not fairly present a company's financial position, operating results, and cash flows.

- a. True
- b. False

ANSWER: True

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

- a. True
- b. False

ANSWER: False

39. 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

40. A company with healthy cash flows from operating activities is generally in a good position to repay its debts.

- a. True
- b. False

ANSWER: True

41. The International Accounting Standards Board (IASB) was created in response globalization creating a need for a common set of global accounting principles.

- a. True
- b. False

ANSWER: True

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42. While International Financial Reporting Standards (IFRS) may have recently been adopted in Canada, not all companies are required to prepare their financial statements using these standards.

a. True

b. False

ANSWER: True

43. The objectives of \_\_\_\_\_ accounting involve providing external decision makers with information that assists them in assessing the amounts, timing, and uncertainties of a company's future cash flows.

ANSWER: financial

44. The three forms of business organizations are \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_.

ANSWER: (in any order):

sole proprietorships

partnerships

corporations

45. The type of business activity that relates to obtaining funds from either issuing shares or borrowing money is called \_\_\_\_\_.

ANSWER: financing

46. For publicly traded companies in Canada, the names of the four basic financial statements are

\_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_.

ANSWER: (in any order):

statement of financial position

statement of earnings

statement of changes in equity

statement of cash flows

47. The fundamental accounting equation is \_\_\_\_\_ = \_\_\_\_\_ + \_\_\_\_\_.

ANSWER: Assets

Liabilities

Shareholders' Equity

48. Current liabilities are usually listed on the appropriate financial statement in increasing order of \_\_\_\_\_.

ANSWER: either of these:

maturity

due date

49. \_\_\_\_\_ is a liquidity measure that is calculated by subtracting current liabilities from current assets.

ANSWER: Working capital

50. For privately held companies, the financial statement that reports revenues is called the \_\_\_\_\_.

ANSWER: statement of earnings

51. For privately held companies, the financial statement on which both net income and dividends declared can be found is the \_\_\_\_\_.

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ANSWER: statement of retained earnings

52. Net income from the statement of earnings \_\_\_\_\_ retained earnings.

ANSWER: increases

53. Creditors, lenders, investors, and shareholders all have claims to an entity's \_\_\_\_\_.

ANSWER: either:  
assets  
economic resources

54. \_\_\_\_\_ are cash and other assets that are reasonably expected to be converted into cash within one year or operating cycle, whichever is longer.

ANSWER: Current assets

55. Property, plant, and equipment is classified as \_\_\_\_\_ assets on the statement of financial position.

ANSWER: noncurrent

56. \_\_\_\_\_ is a liquidity measure that is calculated by dividing current assets by current liabilities.

ANSWER: Current ratio

57. The ability of a company to pay its debt as it comes due relates to \_\_\_\_\_.

ANSWER: liquidity

58. In a(n) \_\_\_\_\_-step statement of earnings, all expenses and losses are added together then deducted from the sum of all revenues and gains.

ANSWER: single

59. The statement of cash flows classifies cash flow into these three categories: \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_.

ANSWER: (in any order):  
financing  
investing  
operating

60. A company's ending cash balance appears on \_\_\_\_\_ of the four basic financial statements.

ANSWER: (either):  
3  
three

61. The demand for accounting information comes from users both inside and outside the business. The objectives of \_\_\_\_\_ accounting are focused most specifically on satisfying the information needs of external users.

ANSWER: financial

62. The current ratio is found by dividing current assets by \_\_\_\_\_.

ANSWER: current liabilities

63. The various rules and conventions that have evolved over time to guide the preparation of financial statements in Canada are called \_\_\_\_\_.

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ANSWER: (either):

GAAP

Generally Accepted Accounting Principles

64. Which of the following is an internal user of financial information?

- a. company manager
- b. government
- c. creditor
- d. investor

ANSWER: a

65. Which of the following statements is characteristic of external users of financial information?

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

ANSWER: c

66. Who is considered an internal user of financial statements?

- a. a supplier considering selling to the company on credit
- b. a labour union representing employees of a company in labour negotiations
- c. a financial analyst preparing recommendations on companies in a certain industry
- d. a manager who is supervising production workers

ANSWER: d

67. Who lends funds to a business entity and expects repayment with interest?

- a. owner
- b. creditor
- c. proprietor
- d. shareholder

ANSWER: b

68. What branch of accounting is concerned with providing outside decision makers with information to assess the amounts, timing, and uncertainties of the company's future cash flows?

- a. financial accounting
- b. auditing
- c. managerial accounting
- d. bookkeeping

ANSWER: a

69. Who invests funds in a business and is considered an owner?

- a. banker
- b. creditor
- c. shareholder



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d. lender

ANSWER: c

70. 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

71. In which form of organization are the owners' legal responsibilities for the debts of the business limited to the amount they invested in it?

- a. cooperative
- b. corporation
- c. partnership
- d. proprietorship

ANSWER: b

72. Which of the following three main activities are businesses engaged in?

- a. financing, investing, operating
- b. cash, credit, noncash
- c. financing, crediting, operating
- d. financing, managing, operating

ANSWER: a

73. What are economic resources?

- a. assets
- b. liabilities and shareholders' equity
- c. owners' equity and shareholders' equity
- d. revenues

ANSWER: a

74. What are revenues?

- a. decreases in assets resulting from the sale of goods or services
- b. increases in equity resulting from the sale of products or services
- c. assets used or consumed in the sale of products or services
- d. increases in the financing activities

ANSWER: b

75. What type of account is unearned revenue?

- a. shareholders' equity
- b. liability
- c. asset
- d. expense

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ANSWER: b

76. What are expenses?

- a. the cost of assets used in the investing activities of a business
- b. the amount of interest or claim that the owners have in the business
- c. the future economic resources of a business entity
- d. the cost of assets used in the operations of a business

ANSWER: d

77. What are the resources used to earn revenues during a period?

- a. net income
- b. dividends
- c. revenues
- d. expenses

ANSWER: d

78. Which type of business activity involves purchasing new equipment?

- a. financing
- b. operating
- c. investing
- d. measuring

ANSWER: c

79. Which account is a liability?

- a. cash
- b. retained earnings
- c. accounts payable
- d. accounts receivable

ANSWER: c

80. You are a potential creditor and are concerned that a particular company you are ready to lend money to may have too much debt. Which financial statement will provide you with the information you need to evaluate your concern?

- a. statement of financial position
- b. statement of earnings
- c. statement of retained earnings
- d. statement of changes in equity

ANSWER: a

81. Which financial statement would you analyze to assess a firm's operating performance over the past year?

- a. statement of financial position
- b. statement of retained earnings
- c. statement of earnings
- d. statement of changes in equity

ANSWER: c

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82. Which financial statement would you refer to in order to determine the resources (assets) a company owns?
- a. statement of financial position
  - b. statement of retained earnings
  - c. statement of earnings
  - d. statement of cash flows

ANSWER: a

83. Which financial statement shows the end-of-year cash balance for a business entity?
- a. statement of earnings and statement of retained earnings
  - b. statement of financial position and statement of cash flows
  - c. statement of retained earnings and statement of cash flows
  - d. statement of financial position and statement of retained earnings

ANSWER: b

84. Which of the following correctly represents one of the basic financial statement models?
- a.  $\text{assets} - \text{liabilities} = \text{net income}$
  - b.  $\text{assets} + \text{liabilities} = \text{total assets}$
  - c.  $\text{revenues} + \text{expenses} = \text{net income}$
  - d.  $\text{beginning retained earnings} + \text{net income} - \text{dividends} = \text{ending retained earnings}$

ANSWER: d

85. Which of the following is a correct fundamental accounting equation?
- a.  $\text{assets} + \text{liabilities} = \text{shareholders' equity}$
  - b.  $\text{assets} + \text{retained earnings} = \text{shareholders' equity}$
  - c.  $\text{assets} + \text{shareholders' equity} = \text{liabilities}$
  - d.  $\text{assets} = \text{liabilities} + \text{shareholders' equity}$

ANSWER: d

86. How is the statement of financial position linked to the other financial statements?
- a. There is no such link, as each statement contains different accounts and provides different information.
  - b. The amount of retained earnings is reported on the statement of financial position as a liability.
  - c. Retained earnings is added to total assets and reported on the statement of financial position.
  - d. Retained earnings is reported on the statement of financial position.

ANSWER: c

87. What are retained earnings?
- a. the amount of total profits earned by a company since it began operations
  - b. the amount of claim that the owners have on the assets of the company
  - c. the future economic resources of a company
  - d. the accumulated net income that has not been distributed to owners as dividends

ANSWER: d

88. What are current assets?

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- a. the amount of total assets earned by a business since it began operations plus all other resources
- b. the amount of claim that the owners have in the business in the current year
- c. assets expected to be converted into cash within one year or one operating cycle, whichever is longer
- d. the cumulative profits earned by a business less any dividends distributed in the current period

ANSWER: c

89. Which is a classification on the classified statement of financial position?

- a. operating accounts
- b. shareholders' equity
- c. revenues and expenses
- d. net income and dividends

ANSWER: b

90. Which asset is noncurrent?

- a. machinery and equipment
- b. accounts receivable
- c. inventories
- d. unearned revenues

ANSWER: a

91. Which item appears on a statement of financial position?

- a. service revenue
- b. unearned revenue
- c. dividends declared
- d. cash flow from operations

ANSWER: b

92. Which statement reports an entity's financial position at a specific date?

- a. statement of financial position
- b. statement of retained earnings
- c. statement of earnings
- d. statement of cash flows

ANSWER: a

93. Which accounts are normally reported as current liabilities on a classified statement of financial position?

- a. accounts payable and prepaid insurance
- b. interest payable and interest receivable
- c. income taxes payable and salaries payable
- d. common shares and accounts payable

ANSWER: c

94. What are considered current assets?

- a. patents
- b. inventory

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- c. intangibles
- d. property, plant, and equipment

ANSWER: b

95. What are considered tangible assets?

- a. franchises
- b. copyrights
- c. trademarks
- d. investments

ANSWER: d

96. Certain assets 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). How are such assets reported on a classified statement of financial position?

