# *Financial Accounting 5th edition Rich Test Bank*

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Name:_____ Class:_____ Date:_____

# Ch. 01 Accounting and the Financial Statements

1. Internal users of accounting information include present creditors and management.
   a. True
   b. False

*ANSWER:* False

2. Creditors use accounting information to evaluate whether to loan money to a company.
   a. True
   b. False

*ANSWER:* True

3. The purpose of financial reporting is to provide economic information to investors, creditors, and other financial statement users.
   a. True
   b. False

*ANSWER:* True

4. Investing is the business activity that measures a company's ability to generate cash from its revenue and expense activities.
   a. True
   b. False

*ANSWER:* False

5. The three main business activities are financing, operating, and investing.
   a. True
   b. False

*ANSWER:* True

6. The owners of a sole proprietorship, a partnership, and corporations have limited liability.
   a. True
   b. False

*ANSWER:* False

7. There are more corporations than sole proprietorships and partnerships in the United States.
   a. True
   b. False

*ANSWER:* False

8. The four basic financial statements are the Income Statement, Retained Earnings Statement, Balance Sheet, and Statement of Cash Flows.
   a. True
   b. False

*ANSWER:* True

9. Stockholders' equity is composed of two main sources: liabilities and contributed capital.
   a. True

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b. False

*ANSWER:* False

10. The first step in preparing the classified balance sheet is to list the assets in order of liquidity.
    a. True
    b. False

*ANSWER:* False

11. Stockholders equity is composed of contributed capital and retained earnings.
    a. True
    b. False

*ANSWER:* True

12. The classifications in the balance sheet are to help users determine how a company obtained its resources.
    a. True
    b. False

*ANSWER:* True

13. Contributed capital is the residual interest that remains after deducting liabilities from stockholders' equity.
    a. True
    b. False

*ANSWER:* False

14. Current assets include all of the following: cash, inventory, equipment, supplies, and accounts receivable.
    a. True
    b. False

*ANSWER:* False

15. In the stockholders' equity section of a classified balance sheet, a distinction is made between the amounts invested by owners and the amounts financed by creditors.
    a. True
    b. False

*ANSWER:* False

16. One primary purpose of the classified balance sheet is to help users evaluate the working capital of a company.
    a. True
    b. False

*ANSWER:* True

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

*ANSWER:* True

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18. The ending cash balance is shown on the Balance Sheet and the Retained Earnings Statement.
    a. True
    b. False
*ANSWER:* False

19. The current ratio is useful in determining a company's ability to pay obligations when they become due.
    a. True
    b. False
*ANSWER:* True

20. Current liabilities are typically listed in the order in which they will be paid.
    a. True
    b. False
*ANSWER:* True

21. The only financial statement that reports the retained earnings balance at the end of the period is the Retained Earnings Statement.
    a. True
    b. False
*ANSWER:* False

22. The income statement provides information at one specific point in time, while the other basic financial statements provide information on activities that occur over a period of time.
    a. True
    b. False
*ANSWER:* False

23. The income statement summarizes the assets, liabilities, and stockholders' equity for a period of time.
    a. True
    b. False
*ANSWER:* False

24. When an entity's stock issuances exceed its expenses for a period of time, the entity will report net income.
    a. True
    b. False
*ANSWER:* False

25. Income from operations is computed after taking into account interest revenue and interest expense because these items are considered to be operating in nature.
    a. True
    b. False
*ANSWER:* False

26. The amount of earnings distributed to stockholders can be found in the income statement as an expense.
    a. True

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b. False

*ANSWER:* False

27. The four steps in preparing the Income Statement are: 1) prepare a heading, 2) list the revenues of the company, 3) list the expenses of the company, and 4) list the dividends of the company.

a. True

b. False

*ANSWER:* False

28. Net loss reduces a company's retained earnings balance.

a. True

b. False

*ANSWER:* True

29. Dividend payments appear on the Retained Earnings Statement.

a. True

b. False

*ANSWER:* True

30. The Statement of Cash Flows, like the Income Statement, reports only the operating activities of a company.

a. True

b. False

*ANSWER:* False

31. The Statement of Cash Flows shows cash inflows and cash outflows for a period of time.

a. True

b. False

*ANSWER:* True

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

a. True

b. False

*ANSWER:* True

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

a. True

b. False

*ANSWER:* False

34. Violations of ethical standards often lead to long lasting negative consequences for companies.

a. True

b. False

*ANSWER:* True

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## Ch. 01 Accounting and the Financial Statements

35. External users and outside decision-makers use _____ accounting information.
*ANSWER:* financial

36. The demand for accounting information comes from stakeholders both inside and outside the business. The five stakeholder groups discussed in the text include _____, _____, _____, _____, and _____.
*ANSWER:* Managers
Labor unions
Investors
Creditors
Lenders
Governmental agencies
Owners

37. The three forms of business organizations are _____, _____, and _____.
*ANSWER:* sole proprietorships, partnerships, corporations
partnerships, corporations, sole proprietorships
corporations, sole proprietorships, partnerships
sole proprietorship, partnership, corporation
partnership, corporation, sole proprietorship
corporation, sole proprietorship, partnership

38. _____ are the owners of a corporation and have claims to the corporation's economic resources.
*ANSWER:* Stockholders
Shareholders

39. The type of business activity that relates to obtaining funds from either issuing stock or borrowing money is called _____.
*ANSWER:* Financing

40. The names of the four basic financial statements are _____, _____, _____, and _____
*ANSWER:* Income Statement, Balance Sheet, Retained Earnings Statement, Statement of Cash Flows
Balance Sheet, Retained Earnings Statement, Statement of Cash Flows, Income Statement
Retained Earnings Statement, Statement of Cash Flows, Income Statement, Balance Sheet
Statement of Cash Flows, Income Statement, Balance Sheet, Retained Earnings Statement

41. The fundamental accounting equation is _____ = _____ + _____.
*ANSWER:* assets, liabilities, shareholders' equity
assets, shareholders' equity, liabilities
assets, liabilities, stockholders' equity
assets, stockholders' equity, liabilities

42. An obligation that requires payment beyond one year would be categorized on the classified balance sheet as a(n) _____ liability.
*ANSWER:* long-term
long term

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## Ch. 01 Accounting and the Financial Statements

43. The step of listing the liabilities of a company in order of their time to maturity is performed for a financial statement called the _____.
*ANSWER:* classified balance sheet

44. _____ consist of cash and other assets that are reasonably expected to be converted into cash within one year or one operating cycle, whichever is longer.
*ANSWER:* Current assets

45. Property, plant and equipment is classified as _____ assets on the balance sheet.
*ANSWER:* noncurrent

46. _____ is a liquidity measure that is calculated by subtracting current liabilities from current assets.
*ANSWER:* working capital

47. The ability of a company to pay its debt as it comes due is referred to as _____.
*ANSWER:* liquidity

48. The current ratio is found by dividing current assets by _____.
*ANSWER:* current liabilities

49. The financial statement in which you list revenues, starting with sales revenue (service revenue), is called the _____.
*ANSWER:* Income Statement

50. In a(n) _____-step income statement, total expenses are added together and then deducted from total revenues.
*ANSWER:* single

51. The two financial statements in which net income can be found are the _____ and _____.
*ANSWER:* Income Statement, Retained Earnings Statement
Retained Earnings Statement, Income Statement

52. Both net income and dividends can be found on this financial statement: _____.
*ANSWER:* Retained Earnings Statement

53. The Statement of Cash Flows classifies cash flow into these three categories: _____, _____, and _____.
*ANSWER:* Operating, Investing, Financing
Investing, Financing, Operating
Financing, Operating, Investing

54. Cash flows related to the acquisition or sale of long-term assets are reported as part of cash flows from _____ activities.
*ANSWER:* investing

55. Net Income from the Income Statement increases the balance of _____.
*ANSWER:* retained earnings

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56. Which one of the following is an internal user of financial information?
    a. company management
    b. governmental agencies
    c. creditors
    d. investors

*ANSWER:* a

57. Which of the following users of accounting information would be interested in knowing a company's prospects of making future dividend payments?
    a. investors
    b. suppliers
    c. labor union
    d. governmental agencies

*ANSWER:* a

58. Which one of the following is **not** an external user of the financial statements of a company?
    a. Internal Revenue Service
    b. creditors
    c. stockholders
    d. the Company's President

*ANSWER:* d

59. Which one of the following groups is considered an internal user of financial statements?
    a. A supplier considering selling to the company on credit
    b. The labor union representing employees of a company that is involved in labor negotiations
    c. The financial analysts of a brokerage firm who are preparing recommendations for the firm's brokers on companies in a certain industry
    d. Managers of the company that supervise production workers

*ANSWER:* d

60. External users of financial information
    a. need detailed accounting records of the business to make informed decisions.
    b. are primarily responsible for the preparation of financial statements.
    c. rely on the financial statements to help make informed decisions.
    d. rely on the employees to tell them whether the company is a good investment.

