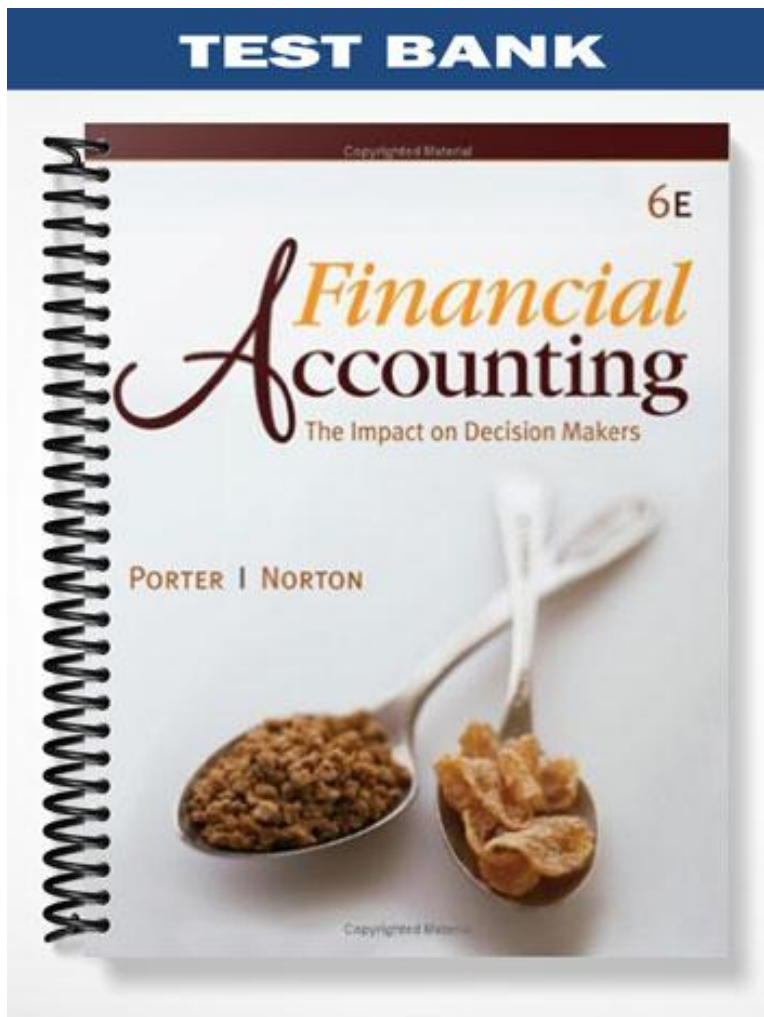


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*Financial*  
**Accounting**  
The Impact on Decision Makers

PORTER | NORTON

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# Chapter 2: Financial Statements and the Annual Report

Student: \_\_\_\_\_

1. What is the primary objective of financial reporting?
  - A. To help investors make credit decisions.
  - B. To help management assess cash flows.
  - C. To protect users from fraudulent financial information.
  - D. To provide useful information for decision making
  
2. “Claims to economic resources” are known as
  - A. Assets and liabilities
  - B. Liabilities and stockholders’ equity
  - C. Owners’ equity and stockholders’ equity
  - D. Retained earnings and revenues
  
3. Which of the following is **not** an objective of financial reporting?
  - A. To reflect prospective cash receipts to investors and creditors.
  - B. To reflect prospective cash flows to an enterprise.
  - C. To reflect resources and claim to resources.
  - D. To reflect current stock prices and information concerning stock markets.
  
4. Which of the following statements is **true** concerning external users of financial information?
  - A. External users need detailed records of the business to make informed decisions.
  - B. External users are primarily responsible for the preparation of financial statements.
  - C. External users rely on the financial statements to help make informed decisions.
  - D. External users rely on management to tell them whether the company is a good investment
  
5. Relevant information can be quantitative or qualitative. In deciding whether to go to college part-time or full-time, which of the following is a qualitative factor for a student?
  - A. The cost of tuition
  - B. The opportunity to make friends
  - C. The price of football tickets
  - D. “Good Student” discounts on auto insurance rates.

6. The preparation of financial statements requires that the information be understandable

- A. Only to CPAs.
- B. To those willing to spend the time to understand it.
- C. Only to those who take an accounting course.
- D. Only to financial analysts and brokers.

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

- A. Relevant
- B. Consistent
- C. Predictable
- D. Comparable

8. If an investor can use accounting information for two different companies to evaluate the types and amounts of expenses, the information is said to have the quality of

- A. Comparability
- B. Consistency
- C. Neutrality
- D. Understandability

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

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

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

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

11. Information that is material means that an error or alternative method of handling a transaction

- A. Would possibly affect the judgment of someone relying on the financial statements
- B. Would not affect the decisions of users
- C. Might cause a company to understate its earnings for the accounting period
- D. Could increase the profitability of a company

12. An accountant is uncertain about the best estimate of an amount for a business transaction. If two amounts are about equally likely, the amount least likely to overstate assets and income is selected. Which of the following qualities is characterized by this action?

- A. Comparability
- B. Conservatism
- C. Materiality
- D. Neutrality

13. The qualitative characteristics of accounting data include

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

14. To determine the source of a company's assets, on which financial statement will you look?

- A. Balance Sheet only
- B. Income Statement only
- C. Both the Balance Sheet and the Income Statement
- D. Both the Income Statement and the Statement of Retained Earnings

### 15. Bailey Company

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

Cash	\$ 50,000	Accounts Receivable	\$ 40,000
Inventory	\$ 60,000	Land	\$ 75,000
Accounts Payable	\$ 45,000	Notes Payable (due 2020)	\$150,000
Retained Earnings	???		

Refer to Bailey Company. Calculate Current Assets.

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

## 16. Bailey Company

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

Cash	\$ 50,000	Accounts Receivable	\$ 40,000
Inventory	\$ 60,000	Land	\$ 75,000
Accounts Payable	\$ 45,000	Notes Payable (due 2020)	\$150,000
Retained Earnings	???		

Refer to Bailey Company. Calculate Current Liabilities

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

17. Which one of the following items is reported as a current asset on a classified balance sheet?

- A. Inventory
- B. Accounts Payable
- C. Land
- D. Common Stock

18.

<b>Jones Com pany</b>				
	Cash	\$ 50,000	Inventory	\$ 45,000
	Land	\$ 75,000	Accumulated Depreciation	\$ 40,000
	Plant & Equipment	\$150,000	Accounts Payable	\$ 60,000

Refer to Jones Company. Calculate Current Assets.

- A. \$220,000
- B. \$155,000
- C. \$130,000
- D. \$ 95,000

19. Which of the following accounts are normally reported as current liabilities on a classified balance sheet?

- A. Accounts Payable and Bonds Payable
- B. Interest Payable and Mortgage Payable
- C. Income Taxes Payable and Salaries Payable
- D. Capital Stock and Accounts payable

20. Which one of the following is **not** a major category for long-term assets?

- A. Intangibles
- B. Property, Plant, and Equipment
- C. Receivables
- D. Goodwill

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

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

22. Which of the following statements is **true** concerning intangible assets?

- A. Intangible assets have no economic substance.
- B. Intangible assets lack physical existence.
- C. Intangible assets are listed in the stockholders' equity section of the Balance Sheet.
- D. Intangible assets appear in the current assets section of the Balance Sheet.

23. How are assets which are expected to be realized in cash, sold, or consumed within the normal operating cycle of a business or within one year (if the operating cycle is shorter than one year) reported on a classified balance sheet?

- A. Property, Plant, and Equipment
- B. Current Assets
- C. Intangible Assets
- D. Current Liabilities

24. Which of the following terms characterizes the time period between the investment of cash in merchandise and the collection of cash from the sale of that merchandise?

- A. Operating cycle
- B. Natural business year
- C. Accounting period
- D. Fiscal period

25. Which set of items below are current assets?

- A. Accounts Receivable, Net Income, Inventory, and Dividends
- B. Cash, Accounts Receivable, Capital Stock, and Sales
- C. Net Income, Cash, Office Supplies, and Inventory
- D. Cash, Accounts Receivable, Inventory, and Office Supplies

26. One significant difference between a classified and a non-classified balance sheet is the distinction between which of the following items?

- A. Assets and Liabilities
- B. Current and Noncurrent items
- C. Liabilities and Owners' Equity
- D. Resources invested by the owners and amounts borrowed from creditors

27. For several years, Bozeman Corporation has had a current ratio that was consistent with other companies in its industry. For the most recent year, Bozeman's current ratio was significantly higher than that for the industry. What is the **best** possible explanation for this situation?

- A. The other companies in the industry were not as profitable.
- B. Bozeman's liquidity has improved
- C. Bozeman has less property, plant and equipment than other companies.
- D. Bozeman has too much debt.

### 28. Curbo Brothers

Curbo Brothers, Inc. a retailer of men's clothing, earned a net profit of \$77,000 for 2010. The balance sheet for Curbo Brothers includes the following items:

Cash	\$ 29,000	Accounts Receivable	\$ 39,000
Inventory	\$ 79,000	Prepaid Insurance	\$ 3,000
Land	\$ 90,000	Accounts Payable	\$ 21,000
Taxes Payable	\$ 29,000	Capital Stock	\$ 50,000
Retained Earnings	\$ 97,000	Long-term Notes Payable	\$ 43,000

Refer to Curbo Brothers. Calculate the total amount of current assets for Curbo Brothers.

- A. \$ 100,000
- B. \$ 147,000
- C. \$ 150,000
- D. \$ 249,000

### 29. Curbo Brothers

Curbo Brothers, Inc. a retailer of men's clothing, earned a net profit of \$77,000 for 2010. The balance sheet for Curbo Brothers includes the following items:

Cash	\$ 29,000	Accounts Receivable	\$ 39,000
Inventory	\$ 79,000	Prepaid Insurance	\$ 3,000
Land	\$ 90,000	Accounts Payable	\$ 21,000
Taxes Payable	\$ 29,000	Capital Stock	\$ 50,000
Retained Earnings	\$ 97,000	Long-term Notes Payable	\$ 43,000

Refer to Curbo Brothers. Calculate the current ratio for Curbo Brothers.

- A. 2.58 to 1
- B. 2.75 to 1
- C. 3.00 to 1
- D. 2.00 to 1

### 30. Curbo Brothers

Curbo Brothers, Inc. a retailer of men's clothing, earned a net profit of \$77,000 for 2010. The balance sheet for Curbo Brothers includes the following items:

Cash	\$ 29,000	Accounts Receivable	\$ 39,000
Inventory	\$ 79,000	Prepaid Insurance	\$ 3,000
Land	\$ 90,000	Accounts Payable	\$ 21,000
Taxes Payable	\$ 29,000	Capital Stock	\$ 50,000
Retained Earnings	\$ 97,000	Long-term Notes Payable	\$ 43,000

Refer to Curbo Brothers. The average current ratio for stores such as Curbo Brothers is 2.4 to 1. What does this comparison tell you about Curbo Brothers' liquidity?

- A. It is more liquid than its competitors
- B. It has more long-term assets than its competitors
- C. Since a rule of thumb for current ratios is 2 to 1, neither Curbo Brothers nor its competitors is liquid.
- D. Curbo Brothers is more profitable than its competitors.

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

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

32. What is the correct method for calculating working capital?

- A. Total Assets minus Total Liabilities
- B. Current Assets minus Total Liabilities
- C. Current Assets minus Current Liabilities
- D. Current Assets plus Current Liabilities



33. Ring Company has current assets of \$20,000, current liabilities of \$8,000, and long-term liabilities of \$3,000. Ring wants to buy new equipment. How much of its existing cash can Ring use to acquire equipment without allowing its current ratio to decline below 2.0 to 1?
- A. \$ 4,000
  - B. \$ 8,000
  - C. \$ 10,000
  - D. \$ 12,000

34. Craig Corp. increased its dollar amount of working capital over the past several years. To further evaluate the company's short-run liquidity, which one of the following measures should be used?
- A. The current ratio
  - B. An analysis of the company's long-term debt
  - C. An analysis of the return on stockholders' equity
  - D. An analysis of retained earnings

35. Which financial statement reports information helpful in assessing working capital?
- A. Income Statement
  - B. Balance Sheet
  - C. Statement of Retained Earnings
  - D. Statement of Cash Flows

36.