- a. as property, plant, and equipment
- b. as current assets
- c. as intangible assets
- d. as current liabilities

ANSWER: b

97. What are current assets?

- a. accounts receivable, net income, inventory, and dividends
- b. cash, accounts receivable, common shares, and sales
- c. net income, cash, office supplies, and inventory
- d. cash, accounts receivable, inventory, and office supplies

ANSWER: d

98. For the most recent year, a company's current ratio was significantly lower than its industry's average. What is the best possible explanation for this situation?

- a. The company's competitors were profitable.
- b. The company's liquidity improved.
- c. The company had less equity than the rest of the industry.
- d. The company's liquidity was worse than the industry.

ANSWER: d

99. What is another term for short-term investments?

- a. inventories
- b. accounts receivable
- c. contributed capital
- d. marketable securities

ANSWER: d

100. Which of the following best describes a distribution of the net income of a corporation to its owners?

- a. retained earnings

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- b. dividends
- c. expense
- d. monetization

ANSWER: b

101. What is reported as a component of shareholders' equity on a classified statement of financial position?

- a. contributed capital
- b. accounts payable
- c. net income
- d. land

ANSWER: a

102. What an appropriate date format for a financial statement heading?

- a. Statement of Financial Position—For the Year Ended June 30
- b. Statement of Earnings—At December 31
- c. Statement of Earnings—For the Year Ended December 31
- d. Statement of Retained Earnings—At December 31

ANSWER: c

103. Which statement summarizes the results of a company's operations?

- a. statement of earnings
- b. statement of cash flows
- c. statement of retained earnings
- d. statement of financial position

ANSWER: a

104. What would appear on a statement of earnings?

- a. unearned revenue
- b. retained earnings
- c. cost of sales
- d. dividends

ANSWER: c

105. What is shown on the statement of earnings?

- a. the liquidity of the company on an annual basis
- b. a summary of the results of operations for a period of time
- c. how much profit the company has earned since it began operations
- d. net income equal to the amount of cash on the statement of financial position

ANSWER: b

106. On a multiple-step statement of earnings, which items would be included in the calculation of income from operations?

- a. income taxes
- b. interest income

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- c. interest expense
- d. selling expenses

ANSWER: d

107. Which financial statement answers the question, "How much debt does this company have?"

- a. statement of cash flows
- b. single-step statement of earnings
- c. multiple-step statement of earnings
- d. classified statement of financial position

ANSWER: d

108. On a multiple-step statement of earnings, operating income is calculated by subtracting total operating expenses from which of the following amounts?

- a. net sales
- b. gross margin
- c. cost of goods sold
- d. income before taxes

ANSWER: b

109. The list below contains several items that appear on a multiple-step statement of earnings.

- 1. other income and expense
- 2. income before income taxes
- 3. net income
- 4. operating expenses
- 5. gross margin
- 6. net sales
- 7. income from operations

In which order would these items appear on a multiple-step statement of earnings?

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

ANSWER: c

110. Which statement best describes a company's operating activities?

- a. They are cash flows directly related to earning income.
- b. They represent the right to receive a benefit in the future.
- c. They are necessary to provide the money to start a business.
- d. They are needed to provide the valuable assets required to run a business.

ANSWER: a

111. On January 1, a company reported assets of \$1,000,000 and liabilities of \$600,000. During the year, assets decreased by \$100,000 and shareholders' equity decreased \$200,000. What is the amount of liabilities at December 31?

- a. \$300,000

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- b. \$400,000
- c. \$500,000
- d. \$700,000

ANSWER: d

112. Which equation represents the statement of retained earnings activity?

- a. beginning retained earnings + net income + dividends = ending retained earnings
- b. beginning retained earnings + net income – dividends = ending retained earnings
- c. beginning retained earnings + dividends – net income = ending retained earnings
- d. beginning retained earnings + cash inflows – cash outflows = ending retained earnings

ANSWER: b

113. A company had total assets of \$650,000 and total shareholders' equity of \$250,000 at the beginning of the year. During the year, total assets increased by \$350,000, total liabilities increased by \$100,000, and dividends were declared and paid in the amount of \$300,000. No other transactions occurred except revenues and expenses. How much is net income for the year?

- a. \$500,000
- b. \$550,000
- c. \$650,000
- d. \$750,000

ANSWER: b

114. On January 1, Year 1, a company's balance in retained earnings was \$10,000,000. At December 31, Year 1, the balance in retained earnings was \$9,400,000. If the company earned net income of \$440,000 during the year, what was the amount of dividends declared?

- a. \$440,000
- b. \$600,000
- c. \$1,000,000
- d. \$1,040,000

ANSWER: d

115. On January 1, Year 1, a company's balance in retained earnings was \$275,000. During Year 1, the company earned net income of \$23,500 and paid \$11,200 in dividends. Calculate the retained earnings balance at December 31, Year 1.

- a. \$240,300
- b. \$262,700
- c. \$287,300
- d. \$309,700

ANSWER: c

116. A company has \$10,500,000 of revenues, declares and pays \$550,000 in dividends, and has net income of \$1,600,000. How much were expenses for the year?

- a. \$550,000
- b. \$8,350,000
- c. \$8,900,000
- d. \$9,450,000



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ANSWER: c

117. A company has assets of \$5,000,000, liabilities of \$3,000,000, and retained earnings of \$1,200,000. How much is total shareholders' equity?

- a. \$800,000
- b. \$1,200,000
- c. \$2,000,000
- d. \$3,200,000

ANSWER: c

118. What is the total sales for a company that reported a net loss of \$1,500,000 and total expenses of \$2,900,000?

- a. \$1,400,000
- b. \$1,500,000
- c. \$2,900,000
- d. \$4,400,000

ANSWER: a

119. A company has current assets of \$2,100,000 and current liabilities of \$500,000. How much is its working capital?

- a. \$500,000
- b. \$1,600,000
- c. \$2,100,000
- d. \$2,600,000

ANSWER: b

120. Which of the following calculates working capital?

- a. current assets divided by current liabilities
- b. total assets minus total liabilities
- c. current assets minus current liabilities
- d. current assets plus current liabilities

ANSWER: c

121. A company has current assets of \$100,000, total assets of \$250,000, current liabilities of \$20,000, and long-term liabilities of \$50,000. How much of its existing cash can the company use to acquire equipment without allowing its current ratio to decline below 2.0 to 1?

- a. \$40,000
- b. \$60,000
- c. \$150,000
- d. \$180,000

ANSWER: b

122. A company has increased its dollar amount of working capital over the past several years. Which of the following measures should be used to further evaluate the company's liquidity?

- a. the current ratio
- b. an analysis of the company's long-term debt

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- c. an analysis of the return on shareholders' equity
- d. the asset ratio

ANSWER: a

123. Which financial statement reports information helpful in assessing working capital?

- a. statement of financial position
- b. capital statement
- c. statement of retained earnings
- d. statement of cash flows

ANSWER: a

124. If the current ratio is 2 to 1 and total assets equal \$200,000, how much is working capital?

- a. \$100,000
- b. \$200,000
- c. \$300,000
- d. \$400,000

ANSWER: a

125. Which of the following is working capital and current ratio most useful for evaluating?

- a. a company's liquidity
- b. a company's solvency
- c. a company's revenues
- d. a company's profitability

ANSWER: a

126. Which of the following is NOT a characteristic of liquidity?

- a. It measures the ability of the firm to pay financial obligations as they become due.
- b. It can be measured in terms of working capital.
- c. It can be assessed by the current ratio.
- d. It measures the ability of the company to pay its long-term debts.

ANSWER: d

The end-of-year statement of financial position for Bargain Spot Fabrics consisted of the following amounts:

Cash	\$ 75,000	Accounts receivable	\$250,000
Property, plant, and equipment	350,000	Long-term debt	200,000
Common shares	500,000	Accounts payable	100,000
Retained earnings		Inventory	175,000

127. Refer to Bargain Spot Fabrics. What amount should the company report on its statement of financial position for total assets?

- a. \$500,000
- b. \$750,000
- c. \$850,000
- d. \$1,650,000

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ANSWER: c

128. Refer to Bargain Spot Fabrics. What is the retained earnings balance at the end of the current year?

- a. \$50,000
- b. \$550,000
- c. \$800,000
- d. \$850,000

ANSWER: a

Bay Camera reported the following items on its financial statements for the year ended December 31:

Sales	\$780,000	Cost of sales	\$700,000
Selling, general and administrative expense	20,000	Other expense	15,000
Dividends Declared	5,000	Income tax expense	12,500

129. Refer to Bay Camera. What is the company's net income for the current year?

- a. \$22,500
- b. \$27,500
- c. \$32,500
- d. \$42,500

ANSWER: c

130. Refer to Bay Camera. What amount will be reported as retained earnings on the statement of financial position at December 31, assuming this is the first year of operations?

- a. \$22,500
- b. \$27,500
- c. \$32,500
- d. \$42,500

ANSWER: b

Beard Marine reported the following information for the year ended December 31, Year 1:

Net income	\$100,000
Dividends declared and paid	6,000
Retained earnings at December 31, Year 1	120,000

131. Refer to Beard Marine. What was the balance of retained earnings at January 1, Year 1?

- a. \$ 20,000
- b. \$ 26,000
- c. \$106,000
- d. \$214,000

ANSWER: b

132. Refer to Beard Marine. What was the economic effect of the dividend payment?

- a. It reduced net income.
- b. It increased net income.
- c. It reduced contributed capital.