*ANSWER:* c

61. What is the primary objective of financial reporting?
    a. To help the creditors in evaluating their decision to make loans to a company
    b. To help management make appropriate decisions related to company operations
    c. To help the investors assess the future prospects of a company
    d. All of these

*ANSWER:* d

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

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

*ANSWER:* a

63. What is the name for a person who lends funds to a business entity and expects repayment of the funds with interest?

a. creditor
b. owner
c. proprietor
d. stockholder

*ANSWER:* a

64. Which of the following invests funds into a business and is considered an owner?

a. stockholders
b. creditors
c. bankers
d. lenders

*ANSWER:* a

65. Which of the following is **not** a form of a business organization?

a. sole proprietorship
b. partnership
c. governmental agency
d. corporation

*ANSWER:* c

66. In which form of organization is the owners' legal responsibility for the debt of the business limited to the amount they invested in the business?

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

*ANSWER:* b

67. Businesses engage in which of the following three main activities?

a. Financing, Investing, and Operating
b. Financing, Investing, and Credit
c. Financing, Credit, and Operating
d. Financing, Management, and Operating

*ANSWER:* a

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68. Which one of the following is **not** one of the three business activities?
a. financing
b. operating
c. investing
d. measuring

*ANSWER:* d

69. Which organization has been entrusted with the development of generally accepted accounting principles (GAAP)?
a. the Institute of Management Accountants (IMA)
b. the Accounting Principles Board (APB)
c. the International Accounting Standards Board (IASB)
d. the Financial Accounting Standards Board (FASB)

*ANSWER:* d

70. On January 1, current year, a company reported assets of $1,000,000 and liabilities of $600,000. During the year, assets decreased by $100,000 and Stockholders' Equity decreased by $200,000. What is the amount of liabilities on December 31, current year?
a. $200,000
b. $500,000
c. $600,000
d. $700,000

*ANSWER:* d

71. Economic resources are known as
a. assets.
b. liabilities and stockholders' equity.
c. owners' equity and stockholders' equity.
d. retained earnings and revenues.

*ANSWER:* a

72. Which one of the following correctly represents one of the basic financial statement models?
a. Assets − Liabilities = Net Income
b. Assets + Liabilities = Total Assets
c. Revenues + Expenses = Net Income
d. Beginning Retained Earnings + Net Income − Dividends = Ending Retained Earnings

*ANSWER:* d

73. Which one of the following is the correct fundamental accounting equation?
a. Assets + Liabilities = Stockholders' Equity
b. Assets + Retained Earnings = Stockholders' Equity
c. Assets + Stockholders' Equity = Liabilities
d. Assets = Liabilities + Stockholders' Equity

*ANSWER:* d

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74. You are a potential creditor and are concerned that a particular company you are ready to give a loan to might have too much debt. Which financial statement would provide you the information needed in order to evaluate your concern?

a. the Balance Sheet
b. the Income Statement
c. the Retained Earnings Statement
d. the Statement of Public Accounting

*ANSWER:* a

75. What is the classification unearned revenue on a balance sheet?

a. stockholders' equity
b. liability
c. asset
d. revenue

*ANSWER:* b

76. Which financial statement would you refer to in order to determine how much resources (assets) the company owned?

a. the Balance Sheet
b. the Retained Earnings Statement
c. the Income Statement
d. the Statement of Cash Flows

*ANSWER:* a

77. Which one of the following financial statements show the end of the year cash balance for a business entity?

a. the Income Statement and the Retained Earnings Statement
b. the Balance Sheet and the Statement of Cash Flows
c. the Retained Earnings Statement and the Statement of Cash Flows
d. the Balance Sheet and the Retained Earnings Statement

*ANSWER:* b

78. Which of the following statements about balance sheets is correct?

a. The amount of retained earnings is reported on the Balance Sheet as a liability.
b. Retained earnings is added to total assets and reported on the Balance Sheet.
c. Retained earnings is reported in the stockholders' equity section of the Balance Sheet.
d. There is no link between the Balance Sheet and other statements, as each contains different accounts and provides different information.

*ANSWER:* c

79. Bennett Motors is facing the following events. Which decision will **least** likely require Bennett's financial information?

a. A local bank is reviewing the company’s loan application.
b. The company is attempting to sell its stock to the public.
c. The labor union representing the company's employees is negotiating a pay raise as part of a new labor agreement.

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d. The company's management is deciding whether to get detailing done on its vehicles today or tomorrow.

*ANSWER:* d

80. Which of the following best describes the term "retained earnings" of a company?
a. The amount of total profits earned by a company since it began operations
b. The amount of claim that the owners have on the assets of the company
c. The future economic resources of a company
d. The accumulated net income of a company that has not been distributed to owners in the form of dividends

*ANSWER:* d

81. Which of the following best describes the term "current assets"?
a. The amount of total profits earned by a business since it began operations plus all the existing resources
b. The amount of claim that the owners have in the business in the current year
c. Assets expected to be converted into cash within one year or one operating cycle, whichever is longer
d. The cumulative profits earned by a business during its life less any dividends distributed in the current period

*ANSWER:* c

82. Which one of the following items is a classification on the Classified Balance Sheet?
a. operating accounts
b. stockholders' equity
c. revenues and expenses
d. net income and dividends

*ANSWER:* b

83. Which of the following is a noncurrent asset?
a. property, plant, and equipment
b. accounts receivable
c. inventories
d. unearned revenues

*ANSWER:* a

84. Which one of the following items appears on a balance sheet?
a. service revenue
b. unearned revenue
c. dividends
d. cash flow from operations

*ANSWER:* b

85. Which one of the following financial statements reports an entity's financial position at a specific date?
a. the Balance Sheet
b. the Retained Earnings Statement
c. the Income Statement
d. both the Income Statement and the Balance Sheet

*ANSWER:* a

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86. **Bargain Spot Fabrics**

This company's end-of-year balance sheet consisted of the following amounts:

| | | | |
|---|---|---|---|
| Cash | $ 75,000 | Accounts Receivable | $250,000 |
| Property, plant & equipment | 350,000 | Long-term liabilities | 200,000 |
| Common stock | 500,000 | Accounts payable | 100,000 |
| Retained Earnings | ? | Inventory | 175,000 |

What amount should the company report on its Balance Sheet for *Total Assets*?

a. $550,000
b. $775,000
c. $850,000
d. $950,000

*ANSWER:* c

87. **Bargain Spot Fabrics**

This company's end-of-year balance sheet consisted of the following amounts:

| | | | |
|---|---|---|---|
| Cash | $ 75,000 | Accounts Receivable | $250,000 |
| Property, plant & equipment | 350,000 | Long-term liabilities | 200,000 |
| Common stock | 500,000 | Accounts payable | 100,000 |
| Retained Earnings | ? | Inventory | 175,000 |

What is the retained earnings balance at the end of the current year?

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

*ANSWER:* a

88. A company had the following balance sheet amounts at the beginning of the year:

| | |
|---|---|
| Total assets | $650,000 |
| Total stockholder's equity | 250,000 |

During the year, total assets increased by $350,000, total liabilities increased by $100,000, and dividends were paid in the amount of $300,000. No other transactions occurred except revenues and expenses. How much is net income for the year?