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Cash	\$ 30,000	Accumulated Depreciation	\$ 12,000
Merchandise Inventory	\$ 21,000	Notes Payable-Due 12/31/2020	\$120,000
Land	\$ 40,000	Accounts Payable	\$ 14,000
Buildings	\$ 80,000	Equipment	\$ 33,000
Accounts Receivable	\$ 25,000	Notes Payable-Due 07/01/2011	\$ 24,000

Refer to Shasta Corporation's list of accounts at December 31, 2010. What is Shasta Corp.'s current ratio?

- A. 0.48 to 1
- B. 2.00 to 1
- C. 2.55 to 1
- D. 2.86 to 1

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

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

38. For which of the following is the current ratio is most useful?

- A. In evaluating a company's liquidity.
- B. In evaluating a company's solvency.
- C. In evaluating a company's profitability.
- D. In evaluating a company's probability.

39. Which of the following events will cause a company's current ratio to decrease?

- A. The sale of inventory for cash.
- B. The sale of inventory for credit (accounts receivable).
- C. Paying off accounts payable with cash.
- D. Paying off long-term debt with cash.

40. Which of the following events will cause a company's current ratio to increase?

- A. The collection of an account receivable.
- B. Selling land at a loss.
- C. The discharge of an account payable by signing a short-term note payable.
- D. Paying off a long-term loan.

41. Liquidity relates to a company's ability to do which of the following?

- A. The ability to pay its financial obligations as they become due.
- B. The ability to stay in business over the long run.
- C. The ability to pay dividends to its stockholders.
- D. The ability to collect the amount their customers owe the company.

42. Which of the following would **not** appear on an income statement?

- A. Sales Revenue
- B. Cost of Goods Sold
- C. Accounts Receivable
- D. Insurance Expense

43. Which statement is **true** concerning an income statement?

- A. The Income Statement shows how much profit the company has earned since it began operations.
- B. Net Income on the Income Statement should be equal to the amount of cash on the Balance Sheet.
- C. The Income Statement summarizes the results of operations for a period of time.
- D. The Income Statement indicates the liquidity of the company on an annual basis.

44. Which statement is **true** concerning gains and losses?

- A. Gains and losses are reported on the Balance Sheet in the asset and liability sections, respectively.
- B. Gains and losses are special types of revenues and expenses that are reported on the Income Statement.
- C. The amounts of gains and losses are included in the calculations of the gross profit ratio.
- D. Gains and losses are reported only on a multi-step income statement.

45. A question asked by stockholders is, "How much profit did the company make?" What should the stockholder examine to get the most information that will help evaluate the answer to this question?

- A. The Balance Sheet because retained earnings represents current profits.
- B. The Statement of Cash Flows as cash inflows and outflows represents current profits.
- C. The Income Statement since it shows the revenues and expenses for the period.
- D. The economic resources of the company.

46. Under current accounting principles, how is net income on the income statement measured?

- A. Net change in owners' equity during the period.
- B. Excess of revenues over expenses during the period.
- C. Net change in the cash balance during the period.
- D. Excess of revenues over expenses less any dividends paid during the period.

47. Which of the following statements is **true** regarding the multiple-step income statement?

- A. The multiple-step income statement is used only by companies that sell products, not those that provide services.
- B. The multiple-step income statement is helpful in determining a company's working capital
- C. The multiple-step income statement reports the same net income as the single-step income statement.
- D. The multiple-step income statement is required under generally accepted accounting principles.

48. How is income from operations determined?
- A. By subtracting the cost of goods sold from sales.
  - B. By subtracting the total operating expenses from sales
  - C. By subtracting the total operating expenses from gross profit.
  - D. By subtracting selling expenses from operating revenues.

49.

	1)	Other revenue and expenses	5)	Net Income
	2)	Income before taxes	6)	Operating revenues
	3)	Income taxes	7)	Income from operations
	4)	Operating expenses		

The list above contains several items that appear on an income statement. Select the choice that lists the items in the order they would appear on a multi-step income statement

- A. 6, 1, 7, 4, 2, 3, 5
- B. 7, 6, 1, 4, 2, 3, 5
- C. 6, 4, 7, 1, 2, 3, 5
- D. 6, 7, 4, 1, 2, 3, 5

### 50. Lambert Company

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

General and Administrative Expenses	\$2,200	Operating Revenues	\$6,000
Selling Expenses	\$1,800	Income Taxes	\$ 600
Other Revenues (Expenses)	\$ 800	Dividends Paid	\$1,200

Refer to the Lambert Company. What is Lambert Company's income from operations?

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

### 51. Lambert Company

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

General and Administrative Expenses	\$2,200	Operating Revenues	\$6,000
Selling Expenses	\$1,800	Income Taxes	\$ 600
Other Revenues (Expenses)	\$ 800	Dividends Paid	\$1,200

Refer to Lambert Company. What is Lambert Company's Net Income?

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

## 52. Lambert Company

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

General and Administrative Expenses	\$2,200	Operating Revenues	\$6,000
Selling Expenses	\$1,800	Income Taxes	\$ 600
Other Revenues (Expenses)	\$ 800	Dividends Paid	\$1,200

Refer to Lambert Company. By what amount will net income on a single-step income statement differ from net income on a multi-step income statement if Randolph Company prepares both formats?

- A. \$ 800
- B. \$ 600
- C. \$ 200
- D. \$ -0-

53. Denton Stores, Inc. is concerned about its profitability for the current year, since its earnings have dropped 10% since last year. Which of the following is the **least** useful comparison in evaluating the drop in Denton Store's profit margin?

- A. Comparison with the industry average for the current year.
- B. Comparison with its current ratio for the current year
- C. Comparison with the profit margins for its major competitors for the current year.
- D. Comparison with its profit margins for the past five years.

54. Assume that you want to determine the profit margin for a company. Which one of the following financial statements is the **best** source of this information?

- A. Statement of Retained Earnings
- B. Statement of Cash Flows
- C. Statement of Stockholders' Equity
- D. Income Statement

## 55. Tippecanoe, Inc.

	<u>2010</u>	<u>2009</u>
Operating revenues	\$1,900,000	\$1,600,000
Operating expenses	1,400,000	1,100,000
Income taxes	200,000	200,000

Refer to Tippecanoe Inc. Which statement best represents Tippecanoe's performance?

- A. Tippecanoe's profit margin ratio decreased.
- B. Tippecanoe has become more profitable.
- C. Tippecanoe's increase in operating revenues increased the company's net income.
- D. Tippecanoe's operating expenses as a percentage of operating revenues remained the same.

**56. Tippecanoe, Inc.**

	<u>2010</u>	<u>2009</u>
Operating revenues	\$1,900,000	\$1,600,000
Operating expenses	1,400,000	1,100,000
Income taxes	200,000	200,000

Refer to Tippecanoe Inc. and answer this question regarding its profit margin.

- A. The profit margin was 15.7% in 2010.
- B. The profit margin was 15.7% in 2009.
- C. The profit margin was 31.5% in 2010.
- D. The profit margin was 31.5% in 2009.

**57. Tippecanoe, Inc.**

	<u>2010</u>	<u>2009</u>
Operating revenues	\$1,900,000	\$1,600,000
Operating expenses	1,400,000	1,100,000
Income taxes	200,000	200,000

Refer to Tippecanoe Inc. Which ratio are you able to calculate given only the information provided by Tippecanoe?

- A. Profit Margin
- B. Current Ratio
- C. Working Capital
- D. Gross Profit Percentage

58. Donnet, Inc. earned \$600,000 profit during 2010. On which financial statement(s) will you find the dollar amount of the profit earned by the company?

- A. Balance Sheet and Income Statement
- B. Income Statement only
- C. Statement of Retained Earnings only
- D. Income Statement and Statement of Retained Earnings

59. Which one of the following equations represents retained earnings activity?

- A. Beginning balance + net income + dividends = profits for the year
- B. Beginning balance + cash inflows - cash outflows = ending balance
- C. Beginning balance + dividends - net income = ending balance
- D. Beginning balance + net income - dividends = ending balance

**60. Home Solutions, Inc.**

Home Solutions began operations on January 2, 2010, with an investment of \$50,000 by each of its two stockholders. Net income for its first year of business was \$240,000. Home Solutions paid a total of \$100,000 in dividends to its stockholders during the year.

Refer to Home Solutions, Inc. and calculate its Retained Earnings balance at December 31, 2010.

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

**61. Home Solutions, Inc.**

Home Solutions began operations on January 2, 2010, with an investment of \$50,000 by each of its two stockholders. Net income for its first year of business was \$240,000. Home Solutions paid a total of \$100,000 in dividends to its stockholders during the year.

Refer to the Home Solutions. The dividends for the year

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

**62. Home Solutions, Inc.**

Home Solutions began operations on January 2, 2010, with an investment of \$50,000 by each of its two stockholders. Net income for its first year of business was \$240,000. Home Solutions paid a total of \$100,000 in dividends to its stockholders during the year.

Refer to the Home Solutions. If Home Solutions' revenues were \$500,000 for the year ended December 31, 2010, how much were total expenses?

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

63. A company is not required to prepare **both** a(n)

- A. Income Statement and Statement of Stockholders' Equity
- B. Income Statement and Statement of Retained Earnings
- C. Statement of Stockholders' Equity and Statement of Retained Earnings
- D. Statement of Cash Flows and Statement of Retained Earnings

64. Charmane's Cookies borrowed \$500,000 from the First National Bank. Charmane then hired a contractor to build a new cookie distribution outlet. In which section of Charmane's statement of cash flows would you find information that indicated that Charmane acquired the new cookie distribution outlet?

- A. Operating Activities
- B. Investing Activities
- C. Financing Activities
- D. Profit Activities

65. A bank loaned \$62 million to Allison Corporation to finance the construction of a new distribution warehouse. In which section of Allison's Statement of Cash Flows would you be able to determine whether the company repaid any portion of the debt during the year?

- A. Operating Activities
- B. Investing Activities
- C. Financing Activities
- D. Profit Activities

66. Which of the following categories on a statement of cash flows is used to report the cash flow effects of transactions involving the company's stock?

- A. Operating Activities
- B. Investing Activities
- C. Financing Activities
- D. Profit Activities

67. Which one of the following categories on a statement of cash flows is used to report the cash flow effects of buying and selling property, plant and equipment?

- A. Operating Activities
- B. Investing Activities
- C. Financing Activities
- D. Profit Activities



68. Which one of the following is considered a financing activity?

- A. The payment of interest on a note payable to the bank.
- B. Selling products to customers
- C. Paying wages to employees
- D. The payment of a cash dividend.

69. Which one of the following statements is **true**?

- A. The two primary sources of financing available to corporations are borrowed funds and funds invested by owners
- B. Financing activities involve the acquisition of property, plant and equipment.
- C. Borrowed funds are a more permanent source of financing than funds invested by owners
- D. Investing activities involve the selling of products or services and the incurring of expenses related to selling these products and services

### 70. Northern Shoes

Northern Shoes reported the following items on its Statement of Cash Flows for the current year:

Net cash inflows from operating activities	\$ 70,000
Net cash outflows from investing activities	( 20,000)
Net cash outflows from financing activities	( 40,000)
Cash balance at the beginning of the year	\$ 30,000

Refer to Northern Shoes. What was the amount of their net increase or decrease in the cash balance for the current year?

- A. \$ 10,000 increase
- B. \$ 30,000 increase
- C. \$ 40,000 increase
- D. \$ 70,000 increase

### 71. Northern Shoes

Northern Shoes reported the following items on its Statement of Cash Flows for the current year:

Net cash inflows from operating activities	\$ 70,000
Net cash outflows from investing activities	( 20,000)
Net cash outflows from financing activities	( 40,000)
Cash balance at the beginning of the year	\$ 30,000

Refer to Northern Shoes. What was their cash balance at the end of the current year?

- A. \$ 10,000
- B. \$ 30,000
- C. \$ 40,000
- D. \$ 70,000

72. Which financial statement reports the sources and uses of an entity's cash resources?

- A. Income Statement
- B. Statement of Retained Earnings
- C. Balance Sheet
- D. Statement of Cash Flows

73. During its fifth year of operations, Rostone Company reports a beginning cash balance of \$132,000, cash inflows from investing activities of \$210,000, cash outflows for financing activities of \$79,000, and cash outflows for operating activities of \$13,000. What was Rostone's cash balance at the end of the fifth year

- A. \$ 250,000
- B. \$ 434,000
- C. \$ 276,000
- D. \$ 132,000

74. Which of the following best describes a company's financing activities?

- A. Financing activities focus on the sale of products and services.
- B. Financing activities include selling products.
- C. Financing activities enable a company to acquire assets needed to run a business.
- D. Financing activities are represented by the revenues and expenses on the income statement.