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d. It reduced total retained earnings.

ANSWER: d

B&B Painting reported the following information for the year ended December 31, Year 2:

Revenues	\$2,500,000
Expenses	2,000,000
Retained earnings at December 31, Year 1	100,000
Retained earnings at December 31, Year 2	450,000

133. Refer to B&B Painting. How much was declared in dividends in Year 2?

- a. \$150,000
- b. \$250,000
- c. \$350,000
- d. \$500,000

ANSWER: a

Barr Attorneys reported the following information for the year ended December 31, Year 2:

Revenue	\$14,000,000
Expenses	11,500,000
Dividends declared and paid	1,000,000
Retained earnings at December 31, Year 2	1,750,000

134. Refer to Barr Attorneys. What was the retained earnings balance at December 31, Year 1?

- a. \$250,000
- b. \$750,000
- c. \$1,500,000
- d. \$2,500,000

ANSWER: a

The following information is provided for Beaver Tree Service:

Beginning retained earnings	\$550,000
Ending retained earnings	700,000
Dividends paid	100,000
Revenue	525,000

135. Refer to Beaver Tree Service. What was net income?

- a. \$50,000
- b. \$150,000
- c. \$250,000
- d. \$425,000

ANSWER: c

136. Refer to Beaver Tree Service. How much were expenses?

- a. \$100,000
- b. \$150,000

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c. \$275,000

d. \$450,000

ANSWER: c

Bronzing Solutions reports the following information at December 31, Year 1:

Sales	\$15,000,000
Cash	3,000,000
Unearned revenue	400,000
Dividends	1,000,000
Cost of sales	8,500,000

137. Refer to Bronzing Solutions. What is gross profit?

a. \$5,500,000

b. \$6,100,000

c. \$6,500,000

d. \$6,900,000

ANSWER: c

Benchmark Surveyors has the following balances:

Cash	\$234,000	Accounts payable	\$ 97,000
Inventories	121,000	Notes payable (due 2018)	211,000
Land	453,000	Accounts receivable	46,000

138. Refer to Benchmark Surveyors. How much is current assets?

a. \$280,000

b. \$355,000

c. \$401,000

d. \$808,000

ANSWER: c

139. Refer to Benchmark Surveyors. How much is current liabilities?

a. \$51,000

b. \$97,000

c. \$143,000

d. \$318,000

ANSWER: b

Barnes Restaurant reports the following amounts:

Cash	\$125,000	Inventory	\$215,000
Land	275,000	Unearned revenue	117,000
Equipment	350,000	Common shares	300,000

140. Refer to Barnes Restaurant. How much are current assets?

a. \$125,000

b. \$340,000

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c. \$457,000

d. \$615,000

ANSWER: b

Bass Tours has the following account balances:

Inventory	\$380,000	Accounts receivable	\$190,000
Land	290,000	Accounts payable	180,000
Cash	129,000	Unearned revenue	110,000
Prepaid rent	33,000	Common shares	312,000
Retained earnings	220,000	Long-term notes payable	200,000

141. Refer to Bass Tours. How much is the total current assets?

a. \$319,000

b. \$352,000

c. \$699,000

d. \$732,000

ANSWER: d

142. Refer to Bass Tours. How much is the current ratio?

a. 2.41 to 1

b. 3.88 to 1

c. 4.07 to 1

d. 2.52 to 1

ANSWER: d

143. Refer to Bass Tours. If the average current ratio for similar companies is 2.0 to 1, what does this tell you about this company's liquidity?

a. The company is more liquid than its competitors.

b. The company has more long-term assets than its competitors.

c. The company has a greater chance of going bankrupt than its competitors.

d. The company is more profitable than its competitors.

ANSWER: a

Barrett Oil Company reported the following balances as of December 31, Year 1:

Accounts receivable	\$125,000	Unearned revenue	\$ 5,000
Cash	150,000	Notes payable (due in 6 months)	115,000
Land	200,000	Accounts payable	70,000
Building	400,000	Equipment	165,000
Inventories	105,000	Notes payable (due 07/01/2020)	600,000

144. Refer to Barrett Oil. What is the company's current ratio?

a. 5.43 to 1

b. 2.55 to 1

c. 2.30 to 1

d. 2.00 to 1

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ANSWER: d

Bellweather Times reports the following balances:

Other revenue	\$180,000	General and administrative expense	\$320,000
Dividends paid	\$220,000	Operating revenues	\$700,000
Selling expenses	\$280,000	Income tax expense	\$60,000

145. Refer to Bellweather Times. What is the company's income from operations?

- a. \$40,000
- b. \$100,000
- c. \$220,000
- d. \$280,000

ANSWER: b

146. Refer to Bellweather Times. What is the company's net income?

- a. \$40,000
- b. \$100,000
- c. \$220,000
- d. \$280,000

ANSWER: c

147. Refer to Bellweather Times. By what amount will net income on a single-step statement of earnings differ from net income on a multiple-step statement of earnings if the company prepares both formats?

- a. \$0
- b. \$2,000
- c. \$6,000
- d. \$8,000

ANSWER: a

Black Beauty Stables reported the following statement of earnings amounts:

	<u>Year 2</u>	<u>Year 1</u>
Sales revenues	\$950,000	\$800,000
Operating expenses	\$700,000	\$550,000
Income taxes	\$100,000	\$100,000

148. Refer to Black Beauty Stables. Which of the following best describes the company's performance?

- a. The company has become more profitable.
- b. The increase in operating revenues increased the company's net income.
- c. The operating expenses as a percentage of operating revenues remained the same.
- d. The company's operating profit as a percentage of operating revenues decreased.

ANSWER: d

Been There Used Furniture began operations on January 1, Year 1, with an initial investment of \$100,000 from each of its five shareholders. During the year, the company had net income of \$200,000 and declared and paid dividends of \$50,000.

149. Refer to Been There Used Furniture. What is the retained earnings balance at December 31, Year 1?

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## Chapter 1 - Financial Statements and Decision Making

- a. \$150,000
- b. \$200,000
- c. \$250,000
- d. \$650,000

ANSWER: a

150. Refer to Been There Used Furniture. Which of the following can be said about its dividends for the year?

- a. They decreased the amount of capital shares reported by the company.
- b. They were part of the company's operating expense.
- c. They should be reported on the statement of financial position.
- d. They were reported on the statement of retained earnings.

ANSWER: d

151. Refer to Been There Used Furniture. If the company's revenues were \$500,000 for the year ended December 31, Year 1, how much were total expenses?

- a. \$250,000
- b. \$300,000
- c. \$350,000
- d. \$450,000

ANSWER: b

The accountant prepared the following list of account balances from the records of Backus Tractor Sales for the year ended December 31, Year 1.

Sales Revenue	\$2,060,000	Cash	\$300,000
Accounts Receivable	140,000	Selling Expenses	440,000
Equipment	420,000	Common Stock	170,000
Accounts Payable	120,000	Interest Income	30,000
Salaries & Wages Expense	400,000	Cost of Sales	510,000
Inventories	220,000	Prepaid Expenses	20,000
Income Taxes Payable	50,000	Income Taxes Expense	180,000
Notes Payable	200,000	Retained Earnings	?

152. Refer to Backus Tractor Sales. What is the amount of total assets?

- a. \$170,000
- b. \$540,000
- c. \$680,000
- d. \$1,100,000

ANSWER: d

153. Refer to Backus Tractor Sales. How much of the total assets are current assets?

- a. \$170,000
- b. \$540,000
- c. \$680,000
- d. \$1,100,000

ANSWER: c



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154. Refer to Backus Tractor Sales. What is the amount of total liabilities?

- a. \$120,000
- b. \$170,000
- c. \$370,000
- d. \$540,000

ANSWER: c

155. Refer to Backus Tractor Sales. How much of the total liabilities are current liabilities?

- a. \$120,000
- b. \$170,000
- c. \$370,000
- d. \$640,000

ANSWER: b

156. Refer to Backus Tractor Sales. How much is the working capital?

- a. \$170,000
- b. \$300,000
- c. \$510,000
- d. \$680,000

ANSWER: c

157. Refer to Backus Tractor Sales. How much is the current ratio?

- a. 1.84 to 1
- b. 2.97 to 1
- c. 4.00 to 1
- d. 6.47 to 1

ANSWER: c

158. Refer to Backus Tractor Sales. If the average current ratio for similar companies is 2.0 to 1, what does this tell you about this company's liquidity?

- a. The company is more liquid than its competitors.
- b. The company has more long-term assets than its competitors.
- c. The company has a greater chance of going bankrupt than its competitors.
- d. The company is more profitable than its competitors.

ANSWER: a

159. Refer to Backus Tractor Sales. What is the retained earnings balance at December 31, Year 1?

- a. \$150,000
- b. \$200,000
- c. \$250,000
- d. \$650,000

ANSWER: a

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## Chapter 1 - Financial Statements and Decision Making

160. Which of the following statements best relates to the “notes to the financial statements”?

- a. They should be shown at the bottom of the statement of earnings.
- b. They should be excluded, as they are not an integral part of the financial statements.
- c. They should be considered an optional part of the financial statements.
- d. They should be included as an integral part of the financial statements.