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

*ANSWER:* d

89. If a company has assets of $5,000,000, liabilities of $3,000,000, and retained earnings of $1,200,000, how much is total stockholders' equity?

a. $800,000

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b. $2,000,000
c. $3,800,000
d. $1,800,000

*ANSWER:* b

90. **Benchmark Surveyors**

The following balances are provided:

| | | | |
|---|---|---|---|
| Cash | $234,000 | Accounts Payable | $97,000 |
| Inventory | 121,000 | Notes Payable, long-term | 211,000 |
| Land | 453,000 | Accounts Receivable | 46,000 |

Calculate Current Assets.

a. $498,000
b. $401,000
c. $854,000
d. $709,000

*ANSWER:* b

91. **Benchmark Surveyors**

The following balances are provided:

| | | | |
|---|---|---|---|
| Cash | $234,000 | Accounts Payable | $97,000 |
| Inventory | 121,000 | Notes Payable, long-term | 211,000 |
| Land | 453,000 | Accounts Receivable | 46,000 |

Calculate Current Liabilities.

a. $97,000
b. $211,000
c. $354,000
d. $143,000

*ANSWER:* a

92. Which one of the following items is reported as part of stockholders' equity on a classified balance sheet?

a. Unearned Revenue
b. Accounts Payable
c. Land
d. Common Stock

*ANSWER:* d

93. Barnes Restaurant reports the following amounts:

| | | | |
|---|---|---|---|
| Cash | $125,000 | Inventory | $215,000 |
| Land | 275,000 | Unearned Revenue | 117,000 |
| Equipment | 350,000 | Common Stock | 300,000 |

Calculate Current Assets.

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a. $457,000
b. $615,000
c. $125,000
d. $340,000

*ANSWER:* d

94. Which of the following accounts are normally reported as current liabilities on a classified balance sheet?
a. Accounts Payable and Prepaid Insurance
b. Interest Payable and Interest Receivable
c. Income Taxes Payable and Salaries Payable
d. Common Stock and Accounts Payable

*ANSWER:* c

95. Which one of the following is **not** a major category of long-term assets?
a. intangible and other noncurrent assets
b. property, plant, and equipment
c. inventory
d. long-term investments

*ANSWER:* c

96. Which of the following would **not** be considered an intangible asset?
a. franchises
b. copyrights
c. investments
d. trademarks

*ANSWER:* c

97. If assets are expected to be realized in cash, sold, or consumed within the normal operating cycle of a business or within 1 year (if the operating cycle is shorter than 1 year), how are they reported on a classified balance sheet?
a. property, plant, and equipment
b. current assets
c. intangible assets
d. current liabilities

*ANSWER:* b

98. Which set of items below are current assets?
a. Accounts Receivable, Net Income, Inventory, and Dividends
b. Cash, Accounts Receivable, Common Stock, and Sales
c. Net Income, Cash, Office Supplies, and Inventory
d. Cash, Accounts Receivable, Inventory, and Office Supplies

*ANSWER:* d

99. A nonclassified balance sheet typically does **not** have a distinction between which of the following items?
a. assets and liabilities

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b. current and noncurrent items
c. liabilities and stockholders' equity
d. resources invested by the owners and amounts borrowed from creditors

*ANSWER:* b

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

a. The company's competitors were profitable.
b. The company's liquidity has improved compared to previous years.
c. The company has less equity than the rest of the industry.
d. The company's liquidity is worse than the rest of the industry.

*ANSWER:* d

101. **Bass Tours**

The following balances were taken from the company's records:

| | | | |
|---|---|---|---|
| Inventory | $380,000 | Accounts Receivable | $190,000 |
| Land | 290,000 | Accounts Payable | 180,000 |
| Cash | 129,000 | Unearned Revenue | 110,000 |
| Prepaid Rent | 33,000 | Common Stock | 312,000 |
| Retained Earnings | 220,000 | Long-term Notes Payable | 200,000 |

Calculate the total current assets.

a. $842,000
b. $1,022,000
c. $732,000
d. $842,000

*ANSWER:* c

102. **Bass Tours**

The following balances were taken from the company's records:

| | | | |
|---|---|---|---|
| Inventory | $380,000 | Accounts Receivable | $190,000 |
| Land | 290,000 | Accounts Payable | 180,000 |
| Cash | 129,000 | Unearned Revenue | 110,000 |
| Prepaid Rent | 33,000 | Common Stock | 312,000 |
| Retained Earnings | 220,000 | Long-term Notes Payable | 200,000 |

Calculate the current ratio.

a. 3.00 to 1
b. 2.75 to 1
c. 2.52 to 1
d. 2.10 to 1

*ANSWER:* c

103. **Bass Tours**

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The following balances were taken from the company's records:

| | | | |
|---|---|---|---|
| Inventory | $380,000 | Accounts Receivable | $190,000 |
| Land | 290,000 | Accounts Payable | 180,000 |
| Cash | 129,000 | Unearned Revenue | 110,000 |
| Prepaid Rent | 33,000 | Common Stock | 312,000 |
| Retained Earnings | 220,000 | Long-term Notes Payable | 200,000 |

If the average current ratio for similar companies is 2 to 1, what does this tell you about Bass's financial position?

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

*ANSWER:* a

104. If a company has current assets of $2,100,000 and current liabilities of $500,000, calculate its working capital.

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

*ANSWER:* c

105. Working capital is calculated by which of the following?

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

*ANSWER:* c

106. A company has current assets of $100,000, total assets of $250,000, current liabilities of $20,000, and long-term liabilities of $50,000. How much of its existing cash can the company use to acquire equipment without allowing its current ratio to decline below 2 to 1?

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

*ANSWER:* d

107. A company has been witnessing an increase in its dollar amount of working capital over the past several years. Which one of the following measures should be used to further evaluate the company's short-run liquidity?

a. The Asset Ratio
b. An analysis of the company's long-term debt
c. An analysis of the return on stockholders' equity
d. The Current Ratio

*ANSWER:* d

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## Ch. 01 Accounting and the Financial Statements

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

a. the Balance Sheet
b. the Income Statement
c. the Retained Earnings Statement
d. the Statement of Cash Flows

*ANSWER:* a

109. Barrett Oil Company reported the following balances as of December 31:

| | | | |
|---|---|---|---|
| Accounts Receivable | $125,000 | Unearned Revenue | $ 5,000 |
| Cash | 150,000 | Notes Payable (due in 6 months) | 115,000 |
| Land | 200,000 | Accounts Payable | 70,000 |
| Building | 400,000 | Equipment | 165,000 |
| Inventories | 105,000 | Notes Payable (due in 5 years) | 600,000 |

What is the company's current ratio?

a. 0.48 to 1
b. 2.00 to 1
c. 2.55 to 1
d. 2.86 to 1

*ANSWER:* b

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

a. $0
b. $100,000
c. $200,000
d. $300,000

*ANSWER:* b

111. For which of the following purposes is working capital and current ratio most useful?

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

*ANSWER:* a

112. A question frequently asked by investors is "How much debt does this company have?" Which financial statement answers this question?

a. the single step income statement
b. the cash flow statement
c. the multiple-step income statement
d. the classified balance sheet

*ANSWER:* d

113. Resources that provide a benefit over a number of years and lack physical substance are classified as _____.

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a. property, plant, and equipment
b. intangible assets
c. long-term investments
d. contributed capital

*ANSWER:* b

114. Liquidity
a. measures the ability of the firm to pay financial obligations as they become due.
b. can be measured in terms of working capital.
c. can be assessed by the current ratio.
d. All of these.