75. Which of the following best describes a company's operating activities?

- A. Operating activities focus on the sale of products and services.
- B. Operating activities are necessary to provide the money to start a business.
- C. Operating activities are needed to provide the valuable assets required to run a business.
- D. Operating activities represent the right to receive a benefit in the future

76. Which one of the following is an investing activity of a business?

- A. Paying for purchases of inventory
- B. Issuing stock for cash
- C. Borrowing money from a bank.
- D. Purchasing a manufacturing plant for cash

77. Which one of the following is an financing activity of a business?

- A. Paying for purchases of inventory
- B. Issuing stock for cash
- C. Paying salaries
- D. Purchasing a manufacturing plant

78. Which one of the following is an operating activity of a business?

- A. Paying for purchases of inventory
- B. Issuing stock for cash
- C. Borrowing money from a bank
- D. Purchasing a manufacturing plant.

79. Which of the following represents the correct sequence of the three business activities on the Statement of Cash Flows?

- A. Financing - Operating - Investing
- B. Investing - Operating - Financing
- C. Operating - Investing - Financing
- D. Financing - Investing - Operating

80. As used in accounting, the “Notes to the Financial Statements” should be:

- A. Listed with the liabilities on the Balance Sheet
- B. Omitted at the option of the company
- C. Included as an integral part of the financial statements
- D. Reported as expenses on the Income Statement

81. Which of the following items will be found in a corporate annual report?

- A. Company Budgets
- B. Notes to the Financial Statements
- C. Selected financial data from competitor companies
- D. Managements statement that the auditors are responsible for the financial statements.

82. Which one of the following items is **least** likely to be found in a corporate annual report?

- A. Notes to the Financial Statements
- B. Forecasts of Cash Flows and Earnings
- C. Report of the Independent Accountants
- D. Management’s Discussion and Analysis

83. A discussion of the financial statements with explanations of certain amounts in the statements is **most** likely found in which of the following sections of a corporate annual report?

- A. Report of the Independent Accountants
- B. Notes to the Financial Statements
- C. Management’s Discussion and Analysis
- D. Balance Sheet

84. An investor found the following in an annual report: "The financial statements, in our opinion, present fairly the financial position, operating results, and cash flows, in conformity with accounting principles generally accepted in the United States." In which section of the annual report did the investor find this?

- A. Balance Sheet
- B. Notes to the Financial Statements
- C. Management's Discussion and Analysis
- D. Report of the Independent Accountants

85. Which of the following represents one of the purposes of the notes to financial statements?

- A. To provide a place for management to justify questionable items in the statements.
- B. To provide comparative ratios for the company's financial data
- C. To provide the CPA's opinion of the fairness of the financial statements.
- D. To satisfy the need for full disclosure of all the facts relevant to a company's results and financial position

86. Accountants are the main reason financial statements are prepared.  
True False

87. The Financial Accounting Standards Board created the objectives of financial reporting.  
True False

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

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

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

91. Materiality deals with the size of an error in accounting information.  
True False

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

True False

93. Current assets, other than cash, will be converted into cash or assigned to expenses within a company's operating cycle.

True False

94. Obligations related to operating activities that will be paid within the company's operating cycle must be reported as current liabilities on a classified income statement.

True False

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

True False

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

True False

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

True False

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

True False

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

True False

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

True False

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

True False

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

True False

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

True False

104. Dividends paid reduce a company's retained earnings balance.

True False

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

True False

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

True False

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

True False

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

True False

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

True False

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

True False

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

True False

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

True False

113. *Select the term from the list below which best describes each statement.*

Understandability  
Comparability  
Materiality

Relevance  
Consistency  
Conservatism

Reliability  
Operating Cycle  
Liquidity

\_\_\_\_\_ is the magnitude of an omission or misstatement in accounting information that will affect the judgment of someone relying on the information

114. *Select the term from the list below which best describes each statement.*

Understandability  
Comparability  
Materiality

Relevance  
Consistency  
Conservatism

Reliability  
Operating Cycle  
Liquidity

\_\_\_\_\_ is the capacity of information to make a difference in a decision

115. *Select the term from the list below which best describes each statement.*

Understandability  
Comparability  
Materiality

Relevance  
Consistency  
Conservatism

Reliability  
Operating Cycle  
Liquidity

\_\_\_\_\_ is the practice of using the least optimistic estimate when two estimates of amounts are about equally likely

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116. *Select the term from the list below which best describes each statement.*

Understandability  
Comparability  
Materiality

Relevance  
Consistency  
Conservatism

Reliability  
Operating Cycle  
Liquidity

\_\_\_\_\_ is the quality of accounting information that makes it comprehensible to those willing to spend the necessary time

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117. *Select the term from the list below which best describes each statement.*

Understandability  
Comparability  
Materiality

Relevance  
Consistency  
Conservatism

Reliability  
Operating Cycle  
Liquidity

\_\_\_\_\_ is the quality of accounting information that makes it dependable in representing the events that it purports to represent

---

118. *Select the term from the list below which best describes each statement.*

Understandability  
Comparability  
Materiality

Relevance  
Consistency  
Conservatism

Reliability  
Operating Cycle  
Liquidity

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

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119. *Select the term from the list below which best describes each statement.*

Understandability  
Comparability  
Materiality

Relevance  
Consistency  
Conservatism

Reliability  
Operating Cycle  
Liquidity



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

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120. \_\_\_\_\_ have claims to an entity's economic resources

---

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

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122. Property, plant and equipment is classified as \_\_\_\_\_ assets on the balance sheet.

---

123. \_\_\_\_\_ is the process of writing off the cost of tangible assets and \_\_\_\_\_ is the process of writing off the cost of intangible assets.

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

---

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

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

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127. On the Statement of Cash Flows, the \_\_\_\_\_ section involves the acquisition and sale of long-term assets.

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128. On the Statement of Cash Flows, the \_\_\_\_\_ section involves the purchase and sale of products and services.

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129. On the Statement of Cash Flows, the \_\_\_\_\_ section involves the issuance and repayment of long term liabilities and stock transactions.

---

### 130. Mardis Company

The following information is taken from Mardis Company's Balance Sheet at December 31, 2010:

Cash	\$ 24,000
Retained Earnings	14,000
Inventory	8,000
Equipment	38,000
Accounts Payable	7,000
Bonds Payable	23,000
Capital Stock	26,000

Using the information provided for Mardis Company, answer the following questions:

- A) How much did debt investors provide to Mardis Company?
- B) On which financial statement would an investor look to see if any stock was issued during the year?

### 131. David Corp.

Listed below are several accounts from the financial records of David Corporation at December 31, 2010:

Retained Earnings	\$ 37,000	Notes Payable - Due July 1, 2011	\$ 12,000
Accumulated Depreciation	\$ 13,000	Interest Payable	\$ 1,000
Income Taxes Payable	\$ 24,000	Office Supplies	\$ 2,000
Buildings	\$ 48,000	Accounts Payable	\$ 36,000
Cash	\$ 11,000	Inventory	\$ 33,000
Accounts Receivable	\$ 35,000	Land	\$ 50,000
Capital Stock	\$ 60,000	Prepaid Rent	\$ 4,000

Refer to David Corp. Prepare the current assets section of the Balance Sheet for David Corp. at December 31, 2010. You may omit the heading. How does the concept of liquidity apply?

### 132. David Corp.

Listed below are several accounts from the financial records of David Corporation at December 31, 2010:

Retained Earnings	\$ 37,000	Notes Payable - Due July 1, 2011	\$ 12,000
Accumulated Depreciation	\$ 13,000	Interest Payable	\$ 1,000
Income Taxes Payable	\$ 24,000	Office Supplies	\$ 2,000
Buildings	\$ 48,000	Accounts Payable	\$ 36,000
Cash	\$ 11,000	Inventory	\$ 33,000
Accounts Receivable	\$ 35,000	Land	\$ 50,000
Capital Stock	\$ 60,000	Prepaid Rent	\$ 4,000

Refer to David Corp. Prepare the current liabilities section of the balance sheet for David Corp. at December 31, 2010. You may omit the heading. If the amount of current liabilities were larger, what effect would this have on the current ratio?

### 133. David Corp.

Listed below are several accounts from the financial records of David Corporation at December 31, 2010:

Retained Earnings	\$ 37,000	Notes Payable - Due July 1, 2011	\$ 12,000
Accumulated Depreciation	\$ 13,000	Interest Payable	\$ 1,000
Income Taxes Payable	\$ 24,000	Office Supplies	\$ 2,000
Buildings	\$ 48,000	Accounts Payable	\$ 36,000
Cash	\$ 11,000	Inventory	\$ 33,000
Accounts Receivable	\$ 35,000	Land	\$ 50,000
Capital Stock	\$ 60,000	Prepaid Rent	\$ 4,000

Refer to David Corp. Prepare the long-term asset section of David Corp.'s balance sheet at December 31, 2010. You may omit the heading. Why are these amounts classified as "long-term"?

### 134. David Corp.

Listed below are several accounts from the financial records of David Corporation at December 31, 2010:

Retained Earnings	\$ 37,000	Notes Payable - Due July 1, 2011	\$ 12,000
Accumulated Depreciation	\$ 13,000	Interest Payable	\$ 1,000
Income Taxes Payable	\$ 24,000	Office Supplies	\$ 2,000
Buildings	\$ 48,000	Accounts Payable	\$ 36,000
Cash	\$ 11,000	Inventory	\$ 33,000
Accounts Receivable	\$ 35,000	Land	\$ 50,000
Capital Stock	\$ 60,000	Prepaid Rent	\$ 4,000

Refer to David Corp. Calculate David's current ratio at December 31, 2010. What does this ratio tell you about the "composition" of the current assets?

### 135. David Corp.

Listed below are several accounts from the financial records of David Corporation at December 31, 2010:

Retained Earnings	\$ 37,000	Notes Payable - Due July 1, 2011	\$ 12,000
Accumulated Depreciation	\$ 13,000	Interest Payable	\$ 1,000
Income Taxes Payable	\$ 24,000	Office Supplies	\$ 2,000
Buildings	\$ 48,000	Accounts Payable	\$ 36,000
Cash	\$ 11,000	Inventory	\$ 33,000
Accounts Receivable	\$ 35,000	Land	\$ 50,000
Capital Stock	\$ 60,000	Prepaid Rent	\$ 4,000

Refer to David Corp.. Calculate the amount of working capital at December 31, 2010 for David Corp. What can you learn from the current ratio that you cannot learn from the amount of working capital?

136.

**Fillmore Company**

Fillmore Company calculated the following amounts concerning its financial information for the years ending December 31, 2010 and 2009:

Current Ratio	<u>2010</u>	<u>2009</u>
Profit Margin	3.1 to 1	2.0 to 1
	22 %	18%

Refer to Fillmore Company. Examine Fillmore's ratios. Is the change in the current ratio favorable or not? Explain.

137.

**Fillmore Company**

Fillmore Company calculated the following amounts concerning its financial information for the years ending December 31, 2010 and 2009:

Current Ratio	<u>2010</u>	<u>2009</u>
Profit Margin	3.1 to 1	2.0 to 1
	22 %	18%

Refer to Fillmore Company. Suppose Fillmore Company had a decrease in its cash account from 2009 to 2010. Would the other current asset amounts have increased or decreased? Explain.

### 138. Maryville Corporation

Presented below are the condensed balance sheets of Maryville Corporation at December 31, 2010 and 2009. Net income for the years ending December 31, 2010 and 2009 is \$346,000 and \$109,000.

	<u>Dec</u> <u>December 31, 2009</u>	
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Refer to Maryville Corporation. Did the current ratio increase or decrease from 2009 to 2010? Make any necessary calculations and explain your answer. Which financial statement users are most concerned with this ratio?

### 139. Maryville Corporation

Presented below are the condensed balance sheets of Maryville Corporation at December 31, 2010 and 2009. Net income for the years ending December 31, 2010 and 2009 is \$346,000 and \$109,000.

	<u>Dec</u> <u>December 31, 2009</u>	
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Refer to Maryville Corporation. Explain the change in the amount of working capital from 2009 to 2010. Why do users believe the current ratio provides more information than the dollar amount of working capital? Explain.