ANSWER: d

161. Which of the following sections is NOT found in a corporate annual report?

- a. Notes to the Financial Statements
- b. Internal Budget Reports
- c. Auditor’s Report
- d. Management’s Discussion and Analysis

ANSWER: b

162. Which of the following best describes a report’s section titled “Management’s Discussion and Analysis”?

- a. It is a report signed by the independent auditor.
- b. It explains various items reported in the financial statements.
- c. It can be a substituted for the notes to the financial statements.
- d. It provides assurances that the auditors are responsible for the financial statements.

ANSWER: b

163. In which section of the annual report would you find the following: “The financial statements, in our opinion, present fairly the financial position, operating results, and cash flows, in conformity with generally accepted accounting principles”?

- a. Management Report
- b. Notes to the Financial Statements
- c. Management’s Discussion and Analysis
- d. Report of the Independent Auditor

ANSWER: d

164. Which of the following is one purpose of the Report of the Independent Auditor?

- a. to provide comparative ratios for the company’s financial data
- b. to provide a place for management to justify questionable items in the statements
- c. to satisfy the need for full disclosure of all the facts relevant to a company’s results and financial position
- d. to provide an unbiased opinion regarding whether or not the financial statements are a fair presentation of the financial health of the company

ANSWER: d

The accountant prepared the following list from the accounting records of Ben & Terry’s Ice Cream for the year ended December 31, Year 1:

Retained Earnings	Prepaid Expenses	\$ 50,000
Cash	\$ 77,000Common Stock	400,000
Accounts Payable	50,000Accounts Receivable	170,000
Sales Revenue	955,000Interest Income	50,000
Cost of Sales	700,000Salary Expense	140,000

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Land	750,000	Income Tax Expense	20,000
Notes Payable	450,000	Selling Expense	45,000
Inventory	200,000	Salaries Payable	40,000

165. Refer to Ben & Terry's Ice Cream. What is the amount of total assets at the end of Year 1?

- a. \$915,000
- b. \$1,197,000
- c. \$1,247,000
- d. \$3,182,000

ANSWER: c

166. Refer to Ben & Terry's Ice Cream. What is the amount of total liabilities at the end of Year 1?

- a. \$50,000
- b. \$90,000
- c. \$500,000
- d. \$540,000

ANSWER: d

167. Refer to Ben & Terry's Ice Cream. What is the amount of total equity at the end of Year 1?

- a. \$707,000
- b. \$1,157,000
- c. \$2,682,000
- d. \$3,182,000

ANSWER: a

168. Refer to Ben & Terry's Ice Cream. What is the amount of total revenues at the end of Year 1?

- a. \$785,000
- b. \$835,000
- c. \$955,000
- d. \$1,005,000

ANSWER: d

169. Refer to Ben & Terry's Ice Cream. What is the amount of total expenses at the end of Year 1?

- a. \$855,000
- b. \$885,000
- c. \$905,000
- d. \$955,000

ANSWER: c

170. Refer to Ben & Terry's Ice Cream. What is the amount of net income for Year 1?

- a. \$500,000
- b. \$100,000
- c. \$307,000
- d. \$707,000

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ANSWER: b

Dunn, Inc., started the year with total assets of \$1,400,000 and total liabilities of \$240,000. Net income for the year is \$1,000,000 and dividends declared and paid during the year are \$450,000.

171. Refer to Dunn, Inc. What is the amount of shareholders' equity at the end of the year?

- a. \$1,160,000
- b. \$1,610,000
- c. \$1,710,000
- d. \$2,160,000

ANSWER: c

Certain-2-Be started business on January 1, Year 1 with assets of \$1,000,000 and shareholders' equity of \$565,000. By the end of the year, assets increased by \$100,000 and liabilities decreased by \$150,000. Other than net income or loss, the only change in shareholders' equity was dividends declared in the amount of \$50,000.

172. Refer to Certain-2-Be. What is the amount of shareholders' equity at the end of Year 1?

- a. \$515,000
- b. \$565,000
- c. \$615,000
- d. \$815,000

ANSWER: d

173. Refer to Certain-2-Be. What is the amount of net income for Year 1?

- a. \$300,000
- b. \$350,000
- c. \$400,000
- d. \$500,000

ANSWER: a

For Durable Plastic Products the beginning balance of retained earnings was \$800,000, and the ending balance was \$500,000. The company declared and paid dividends of \$50,000.

174. Refer to Durable Plastic Products. What is the amount of net income or net loss for Year 1?

- a. \$250,000 net loss
- b. \$250,000 net income
- c. \$300,000 net loss
- d. \$300,000 net income

ANSWER: a

Presented below are selected data from the statement of financial position of a Do-Our-Best:

Current assets	\$250,000
Property, plant, and equipment	700,000
Other assets	???
Current liabilities	200,000
Total long-term debt	500,000

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Total shareholders' equity 275,000

175. Refer to Do-Our-Best. What is the amount of "Other assets"?

- a. \$0
- b. \$25,000
- c. \$250,000
- d. \$750,000

ANSWER: b

176. Refer to Do-Our-Best. How much of the company is financed by owners?

- a. \$0
- b. \$25,000
- c. \$275,000
- d. \$700,000

ANSWER: c

**The following information is provided for Balloon-E-Tunes for the year ended December 31, Year 1:**

Retained earnings	\$370,000	Notes payable (due in 6 years)	\$120,000
Accumulated depreciation	130,000	Salaries payable	10,000
Income taxes payable	240,000	Supplies inventory	20,000
Plant	480,000	Accounts payable	360,000
Cash	110,000	Inventory	330,000
Accounts receivable	350,000	Land	500,000
Common shares	600,000	Prepaid insurance	40,000

177. Refer to Balloon-E-Tunes. What is the current ratio at December 31, Year 1.

- a. 1.30 to 1
- b. 1.33 to 1
- c. 1.36 to 1
- d. 1.39 to 1

ANSWER: d

178. Refer to Balloon-E-Tunes. What is the working capital at December 31, Year 1?

- a. \$110,000
- b. \$240,000
- c. \$480,000
- d. \$490,000

ANSWER: b

Match each description to one of the items listed below. (*Choices may be used more than once.*)

- a. Accounting Standards for Private Enterprise (ASPE)
- b. *CPA Handbook*
- c. Financial Accounting Standards Board (FASB)
- d. Generally Accepted Accounting Principles (GAAP)
- e. International Accounting Standards Board (IASB)

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f. International Financial Reporting Principles (IFRS)

g. Ontario Securities Commission (OSC)

h. Securities and Exchange Commission (SEC)

179. common rules and conventions that have been developed over time and across companies to guide the preparation of financial statements

ANSWER: d

180. formed to establish accounting rules for publicly traded companies in Canada

ANSWER: g

181. formed to establish accounting rules for publicly traded companies in the United States

ANSWER: h

182. publication of detailed accounting principles in Canada

ANSWER: b

183. works to reduce differences in accounting standards throughout the world

ANSWER: e

184. a common set of global accounting principles, used by more than 100 countries to facilitate business around the world

ANSWER: f

185. an alternative, simpler set of accounting principles that entities can use for financial reporting in Canada, provided the entity is not publicly traded

ANSWER: a

Several items from the financial statements of Fireside Tires are listed. Use the following choices to identify the type of account for each item listed. (*Choices may be used more than once.*)

a. assets

b. liabilities

c. revenues

d. expenses

e. shareholders' equity

186. Inventory

ANSWER: a

187. Net sales

ANSWER: c

188. Unearned revenue

ANSWER: b

189. Interest income

ANSWER: c

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190. Research and development expense

ANSWER: d

191. Accounts receivable

ANSWER: a

192. Common shares

ANSWER: e

193. Long-term loans payable

ANSWER: b

194. Cash

ANSWER: a

195. Retained earnings

ANSWER: e

196. Patents

ANSWER: a

Match each description to the item listed below.

- a. cash flows from financing activities
- b. cash flows from investing activities
- c. cash flows from operating activities

197. cash flows directly related to earning income

ANSWER: c

198. cash flows related to obtaining capital for the company

ANSWER: a

199. cash flows related to the acquisition or sale of investments and long-term assets

ANSWER: b

Match each statement to the item listed below.

- a. current assets
- b. current liabilities
- c. gross margin
- d. income from operations
- e. intangible assets
- f. long-term investments
- g. long-term liabilities
- h. net profit margin

200. net sales less cost of goods sold

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ANSWER: c

201. resources that provide a benefit over a number of years but which lack physical substance

ANSWER: e

202. investment in the debt and shares of other companies that is expected to be held for more than a year

ANSWER: f

203. obligations that must be satisfied within a year

ANSWER: b

204. net income divided by sales revenue

ANSWER: h

205. gross margin less operating expenses

ANSWER: d

206. obligations that will require payment beyond one year

ANSWER: g

207. cash and other resources that are expected to become cash or used up within a year's time or less

ANSWER: a

Match each statement to the item listed below.

a. audit report

b. fiscal year

c. financial statements

d. management's discussion and analysis

e. notes to the financial statements

208. section in the annual report that often highlights favourable or unfavourable trends and significant risks facing the company

ANSWER: d

209. accounting period that may or may not cover January 1–December 31

ANSWER: b

210. contains the auditor's opinion as to whether the financial statements fairly present the company's financial position and results of operations

ANSWER: a

211. set of reports that communicate a company's financial position and results of operations

ANSWER: c

212. information that clarifies and expands upon the information presented in the financial statements

ANSWER: e



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The accountant prepared the following list of account balances from the records of Backus Tractor Sales for the year ended December 31, Year 1.