*ANSWER:* d

115. Which of the following would appear on an income statement?
a. unearned revenue
b. cost of sales
c. retained earnings
d. dividends

*ANSWER:* b

116. **Beaver Tree Service**

| | |
|---|---|
| Beginning Retained Earnings | $550,000 |
| Ending Retained Earnings | 700,000 |
| Dividends Paid | 100,000 |
| Revenue | 525,000 |

What is the company's net income?
a. $150,000
b. $250,000
c. $300,000
d. $350,000

*ANSWER:* b

117. **Beaver Tree Service**

| | |
|---|---|
| Beginning Retained Earnings | $550,000 |
| Ending Retained Earnings | 700,000 |
| Dividends Paid | 100,000 |
| Revenue | 525,000 |

The company's expenses are:
a. $100,000.
b. $150,000.
c. $450,000.

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d. $275,000.

*ANSWER:* d

118. If a company has revenues of $10,500,000, declares and pays $550,000 in dividends, and has net income of $1,600,000, how much were expenses for the year?

a. $9,950,000

b. $1,050,000

c. $2,150,000

d. $8,900,000

*ANSWER:* d

119. **Bay Camera**

The company reported the following items on its financial statements for the current year ended December 31:

| | | | |
|---|---|---|---|
| Sales | $780,000 | Cost of Sales | $700,000 |
| Selling, general & administrative expense | 20,000 | Other Expense | 15,000 |
| Dividends | 5,000 | Income Tax Expense | 12,500 |

What amount will be reported as *Retained Earnings* on the Balance Sheet at December 31, current year, assuming this is the first year of operations?

a. $22,500

b. $27,500

c. $42,500

d. Not enough information is provided.

*ANSWER:* b

120. **Bay Camera**

The company reported the following items on its financial statements for the year ended December 31:

| | | | |
|---|---|---|---|
| Sales | $780,000 | Cost of Sales | $700,000 |
| Selling, general, and administrative expenses | 20,000 | Other Expense | 15,000 |
| Dividends | 5,000 | Income Tax Expense | 12,500 |

What is the company's *Net Income* for the current year?

a. $22,500

b. $32,500

c. $42,500

d. $80,000

*ANSWER:* b

121. Suppose a company reports the following information at December 31:

| | |
|---|---|
| Sales | $15,000,000 |
| Cash | $ 3,000,000 |
| Unearned Revenue | $ 400,000 |

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| | |
|---|---|
| Dividends | $ 1,000,000 |
| Cost of Sales | $ 8,500,000 |

What is the company's Gross Profit?

a. $6,100,000
b. $5,500,000
c. $6,500,000
d. $12,000,000

*ANSWER:* c

122. Which of the following best describes the term "expenses"?

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

*ANSWER:* d

123. Which financial statement would you analyze to assess a firm’s operating performance for the past year?

a. the Balance Sheet
b. the Retained Earnings Statement
c. the Income Statement
d. the Statement of Public Accounting

*ANSWER:* c

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

a. the Statement of Cash Flows
b. the Retained Earnings Statement
c. the Balance Sheet
d. the Income Statement

*ANSWER:* d

125. Calculate total sales for a company that reported a net loss of $1,500,000 and total expenses of $2,900,000.

a. $4,400,000
b. $1,400,000
c. $2,400,000
d. $1,600,000

*ANSWER:* b

126. The Income Statement shows

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

*ANSWER:* c

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127. Which of the following items would not be reported on a multiple-step income statement after income from operations?

a. income taxes
b. interest income
c. selling expenses
d. interest expense

*ANSWER:* c

128. The cost of resources used to earn revenues during a period is called

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

*ANSWER:* b

129. On a multiple-step income statement, income from operations results from subtracting total operating expenses from which of the following amounts?

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

*ANSWER:* a

130. "Revenues" are best described as

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

*ANSWER:* b

131. Net profit margin is calculated as _____.

a. net income divided by sales revenue
b. sales revenue divided by net income
c. net income divided by income from operations
d. income from operations divided by net income

*ANSWER:* a

132. Which of the following is the correct date format for a financial statement heading?

a. Balance Sheet for the Year Ended June 30
b. Income Statement at December 31
c. Income Statement for the Year Ended December 31
d. Retained Earnings Statement at December 31

*ANSWER:* c

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133. The list below contains several items that appear on a multiple-step income statement.

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

Select the choice that lists the items in the order they would appear on a multiple-step income statement.

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

*ANSWER:* a

134. **Bellweather Times**

The company reports the following balances:

| | | |
|---|---|---|
| Other Revenue | $180,000 General and Administrative Expense | $320,000 |
| Dividends paid | $220,000 Gross Margin | $700,000 |
| Selling Expenses | $280,000 Income Tax Expense | $60,000 |

What is the company's income from operations?

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

*ANSWER:* c

135. **Bellweather Times**

The company reports the following balances:

| | | |
|---|---|---|
| Other Revenue | $180,000 General and Administrative Expense | $320,000 |
| Dividends paid | $220,000 Gross Margin | $700,000 |
| Selling Expenses | $280,000 Income Tax Expense | $60,000 |

What is the company's Net Income?

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

*ANSWER:* b

136. **Bellweather Times**
The company reports the following balances:

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| | | |
|---|---|---|
| Other Revenue | $180,000 General and Administrative Expense | $320,000 |
| Dividends paid | $220,000 Gross Margin | $700,000 |
| Selling Expenses | $280,000 Income Tax Expense | $60,000 |

By what amount will net income on a single-step income statement differ from net income on a multiple-step income statement if the company prepares both formats?

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

*ANSWER:* a

137. Been There Used Furniture began operations on January 1, current year, with an initial investment of $100,000 from each of its five stockholders. During the year, the company had net income of $200,000 and paid dividends of $50,000. If the company's revenues were $500,000 for the year ended December 31, current year, how much were total expenses?

a. $300,000
b. $250,000
c. $350,000
d. $800,000

*ANSWER:* a

138. A company reported the following income statement amounts:

| | **Current year** | **Prior year** |
|---|---|---|
| Service revenues | $950,000 | $800,000 |
| Operating expenses | $700,000 | $550,000 |
| Income taxes expense | $100,000 | $100,000 |

Which of the following best describes the company's performance?

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

*ANSWER:* a

139. Which one of the following equations represents the Retained Earnings Statement activity?

a. Beginning retained earnings + net income + dividends = ending retained earnings
b. Beginning retained earnings + cash inflows − cash outflows = ending retained earnings
c. Beginning retained earnings + dividends − net income = ending retained earnings
d. Beginning retained earnings + net income − dividends = ending retained earnings

*ANSWER:* d

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

Calculate the retained earnings balance at December 31, current year.

a. $150,000
b. $200,000

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c. $500,000
d. $650,000

*ANSWER:* a

141. Barr Attorneys reported the following information for the year ended December 31, current year.

| | |
|---|---|
| Revenue | $14,000,000 |
| Expenses | 11,500,000 |
| Dividends | 1,000,000 |
| Retained Earnings at December 31, current year | 1,750,000 |

What was the retained earnings balance at December 31, prior year?

a. $ 250,000
b. $2,500,000
c. $1,500,000
d. $ 350,000

*ANSWER:* a

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

a. $263,800
b. $298,500
c. $262,700
d. $287,300

*ANSWER:* d

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

a. retained earnings
b. dividends
c. liquidation of assets
d. monetary unit

*ANSWER:* b

144. B&B Painting reported the following information for the year ended December 31, current year.

| | |
|---|---|
| Revenues | $2,500,000 |
| Expenses | 2,000,000 |
| Retained Earnings at December 31, prior year | 100,000 |
| Retained Earnings at December 31, current year | 450,000 |

How much was paid out in dividends in the current year?

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

*ANSWER:* b

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145. On January 1, a company's balance in retained earnings was $10,000,000. At December 31, the balance in retained earnings was $9,400,000. If the company earned net income of $440,000 during the year, how much were dividends?

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

*ANSWER:* a

146. **Beard Marine**

The company reported the following information for the year ended December 31:

| | |
|---|---|
| Net income | $100,000 |
| Dividends | 6,000 |
| Retained earnings at December 31, current year | 120,000 |

What was the economic effect of the dividend payment?

a. The dividend reduced net income for the current year.
b. The dividend would have been added to net income if the company's accounting equation were in balance.
c. The dividend reduced total retained earnings.
d. The dividends reduced income from operations.