## 140. Maryville Corporation

Presented below are the condensed balance sheets of Maryville Corporation at December 31, 2010 and 2009. Net income for the years ending December 31, 2010 and 2009 is \$346,000 and \$109,000.

	<u>Dec</u> <u>December 31, 2009</u>	
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Refer to Maryville Corporation. Maryville Corporation's creditors need to know whether its working capital position improved during the year. How would you evaluate this?

## 141. Maryville Corporation

Presented below are the condensed balance sheets of Maryville Corporation at December 31, 2010 and 2009. Net income for the years ending December 31, 2010 and 2009 is \$346,000 and \$109,000.

	<u>Dec</u> <u>December 31, 2009</u>	
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Refer to Maryville Corporation. The balance sheets show a large increase in Retained Earnings during 2008. Identify the possible reason(s) for this increase.

### 142. Evertrue Corporation

Presented below are all of the items from Evertrue Corporation's income statement for the years ending December 31, 2010 and 2009.

	December 31, 2010	December 31, 2009
Service fees	\$2,300,000	\$2,100,000
General and administrative expenses	1,900,000	1,500,000
Other income, net	40,000	20,000
Income taxes	150,000	180,000

Refer to Evertrue Corporation. How much is net income for the year ended December 31, 2010? If Evertrue Corporation had used a single-step statement, by how much would net income be different? Explain.

### 143. Evertrue Corporation

Presented below are all of the items from Evertrue Corporation's income statement for the years ending December 31, 2010 and 2009.

	December 31, 2010	December 31, 2009
Service fees	\$2,300,000	\$2,100,000
General and administrative expenses	1,900,000	1,500,000
Other income, net	40,000	20,000
Income taxes	150,000	180,000

Refer to Evertrue Corporation. Compare the profit margins for 2010 and 2009. Is the company becoming more or less profitable or staying the same? What could be contributing to this?

**144. Hannah, Inc.**

Hannah, Inc. reported \$52,000 of net income for 2010. Hannah's balance sheet at December 31, 2010 includes the following amounts:

Wages Payable	\$ 1,000	Inventory	\$ 26,000
Prepaid Rent	3,000	Land	40,000
Cash	15,000	Accounts Receivable	22,000
Accounts Payable	25,000	Capital Stock	40,000
Retained Earnings	29,000	Income Taxes Payable	11,000

Refer to Hannah, Inc. Which item is most "liquid"? Why is liquidity important?

**145. Hannah, Inc.**

Hannah, Inc. reported \$52,000 of net income for 2010. Hannah's balance sheet at December 31, 2010 includes the following amounts:

Wages Payable	\$ 1,000	Inventory	\$ 26,000
Prepaid Rent	3,000	Land	40,000
Cash	15,000	Accounts Receivable	22,000
Accounts Payable	25,000	Capital Stock	40,000
Retained Earnings	29,000	Income Taxes Payable	11,000

Refer to Hannah, Inc. Has Hannah, Inc. been profitable since it began operations? How do you know?

146. Gala, Inc. incurred a net loss of \$20,000 for 2010. The balance sheet at December 31, 2010, for Gala, Inc., includes the following items:

Cash	\$23,000
Accounts receivable	13,000
Inventory	45,000
Prepaid insurance	1,000
Land	21,000
Building	80,000
Accounts payable	55,000
Salaries payable	2,000
Capital stock	100,000
Retained earnings	25,000



A) Determine Gala's current ratio and working capital.

B) Beyond the information provided in your answers to "A," what does the composition of Gala's current assets tell you about its liquidity.

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

147. Listed below are several amounts from the accounting records of Brooks, Inc. for the year ended December 31, 2010. Prepare a multiple-step income statement in good form.

Service revenue	\$161,000
Selling expenses	121,000
Income tax expense	3,000
General and administrative expenses	35,000
Interest revenue	5,000

148. Listed below are several amounts from the accounting records of Sotheby Realtors, Inc., for the year ended December 31, 2010. Prepare a single-step income statement in good form.

Salaries expenses	\$ 87,000
Depreciation expense	11,000
Commission fees earned	202,000
Retained earnings	32,000
Rent expense	12,000
Income taxes expense	46,000

149. During 2010, Media One reported \$60,000 of net income and generated \$80,000 of cash from operations. During the year, Media One paid \$15,000 to purchase a new delivery truck and also paid dividends in the amount of \$30,000. Media One borrowed \$40,000 cash from the bank. At the beginning of the year, cash amounted to \$50,000.

- A) Prepare a Statement of Cash Flows for the year ended December 31, 2010.
- B) How much more cash does Media One have available at the end of the year than at the beginning?
- C) Why is there a difference between net income and cash flows from operations?

150. Barton Corporation began operations on January 2, 2008, with a total investment of \$150,000 by its stockholders. Net income for its first year of business was \$90,000. During 2009 and 2010, net income increased to \$188,000 and to \$217,000, respectively. Barton paid \$85,000 in dividends to its shareholders in each of the three years.

- A) In good form, prepare a statement of retained earnings for the year ended December 31, 2009.
- B) How much is total retained earnings on December 31, 2010?
- C) Explain the link between the statement of retained earnings and the balance sheet.

151. Mason Corporation was organized on January 1, 2010, with the investment of \$500,000 in cash by its stockholders. Mason signed a ten-year, \$300,000 promissory note at a local bank during 2010 and received cash in the same amount. The company immediately purchased an office building for \$800,000, paying in cash. During its first year, Mason generated \$35,000 in cash from operations and paid \$30,000 in cash dividends.

A) In good form, prepare a statement of cash flows for the year ended December 31, 2010.

B) What does this statement tell you that an income statement does not?

152. Sprint Company reported revenues of \$165,000 and net income of \$20,000 for 2010. Cash generated by operations was \$40,000. In addition, Sprint Company borrowed \$24,000 from a bank. During 2010, Sprint purchased new equipment for \$30,000 cash and paid cash dividends of \$15,000 to stockholders. Sprint's cash balance at the beginning of 2010 was \$22,000.

A) Identify the amount of cash flows for financing, investing, and operating activities for 2010 by filling in the amounts below.

	Financing Cash Flows:	
	Investing Cash Flows:	
	Operating Cash Flows:	

B) Did Sprint Company's operating activities generate enough cash to cover its investing and financing activities? Explain.

C) How much did Sprint Company's cash balance increase or decrease during 2010?

0?

153. Presented below are items from Super Shoes statement of cash flows for 2010.

Cash flows provided by operating activities	\$75,000
Cash flows provided by financing activities	115,000
Cash at the beginning of the year	60,000
Cash flows used by investing activities	(100,000)

- A) Determine whether Super Shoes' cash increased or decreased during the year.
- B) How much cash does Super Shoes have at the end of 2010?
- C) What is the purpose of the Statement of Cash Flows?

154. Most financial reports contain the following list of basic elements. For each element identify the person(s) who prepared the element and describe the information a user would expect to find in each element. Some information is verifiable, while other information is subjectively chosen by management. Indicate whether the information in each element is verifiable.

Elements	Prepared By	Information Provided	Verifiable/ Yes or No?
Management Discussion & Analysis			
Financial Statements			
Notes to Financial Statements			
Report of Independent Accountants			

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

156. Marshall Dillon, a newly hired accountant, wanted to impress his boss, so he stayed late one night to analyze the office supplies expense account. He determined the cost by month, for the past 12 months, of each of the following: computer paper, copy paper, fax paper, pencils and pens, note pads, postage, corrections supplies, stationery, and miscellaneous items. Why do companies not include information of this nature in published financial statements?

157. Lacey Company claims its financial information is useful. What two qualities must be present in order to have "useful" accounting information? Explain these two qualities.

158. What is the difference between comparability and consistency?

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

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

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

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

163. Potential stockholders and lenders are interested in a company's financial statements. Several financial statement items appear below. Answer the questions that follow.

Accounts receivable  
Cash  
Common stock  
Retained earnings  
Office supplies  
Unearned revenue

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

Advertising expense  
Income taxes  
Dividends  
Service revenue  
Sales

- A) List the two items from above in which stockholders would be most interested. Explain why the two you selected are important to stockholders.
- B) In which one item would lenders be most interested? Explain why this item is important.

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

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



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

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

1. What is the primary objective of financial reporting?
  - A. To help investors make credit decisions.
  - B. To help management assess cash flows.
  - C. To protect users from fraudulent financial information.
  - D.** To provide useful information for decision making
  
2. “Claims to economic resources” are known as
  - A. Assets and liabilities
  - B.** Liabilities and stockholders’ equity
  - C. Owners’ equity and stockholders’ equity
  - D. Retained earnings and revenues
  
3. Which of the following is **not** an objective of financial reporting?
  - A. To reflect prospective cash receipts to investors and creditors.
  - B. To reflect prospective cash flows to an enterprise.
  - C. To reflect resources and claim to resources.
  - D.** To reflect current stock prices and information concerning stock markets.
  
4. Which of the following statements is **true** concerning external users of financial information?
  - A. External users need detailed records of the business to make informed decisions.
  - B. External users are primarily responsible for the preparation of financial statements.
  - C.** External users rely on the financial statements to help make informed decisions.
  - D. External users rely on management to tell them whether the company is a good investment
  
5. Relevant information can be quantitative or qualitative. In deciding whether to go to college part-time or full-time, which of the following is a qualitative factor for a student?
  - A. The cost of tuition
  - B.** The opportunity to make friends
  - C. The price of football tickets
  - D. “Good Student” discounts on auto insurance rates.

6. The preparation of financial statements requires that the information be understandable

- A. Only to CPAs.
- B.** To those willing to spend the time to understand it.
- C. Only to those who take an accounting course.
- D. Only to financial analysts and brokers.

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

- A.** Relevant
- B. Consistent
- C. Predictable
- D. Comparable

8. If an investor can use accounting information for two different companies to evaluate the types and amounts of expenses, the information is said to have the quality of

- A.** Comparability
- B. Consistency
- C. Neutrality
- D. Understandability

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

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

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

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

11. Information that is material means that an error or alternative method of handling a transaction

- A.** Would possibly affect the judgment of someone relying on the financial statements
- B. Would not affect the decisions of users
- C. Might cause a company to understate its earnings for the accounting period
- D. Could increase the profitability of a company

12. An accountant is uncertain about the best estimate of an amount for a business transaction. If two amounts are about equally likely, the amount least likely to overstate assets and income is selected. Which of the following qualities is characterized by this action?

- A. Comparability
- B.** Conservatism
- C. Materiality
- D. Neutrality

13. The qualitative characteristics of accounting data include

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

14. To determine the source of a company's assets, on which financial statement will you look?

- A.** Balance Sheet only
- B. Income Statement only
- C. Both the Balance Sheet and the Income Statement
- D. Both the Income Statement and the Statement of Retained Earnings

### 15. Bailey Company

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

Cash	\$ 50,000	Accounts Receivable	\$ 40,000
Inventory	\$ 60,000	Land	\$ 75,000
Accounts Payable	\$ 45,000	Notes Payable (due 2020)	\$150,000
Retained Earnings	???		

Refer to Bailey Company. Calculate Current Assets.

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

## 16. Bailey Company

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

Cash	\$ 50,000	Accounts Receivable	\$ 40,000
Inventory	\$ 60,000	Land	\$ 75,000
Accounts Payable	\$ 45,000	Notes Payable (due 2020)	\$150,000
Retained Earnings	???		

Refer to Bailey Company. Calculate Current Liabilities

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

17. Which one of the following items is reported as a current asset on a classified balance sheet?

- A.** Inventory
- B. Accounts Payable
- C. Land
- D. Common Stock

18.

<b>Jones Com pany</b>				
	Cash	\$ 50,000	Inventory	\$ 45,000
	Land	\$ 75,000	Accumulated Depreciation	\$ 40,000
	Plant & Equipment	\$150,000	Accounts Payable	\$ 60,000

Refer to Jones Company. Calculate Current Assets.

- A. \$220,000
- B. \$155,000
- C. \$130,000
- D.** \$ 95,000

19. Which of the following accounts are normally reported as current liabilities on a classified balance sheet?

- A. Accounts Payable and Bonds Payable
- B. Interest Payable and Mortgage Payable
- C.** Income Taxes Payable and Salaries Payable
- D. Capital Stock and Accounts payable

20. Which one of the following is **not** a major category for long-term assets?

- A. Intangibles
- B. Property, Plant, and Equipment
- C. Receivables**
- D. Goodwill

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

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

22. Which of the following statements is **true** concerning intangible assets?

- A. Intangible assets have no economic substance.
- B. Intangible assets lack physical existence.**
- C. Intangible assets are listed in the stockholders' equity section of the Balance Sheet.
- D. Intangible assets appear in the current assets section of the Balance Sheet.