Sales Revenue	\$2,060,000	Cash	\$300,000
Accounts Receivable	140,000	Selling Expenses	440,000
Equipment	420,000	Common Stock	170,000
Accounts Payable	120,000	Interest Income	30,000
Salaries & Wages Expense	400,000	Cost of Sales	510,000
Inventories	220,000	Prepaid Expenses	20,000
Income Taxes Payable	50,000	Income Taxes Expense	180,000
Notes Payable	200,000	Retained Earnings	?

213. Refer to Backus Tractor Sales.

- A) What is the amount of current assets at the end of Year 1?  
What is the amount of total assets at the end of Year 1?
- B) What is the amount of current liabilities at the end of Year 1?
- C) What parties have a claim on the company's assets? Explain your answer in the terms of the accounting equation.

ANSWER: A) Current Assets = \$680,000  
(\$300,000 Cash + \$140,000 Accounts Receivable + \$220,000 Inventories + 20,000  
Prepaid Expenses = \$680,000)

Total Assets = \$1,100,000  
(\$300,000 Cash + \$140,000 Accounts Receivable + \$220,000 Inventories + \$20,000  
Prepaid Expenses + \$420,000 Equipment)

- B) Current Liabilities = \$170,000  
(\$120,000 Accounts Payable + \$50,000 Income Taxes Payable )

- C) Both the creditors and the owners have a claim on the assets of the corporation. The creditors have their claim arising from the liabilities of the corporation, while the owners have a claim through the shareholders' equity.

214. Refer to Backus Tractor Sales.

- A) What is the balance of retained earnings at the end of Year 1?
- B) What is the amount of total shareholders' equity at the end of Year 1?
- C) Name the two events that might cause shareholders' equity to increase.

ANSWER: A) \$560,000  
(\$1,100,000 Total Assets – \$370,000 Total Liabilities – \$170,000 Common Shares =  
\$560,000)

- B) \$730,000  
(\$1,100,000 Total Assets – \$370,000 Total Liabilities = \$730,000)  
OR  
(\$170,000 Common Shares + \$560,000 Retained Earnings = \$730,000)

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- C) Shareholders' equity can increase when common shares is issued to investors. It also can increase through increases to retained earnings or the net income of the business is greater than any dividends declared and paid to the shareholders.

215. Refer to Backus Tractor Sales.

- A) What is the amount of total revenues for Year 1?
- B) What is the amount of the total expenses for Year 1?
- C) What is the purpose of the statement of earnings?
- D) Is this company profitable? Explain your answer.

- ANSWER: A) \$2,090,000  
(\$2,060,000 Sales Revenue + \$30,000 Interest Income = \$2,090,000)
- B) \$1,530,000  
(\$510,000 Cost of Sales + \$400,000 Salaries & Wages Expense + \$440,000 Selling Expenses + \$180,000 Income Taxes Expense = \$1,530,000)
- C) The purpose of the statement of earnings is to provide information regarding the revenues and expenses of the entity. The difference shows the profitability of the company for a particular period of time.
- D) The company had net income for the period of \$560,000. Since revenues exceeded expenses for the period, the company would be considered profitable.

216. Refer to Backus Tractor Sales. Prepare a statement of earnings in good form.

ANSWER:

Backus Tractor Sales Statement of Earnings For the Year Ended December 31, Year 1			
Revenues:			
	Sales revenue	\$2,060,000	
	Interest income	<u>30,000</u>	\$2,090,000
Expenses:			
	Cost of sales	\$ 510,000	
	Salaries & wages expense	400,000	
	Selling expenses	440,000	
	Income taxes expense	<u>180,000</u>	<u>1,530,000</u>
Net income			<u>\$ 560,000</u>

217. Refer to Backus Tractor Sales. Prepare a statement of financial position in good form.

ANSWER:

Backus Tractor Sales Statement of Financial Position December 31, Year 1			
<u>Assets</u>		<u>Liabilities &amp; Shareholders' Equity</u>	
Cash	\$ 300,000	Accounts payable	\$ 120,000

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Accounts receivable	140,000	Income taxes payable	50,000
Inventories	220,000	Notes payable	200,000
Prepaid expenses	20,000	Common shares	170,000
Equipment	<u>420,000</u>	Retained earnings	<u>560,000</u>
Total assets	<u>\$1,100,000</u>	Total liabilities & shareholders' equity	<u>\$1,100,000</u>

### Ben & Terry's Ice Cream

The accountant prepared the following list from the accounting records of Ben & Terry's Ice Cream for the year ended December 31, Year 1:

Retained Earnings		Prepaid Expenses	\$ 50,000
Cash	\$ 77,000	Common Stock	400,000
Accounts Payable	50,000	Accounts Receivable	170,000
Sales Revenue	955,000	Interest Income	50,000
Cost of Sales	700,000	Salary Expense	140,000
Land	750,000	Income Tax Expense	20,000
Notes Payable	450,000	Selling Expense	45,000
Inventory	200,000	Salaries Payable	40,000

218. Refer to Ben & Terry's Ice Cream

- A) What is the amount of total assets at the end of Year 1?
- B) What is the amount of total liabilities at the end of Year 1?
- C) What is the amount of total equity at the end of Year 1?
- ANSWER: A) \$1,247,000  
 (\$77,000 Cash + \$170,000 Accounts Receivable + \$200,000 Inventories + \$50,000 Prepaid Expense + \$750,000 Land = \$1,247,000)
- B) \$540,000  
 (\$50,000 Accounts Payable + \$450,000 Notes Payable + \$40,000 Salaries Payable = \$540,000)
- C) \$707,000  
 (\$1,247,000 Total Assets – \$540,000 Total Liabilities = \$707,000)

219. Refer to Ben & Terry's Ice Cream

- A) What is the amount of total revenues for Year 1?
- B) What is the amount of total expenses for Year 1?
- C) What is the amount of net income for Year 1?
- ANSWER: A) \$1,005,000  
 (\$955,000 Sales Revenue + \$50,000 Interest Income = \$1,005,000)
- B) \$905,000  
 (\$700,000 Cost of Sales + \$140,000 Salary Expense + \$20,000 Income Tax Expense + \$45,000 Selling Expense = \$905,000)

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- C) \$100,000  
 (\$1,005,000 Total Revenue – \$905,000 Total Expenses = \$100,000)

220. Refer to Ben & Terry's Ice Cream. Prepare a statement of earnings in good form.

ANSWER:

Ben & Terry's Ice Cream Statement of Earnings For the Year Ended December 31, Year 1			
Revenues:			
	Sales revenue	\$955,000	
	Interest income	<u>50,000</u>	\$1,005,000
Expenses:			
	Cost of sales	\$700,000	
	Salary expense	140,000	
	Selling expense	45,000	
	Income tax expense	<u>20,000</u>	<u>905,000</u>
Net Income			<u>\$ 100,000</u>

221. Refer to Ben & Terry's Ice Cream. Prepare a statement of financial position in good form.

ANSWER:

Ben & Terry's Ice Cream Statement of financial position As of December 31, Year 1			
<u>Assets</u>		<u>Liabilities &amp; Owners' Equity</u>	
Cash	\$ 77,000	Accounts payable	\$ 50,000
Accounts receivable	170,000	Salaries payable	40,000
Inventory	200,000	Notes payable	450,000
Prepaid expenses	50,000	Common shares	400,000
Land	<u>750,000</u>	Retained earnings	<u>307,000</u>
Total assets	<u>\$1,247,000</u>	Total liabilities and owners' equity	<u>\$1,247,000</u>

### Dunn, Inc.

Dunn, Inc., started the year with total assets of \$1,400,000 and total liabilities of \$240,000. Net income for the year is \$1,000,000 and dividends declared and paid during the year are \$450,000.

222. Refer to Dunn Inc.

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

ANSWER:

A)

	<u>Assets</u>		<u>Liabilities</u>		<u>Equity</u>				
Beginning	\$1,400,000	=	\$240,000	+	\$1,160,000				
Beginning Equity + Issuance of Shares + Net Income – Dividends Declared = Ending Equity									
	\$1,160,000	+	0	+	\$1,000,000	–	\$450,000	=	\$1,710,000

- B) Yes. Assuming the company has enough cash to do so, additional dividends can be paid. Net income exceeded the amount of dividends paid by \$550,000 (\$1,000,000 –

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\$450,000), so the amount paid could have been increased. Also the company has total positive retained earnings.

### Certain-2-Be

Certain-2-Be started business on January 1, Year 1 with assets of \$1,000,000 and shareholders' equity of \$565,000. By the end of the year, assets increased by \$100,000 and liabilities decreased by \$150,000. Other than net income or loss, the only change in shareholders' equity was dividends declared in the amount of \$50,000.

223. Refer to Certain-2-Be.

A) What was the amount total shareholders' equity at the end of Year 1?

B) What was the amount net income or net loss for Year 1?

ANSWER: A)

	<u>Assets</u>		<u>Liabilities</u>	<u>Shareholders Equity</u>
Beginning of year	\$1,000,000		\$435,000	\$565,000
Change during year	<u>+100,000</u>		<u>(150,000)</u>	<u>+250,000</u>
End of year	\$1,100,000	=	285,000	\$815,000

B)

Beginning shareholders' equity + Net income – Dividends = Ending shareholders' equity

\$565,000 + Net income – \$50,000 = \$815,000

\$300,000

224. Presented below are selected data from the statement of financial position of Do-Our-Best:

Current assets	\$250,000
Property, plant, and equipment	700,000
Other assets	???
Current liabilities	200,000
Total long-term debt	500,000
Total shareholders' equity	275,000

A) Determine the amount of "Other assets."

B) How much of the company is financed by creditors? How much is financed by the owners?