*ANSWER:* c

147. **Beard Marine**

The company reported the following information for the year ended December 31:

| | |
|---|---|
| Net income | $100,000 |
| Dividends | 6,000 |
| Retained earnings at December 31, current year | 120,000 |

What was the balance of Retained Earnings at January 1, current year?

a. $21,000
b. $26,000
c. $106,000
d. $214,000

*ANSWER:* b

148. Been There Used Furniture began operations on January 1, current year, with an initial investment of $100,000 from each of its five stockholders. During the year, the company had net income of $200,000 and paid dividends of $50,000. The dividends for the year

a. increase the amount of common stock reported by the company
b. are part of the company's operating expense.
c. are reported on the Retained Earnings Statement.
d. are reported on the Income Statement.

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*ANSWER:* c

149. Which one of the following is **not** one of the activities on the Statement of Cash Flows?
a. operating activities
b. investing activities
c. retained activities
d. financing activities

*ANSWER:* c

150. Which of the following best describes a company's operating activities?
a. Operating activities are cash flows directly related to earning income.
b. Operating activities are necessary to provide the money to start a business.
c. Operating activities are needed to provide the valuable assets required to run a business.
d. Operating activities represent the right to receive a benefit in the future.

*ANSWER:* a

151. Identify the category of the statement of cash flows that reports the cash flows related to obtaining capital for a company.
a. operating activities
b. investing activities
c. financing activities
d. noncurrent activities

*ANSWER:* c

152. Net Income appears on which financial statement(s)?
a. The Balance Sheet only
b. The Income Statement only
c. Both the Balance Sheet and the Income Statement
d. Both the Income Statement and the Retained Earnings Statement

*ANSWER:* d

153. The beginning balance of retained earnings was $800,000 and the ending balance was $500,000. The company paid dividends of $50,000.

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

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

*ANSWER:* A) (250,000) loss
[$500,000 Ending Retained Earnings − $800,000 Beginning Retained Earnings = ($300,000)]
[($300,000) decrease + $50,000 Dividends Paid = ($250,000) loss]

B) The Income Statement will show the sources of amounts earned (Revenues) as well as the amount and type of costs incurred by the company (Expenses) during the period.

154. **Backus Tractor Sales**

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The accountant prepared the following list of account balances from the company's records for the year ended December 31.

| | | | |
|---|---|---|---|
| Sales Revenue | $1,650,000 | Cash | $300,000 |
| Accounts Receivable | 140,000 | Selling Expenses | 440,000 |
| Equipment | 420,000 | Common Stock | 170,000 |
| Accounts Payable | 120,000 | Interest Income | 30,000 |
| Salaries & Wages Expense | 400,000 | Cost of Sales | 510,000 |
| Inventories | 220,000 | Prepaid Expenses | 20,000 |
| Income Taxes Payable | 50,000 | Income Taxes Expense | 180,000 |
| Notes Payable, due in 2 years | 200,000 | Retained Earnings | ? |

Determine the following amounts for Backus Tractor Sales:

A) The balance of Retained Earnings at the end of the year

B) The total stockholders' equity at the end of the year

C) Name the two events that might cause stockholders' equity to increase.

*ANSWER:* A) $560,000
($1,100,000 Total Assets − $370,000 Total Liabilities − $170,000 Common Stock = $560,000)

B) $730,000
($1,100,000 Total Assets − $370,000 Total Liabilities = $730,000)
OR
($170,000 Common Stock + $560,000 Retained Earnings = $730,000)

C) Stockholders' Equity can increase when common stock is issued to investors. It also can increase through increases in retained earnings. The later happens when the net income of the business is greater than any dividends paid to the shareholders.

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

A) Prepare a Retained Earnings Statement for the year ended December 31.

B) What is the nature or purpose of the Retained Earnings Statement?

C) What was the amount of common stock at the beginning of the year?

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

E) How do you identify whether the company was profitable during the year by examining the Retained Earnings Statement?

*ANSWER:*

A)

Best Deal Auto Parts
Retained Earnings Statement
For the Year Ended December 31

| | |
|---|---|
| Retained Earnings, January 1 | $160,000 |
| Add: Net income | 100,000 |

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| | |
|---|---|
| Deduct: Dividends | (80,000) |
| Retained Earnings, December 31 | $180,000 |

B) Retained earnings is the amount of income earned by the company less any dividends paid to the stockholders since the company began operations. The retained earnings statement summarizes and explains the changes in retained earnings during the accounting period.

C) $100,000
($400,000 Total Assets − $140,000 Total Liabilities − $160,000 Beginning Retained Earnings = $100,000)

D) One way that the company can increase stockholders' equity is by selling additional shares of stock to investors. Another way is by retaining some or all of the net income earned each year rather than paying it out in dividends. This accumulated income is the company's retained earnings.

E) The Retained Earnings Statement shows that the company was profitable for the year as there is reported net income for the period. If the company were to experience an operating loss, then this would be shown as a deduction from the beginning balance of retained earnings.

156. Presented below are selected data from a balance sheet:

| | |
|---|---|
| Current assets | $250,000 |
| Property, plant, & equipment | 700,000 |
| Other assets | ? ? ? |
| Current liabilities | 200,000 |
| Total Long-term debt | 500,000 |
| Total Stockholders' equity | 275,000 |

A) Determine the amount of "Other assets."
(Hint: You must use the accounting equation concept to determine your answer.)

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

*ANSWER:* A) $25,000
($200,000 Current liabilities + $500,000 Long-term debt + $275,000 Stockholders' equity = $975,000 Total Assets)
($975,000 Total Assets − $250,000 Current assets − $700,000 Property, plant, & equipment = $25,000)

B) Amount of financing by creditors: $700,000
($200,000 Current liabilities + $500,000 Long-term debt = $700,000)

Amount of financing by owners': $275,000
($275,000 Stockholders' equity)

157. The following accounts were taken from a company's accounting records. Answer the questions that follow.

| | | | |
|---|---|---|---|
| Total liabilities, end of the yr. | $920,000 | Total assets, end of the yr. | $1,430,000 |

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| | | | |
|---|---|---|---|
| Common stock, end of the yr. | 160,000 | Retained earnings, beginning of the yr. | 150,000 |
| Dividends for the period | 200,000 | Net income for the yr. | 400,000 |

A) How much is the balance of Retained Earnings at the end of the year?

B) Show the company's accounting equation at the end of the year with the respective dollar amounts.

C) If stockholders' equity increases during the year, does that mean that the company is profitable? Explain your answer.

*ANSWER:* A) $350,000
($150,000 Retained earnings, beginning of the year + $400,000 Net income − $200,000 Dividends for the period = $350,000)
OR
($1,430,000 Total assets, end of the year − $920,000 Total liabilities, end of the year − $160,000 Common stock, end of the year = $350,000)

B) $1,430,000 Total assets, end of the year = $920,000 Total liabilities, end of the year + $510,000 Stockholders' Equity, end of the year
($160,000 Common stock, end of the year + $350,000 Retained earnings, end of the year)

C) This would depend upon what causes the stockholders' equity to increase. If the increase was due to an increase in retained earnings, then the company would have been profitable for the period. But if the increase was due to an increase in the amount of common stock issued, this would not be a measure of profitability.

158. A certain company started business on January 1 with assets of $1,000,000 and stockholders' equity of $565,000. By the end of the year, assets increased by $100,000 and liabilities decreased by $150,000. Other than net income or loss, the only change in stockholders' equity was due to dividends paid worth $50,000.

A) What was the amount of total stockholders' equity at the end of the year?

B) What was the amount of net income or net loss for the year?