23. How are assets which are expected to be realized in cash, sold, or consumed within the normal operating cycle of a business or within one year (if the operating cycle is shorter than one year) reported on a classified balance sheet?

- A. Property, Plant, and Equipment
- B. Current Assets**
- C. Intangible Assets
- D. Current Liabilities

24. Which of the following terms characterizes the time period between the investment of cash in merchandise and the collection of cash from the sale of that merchandise?

- A. Operating cycle**
- B. Natural business year
- C. Accounting period
- D. Fiscal period

25. Which set of items below are current assets?

- A. Accounts Receivable, Net Income, Inventory, and Dividends
- B. Cash, Accounts Receivable, Capital Stock, and Sales
- C. Net Income, Cash, Office Supplies, and Inventory
- D. Cash, Accounts Receivable, Inventory, and Office Supplies**

26. One significant difference between a classified and a non-classified balance sheet is the distinction between which of the following items?

- A. Assets and Liabilities
- B. Current and Noncurrent items**
- C. Liabilities and Owners' Equity
- D. Resources invested by the owners and amounts borrowed from creditors

27. For several years, Bozeman Corporation has had a current ratio that was consistent with other companies in its industry. For the most recent year, Bozeman's current ratio was significantly higher than that for the industry. What is the **best** possible explanation for this situation?

- A. The other companies in the industry were not as profitable.
- B. Bozeman's liquidity has improved**
- C. Bozeman has less property, plant and equipment than other companies.
- D. Bozeman has too much debt.

### 28. Curbo Brothers

Curbo Brothers, Inc. a retailer of men's clothing, earned a net profit of \$77,000 for 2010. The balance sheet for Curbo Brothers includes the following items:

Cash	\$ 29,000	Accounts Receivable	\$ 39,000
Inventory	\$ 79,000	Prepaid Insurance	\$ 3,000
Land	\$ 90,000	Accounts Payable	\$ 21,000
Taxes Payable	\$ 29,000	Capital Stock	\$ 50,000
Retained Earnings	\$ 97,000	Long-term Notes Payable	\$ 43,000

Refer to Curbo Brothers. Calculate the total amount of current assets for Curbo Brothers.

- A. \$ 100,000
- B. \$ 147,000
- C. \$ 150,000**
- D. \$ 249,000

### 29. Curbo Brothers

Curbo Brothers, Inc. a retailer of men's clothing, earned a net profit of \$77,000 for 2010. The balance sheet for Curbo Brothers includes the following items:

Cash	\$ 29,000	Accounts Receivable	\$ 39,000
Inventory	\$ 79,000	Prepaid Insurance	\$ 3,000
Land	\$ 90,000	Accounts Payable	\$ 21,000
Taxes Payable	\$ 29,000	Capital Stock	\$ 50,000
Retained Earnings	\$ 97,000	Long-term Notes Payable	\$ 43,000

Refer to Curbo Brothers. Calculate the current ratio for Curbo Brothers.

- A. 2.58 to 1
- B. 2.75 to 1
- C. 3.00 to 1**
- D. 2.00 to 1

### 30. Curbo Brothers

Curbo Brothers, Inc. a retailer of men's clothing, earned a net profit of \$77,000 for 2010. The balance sheet for Curbo Brothers includes the following items:

Cash	\$ 29,000	Accounts Receivable	\$ 39,000
Inventory	\$ 79,000	Prepaid Insurance	\$ 3,000
Land	\$ 90,000	Accounts Payable	\$ 21,000
Taxes Payable	\$ 29,000	Capital Stock	\$ 50,000
Retained Earnings	\$ 97,000	Long-term Notes Payable	\$ 43,000

Refer to Curbo Brothers. The average current ratio for stores such as Curbo Brothers is 2.4 to 1. What does this comparison tell you about Curbo Brothers' liquidity?

- A. It is more liquid than its competitors**
- B. It has more long-term assets than its competitors
- C. Since a rule of thumb for current ratios is 2 to 1, neither Curbo Brothers nor its competitors is liquid.
- D. Curbo Brothers is more profitable than its competitors.

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

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

32. What is the correct method for calculating working capital?

- A. Total Assets minus Total Liabilities
- B. Current Assets minus Total Liabilities
- C. Current Assets minus Current Liabilities**
- D. Current Assets plus Current Liabilities



33. Ring Company has current assets of \$20,000, current liabilities of \$8,000, and long-term liabilities of \$3,000. Ring wants to buy new equipment. How much of its existing cash can Ring use to acquire equipment without allowing its current ratio to decline below 2.0 to 1?

- A.** \$ 4,000
- B. \$ 8,000
- C. \$ 10,000
- D. \$ 12,000

34. Craig Corp. increased its dollar amount of working capital over the past several years. To further evaluate the company's short-run liquidity, which one of the following measures should be used?

- A.** The current ratio
- B. An analysis of the company's long-term debt
- C. An analysis of the return on stockholders' equity
- D. An analysis of retained earnings

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

- A. Income Statement
- B.** Balance Sheet
- C. Statement of Retained Earnings
- D. Statement of Cash Flows

36.

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Cash	\$ 30,000	Accumulated Depreciation	\$ 12,000
Merchandise Inventory	\$ 21,000	Notes Payable-Due 12/31/2020	\$120,000
Land	\$ 40,000	Accounts Payable	\$ 14,000
Buildings	\$ 80,000	Equipment	\$ 33,000
Accounts Receivable	\$ 25,000	Notes Payable-Due 07/01/2011	\$ 24,000

Refer to Shasta Corporation's list of accounts at December 31, 2010. What is Shasta Corp.'s current ratio?

- A. 0.48 to 1
- B. 2.00 to 1**
- C. 2.55 to 1
- D. 2.86 to 1

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

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

38. For which of the following is the current ratio is most useful?

- A. In evaluating a company's liquidity.**
- B. In evaluating a company's solvency.
- C. In evaluating a company's profitability.
- D. In evaluating a company's probability.

39. Which of the following events will cause a company's current ratio to decrease?

- A. The sale of inventory for cash.
- B. The sale of inventory for credit (accounts receivable).
- C. Paying off accounts payable with cash.
- D. Paying off long-term debt with cash.**

40. Which of the following events will cause a company's current ratio to increase?

- A. The collection of an account receivable.
- B. Selling land at a loss.**
- C. The discharge of an account payable by signing a short-term note payable.
- D. Paying off a long-term loan.

41. Liquidity relates to a company's ability to do which of the following?

- A. The ability to pay its financial obligations as they become due.**
- B. The ability to stay in business over the long run.
- C. The ability to pay dividends to its stockholders.
- D. The ability to collect the amount their customers owe the company.

42. Which of the following would **not** appear on an income statement?

- A. Sales Revenue
- B. Cost of Goods Sold
- C. Accounts Receivable**
- D. Insurance Expense

43. Which statement is **true** concerning an income statement?

- A. The Income Statement shows how much profit the company has earned since it began operations.
- B. Net Income on the Income Statement should be equal to the amount of cash on the Balance Sheet.
- C. The Income Statement summarizes the results of operations for a period of time.**
- D. The Income Statement indicates the liquidity of the company on an annual basis.

44. Which statement is **true** concerning gains and losses?

- A. Gains and losses are reported on the Balance Sheet in the asset and liability sections, respectively.
- B. Gains and losses are special types of revenues and expenses that are reported on the Income Statement.**
- C. The amounts of gains and losses are included in the calculations of the gross profit ratio.
- D. Gains and losses are reported only on a multi-step income statement.

45. A question asked by stockholders is, "How much profit did the company make?" What should the stockholder examine to get the most information that will help evaluate the answer to this question?

- A. The Balance Sheet because retained earnings represents current profits.
- B. The Statement of Cash Flows as cash inflows and outflows represents current profits.
- C. The Income Statement since it shows the revenues and expenses for the period.**
- D. The economic resources of the company.

46. Under current accounting principles, how is net income on the income statement measured?

- A. Net change in owners' equity during the period.
- B. Excess of revenues over expenses during the period.**
- C. Net change in the cash balance during the period.
- D. Excess of revenues over expenses less any dividends paid during the period.

47. Which of the following statements is **true** regarding the multiple-step income statement?

- A. The multiple-step income statement is used only by companies that sell products, not those that provide services.
- B. The multiple-step income statement is helpful in determining a company's working capital
- C. The multiple-step income statement reports the same net income as the single-step income statement.**
- D. The multiple-step income statement is required under generally accepted accounting principles.

48. How is income from operations determined?
- A. By subtracting the cost of goods sold from sales.
  - B. By subtracting the total operating expenses from sales
  - C.** By subtracting the total operating expenses from gross profit.
  - D. By subtracting selling expenses from operating revenues.

49.

1)	Other revenue and expenses	5)	Net Income
2)	Income before taxes	6)	Operating revenues
3)	Income taxes	7)	Income from operations
4)	Operating expenses		

The list above contains several items that appear on an income statement. Select the choice that lists the items in the order they would appear on a multi-step income statement

- A. 6, 1, 7, 4, 2, 3, 5
- B. 7, 6, 1, 4, 2, 3, 5
- C.** 6, 4, 7, 1, 2, 3, 5
- D. 6, 7, 4, 1, 2, 3, 5

### 50. Lambert Company

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

General and Administrative Expenses	\$2,200	Operating Revenues	\$6,000
Selling Expenses	\$1,800	Income Taxes	\$ 600
Other Revenues (Expenses)	\$ 800	Dividends Paid	\$1,200

Refer to the Lambert Company. What is Lambert Company's income from operations?

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

### 51. Lambert Company

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

General and Administrative Expenses	\$2,200	Operating Revenues	\$6,000
Selling Expenses	\$1,800	Income Taxes	\$ 600
Other Revenues (Expenses)	\$ 800	Dividends Paid	\$1,200

Refer to Lambert Company. What is Lambert Company's Net Income?

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

## 52. Lambert Company

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

General and Administrative Expenses	\$2,200	Operating Revenues	\$6,000
Selling Expenses	\$1,800	Income Taxes	\$ 600
Other Revenues (Expenses)	\$ 800	Dividends Paid	\$1,200

Refer to Lambert Company. By what amount will net income on a single-step income statement differ from net income on a multi-step income statement if Randolph Company prepares both formats?

- A. \$ 800
- B. \$ 600
- C. \$ 200
- D. \$ -0-**

53. Denton Stores, Inc. is concerned about its profitability for the current year, since its earnings have dropped 10% since last year. Which of the following is the **least** useful comparison in evaluating the drop in Denton Store's profit margin?

- A. Comparison with the industry average for the current year.
- B. Comparison with its current ratio for the current year**
- C. Comparison with the profit margins for its major competitors for the current year.
- D. Comparison with its profit margins for the past five years.

54. Assume that you want to determine the profit margin for a company. Which one of the following financial statements is the **best** source of this information?

- A. Statement of Retained Earnings
- B. Statement of Cash Flows
- C. Statement of Stockholders' Equity
- D. Income Statement**

## 55. Tippecanoe, Inc.

	<u>2010</u>	<u>2009</u>
Operating revenues	\$1,900,000	\$1,600,000
Operating expenses	1,400,000	1,100,000
Income taxes	200,000	200,000

Refer to Tippecanoe Inc. Which statement best represents Tippecanoe's performance?

- A.** Tippecanoe's profit margin ratio decreased.
- B. Tippecanoe has become more profitable.
- C. Tippecanoe's increase in operating revenues increased the company's net income.
- D. Tippecanoe's operating expenses as a percentage of operating revenues remained the same.

**56. Tippecanoe, Inc.**

	<u>2010</u>	<u>2009</u>
Operating revenues	\$1,900,000	\$1,600,000
Operating expenses	1,400,000	1,100,000
Income taxes	200,000	200,000

Refer to Tippecanoe Inc. and answer this question regarding its profit margin.

- A. The profit margin was 15.7% in 2010.
- B.** The profit margin was 15.7% in 2009.
- C. The profit margin was 31.5% in 2010.
- D. The profit margin was 31.5% in 2009.