ANSWER: A) \$25,000

(\$200,000 Current liabilities + \$500,000 Long-term debt + \$275,000 Shareholders' equity = \$975,000 Total assets)

... (\$975,000 Total Assets – \$250,000 Current assets – \$700,00 PPE = \$25,000)

B) Amount of financing by creditors: \$700,000 (Total liabilities)

(\$200,000 Current liabilities + \$500,000 Long-term debt = \$700,000)

Amount of financing by owners: \$275,000

(Shareholders' equity)

225. Presented below are selected data from the accounting records of a certain company for Year 1:

Sales	\$900,000
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Income tax expense	80,000
Cost of sales	550,000
Operating expenses	150,000
Dividends declared	75,000

- A) Calculate the net income or loss for the year.
- B) Did the company's financial position improve or deteriorate during the year? Explain.
- C) Is the company profitable? Explain.

ANSWER:

- A) \$120,000  
 (\$900,000 Sales – \$550,000 Cost of sales – \$150,000 Operating expenses – \$80,000 Income tax expense = \$120,000)
- B) The financial position improved since the net income increases the company's retained earnings.
- C) Yes. The amount of revenues exceeds the amount of expenses by \$120,000.

226. The following statement of financial position information for a certain company is provided:

	<u>Assets</u>	<u>Liabilities</u>	<u>Shareholders' Equity</u>
January 1, Year 1	\$1,500,000	\$540,000	\$ _____
December 31, Year 1	1,810,000	_____	1,400,000

- A) What is the amount of shareholders' equity at January 1, Year 1?
- B) What is the amount of liabilities at December 31, Year 1?
- C) Assume that the company declared and paid dividends of \$620,000 during the year. How much net income did it earn during the year?
- D) Assume that the company did not declare any dividends during the year. Without looking at the statement of earnings, how can you tell if the company is profitable or not?

- ANSWER: A) \$960,000  
 (\$1,500,000 Assets – \$540,000 Liabilities = \$960,000)
- B) \$410,000  
 (\$1,810,000 Assets – \$1,400,000 Shareholders' Equity = \$410,000 Liabilities)
- C) \$1,060,000  
 (\$960,000 Beginning Shareholders' Equity + X – \$620,000 Dividend declared = \$1,400,000 Ending Shareholders' Equity)  
 (X = \$1,060,000)

- D) Assuming that the increase in shareholders' equity would come from net income, the company would have to be considered profitable. Net income will increase retained earnings which is a part of shareholders' equity. However, it is possible that the company issued additional shares. This, too, would increase Shareholders' Equity.

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227. A company began the year with total assets of \$10,000,000 and total liabilities of \$6,200,000. No additional shares were issued during the year.

A) What was the amount of total assets at the end of the year if liabilities decreased by \$600,000 and shareholders' equity increased by \$900,000?

B) Was the company profitable? Explain your answer.

ANSWER: A) \$10,300,000

	<u>Assets</u>	<u>Liabilities</u>	<u>Shareholders' Equity</u>
Beginning of the year	\$10,000,000	= \$6,200,000	+ \$3,800,000
Change during the year	<u>300,000</u>	<u>= (600,000)</u>	<u>+ 900,000</u>
End of the year	\$10,300,000	= \$5,600,000	+ \$4,700,000

B) Since no additional shares were issued during the year, the increase in shareholders' equity would come from net income so the company would have to be considered profitable. Net income will increase retained earnings, which is a part of shareholders' equity.

228. For Durable Plastic Products the beginning balance of retained earnings was \$800,000, and the ending balance was \$500,000. The company declared and paid dividends of \$50,000.

A) Determine the amount of net income (loss) for the year.

B) What information would one find on the statement of earnings in addition to net income?

ANSWER:

A)  
Beginning retained earnings + Net income (loss) – Dividends = Ending retained earnings  
\$800,000 + **Net loss** – \$50,000 = \$500,000  
**\$250,000**

B) The statement of earnings will show the sources of amounts earned (revenues) as well as the amount and type of costs incurred by the company (expenses) during the period.

229. Best Deal Auto Parts began Year 1 with \$400,000 in assets, \$140,000 in liabilities, and \$160,000 of retained earnings. Net income for the year was \$100,000, and dividends of \$80,000 were declared and paid.

A) Prepare a statement of retained earnings for Year 1.

B) What is the nature or purpose of the statement of retained earnings?

C) What was the amount of common shares at the beginning of Year 1?

D) What events would cause the two shareholders' equity items to increase?

E) How do you identify whether the company was profitable during Year 1 by examining the statement of retained earnings?

ANSWER:

A)  
Best Deal Auto Parts  
Statement of Retained Earnings  
For the Year Ended December 31, year 1

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Retained earnings, January 1, Year 1	\$160,000
Add: Net income	100,000
Deduct: Dividends declared	<u>(80,000)</u>
Retained earnings, December 31, Year 1	<u>\$180,000</u>

- B) Retained earnings represents the accumulated income (since the company began operations) earned of the company that has not been distributed to owners in the form of dividends. The statement of retained earnings is prepared to determine how the retained earnings account has been impacted by business and certain shareholder transactions during a period of time.
- C) \$100,000  
 (\$400,000 Total Assets – \$140,000 Total Liabilities – \$160,000 Beginning Retained Earnings = \$100,000)
- D) One way that the company can increase shareholders' equity is to issue (i.e., sell) additional shares to investors. Another way is to increase retained earnings when the company reports net income for the period greater than the dividends paid.
- E) The statement of retained earnings shows net income (or net loss) for the period. Net income indicates profitability; net loss indicates the opposite.

230. The following accounts were taken from a company's accounting records:

Total liabilities, (end of year)	\$920,000	Total assets, (end of year)	\$1,430,000
Common shares, (end of year)	160,000	Retained earnings, (beginning of year)	150,000
Dividends declared	200,000	Net income for the year	400,000

- A) How much is the balance of retained earnings at the end of the year?
- B) How much is the balance of shareholders' equity at the end of the year?
- C) If shareholders' equity increases during the year, does that mean that the company is profitable? Explain your answer.

ANSWER:

- A) \$350,000  
 (\$150,000 Retained earnings, beginning of the year + \$400,000 Net income – \$200,000 Dividends for the period = \$350,000)  
 OR  
 (\$1,430,000 Total assets, end of the year – \$920,000 Total liabilities, end of the year – \$160,000 Common shares, end of the year = \$350,000)
- B) \$1,430,000 Total assets, end of the year = \$920,000 Total liabilities, end of the year + \$510,000 Shareholders' Equity, end of the year  
 (\$160,000 Common shares, end of the year + \$350,000 Retained earnings, end of the year)
- C) One way that the company can increase shareholders' equity is to issue (i.e., sell) additional shares to investors. Another way is to increase retained earnings when the company reports net income for the period greater than the dividends paid. Only if the increase were due (at least partly) to net income would there be indication



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of profitability.

231. Classify the following items according to the financial statement on which each belongs, either the statement of earnings (E), statement of retained earnings (RE), or the statement of financial position (FP). Also indicate whether each is a revenue (R), expense (EX), asset (A), liability (L), or shareholders' equity (SE) item.

	<u>Appears on Which Statement?</u>	<u>Type of Account</u>
i) Retained earnings	_____	_____
ii) Equipment	_____	_____
iii) Common shares	_____	_____
iv) Unearned revenue	_____	_____
v) Sales	_____	_____
vi) Rent expense	_____	_____
vii) Inventories	_____	_____
ANSWER: i) Retained earnings	FP, RE	SE
ii) Equipment	FP	A
iii) Common shares	FP	SE
iv) Unearned revenue	FP	L
v) Sales	E	R
vi) Rent expense	E	EX
vii) Inventories	FP	A

232. The following amounts were taken from the accounting records of a certain company at December 31:

Service revenue	\$600,000	Salaries expense	\$200,000
Dividends declared	50,000	Rent expense	86,000
Buildings	110,000	Land	100,000
Accounts payable	40,000	Accounts receivable	28,000
Common shares	60,000	Retained earnings, Jan. 1	400,000
Utilities expense	19,000	Notes payable	30,000
Income tax payable	4,000	Income tax expense	110,000

A) Calculate net income for the year.

B) Calculate retained earnings at the end of the year.

ANSWER: A) \$185,000  
 (\$600,000 Service Revenue – \$200,000 Salaries Expense – \$86,000 Rent Expense – \$19,000 Utilities Expense – \$110,000 Income Tax Expense = \$185,000)

B) \$535,000  
 (\$400,000 Retained Earnings, Jan 1 + \$185,000 Net Income – \$50,000 Dividends Declared = \$535,000)

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233. The following amounts were taken from the accounting records of a certain company at December 31:

Accounts payable	\$400,000	Dividends declared and paid	\$100,000
Cash	\$100,000	Expenses	\$600,000
Inventories	\$700,000	Revenue	\$750,000

- A) Calculate total assets.
- B) Calculate net income for the year.
- C) Calculate total shareholders' equity at the end of the year.
- D) Calculate total shareholders' equity at the beginning of the year assuming there were no shares transactions during the year.

ANSWER: A) \$800,000  
( $\$100,000 \text{ Cash} + \$700,000 \text{ Inventories} = \$800,000$ )

B) \$150,000  
( $\$750,000 \text{ Revenue} - \$600,000 \text{ Expenses} = \$150,000$ )

C) \$400,000  
( $\$800,000 \text{ Total Assets} - \$400,000 \text{ Total Liabilities} = \$400,000$ )

D) \$350,000  
( $\$400,000 \text{ End-of-year} - \$150,000 \text{ (NI} = \$750,000 - \$600,000) + \$100,000 \text{ (Dividends)}$ )

234. The following information is taken from the statement of financial position at December 31:

Cash	\$288,000	Retained earnings	\$168,000
Inventory	96,000	Accounts payable	84,000
Equipment	456,000	Bonds payable	276,000
Common shares	312,000		

- A) How much did creditors provide to this company?
- B) On which financial statement would an investor look to see if any shares were issued during the year?