*ANSWER:* A)

| | **Assets** | | **Liabilities** | **Stockholders' Equity** |
|---|---|---|---|---|
| Beginning of the year | $1,000,000 | | $435,000 | $565,000 |
| Change during the year | +100,000 | | −150,000 | +250,000 |
| End of the year | $1,100,000 | = | 285,000 | $815,000 |

B)

| | |
|---|---|
| Change in equity | $ 250,000 |
| Add: Dividends | 50,000 |
| Net Income | $ 300,000 |

159. A certain company began the year with total assets of $10,000,000 and total liabilities of $6,200,000. No additional stock was issued during the year. Use the accounting equation to answer the following questions:

A) What was the amount of Total Assets at the end of the year if Liabilities decreased by $600,000 and Stockholders' Equity increased by $900,000?

B) Was the company profitable? Explain your answer.

*ANSWER:* A) $10,300,000

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| | Assets | Liabilities | Stockholders' Equity |
|---|---|---|---|
| Beginning of the year | $10,000,000 | $6,200,000 | $3,800,000 |
| Change during the year | 300,000 | (600,000) | 900,000 |
| End of the year | $10,300,000 | $5,600,000 | $4,700,000 |

B) Yes, the company was profitable because the Stockholders' Equity increased from the beginning of the year to the end of the year despite no additional stock being issued during the year.

160. The following balance sheet information is provided:

| | Assets | Liabilities | Stockholder's Equity |
|---|---|---|---|
| January 1,current year | $1,500,000 | $540,000 | $_____ |
| December 31, current year | 1,810,000 | _____ | 1,400,000 |

A) What is the amount of Stockholders' Equity at January 1, current year?

B) What is the amount of Liabilities at December 31, current year?

C) Assume that the company paid dividends of $620,000 during the year. How much net income did it earn during the year?

D) Assume that the company paid no dividends during the year. Without looking at the income statement, how can you tell if the company is profitable or not?

*ANSWER:* A) $960,000
($1,500,000 Assets − $540,000 Liabilities = $960,000)

B) $410,000
($1,810,000 Assets − $1,400,000 Stockholders' Equity = $410,000 Liabilities)

C) $1,060,000
($960,000 Beginning Stockholders' Equity + X − $620,000 Dividend = $1,400,000 Ending Stockholders' Equity)

(X = $1,060,000)

D) Assuming that the increase in Stockholders' Equity would come from net income, the company would have to be considered profitable. Net income will increase Retained Earnings which is part of Stockholders' Equity.

161. **Backus Tractor Sales**

The accountant prepared the following list of account balances from the company's records for the year ended December 31.

| | | | |
|---|---|---|---|
| Sales Revenue | $1,650,000 | Cash | $300,000 |
| Accounts Receivable | 140,000 | Selling Expenses | 440,000 |
| Equipment | 420,000 | Common Stock | 170,000 |
| Accounts Payable | 120,000 | Interest Income | 30,000 |

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| | | | |
|---|---|---|---|
| Salaries & Wages Expense | 400,000 | Cost of Sales | 510,000 |
| Inventories | 220,000 | Prepaid Expenses | 20,000 |
| Income Taxes Payable | 50,000 | Income Taxes Expense | 180,000 |
| Notes Payable, due in 2 years | 200,000 | Retained Earnings | ? |

Determine the following amounts for Backus Tractor Sales.

A) Current Assets at the end of the year
Total Assets at the end of the year

B) Total Liabilities at the end of the year

C) What parties have a claim on the company's assets? Explain your answer in terms of the accounting equation.

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

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

B) Total Liabilities = $370,000
($120,000 Accounts Payable + $50,000 Income Taxes Payable + $200,000 Notes Payable = $370,000)

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

162. **Backus Tractor Sales**

The accountant prepared the following list of account balances from the company's records for the year ended December 31.

| | | | |
|---|---|---|---|
| Sales Revenue | $1,650,000 | Cash | $300,000 |
| Accounts Receivable | 140,000 | Selling Expenses | 440,000 |
| Equipment | 420,000 | Common Stock | 170,000 |
| Accounts Payable | 120,000 | Interest Income | 30,000 |
| Salaries & Wages Expense | 400,000 | Cost of Sales | 510,000 |
| Inventories | 220,000 | Prepaid Expenses | 20,000 |
| Income Taxes Payable | 50,000 | Income Taxes Expense | 180,000 |
| Notes Payable, due in 2 years | 200,000 | Retained Earnings | ? |

Prepare a Balance Sheet for Backus Tractor Sales in good form.

*ANSWER:*

Backus Tractor Sales
Balance Sheet
December 31

| **Assets** | | **Liabilities & Stockholders' Equity** | |
|---|---|---|---|
| Cash | $ 300,000 | Accounts payable | $ 120,000 |
| Accounts receivable | 140,000 | Income taxes payable | 50,000 |

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| | | | |
|---|---|---|---|
| Inventories | 220,000 | Notes payable | 200,000 |
| Prepaid expenses | 20,000 | Common stock | 170,000 |
| Equipment | 420,000 | Retained Earnings | 560,000 |
| Total Assets | $1,100,000 | Total Liabilities & Stockholders' Equity | $1,100,000 |

163. **Ben & Terry's Ice Cream**

The accountant prepared the following list from the company's accounting records for the year ended December 31:

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

Determine the following amounts for Ben & Terry's Ice Cream.

A) Total Assets at the end of the year.

B) Total Liabilities at the end of the year.

C) Total Equity at the end of the year.

*ANSWER:* A) $1,247,000
($77,000 Cash + $170,000 Accounts Receivable + $200,000 Inventories + $50,000 Prepaid Expense + $750,000 Land = $1,247,000)

B) $540,000
($50,000 Accounts Payable + $450,000 Notes Payable + $40,000 Salaries Payable = $540,000)

C) $707,000
($1,247,000 Total Assets − $540,000 Total Liabilities = $707,000)

164. **Ben & Terry's Ice Cream**

The accountant prepared the following list from the company's accounting records for the year ended December 31:

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

Using good form, prepare a Balance Sheet for Ben & Terry's Ice Cream.

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*ANSWER:*

Ben & Terry's Ice Cream
Balance Sheet
As of December 31

| **Assets** | | **Liabilities & Owners' Equity** | |
|---|---|---|---|
| Cash | $ 77,000 | Accounts Payable | $ 50,000 |
| Accounts Receivable | 170,000 | Salaries Payable | 40,000 |
| Inventory | 200,000 | Notes Payable | 450,000 |
| Prepaid Expenses | 50,000 | Common Stock | 400,000 |
| Land | 750,000 | Retained Earnings | 307,000 |
| Total Assets | $1,247,000 | Total Liabilities & Owners' Equity | $1,247,000 |

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

A) What is the amount of Dunn's Total Stockholders' Equity at the end of the year?

B) Could Dunn have paid additional dividends during the year? Explain your answer.

*ANSWER:* A) $1,710,000
($1,400,000 Total Assets at the beginning of the year − $240,000 Total Liabilities at beginning of the year = $1,160,000 Total Stockholders' Equity at the beginning of the year)
($1,160,000 Total Stockholders' Equity at the beginning of the year + $1,000,000 Net Income for the year − $450,000 Dividends = $1,710,000)

B) Yes. Assuming the company has enough cash to do so, additional dividends can be paid. Net income exceeded the amount of dividends paid by $550,000 ($1,000,000 − $450,000), so the amount paid could have been increased. Also, the company has total positive retained earnings.

166. Classify the following items according to the financial statements on which each belongs, either the income statement (IS), the Retained Earnings Statement (RE), or the balance sheet (BS). Also, indicate whether each is a revenue (R), an expense (E), an asset (A), a liability (L), or a stockholders' equity (SE) item.

| | **Appears on Which Statements?** | **Type of Account** |
|---|---|---|
| 1. Retained earnings, end of the year | _____ | _____ |
| 2. Equipment | _____ | _____ |
| 3. Common stock | _____ | _____ |
| 4. Unearned revenue | _____ | _____ |
| 5. Sales | _____ | _____ |
| 6. Rent expense | _____ | _____ |
| 7. Inventories | _____ | _____ |

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Ch. 01 Accounting and the Financial Statements

| | | | | |
|---|---|---|---|---|
| *ANSWER:* | 1. | Retained earnings, end of the year | BS, RE | SE |
| | 2. | Equipment | BS | A |
| | 3. | Common stock | BS | SE |
| | 4. | Unearned revenue | BS | L |
| | 5. | Sales | IS | R |
| | 6. | Rent expense | IS | E |
| | 7. | Inventories | BS | A |

167. The following amounts were taken from the accounting records at December 31, current year:

| | | | |
|---|---|---|---|
| Accounts Payable | $400,000 | Dividends Paid | $100,000 |
| Cash | $100,000 | Expenses | $600,000 |
| Inventories | $700,000 | Revenue | $750,000 |

A) Calculate Total Assets.