**57. Tippecanoe, Inc.**

	<u>2010</u>	<u>2009</u>
Operating revenues	\$1,900,000	\$1,600,000
Operating expenses	1,400,000	1,100,000
Income taxes	200,000	200,000

Refer to Tippecanoe Inc. Which ratio are you able to calculate given only the information provided by Tippecanoe?

- A.** Profit Margin
- B. Current Ratio
- C. Working Capital
- D. Gross Profit Percentage

58. Donnet, Inc. earned \$600,000 profit during 2010. On which financial statement(s) will you find the dollar amount of the profit earned by the company?

- A. Balance Sheet and Income Statement
- B. Income Statement only
- C. Statement of Retained Earnings only
- D.** Income Statement and Statement of Retained Earnings

59. Which one of the following equations represents retained earnings activity?

- A. Beginning balance + net income + dividends = profits for the year
- B. Beginning balance + cash inflows - cash outflows = ending balance
- C. Beginning balance + dividends - net income = ending balance
- D.** Beginning balance + net income - dividends = ending balance

**60. Home Solutions, Inc.**

Home Solutions began operations on January 2, 2010, with an investment of \$50,000 by each of its two stockholders. Net income for its first year of business was \$240,000. Home Solutions paid a total of \$100,000 in dividends to its stockholders during the year.

Refer to Home Solutions, Inc. and calculate its Retained Earnings balance at December 31, 2010.

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

**61. Home Solutions, Inc.**

Home Solutions began operations on January 2, 2010, with an investment of \$50,000 by each of its two stockholders. Net income for its first year of business was \$240,000. Home Solutions paid a total of \$100,000 in dividends to its stockholders during the year.

Refer to the Home Solutions. The dividends for the year

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

**62. Home Solutions, Inc.**

Home Solutions began operations on January 2, 2010, with an investment of \$50,000 by each of its two stockholders. Net income for its first year of business was \$240,000. Home Solutions paid a total of \$100,000 in dividends to its stockholders during the year.

Refer to the Home Solutions. If Home Solutions' revenues were \$500,000 for the year ended December 31, 2010, how much were total expenses?

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

63. A company is not required to prepare **both** a(n)

A. Income Statement and Statement of Stockholders' Equity

B. Income Statement and Statement of Retained Earnings

**C.** Statement of Stockholders' Equity and Statement of Retained Earnings

D. Statement of Cash Flows and Statement of Retained Earnings

64. Charmane's Cookies borrowed \$500,000 from the First National Bank. Charmane then hired a contractor to build a new cookie distribution outlet. In which section of Charmane's statement of cash flows would you find information that indicated that Charmane acquired the new cookie distribution outlet?

A. Operating Activities

**B.** Investing Activities

C. Financing Activities

D. Profit Activities

65. A bank loaned \$62 million to Allison Corporation to finance the construction of a new distribution warehouse. In which section of Allison's Statement of Cash Flows would you be able to determine whether the company repaid any portion of the debt during the year?

A. Operating Activities

B. Investing Activities

**C.** Financing Activities

D. Profit Activities

66. Which of the following categories on a statement of cash flows is used to report the cash flow effects of transactions involving the company's stock?

A. Operating Activities

B. Investing Activities

**C.** Financing Activities

D. Profit Activities

67. Which one of the following categories on a statement of cash flows is used to report the cash flow effects of buying and selling property, plant and equipment?

A. Operating Activities

**B.** Investing Activities

C. Financing Activities

D. Profit Activities



68. Which one of the following is considered a financing activity?

- A. The payment of interest on a note payable to the bank.
- B. Selling products to customers
- C. Paying wages to employees
- D.** The payment of a cash dividend.

69. Which one of the following statements is **true**?

- A.** The two primary sources of financing available to corporations are borrowed funds and funds invested by owners
- B. Financing activities involve the acquisition of property, plant and equipment.
- C. Borrowed funds are a more permanent source of financing than funds invested by owners
- D. Investing activities involve the selling of products or services and the incurring of expenses related to selling these products and services

### 70. Northern Shoes

Northern Shoes reported the following items on its Statement of Cash Flows for the current year:

Net cash inflows from operating activities	\$ 70,000
Net cash outflows from investing activities	( 20,000)
Net cash outflows from financing activities	( 40,000)
Cash balance at the beginning of the year	\$ 30,000

Refer to Northern Shoes. What was the amount of their net increase or decrease in the cash balance for the current year?

- A.** \$ 10,000 increase
- B. \$ 30,000 increase
- C. \$ 40,000 increase
- D. \$ 70,000 increase

### 71. Northern Shoes

Northern Shoes reported the following items on its Statement of Cash Flows for the current year:

Net cash inflows from operating activities	\$ 70,000
Net cash outflows from investing activities	( 20,000)
Net cash outflows from financing activities	( 40,000)
Cash balance at the beginning of the year	\$ 30,000

Refer to Northern Shoes. What was their cash balance at the end of the current year?

- A. \$ 10,000
- B. \$ 30,000
- C.** \$ 40,000
- D. \$ 70,000

72. Which financial statement reports the sources and uses of an entity's cash resources?

- A. Income Statement
- B. Statement of Retained Earnings
- C. Balance Sheet
- D. Statement of Cash Flows**

73. During its fifth year of operations, Rostone Company reports a beginning cash balance of \$132,000, cash inflows from investing activities of \$210,000, cash outflows for financing activities of \$79,000, and cash outflows for operating activities of \$13,000. What was Rostone's cash balance at the end of the fifth year

- A. \$ 250,000**
- B. \$ 434,000
- C. \$ 276,000
- D. \$ 132,000

74. Which of the following best describes a company's financing activities?

- A. Financing activities focus on the sale of products and services.
- B. Financing activities include selling products.
- C. Financing activities enable a company to acquire assets needed to run a business.**
- D. Financing activities are represented by the revenues and expenses on the income statement.

75. Which of the following best describes a company's operating activities?

- A. Operating activities focus on the sale of products and services.**
- B. Operating activities are necessary to provide the money to start a business.
- C. Operating activities are needed to provide the valuable assets required to run a business.
- D. Operating activities represent the right to receive a benefit in the future

76. Which one of the following is an investing activity of a business?

- A. Paying for purchases of inventory
- B. Issuing stock for cash
- C. Borrowing money from a bank.
- D. Purchasing a manufacturing plant for cash**

77. Which one of the following is an financing activity of a business?

- A. Paying for purchases of inventory
- B. Issuing stock for cash**
- C. Paying salaries
- D. Purchasing a manufacturing plant

78. Which one of the following is an operating activity of a business?

- A.** Paying for purchases of inventory
- B. Issuing stock for cash
- C. Borrowing money from a bank
- D. Purchasing a manufacturing plant.

79. Which of the following represents the correct sequence of the three business activities on the Statement of Cash Flows?

- A. Financing - Operating - Investing
- B. Investing - Operating - Financing
- C.** Operating - Investing - Financing
- D. Financing - Investing - Operating

80. As used in accounting, the “Notes to the Financial Statements” should be:

- A. Listed with the liabilities on the Balance Sheet
- B. Omitted at the option of the company
- C.** Included as an integral part of the financial statements
- D. Reported as expenses on the Income Statement

81. Which of the following items will be found in a corporate annual report?

- A. Company Budgets
- B.** Notes to the Financial Statements
- C. Selected financial data from competitor companies
- D. Managements statement that the auditors are responsible for the financial statements.

82. Which one of the following items is **least** likely to be found in a corporate annual report?

- A. Notes to the Financial Statements
- B.** Forecasts of Cash Flows and Earnings
- C. Report of the Independent Accountants
- D. Management’s Discussion and Analysis

83. A discussion of the financial statements with explanations of certain amounts in the statements is **most** likely found in which of the following sections of a corporate annual report?

- A. Report of the Independent Accountants
- B. Notes to the Financial Statements
- C.** Management’s Discussion and Analysis
- D. Balance Sheet

84. An investor found the following in an annual report: "The financial statements, in our opinion, present fairly the financial position, operating results, and cash flows, in conformity with accounting principles generally accepted in the United States." In which section of the annual report did the investor find this?

- A. Balance Sheet
- B. Notes to the Financial Statements
- C. Management's Discussion and Analysis
- D.** Report of the Independent Accountants

85. Which of the following represents one of the purposes of the notes to financial statements?

- A. To provide a place for management to justify questionable items in the statements.
- B. To provide comparative ratios for the company's financial data
- C. To provide the CPA's opinion of the fairness of the financial statements.
- D.** To satisfy the need for full disclosure of all the facts relevant to a company's results and financial position

86. Accountants are the main reason financial statements are prepared.  
**FALSE**

87. The Financial Accounting Standards Board created the objectives of financial reporting.  
**TRUE**

88. The purpose of financial reporting is to provide economic information to external decision makers only.  
**FALSE**

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

90. The concept of conservatism is the capacity of information to make a difference in a decision.  
**FALSE**

91. Materiality deals with the size of an error in accounting information.  
**TRUE**

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

**TRUE**

93. Current assets, other than cash, will be converted into cash or assigned to expenses within a company's operating cycle.

**TRUE**

94. Obligations related to operating activities that will be paid within the company's operating cycle must be reported as current liabilities on a classified income statement.

**TRUE**

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

**FALSE**

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

**TRUE**

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

**TRUE**

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

**TRUE**

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

**TRUE**

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

**FALSE**

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

**FALSE**

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

**TRUE**

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

**FALSE**

104. Dividends paid reduce a company's retained earnings balance.

**TRUE**

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

**FALSE**

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

**FALSE**

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

**FALSE**

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

**TRUE**

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

**FALSE**

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

**TRUE**

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

**FALSE**

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

**FALSE**

113. *Select the term from the list below which best describes each statement.*

Understandability  
Comparability  
Materiality

Relevance  
Consistency  
Conservatism

Reliability  
Operating Cycle  
Liquidity

\_\_\_\_\_ is the magnitude of an omission or misstatement in accounting information that will affect the judgment of someone relying on the information

**Materiality**

114. *Select the term from the list below which best describes each statement.*

Understandability  
Comparability  
Materiality

Relevance  
Consistency  
Conservatism

Reliability  
Operating Cycle  
Liquidity

\_\_\_\_\_ is the capacity of information to make a difference in a decision

**Relevance**

115. *Select the term from the list below which best describes each statement.*

Understandability  
Comparability  
Materiality

Relevance  
Consistency  
Conservatism

Reliability  
Operating Cycle  
Liquidity

\_\_\_\_\_ is the practice of using the least optimistic estimate when two estimates of amounts are about equally likely

**Conservatism**

116. *Select the term from the list below which best describes each statement.*

Understandability  
Comparability  
Materiality

Relevance  
Consistency  
Conservatism

Reliability  
Operating Cycle  
Liquidity

\_\_\_\_\_ is the quality of accounting information that makes it comprehensible to those willing to spend the necessary time

**Understandability**

117. *Select the term from the list below which best describes each statement.*

Understandability  
Comparability  
Materiality

Relevance  
Consistency  
Conservatism

Reliability  
Operating Cycle  
Liquidity

\_\_\_\_\_ is the quality of accounting information that makes it dependable in representing the events that it purports to represent

**Reliability**

118. *Select the term from the list below which best describes each statement.*

Understandability  
Comparability  
Materiality

Relevance  
Consistency  
Conservatism

Reliability  
Operating Cycle  
Liquidity

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

**Comparability**

119. *Select the term from the list below which best describes each statement.*

Understandability  
Comparability  
Materiality

Relevance  
Consistency  
Conservatism

Reliability  
Operating Cycle  
Liquidity



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

**Consistency**

120. \_\_\_\_\_ have claims to an entity's economic resources

**Creditors** *or*

**Lenders** *or*

**Investors** *or*

**Stockholders**

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

**Current Assets**

122. Property, plant and equipment is classified as \_\_\_\_\_ assets on the balance sheet.

**noncurrent**

123. \_\_\_\_\_ is the process of writing off the cost of tangible assets and \_\_\_\_\_ is the process of writing off the cost of intangible assets.

**Depreciation, amortization**

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

**Working capital**

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

**liquidity**

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

**single**

127. On the Statement of Cash Flows, the \_\_\_\_\_ section involves the acquisition and sale of long-term assets.

**Investing Activities**

128. On the Statement of Cash Flows, the \_\_\_\_\_ section involves the purchase and sale of products and services.

**Operating Activities**

129. On the Statement of Cash Flows, the \_\_\_\_\_ section involves the issuance and repayment of long term liabilities and stock transactions.