ANSWER: A) \$360,000  
( $\$84,000 \text{ Accounts Payable} + \$276,000 \text{ Bond Payable}$ )

- B) The primary source for seeing whether any shares were issued during the year would be the statement of shareholders' equity. While the statement of financial position may show an amount for "Common shares," this amount is an ending balance, and would not show the results of any transactions involving new issuances of shares during the period.

The following information is provided for Balloon-E-Tunes for the year ended December 31, Year 1:

Retained earnings	\$370,000	Notes payable (due in 6 years)	\$120,000
Accumulated depreciation	130,000	Salaries payable	10,000
Income taxes payable	240,000	Supplies inventory	20,000

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Plant	480,000	Accounts payable	360,000
Cash	110,000	Inventory	330,000
Accounts receivable	350,000	Land	500,000
Common shares	600,000	Prepaid insurance	40,000

235. Refer to Balloon-E-Tunes.

A) Prepare the current assets section of the statement of financial position at December 31, Year 1. You may omit the heading.

B) How does the concept of liquidity apply?

ANSWER: A)

Cash	\$110,000
Accounts receivable	350,000
Inventory	330,000
Prepaid insurance	40,000
Supplies inventory	<u>20,000</u>
Total current assets	<u>\$850,000</u>

B)

Liquidity is an indicator of how close to cash the company's assets are. Those assets that are most liquid are listed first. It relates to the company's ability to pay its obligations as they become due. Current assets are expected to be converted into cash within the next operating cycle, so they are a key determinant of liquidity.

236. Refer to Balloon-E-Tunes.

A) Prepare the current liabilities section of the statement of financial position at December 31, Year 1. You may omit the heading.

B) If the amount of current liabilities were larger, what effect would this have on the current ratio?

ANSWER:

A)

Accounts payable	\$360,000
Salaries payable	10,000
Income taxes payable	<u>240,000</u>
Total	<u>\$610,000</u>

B) When current liabilities increase, the denominator of the current ratio increases. This causes the current ratio itself to decrease.

237. Refer to Balloon-E-Tunes.

A) Prepare the noncurrent asset section of the statement of financial position at December 31, Year 1. You may omit the heading.

B) Why are these amounts classified as "noncurrent"?

ANSWER:

A)

Land	\$500,000
Plant	\$480,000
Less: Accumulated depreciation	<u>(130,000)</u>
Total	<u>\$850,000</u>

B) Noncurrent 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 cost of the building that has benefited the accounting periods to date.

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238. Refer to Balloon-E-Tunes. Calculate the current ratio at December 31, Year 1.

ANSWER: Current Assets = \$850,000

(\$110,000 Cash + \$350,000 Accounts receivable + \$330,000 Inventory + \$40,000 Prepaid Insurance + \$20,000 Supplies inventory = \$850,000)

Current Liabilities = \$610,000

(\$360,000 Accounts Payable + \$10,000 Salaries Payable + \$240,000 Income Taxes Payable = \$610,000)

Current ratio = 1.39 to 1

(\$850,000 / \$610,000)

239. Refer to Balloon-E-Tunes.

A) Calculate the amount of working capital at December 31, Year 1.

B) How does the current ratio differ from working capital?

ANSWER: A)

Current Assets = \$850,000

(\$110,000 Cash + \$350,000 Accounts receivable + \$330,000 Inventory + \$40,000 Prepaid Insurance + \$20,000 Supplies = \$850,000)

Current Liabilities = \$610,000

(\$360,000 Accounts Payable + \$10,000 Salaries Payable + \$240,000 Income Taxes Payable = \$610,000)

Working Capital = \$240,000

(\$850,000 – \$610,000)

B) The current ratio indicates the number of times current assets is greater than current liabilities. The current ratio is based on a relative relationship; whereas, working capital is based on total dollars.

240. After reporting a profit of \$20,000 for the year, a certain company reported the following items on its statement of financial position at December 31, Year 1:

Cash	\$225,000
Accounts receivable	110,000
Inventory	80,000
Prepaid insurance	5,000
Land	100,000
Building	280,000
Accounts payable	60,000
Salaries payable	10,000
Common shares	500,000
Retained earnings	230,000

A) Calculate the current ratio and determine the amount of working capital.

B) Beyond the information provided in your answers to part A, what does the composition of the current assets tell you about the company's liquidity?

C) What other information would one need to fully assess liquidity?

ANSWER: A) Current ratio: 6 to 1

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$(\$225,000 \text{ Cash} + \$110,000 \text{ Accounts receivable} + \$80,000 \text{ Inventory} + \$5,000 \text{ Prepaid insurance}) / (\$60,000 \text{ Accounts payable} + \$10,000 \text{ Salaries payable}) = 6 \text{ to } 1$

Working capital: \$350,000

$(\$420,000 \text{ Total Current Assets} - \$70,000 \text{ Total Current Liabilities}) = \$350,000$

- 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 statement of financial position represents only the ending balance of the cash account. The statement of cash flows also identifies the sources and uses of cash by accounting activity.

B-There Transportation calculated the following amounts concerning its financial information for the years ended December 31, Year 2 and Year 1.

	<u>Year 2</u>	<u>Year 1</u>
Current ratio	4.0 to 1	2.0 to 1

241. Refer to B-There Transportation. Is the change in the current ratio favourable or not? Explain.

**ANSWER:** The current ratio increased from 2.0-to-1 to 4.0-to-1. This is an unusually large increase for most companies. A larger current ratio means a company is more liquid. This increase is favourable, although care must be taken so that the current ratio does not become too large, which may indicate an inefficient cash management system.

242. Refer to B-There Transportation. Suppose the company had a decrease in its cash account from Year 1 to Year 2. Would the other current asset amounts have increased or decreased? Explain.

**ANSWER:** Since the current ratio increased from Year 1 to Year 2, the current assets other than cash would have had to increase substantially to offset the decline in cash. However, cash could also have been used to pay down current liabilities; thus, the current ratio would not be impacted. 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.

The following amounts were taken from the statement of earnings of Beauty World for the year ended December 31, Year 1:

	<u>Year 1</u>
Net sales	\$750,000
Selling, general and administrative expense	450,000
Research and development expense	50,000
Other income (net)	25,000

243. Refer to Beauty World:

A) How much is net income for the year ended December 31, Year 1?

B) Would the net income amount have been different if the company had used a single-step statement of earnings rather than the multiple-step statement? Explain.

**ANSWER:**

A)

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Net Income = \$275,000

(\$750,000 Net Sales + \$25,000 Other Income, net – \$450,000 Selling, General and Administrative Expenses – \$50,000 Research and Development Expense = \$275,000)

B) Net income is the same under a single-step or a multiple-step statement of earnings. Only subtotals and the order the amounts are listed differ.

244. Listed below are several amounts from the accounting records of Bike Links for the year ended December 31, Year 1. Prepare a multiple-step statement of earnings in good form.

Service revenue	\$960,000
Selling expense	176,000
Income tax expense	160,000
General and administrative expenses	280,000
Interest revenue	8,000

ANSWER:

Bike Links Statement of earnings For the Year Ended December 31, Year 1			
Service revenue			\$960,000
Operating expenses:			
	Selling expenses	\$176,000	
	General and administrative expenses	<u>280,000</u>	
	Total operating expenses		<u>456,000</u>
Income from operations			\$ 504,000
Other revenue and expenses			
	Interest revenue		<u>8,000</u>
Income before taxes			\$ 512,000
Income tax expense			<u>160,000</u>
Net income			<u>\$ 352,000</u>

245. Listed below are several amounts from the accounting records of Big Tom's Pawn Shops for the year ended December 31, Year 1. Prepare a single-step statement of earnings in good form.

Salaries expenses	\$145,000
Rent expense	12,000
Sales	225,000
Retained earnings	100,000
Insurance expense	11,000
Income taxes expense	30,000

ANSWER:

Big Tom's Pawn Shops Statement of earnings For the Year Ended December 31, Year 1			
Revenues:			
	Sales		\$225,000
Expenses			
	Salaries expense	\$145,000	
	Rent expense	12,000	
	Insurance expense	11,000	
	Income tax expense	<u>30,000</u>	
	Total expenses		<u>198,000</u>

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## Chapter 1 - Financial Statements and Decision Making

Net income

\$ 27,000

Blackbeard's Restaurant began operations on January 1, Year 1, with a total investment of \$100,000 by its shareholders. The restaurant had a net loss its first year of business of \$15,000. During Year 2 and Year 3, the business was profitable with net incomes of \$25,000 and \$50,000, respectively. The company declared and paid \$5,000 per year in dividends to its shareholders in Year 2 and Year 3.

246. Refer to Blackbeard's Restaurant.

- A) In good form, prepare a statement of retained earnings for the year ended December 31, Year 2.
- B) How much is total retained earnings on December 31, Year 3?
- C) Explain the link between the statement of retained earnings and the statement of financial position.

ANSWER: A)

Blackbeard's Restaurant  
Statement of Retained Earnings  
For the Year Ended December 31, Year 2

Beginning balance, January 1, Year 2	\$(15,000)*
Add: Net income for Year 2	25,000
Less: Dividends declared and paid during the year	<u>(5,000)</u>
Ending balance, December 31, Year 2	<u>\$ 5,000</u>

\*\$-15,000 Net Loss for 2011 – \$0 Dividends declared and paid  
= \$(15,000) Balance, January 1, Year 2

- B) Retained earnings at December 31, Year 3 = \$50,000  
(\$5,000 Beginning Balance, January 1, Year 3 + \$50,000 Net Income for Year 3 – \$5,000 Dividends declared and paid during the year = \$50,000)
- 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 statement of financial position as a component of shareholders' equity.