B) Calculate Net Income for the year.

C) Calculate Total Stockholders' Equity at the end of the year.

D) Calculate Total Stockholders' Equity at the beginning of the year assuming there were no stock transactions during the year.

*ANSWER:* A) $800,000
($100,000 Cash + $700,000 Inventories = $800,000)

B) $150,000
($750,000 Revenue − $600,000 Expenses = $150,000)

C) $400,000
($800,000 Total Assets − $400,000 Accounts Payable = $400,000)

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

168. The following information is taken from the Balance Sheet at December 31:

| | | | |
|---|---|---|---|
| Cash | $288,000 | Retained Earnings | $168,000 |
| Inventory | 96,000 | Accounts Payable | 84,000 |
| Equipment | 456,000 | Bonds Payable | 276,000 |
| Common Stock | 312,000 | | |

A) How much did creditors provide to this company?

B) Which financial statement would an investor look to see if any stock was issued during the year?

*ANSWER:* A) $360,000
($84,000 Accounts Payable + $276,000 Bond Payable)

B) While the Balance Sheet may show an amount for "Common Stock," this amount is an ending balance and would not show the results of any transactions involving new

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issuances of stock during the period. Comparing the current year balance sheet with the prior year balance sheet would give this information in the form of the difference between the contributed capital. Also, the Statement of cash flows for the current year would show this information under the category cash flows from financing activities.

169. **Baloon-E-Tunes**

| | | | |
|---|---|---|---|
| Retained Earnings | $370,000 | Notes Payable (due in 6 years) | $120,000 |
| Accumulated Depreciation | 130,000 | Salaries Payable | 10,000 |
| Income Taxes Payable | 240,000 | Supplies | 20,000 |
| Plant | 480,000 | Accounts Payable | 360,000 |
| Cash | 110,000 | Inventory | 330,000 |
| Accounts Receivable | 350,000 | Land | 500,000 |
| Common Stock | 600,000 | Prepaid Insurance | 40,000 |

Prepare the current assets section of the Balance Sheet. You may omit the heading. How does the concept of liquidity apply?

*ANSWER:*

| | |
|---|---|
| Cash | $110,000 |
| Accounts Receivable | 350,000 |
| Inventory | 330,000 |
| Prepaid Insurance | 40,000 |
| Supplies | 20,000 |
| Total Current Assets | $850,000 |

Liquidity is an indicator of how close to cash the company's assets are. Those assets that are most liquid are listed first. Liquidity relates to the company's ability to pay its obligations as they become due. Current assets are expected to be converted into cash within 1 year or one operating cycle, whichever is longer, so they are a key determinant of liquidity.

170. **Baloon-E-Tunes**

| | | | |
|---|---|---|---|
| Retained Earnings | $370,000 | Notes Payable (due in 6 years) | $120,000 |
| Accumulated Depreciation | 130,000 | Salaries Payable | 10,000 |
| Income Taxes Payable | 240,000 | Supplies | 20,000 |
| Plant | 480,000 | Accounts Payable | 360,000 |
| Cash | 110,000 | Inventory | 330,000 |
| Accounts Receivable | 350,000 | Land | 500,000 |
| Common Stock | 600,000 | Prepaid Insurance | 40,000 |

Prepare the current liabilities section of the balance sheet. You may omit the heading. If the amount of current liabilities were larger, what effect would this have on the current ratio?

*ANSWER:*

| | |
|---|---|
| Accounts Payable | $360,000 |
| Salaries Payable | 10,000 |
| Income Taxes Payable | 240,000 |
| Total | $610,000 |

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

171. **Baloon-E-Tunes**

| | | | |
|---|---|---|---|
| Retained Earnings | $370,000 | Notes Payable (due in 6 years) | $120,000 |

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| | | | |
|---|---|---|---|
| Accumulated Depreciation | 130,000 | Salaries Payable | 10,000 |
| Income Taxes Payable | 240,000 | Supplies | 20,000 |
| Plant | 480,000 | Accounts Payable | 360,000 |
| Cash | 110,000 | Inventory | 330,000 |
| Accounts Receivable | 350,000 | Land | 500,000 |
| Common Stock | 600,000 | Prepaid Insurance | 40,000 |

Prepare the long-term assets section of the balance sheet. You may omit the heading. Why are these amounts classified as "long-term"?

*ANSWER:*

| | | |
|---|---|---|
| Land | | $500,000 |
| Plant | $480,000 | |
| Less: Accumulated Depreciation | (130,000) | 350,000 |
| Total | | $850,000 |

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 provide a benefit for more than one accounting period. Accumulated depreciation is the portion of the cost of the plant that has been expensed in the accounting periods to date.

172. **Baloon-E-Tunes**

| | | | |
|---|---|---|---|
| Retained Earnings | $370,000 | Notes Payable (due in 6 years) | $120,000 |
| Accumulated Depreciation | 130,000 | Salaries Payable | 10,000 |
| Income Taxes Payable | 240,000 | Supplies | 20,000 |
| Plant | 480,000 | Accounts Payable | 360,000 |
| Cash | 110,000 | Inventory | 330,000 |
| Accounts Receivable | 350,000 | Land | 500,000 |
| Common Stock | 600,000 | Prepaid Insurance | 40,000 |

Calculate the current ratio. What does this ratio tell you about the composition of the current assets?

*ANSWER:* Current Assets = $850,000
($110,000 Cash + $350,000 Accounts receivable + $330,000 Inventory + $40,000 Prepaid Insurance + $20,000 Supplies = $850,000)

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

Current ratio = 1.39 to 1
($850,000 / $610,000)

The current ratio does not provide information about the composition of the company's current assets and current liabilities. Only total current assets are used to calculate the current ratio.

173. **Baloon-E-Tunes**

| | | | |
|---|---|---|---|
| Retained Earnings | $370,000 | Notes Payable (due in 6 years) | $120,000 |
| Accumulated Depreciation | 130,000 | Salaries Payable | 10,000 |
| Income Taxes Payable | 240,000 | Supplies | 20,000 |
| Plant | 480,000 | Accounts Payable | 360,000 |
| Cash | 110,000 | Inventory | 330,000 |
| Accounts Receivable | 350,000 | Land | 500,000 |

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| | | | |
|---|---|---|---|
| Common Stock | 600,000 | Prepaid Insurance | 40,000 |

Calculate the amount of working capital. What can you learn from the current ratio that you cannot learn from the amount of working capital?

*ANSWER:* Current Assets = $850,000
($110,000 Cash + $350,000 Accounts receivable + $330,000 Inventory + $40,000 Prepaid Insurance + $20,000 Supplies = $850,000)

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

Working Capital = $240,000
($850,000 − $610,000)

Working capital and the current ratio are both measures of liquidity. Working capital is a dollar amount and the information it can convey is limited. The current ratio is based on a relative relationship and hence allows comparisons to be made between different companies.

174. B-There Transportation calculated the following amounts concerning its financial information for the year ending December 31, current year and prior year.

| | **Current year** | **Prior year** |
|---|---|---|
| Current Ratio | 4.0 to 1 | 2.0 to 1 |

What does this change in the current ratio indicate? Explain.

*ANSWER:* The current ratio increased from 2.0 to 1 to 4.0 to 1. This is an unusually large increase for most companies. A larger current ratio means a company is more liquid. Its current assets as a percentage of its current liabilities have increased.