**Financing Activities**

**130. Mardis Company**

The following information is taken from Mardis Company's Balance Sheet at December 31, 2010:

Cash	\$ 24,000
Retained Earnings	14,000
Inventory	8,000
Equipment	38,000
Accounts Payable	7,000
Bonds Payable	23,000
Capital Stock	26,000

Using the information provided for Mardis Company, answer the following questions:

- A) How much did debt investors provide to Mardis Company?
- B) On which financial statement would an investor look to see if any stock was issued during the year?
- 
- A) \$30,000  
(\$7,000 Accounts Payable + \$23,000 Bond Payable)
- B) The primary source for seeing whether any stock was issued during the year would be the Statement of Stockholders' Equity. While the Balance Sheet may show an amount for "Capital Stock," this amount is an ending balance, and would not show the results of any transactions involving new issuances of stock during the period.

### 131. David Corp.

Listed below are several accounts from the financial records of David Corporation at December 31, 2010:

Retained Earnings	\$ 37,000	Notes Payable - Due July 1, 2011	\$ 12,000
Accumulated Depreciation	\$ 13,000	Interest Payable	\$ 1,000
Income Taxes Payable	\$ 24,000	Office Supplies	\$ 2,000
Buildings	\$ 48,000	Accounts Payable	\$ 36,000
Cash	\$ 11,000	Inventory	\$ 33,000
Accounts Receivable	\$ 35,000	Land	\$ 50,000
Capital Stock	\$ 60,000	Prepaid Rent	\$ 4,000

Refer to David Corp. Prepare the current assets section of the Balance Sheet for David Corp. at December 31, 2010. You may omit the heading. How does the concept of liquidity apply?

Cash	\$ 11,000	
Accounts Receivable	35,000	
Inventory	33,000	
Prepaid Rent	4,000	
Office Supplies	<u>2,000</u>	
Total		\$ 85,000
=====		

Liquidity is an indicator of how close to cash the company's assets are. Those assets that are most liquid are listed first. Current assets are expected to be converted into cash or used up within the next accounting period.

### 132. David Corp.

Listed below are several accounts from the financial records of David Corporation at December 31, 2010:

Retained Earnings	\$ 37,000	Notes Payable - Due July 1, 2011	\$ 12,000
Accumulated Depreciation	\$ 13,000	Interest Payable	\$ 1,000
Income Taxes Payable	\$ 24,000	Office Supplies	\$ 2,000
Buildings	\$ 48,000	Accounts Payable	\$ 36,000
Cash	\$ 11,000	Inventory	\$ 33,000
Accounts Receivable	\$ 35,000	Land	\$ 50,000
Capital Stock	\$ 60,000	Prepaid Rent	\$ 4,000

Refer to David Corp. Prepare the current liabilities section of the balance sheet for David Corp. at December 31, 2010. You may omit the heading. If the amount of current liabilities were larger, what effect would this have on the current ratio?

Accounts Payable	\$ 36,000	
Interest Payable	1,000	
Income Taxes Payable	<u>24,000</u>	
Total		\$ 61,000
	=====	

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

### 133. David Corp.

Listed below are several accounts from the financial records of David Corporation at December 31, 2010:

Retained Earnings	\$ 37,000	Notes Payable - Due July 1, 2011	\$ 12,000
Accumulated Depreciation	\$ 13,000	Interest Payable	\$ 1,000
Income Taxes Payable	\$ 24,000	Office Supplies	\$ 2,000
Buildings	\$ 48,000	Accounts Payable	\$ 36,000
Cash	\$ 11,000	Inventory	\$ 33,000
Accounts Receivable	\$ 35,000	Land	\$ 50,000
Capital Stock	\$ 60,000	Prepaid Rent	\$ 4,000

Refer to David Corp. Prepare the long-term asset section of David Corp.'s balance sheet at December 31, 2010. You may omit the heading. Why are these amounts classified as "long-term"?

Land		\$ 50,000
Buildings	\$ 48,000	
Less: Accumulated Depreciation	( <u>13,000</u> )	<u>35,000</u>
Total		\$ 85,000
		=====

Long-term assets are those that are expected to benefit the company beyond the current accounting period. Both the land and the buildings are expected to benefit more than one accounting period. Accumulated depreciation is the portion of the building's benefit used up.

### 134. David Corp.

Listed below are several accounts from the financial records of David Corporation at December 31, 2010:

Retained Earnings	\$ 37,000	Notes Payable - Due July 1, 2011	\$ 12,000
Accumulated Depreciation	\$ 13,000	Interest Payable	\$ 1,000
Income Taxes Payable	\$ 24,000	Office Supplies	\$ 2,000
Buildings	\$ 48,000	Accounts Payable	\$ 36,000
Cash	\$ 11,000	Inventory	\$ 33,000
Accounts Receivable	\$ 35,000	Land	\$ 50,000
Capital Stock	\$ 60,000	Prepaid Rent	\$ 4,000

Refer to David Corp. Calculate David's current ratio at December 31, 2010. What does this ratio tell you about the "composition" of the current assets?

Current Assets = \$85,000

(\$11,000 Cash + \$35,000 Accounts receivable + \$33,000 Inventory + \$4,000 Prepaid Rent + \$2,000 Office Supplies = \$85,000)

Current Liabilities = \$61,000

(\$36,000 Accounts Payable + \$1,000 Interest Payable + \$24,000 Income Taxes Payable = \$61,000)

Current ratio = 1.39 to 1

(\$85,000 / \$61,000)

The current ratio does not provide information about its composition. Only totals are used to calculate the current ratio

### 135. David Corp.

Listed below are several accounts from the financial records of David Corporation at December 31, 2010:

Retained Earnings	\$ 37,000	Notes Payable - Due July 1, 2011	\$ 12,000
Accumulated Depreciation	\$ 13,000	Interest Payable	\$ 1,000
Income Taxes Payable	\$ 24,000	Office Supplies	\$ 2,000
Buildings	\$ 48,000	Accounts Payable	\$ 36,000
Cash	\$ 11,000	Inventory	\$ 33,000
Accounts Receivable	\$ 35,000	Land	\$ 50,000
Capital Stock	\$ 60,000	Prepaid Rent	\$ 4,000

Refer to David Corp.. Calculate the amount of working capital at December 31, 2010 for David Corp. What can you learn from the current ratio that you cannot learn from the amount of working capital?

Current Assets = \$85,000

(\$11,000 Cash + \$35,000 Accounts receivable + \$33,000 Inventory + \$4,000 Prepaid Rent + \$2,000 Office Supplies = \$85,000)

Current Liabilities = \$61,000

(\$36,000 Accounts Payable + \$1,000 Interest Payable + \$24,000 Income Taxes Payable = \$61,000)

Working Capital = \$24,000

(\$85,000 - \$61,000)

The current ratio indicates the number of times current assets is greater than current liabilities. It is based on a relative relationship, not total dollars, as the amount of working capital is.

136.

**Fillmore Company**

Fillmore Company calculated the following amounts concerning its financial information for the years ending December 31, 2010 and 2009:

Current Ratio	<u>2010</u> 3.1 to 1	<u>2009</u> 2.0 to 1
Profit Margin	22 %	18%

Refer to Fillmore Company. Examine Fillmore's ratios. Is the change in the current ratio favorable or not? Explain.

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

137.

**Fillmore Company**

Fillmore Company calculated the following amounts concerning its financial information for the years ending December 31, 2010 and 2009:

Current Ratio	<u>2010</u> 3.1 to 1	<u>2009</u> 2.0 to 1
Profit Margin	22 %	18%

Refer to Fillmore Company. Suppose Fillmore Company had a decrease in its cash account from 2009 to 2010. Would the other current asset amounts have increased or decreased? Explain.

Since the current ratio increased from 2009 to 2010, the current assets other than cash would have had to increase substantially to offset the decline in cash. The decline in cash changes the liquidity somewhat, in that the other current assets must be converted to cash prior to paying the current period debt.

### 138. Maryville Corporation

Presented below are the condensed balance sheets of Maryville Corporation at December 31, 2010 and 2009. Net income for the years ending December 31, 2010 and 2009 is \$346,000 and \$109,000.

	<u>Dec</u> <u>December 31, 2009</u>	
	<u>emb</u>	
	<u>er</u>	
	<u>31.</u>	
	<u>201</u>	
	<u>0</u>	
C	\$2,228,186	\$2,544,68
u		3
rr		
e		
nt		
A		
ss		
et		
s		
P	530,988	376,647
r		
o		
P		
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ty		
,		
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la		
nt		
,		
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ui		
p		
m		
e		
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N		
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I	<u>131,206</u>	<u>118,121</u>
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Tota	\$2,890,380	\$3,039,27
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C	<u>=====</u>	<u>=====</u>
u	\$1,429,674	\$1,003,90
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L	3,360	7,240
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e		
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m		
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W	<u>112,971</u>	<u>98,081</u>
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Tota	<u>\$1,546,605</u>	<u>\$1,109,22</u>
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Com\$	1,566	\$ 1,54
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Add 365,986	299,483
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Refer to Maryville Corporation. Did the current ratio increase or decrease from 2009 to 2010? Make any necessary calculations and explain your answer. Which financial statement users are most concerned with this ratio?

Current Ratio for 2010 = 1.56 to 1  
(\$2,228,186 Current Assets / \$1,429,674 Current Liabilities)

Current Ratio for 2009 = 2.53 to 1  
(\$2,544,683 Current Assets / \$1,003,906 Current Liabilities)

This ratio is an indicator of the company's ability to pay its current debt when it is due. Maryville's current ratio has declined significantly. A company with decreasing liquidity ratios is not appealing to bankers and creditors, and it may have trouble trying to borrow money, since the decrease indicates the company is less likely able to repay its debts.

### 139. Maryville Corporation

Presented below are the condensed balance sheets of Maryville Corporation at December 31, 2010 and 2009. Net income for the years ending December 31, 2010 and 2009 is \$346,000 and \$109,000.

	<u>Dec</u> <u>emb</u> <u>er</u> <u>31</u> <u>201</u> <u>0</u>	<u>December 31, 2009</u>	
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Refer to Maryville Corporation. Explain the change in the amount of working capital from 2009 to 2010. Why do users believe the current ratio provides more information than the dollar amount of working capital? Explain.

Working Capital, 2009 = \$1,540,777

(\$2,544,683 Current Assets - \$1,003,906 Current Liabilities = \$1,540,777)

Working Capital, 2010 = \$798,512

(\$2,228,186 Current Assets - \$1,429,674 Current Liabilities = \$798,512)

Decrease in Working Capital = \$742,265

(\$1,540,777 Working Capital, 2009 - \$798,512 Working Capital, 2010 = \$742,265)

Working capital represents the excess of current assets over current liabilities in total dollars. The current ratio indicates the number of times that current assets exceed the current liabilities. It is possible that \$742,265 could pay the current debts of one company easily, but pay for only a small portion of a larger company's debts.

## 140. Maryville Corporation

Presented below are the condensed balance sheets of Maryville Corporation at December 31, 2010 and 2009. Net income for the years ending December 31, 2010 and 2009 is \$346,000 and \$109,000.

	<u>Dec</u> <u>December 31, 2009</u>	
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Refer to Maryville Corporation. Maryville Corporation's creditors need to know whether its working capital position improved during the year. How would you evaluate this?

The amount of working capital and the current ratio are the best indicators of a company's working capital position. While the amount of working capital provides the dollar amount of current assets that exceed the company's current debt, the current ratio provides a relative indicator of how many times the dollar amount of current assets exceeds currently due debt. In 2009, Maryville Corporation's working capital was \$1,540,777. However, this figure declined in 2010 to \$798,512. Less current assets are available to cover current liabilities.

## 141. Maryville Corporation

Presented below are the condensed balance sheets of Maryville Corporation at December 31, 2010 and 2009. Net income for the years ending December 31, 2010 and 2009 is \$346,000 and \$109,000.

	<u>Dec</u> <u>December 31, 2009</u>	
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Refer to Maryville Corporation. The balance sheets show a large increase in Retained Earnings during 2008. Identify the possible reason(s) for this increase.

The amount of retained earnings increases primarily because of net income for a period. A company that has a positive balance in retained earnings over time has cumulative profitability in excess of cumulative dividends paid.

#### 142. Evertrue Corporation

Presented below are all of the items from Evertrue Corporation's income statement for the years ending December 31, 2010 and 2009.