Condensed data from the Year 2 and Year 1 financial statements of Baker's Pride Bakery are presented below. The figures are expressed in thousands.

Statement A	<u>Year 2</u>	<u>Year 1</u>
Assets:		
Total current assets	\$219,560	\$198,088
Property, plant, and equipment (net of accumulated depreciation)	18,320	13,996
Investments	3,370	1,167
Other assets	<u>12,220</u>	<u>11,667</u>
Total assets	<u>\$253,470</u>	<u>\$224,918</u>
Liabilities:		
Total current liabilities	\$ 92,990	\$ 95,260
Long-term debt	<u>15,160</u>	<u>22,172</u>
Total liabilities	\$108,150	\$117,432
Shareholders' equity:		
Contributed capital	\$ 53,680	\$ 35,475

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Retained earnings		<u>91,640</u>	<u>72,011</u>
	Total shareholders' equity	<u>\$145,320</u>	<u>\$ 107,486</u>
Total liabilities & shareholders' equity		<u>\$253,470</u>	<u>\$224,918</u>

### Statement B

	<u>Year 2</u>	<u>Year 1</u>
Net sales	\$229,301	\$203,171
Cost of sales	<u>135,453</u>	<u>131,212</u>
Gross margin	\$93,848	\$71,959
Selling, general and administrative expenses	64,832	57,442
Other income (expense)	<u>693</u>	<u>(130)</u>
Income (loss) before income taxes	\$29,709	\$14,387
Income tax expense	<u>3,534</u>	<u>2,320</u>
Net income (loss)	<u>\$ 26,175</u>	<u>\$ 12,067</u>

247. Refer to Baker's Pride Bakery.

A) What is the name of Statement A?

B) What is the name of Statement B?

ANSWER: A) Statement A is the classified statement of financial position

B) Statement B is the multiple-step statement of earnings

248. Refer to Baker's Pride Bakery.

A) Which statement indicates the financial position of the company?

B) What information is provided on that statement that indicates the financial position of the company? Explain.

ANSWER:

A) The classified statement of financial position provides information on the financial position of the company.

B) The classified statement of financial position is expressed in terms of the accounting equation. When total liabilities are subtracted from total assets, the difference is shareholders' equity. This amount represents net worth or the financial position of a company at the statement of financial position date.

249. Refer to Baker's Pride Bakery.

A) Was the company profitable both years?

B) What are the amounts of the total revenues and total expenses, respectively, for Year 2?

C) Which financial statement provides this information to you?

ANSWER:

A) The company was profitable (Revenues > Expenses) in both Year 2 and Year 1.

B) For Year 2, total revenues include net sales of \$229,301 and other income of \$693, for a total of \$229,994. Total expenses for Year 2 include cost of sales of \$135,453, selling, general and administrative expenses of \$64,832, and income tax expense of \$3,534, or a total of \$203,819.

C) Information about revenues, expenses, and profitability is reported on the statement of earnings.

250. Refer to Baker's Pride Bakery. How much of the company is financed by owners at the end of December Year 2?

ANSWER: The amount of financing by owners for Year 2 is represented by the amount of shareholders' equity, \$145,320.

Over time, sales of shares and earnings retained by the company (cumulative net income minus cumulative dividends) cause the amount of shareholders' equity to increase.

251. Refer to Baker's Pride Bakery.



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A) How much of the company is financed by creditors at the end of December Year 2?

B) Evaluate the change from Year 1 to Year 2.

**ANSWER:** A) The amount of financing provided by creditors for Year 2 is the amount of liabilities reported on the statement of financial position, \$108,150.

B) For Year 1, the amount was \$117,432. Total liabilities decreased by \$9,282, or about 8% from Year 1 to Year 2. The company was able to lower its debt while still increasing its assets and shareholders' equity. Of course, this decrease in liabilities must be examined relative to the company's entire financial position.

252. Refer to Baker's Pride Bakery. Based on the information provided, is the company legally organized as a sole proprietorship, partnership, or corporation? How can you tell?

**ANSWER:** The company is organized as a corporation, as evidenced by the shareholders' equity items.

253. Each of the four statements that comprise a full set of financial statements has an underlying equation or formula. List the statements and the underlying equation of each.

**ANSWER:**

1. Statement of earnings: revenues – expenses = net income (net loss)
2. Statement of retained earnings: beginning retained earnings + net income (net loss) – dividends declared = ending retained earnings
3. Statement of financial position: assets = liabilities + shareholders' equity
4. Statement of cash flows: beginning cash ± operating cash flows ± investing cash flows ± financing cash flows = ending cash

254. Complete the following table to compare and contrast sole proprietorships and corporations.

Item	Proprietorship	Corporation
Ease of formation		
Ability to raise large sums of capital		
Taxable entity		
Ownership control and transferability		
Extent of owner liability		
Taxes		

**ANSWER:**

Item	Proprietorship	Corporation
Ease of formation	Easy	More difficult
Ability to raise large sums of capital	Limited	Easier
Taxable entity	No	Yes
Ownership control and transferability	Controlled by owner, limited life	Controlled by shareholders, easier to transfer ownership
Extent of owner liability	Unlimited personal liability	Limited liability
Taxes	Tax advantages	Higher taxes

255. Most annual 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's Discussion and Analysis		
Financial statements		
Notes to financial statements		
Report of the Independent Auditor		

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## Chapter 1 - Financial Statements and Decision Making

ANSWER:

Elements	Prepared By	Information Provided
Management's Discussion and Analysis	Management	· discussion and explanation of various items reported in the financial statements and explanation · highlights favourable and unfavourable trends
Financial statements	Management	statement of earnings, statement of financial position, statement of cash flows, statement of retained earnings
Notes to financial statements	Management	clarifications and explanations that expand upon the information presented in the financial statements
Report of the Independent Auditor	CPA	opinion as to whether the financial statements fairly present the financial position and financial performance of the company

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

ANSWER: Various groups and some of their decisions are as follows:

Shareholders:	Is the company profitable enough to pay dividends? Did the company make a profit for the period?
Management:	How should an item be priced? How effective have marketing campaigns been? How effective were cost-saving efforts? Should we continue operations? Can we give employees raises? Can we give employees bonuses?
Employees:	Will I get a raise this year? Will I get a bonus this year?
Bankers:	Can the company pay interest and principal when it comes due?
Creditors:	Can the company pay bills when they are due?
Government:	How much did the company earn? (i.e., How much taxes should be paid?)

257. What is the purpose of a statement of earnings?

ANSWER: A statement of earnings reports the company's revenues and expenses for a period of time and shows the company's profitability (or lack thereof).

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

ANSWER: 1 statement of financial position  
2 statement of earnings  
3 statement of retained earnings  
4 statement of cash flows

Net income on the statement of earnings increases retained earnings on the statement of retained earnings. The balance in the statement of retained earnings goes to the statement of financial position. The ending balance

## Chapter 1 - Financial Statements and Decision Making

for cash on the statement of cash flows is also shown on the statement of financial position.

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

**ANSWER:** Investors are most interested in cash receipts from dividends and the cash they can receive upon selling their shares. 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 company's statement of financial position, is also a concern for both investors and creditors because even though the company may have what appears to be sufficient cash flows for the current period, the long-term cash flow could be weak.

260. How is a classified statement of financial position useful to decision makers?

**ANSWER:** A classified statement of financial position helps evaluate the liquidity of a company by separating the current assets from long-term assets and the 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.

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

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

262. What information is generally 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.

263. Assume that you have received copies of the financial statements for Best Buy for the years ended December 31, Year 1 and Year 2. Answer the following questions:

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

**ANSWER:** A banker wants to be assured that the company will make its interest payments and repay the principle of the loan in a timely manner. A banker would also want to know about the value of the assets that could be used to secure the loan or liquidated if company can't repay the loan.

A) Investors want to know whether they should make an investment in the company's shares, or continue to hold their investment. They will be looking at the company's recent performance, whether the company has been profitable, how their profits compare with other companies, and how much the company has declared and paid in dividends.

B) A labour negotiator needs to know how much profit the company has made. This information is found on the statement of earnings.

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## Chapter 1 - Financial Statements and Decision Making

### 264. “You Decide” Essay

You are the chairman of the board of directors of NuWave Technology. You are in Vegas attending the company’s annual meeting and it is now time for the question and answer session with shareholders. The very first question you take is this: “I own shares in a dozen companies. Every one of them pays me dividends except NuWave. Why is that?” How do you respond?

**ANSWER:** First, point out that retained earnings is an important source of financing for NuWave. Then explain that you believe that it is in the shareholders’ best interest to reinvest the company’s earnings into the many profitable growth opportunities available rather than pay dividends. Remind the shareholder that the reinvestment of the earnings hopefully will result in higher share prices and increased wealth for shareholders in the future as the company profits from its growth.

### 265. “You Decide” Essay

A friend of yours is seeking advice on which shares to buy. Right now, she is looking for shares that pay cash dividends on a regular basis. She has obtained six years’ worth of financial statements for the two shares under consideration. Describe at least one item on each financial statement that she should study to determine which shares are more likely to pay future cash dividends.

**ANSWER:** Statement of earnings: trend of profitable operations  
Retained earnings statement: payment of cash dividends in the past  
Statement of financial position: existence of sufficient cash from which to pay dividends  
Cash flow statement: trend of positive cash flows from operations