	December 31, 2010	December 31, 2009
Service fees	\$2,300,000	\$2,100,000
General and administrative expenses	1,900,000	1,500,000
Other income, net	40,000	20,000
Income taxes	150,000	180,000

Refer to Evertrue Corporation. How much is net income for the year ended December 31, 2010? If Evertrue Corporation had used a single-step statement, by how much would net income be different? Explain.

Net Income = \$290,000

(\$2,300,000 Service Fees + \$40,000 Other Income, net - \$1,900,000 General and Administrative Expenses - \$150,000 Income Taxes = \$290,000)

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

#### 143. Evertrue Corporation

Presented below are all of the items from Evertrue Corporation's income statement for the years ending December 31, 2010 and 2009.

	December 31, 2010	December 31, 2009
Service fees	\$2,300,000	\$2,100,000
General and administrative expenses	1,900,000	1,500,000
Other income, net	40,000	20,000
Income taxes	150,000	180,000

Refer to Evertrue Corporation. Compare the profit margins for 2010 and 2009. Is the company becoming more or less profitable or staying the same? What could be contributing to this?

Profit Margin for 2010 = 12.60%  
(\$290,000 Net Income / \$2,300,000 Service Fees = 12.60%)

Profit Margin for 2009 = 20.95%  
(\$440,000 Net Income / \$2,100,000 Service Fees = 20.95%)

The decrease in profit margin is unfavorable and indicates that the company is becoming less profitable. A significant increase in general and administrative expenses seems to be the cause of the decline.

#### 144. **Hannah, Inc.**

Hannah, Inc. reported \$52,000 of net income for 2010. Hannah's balance sheet at December 31, 2010 includes the following amounts:

Wages Payable	\$ 1,000	Inventory	\$ 26,000
Prepaid Rent	3,000	Land	40,000
Cash	15,000	Accounts Receivable	22,000
Accounts Payable	25,000	Capital Stock	40,000
Retained Earnings	29,000	Income Taxes Payable	11,000

Refer to Hannah, Inc. Which item is most "liquid"? Why is liquidity important?

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

#### 145. **Hannah, Inc.**

Hannah, Inc. reported \$52,000 of net income for 2010. Hannah's balance sheet at December 31, 2010 includes the following amounts:

Wages Payable	\$ 1,000	Inventory	\$ 26,000
Prepaid Rent	3,000	Land	40,000
Cash	15,000	Accounts Receivable	22,000
Accounts Payable	25,000	Capital Stock	40,000
Retained Earnings	29,000	Income Taxes Payable	11,000



Refer to Hannah, Inc. Has Hannah, Inc. been profitable since it began operations? How do you know?

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

146. Gala, Inc. incurred a net loss of \$20,000 for 2010. The balance sheet at December 31, 2010, for Gala, Inc., includes the following items:

Cash	\$23,000
Accounts receivable	13,000
Inventory	45,000
Prepaid insurance	1,000
Land	21,000
Building	80,000
Accounts payable	55,000
Salaries payable	2,000
Capital stock	100,000
Retained earnings	25,000

A) Determine Gala's current ratio and working capital.

B) Beyond the information provided in your answers to "A," what does the composition of Gala's current assets tell you about its liquidity.

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

A) Current ratio: 1.44 to 1  
( $\$23,000 \text{ Cash} + \$13,000 \text{ Accounts receivable} + \$45,000 \text{ Inventory} + \$1,000 \text{ Prepaid insurance}$ ) / ( $\$55,000 \text{ Accounts payable} + \$2,000 \text{ Salaries payable}$ ) = 1.44 to 1

Working capital: \$25,000  
( $\$82,000 \text{ Total Current Assets} - \$57,000 \text{ Total Current Liabilities} = \$25,000$ )

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

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

147. Listed below are several amounts from the accounting records of Brooks, Inc. for the year ended December 31, 2010. Prepare a multiple-step income statement in good form.

Service revenue	\$161,000
Selling expenses	121,000
Income tax expense	3,000
General and administrative expenses	35,000
Interest revenue	5,000

Brooks, Inc.  
 Income Statement  
 for the Year Ended December 31, 2010

Service Revenue		\$ 161,000
Operating Expenses:		
Selling Expenses	\$ 121,000	
General and Administrative Expenses	<u>35,000</u>	
Total Operating Expenses		<u>156,000</u>
Income from Operations		\$ 5,000
Other Revenue and Expenses		
Interest Revenue		<u>5,000</u>
Income Before Taxes		\$ 10,000
Income Tax Expense		<u>3,000</u>
Net Income		\$ 7,000
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148. Listed below are several amounts from the accounting records of Sotheby Realtors, Inc., for the year ended December 31, 2010. Prepare a single-step income statement in good form.

Salaries expenses	\$ 87,000
Depreciation expense	11,000
Commission fees earned	202,000
Retained earnings	32,000
Rent expense	12,000
Income taxes expense	46,000

Sotheby Realtors, Inc.  
 Income Statement  
 for the Year Ended December 31, 2010

Revenues:			
Commission fees earned			\$ 202,000
Expenses			
Salaries expense	\$ 87,000		
Depreciation expense	11,000		
Rent expense	12,000		
Income tax expense	<u>46,000</u>		
Total Expenses			<u>156,000</u>
Net Income			\$ 46,000
			=====

149. During 2010, Media One reported \$60,000 of net income and generated \$80,000 of cash from operations. During the year, Media One paid \$15,000 to purchase a new delivery truck and also paid dividends in the amount of \$30,000. Media One borrowed \$40,000 cash from the bank. At the beginning of the year, cash amounted to \$50,000.

- A) Prepare a Statement of Cash Flows for the year ended December 31, 2010.
- B) How much more cash does Media One have available at the end of the year than at the beginning?
- C) Why is there a difference between net income and cash flows from operations?

A)  
 Media One  
 Statement of Cash Flows  
 for the Year Ended December 31, 2010

Cash flows from operating activities	\$ 80,000
Cash flows from investing activities:	
Purchase of new truck	( 15,000)
Cash flows from financing activities:	
Proceeds from loan made by bank	40,000
Cash dividends paid	( 30,000)
Increase (Decrease) in cash	\$ 75,000
Cash at the beginning of the year	<u>50,000</u>
Cash at the end of the year	\$125,000
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B) The company has \$75,000 more at the end of the year compared to the beginning of the year

C) Net income is calculated using the accrual basis of accounting, whereas cash flows from operating activities represent the net amount of cash flows from operations of the business

150. Barton Corporation began operations on January 2, 2008, with a total investment of \$150,000 by its stockholders. Net income for its first year of business was \$90,000. During 2009 and 2010, net income increased to \$188,000 and to \$217,000, respectively. Barton paid \$85,000 in dividends to its shareholders in each of the three years.

- A) In good form, prepare a statement of retained earnings for the year ended December 31, 2009.
- B) How much is total retained earnings on December 31, 2010?
- C) Explain the link between the statement of retained earnings and the balance sheet.

A)  
Barton Corporation  
Statement of Retained Earnings  
for the Year Ended December 31, 2009

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\* \$ 9,000 Net Income for 2008 - \$ 85,000 Dividend s paid = \$ 5,000 Balance, January 1, 2009

- B) Retained earnings at December 31, 2010 = \$240,000  
 (\$108,000 Beginning Balance, January 1, 2010 + \$217,000 Net Income for 2010 - \$85,000 Dividends paid during the year = \$240,000)
- C) The ending balance of the retained earnings statement represents the cumulative earnings less all the dividends declared and paid for the life of the business. This amount appears on the balance sheet as a component of owners' equity.

151. Mason Corporation was organized on January 1, 2010, with the investment of \$500,000 in cash by its stockholders. Mason signed a ten-year, \$300,000 promissory note at a local bank during 2010 and received cash in the same amount. The company immediately purchased an office building for \$800,000, paying in cash. During its first year, Mason generated \$35,000 in cash from operations and paid \$30,000 in cash dividends.

A) In good form, prepare a statement of cash flows for the year ended December 31, 2010.

B) What does this statement tell you that an income statement does not?

A)  
 Mason Corporation  
 Statement of Cash Flows  
 for the Year Ended December 31, 2010

Cash flows from operating activities	\$ 35,000
Cash flows from investing activities	
Purchase office building	( 800,000)
Cash flows from financing activities	
Investment by owners	500,000
Loan from bank	300,000
Payment of dividends	( 30,000)
Net increase in cash for the year	\$ 5,000
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B) This statement provides information on the cash inflows and outflows by activity: operating, investing, and financing. The income statement is prepared on the accrual basis that provides information on the revenues earned and the expenses incurred during the period, which may or may not involve cash. The income statement shows the profitability of a company for a period of time. Furthermore, the income statement does not present information regarding all the sources and uses of cash.

152. Sprint Company reported revenues of \$165,000 and net income of \$20,000 for 2010. Cash generated by operations was \$40,000. In addition, Sprint Company borrowed \$24,000 from a bank. During 2010, Sprint purchased new equipment for \$30,000 cash and paid cash dividends of \$15,000 to stockholders. Sprint's cash balance at the beginning of 2010 was \$22,000.

A) Identify the amount of cash flows for financing, investing, and operating activities for 2010 by filling in the amounts below.

Financing Cash Flows:	
Investing Cash Flows:	
Operating Cash Flows:	

B) Did Sprint Company's operating activities generate enough cash to cover its investing and financing activities? Explain.

C) How much did Sprint Company's cash balance increase or decrease during 2010?

0?

A) Financing Cash Flows = \$9,000  
 (\$24,000 Cash borrowed from bank - \$15,000 Cash dividends paid = \$9,000)

Investing Cash Flows = (\$30,000)  
 (Purchase of new equipment)

Operating Cash Flows = \$40,000  
 (Cash generated by operations)

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

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

153. Presented below are items from Super Shoes statement of cash flows for 2010.

Cash flows provided by operating activities	\$75,000
Cash flows provided by financing activities	115,000
Cash at the beginning of the year	60,000
Cash flows used by investing activities	(100,000)

A) Determine whether Super Shoes' cash increased or decreased during the year.

B) How much cash does Super Shoes have at the end of 2010?

C) What is the purpose of the Statement of Cash Flows?

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

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

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

154. Most financial reports contain the following list of basic elements. For each element identify the person(s) who prepared the element and describe the information a user would expect to find in each element. Some information is verifiable, while other information is subjectively chosen by management. Indicate whether the information in each element is verifiable.

Elements	Prepared By	Information Provided	Verifiable/ Yes or No?
Management Discussion & Analysis			
Financial Statements			
Notes to Financial Statements			
Report of Independent Accountants			

Elements	Prepared By	Information Provided	Verifiable/ Yes or No?
Management Discussion & Analysis	Mgmt.	Discussion of financial statements and explanations	No
Financial Statements	Mgmt.	Income statement, balance sheet, statement of cash flows, statement of retained earnings	Yes
Notes to Financial Statements	Mgmt.	Accounting policies and other disclosures	Yes
Report of Independent Accountants	CPA firm.	Opinion that statements are presented fairly	No

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

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

156. Marshall Dillon, a newly hired accountant, wanted to impress his boss, so he stayed late one night to analyze the office supplies expense account. He determined the cost by month, for the past 12 months, of each of the following: computer paper, copy paper, fax paper, pencils and pens, note pads, postage, corrections supplies, stationery, and miscellaneous items. Why do companies not include information of this nature in published financial statements?

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

157. Lacey Company claims its financial information is useful. What two qualities must be present in order to have "useful" accounting information? Explain these two qualities.

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

158. What is the difference between comparability and consistency?

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

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

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

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

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

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

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

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

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

163. Potential stockholders and lenders are interested in a company's financial statements. Several financial statement items appear below. Answer the questions that follow.

Accounts receivable  
Cash  
Common stock  
Retained earnings  
Office supplies  
Unearned revenue

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

Advertising expense  
Income taxes  
Dividends  
Service revenue  
Sales

- A) List the two items from above in which stockholders would be most interested. Explain why the two you selected are important to stockholders.
- B) In which one item would lenders be most interested? Explain why this item is important.

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

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

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

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

A statement of cash flows summarizes the operating, financing, and investing activities of a company for a period of time. Some examples are:

Operating: Collections of cash from customers; Payments to suppliers; Payments for wages

Investing: Purchases or sales of plant assets; Purchases or sales of investments

Financing: Payment of dividends; Issuance of stock to investors

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

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