175. B-There Transportation calculated the following amounts concerning its financial information for the year ending December 31, current year and prior year.

| | **Current year** | **Prior year** |
|---|---|---|
| Current Ratio | 4.0 to 1 | 2.0 to 1 |

Suppose the company had a decrease in its cash account from prior year to current year. Would the other current assets amounts have increased or decreased? Explain.

*ANSWER:* Since the current ratio increased from prior year to current year, the current assets other than cash would have had to increase substantially to offset the decline in cash. However, cash could also have been used to pay down current liabilities but then current ratio would not be impacted substantially.

176. After reporting a profit of $20,000 for the year, a certain company reported the following items on its balance sheet:

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

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

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

C) Which other financial statement would help to fully access liquidity?

*ANSWER:* A) Current ratio: 6 to 1
($225,000 Cash + $110,000 Accounts receivable + $80,000 Inventory + $5,000 Prepaid insurance) / ($60,000 Accounts payable + $10,000 Salaries payable) = 6 to 1

Working capital: $350,000
($420,000 Total Current Assets − $70,000 Total Current Liabilities = $350,000)

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

C) The statement of cash flows would be helpful to determine the cash inflows and outflows that occurred during the year. The 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.

177. The following amounts were taken from the accounting records at December 31, current year:

| | | | |
|---|---|---|---|
| Service Revenue | $600,000 | Salaries Expense | $200,000 |
| Dividends Paid | 50,000 | Rent Expense | 86,000 |
| Buildings | 110,000 | Land | 100,000 |
| Accounts Payable | 40,000 | Accounts Receivable | 28,000 |
| Common Stock | 60,000 | Retained Earnings, Jan. 1,current year | 400,000 |
| Utilities Expense | 19,000 | Notes Payable | 30,000 |
| Income Tax Payable | 4,000 | Income Tax Expense | 110,000 |

A) Calculate net income for the year.

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

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

B) $535,000
($400,000 Retained Earnings, Jan. 1, current year + $185,000 Net Income − $50,000 Dividends Paid = $535,000)

178. Presented below are selected data from the accounting records for the year:

| | |
|---|---|
| Sales | $900,000 |
| Income tax expense | 80,000 |
| Cost of Sales | 550,000 |
| Operating expenses | 150,000 |

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| | |
|---|---|
| Dividends | 75,000 |

A) Calculate the net income or loss for the year.

B) Did the company's financial position improve or deteriorate during the year? Explain.

C) Is the company profitable? Explain.

*ANSWER:* A) Net income: $120,000
($900,000 Sales − $550,000 Cost of sales − $150,000 Operating expenses − $80,000 Income tax expense = $120,000)

B) The financial position improved since the net income increases the company's retained earnings.

C) Yes. The amount of revenues exceeds the amount of expenses by $120,000.

179. **Backus Tractor Sales**

The accountant prepared the following list of account balances from the company's records for the year ended December 31.

| | | | |
|---|---|---|---|
| Sales Revenue | $1,650,000 | Cash | $300,000 |
| Accounts Receivable | 140,000 | Selling Expenses | 440,000 |
| Equipment | 420,000 | Common Stock | 170,000 |
| Accounts Payable | 120,000 | Interest Income | 30,000 |
| Salaries & Wages Expense | 400,000 | Cost of Sales | 510,000 |
| Inventories | 220,000 | Prepaid Expenses | 20,000 |
| Income Taxes Payable | 50,000 | Income Taxes Expense | 180,000 |
| Notes Payable, due in 2 years | 200,000 | Retained Earnings | ? |

Determine the following amounts for Backus Tractor Sales:

A) The total revenues for the year.

B) The total expenses for the year.

C) What is the purpose of the Income Statement?

D) Is this company profitable? Explain your answer.

E) Is this the first year of operations for this company? Explain your answer.

*ANSWER:* A) $1,680,000
($1,650,000 Sales Revenue + $30,000 Interest Income = $1,680,000)

B) $1,530,000
($510,000 Cost of Sales + $400,000 Salaries & Wages Expense + $440,000 Selling Expenses + $180,000 Income Taxes Expense = $1,530,000)

C) The purpose of the Income Statement is to provide information regarding the revenues and expenses of the company. The difference between the two shows the profitability of the company for a particular period of time.

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D) The company had net income of $150,000 for the period. Since revenues exceeded expenses for the period, the company would be considered profitable.

E) This would not be the first year of operations for this company. The reasons for this are that the ending Retained Earnings balance is greater than the net income of $150,000. Since the ending balance of Retained Earnings is $560,000 and Net Income for the period was $150,000 as well as apparently no dividends were being paid to the stockholders during the year, the company began the year with a balance of $410,000 ($560,000 − $150,000) in Retained Earnings.

180. The following amounts were taken from the income statement of Beauty World for the current year ending December 31:

| | **Current year** |
|---|---|
| Net Sales | $750,000 |
| Selling, General, and Administrative Expense | 450,000 |
| Research and Development Expense | 50,000 |
| Other Income (net) | 25,000 |

How much is net income for the current year ended December 31? Would the net income amount have been different if the company had used a single-step income statement rather than the multiple-step income statement? Explain.

*ANSWER:* Net Income = $275,000
($750,000 Net Sales + $25,000 Other Income, net − $450,000 Selling, General, and Administrative Expenses − $50,000 Research and Development Expense = $275,000)
Net income is the same under a single-step or a multiple-step income statement. Only subtotals and the order the amounts are listed in differ.

181. **Backus Tractor Sales**

The accountant prepared the following list of account balances from the company's records for the year ended December 31.

| | | | |
|---|---|---|---|
| Sales Revenue | $1,650,000 | Cash | $300,000 |
| Accounts Receivable | 140,000 | Selling Expenses | 440,000 |
| Equipment | 420,000 | Common Stock | 170,000 |
| Accounts Payable | 120,000 | Interest Income | 30,000 |
| Salaries & Wages Expense | 400,000 | Cost of Sales | 510,000 |
| Inventories | 220,000 | Prepaid Expenses | 20,000 |
| Income Taxes Payable | 50,000 | Income Taxes Expense | 180,000 |
| Notes Payable, due in 2 years | 200,000 | Retained Earnings | ? |

Prepare a single-step Income Statement for Backus Tractor Sales in good form.

*ANSWER:*

Backus Tractor Sales
Income Statement
For the Year Ended December 31

| | | | |
|---|---|---|---|
| Revenues: | | | |
| | Sales revenue | $1,650,000 | |
| | Interest income | 30,000 | $1,680,000 |
| Expenses: | | | |
| | Cost of sales | $ 510,000 | |

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| | | | |
|---|---|---|---|
| | Salaries & wages expense | 400,000 | |
| | Selling expenses | 440,000 | |
| | Income taxes expense | 180,000 | 1,530,000 |
| Net income | | | $ 150,000 |

182. Listed below are several amounts from the accounting records of Bike Links for the year ended December 31. Prepare a multiple-step income statement in good form.

| | |
|---|---|
| Service revenue | $960,000 |
| Selling expense | 176,000 |
| Income taxes expense | 160,000 |
| General and administrative expenses | 280,000 |
| Interest revenue | 8,000 |

*ANSWER:*

Bike Links
Income Statement
For the Year Ended December 31

| | | | |
|---|---|---|---|
| Service Revenue | | | $960,000 |
| Operating Expenses: | | | |
| | Selling Expenses | $176,000 | |
| | General and Administrative Expenses | 280,000 | |
| | Total Operating Expenses | | 456,000 |
| Income from Operations | | | $ 504,000 |
| Other Revenue and Expenses | | | |
| | Interest Revenue | | 8,000 |
| Income Before Taxes | | | $ 512,000 |
| Income Taxes Expense | | | 160,000 |
| Net Income | | | $ 352,000 |

183. **Ben & Terry's Ice Cream**

The accountant prepared the following list from the company's accounting records for the year ended December 31:

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

Determine the following amounts for Ben & Terry's Ice Cream:

A) Total Revenues for the year.

B) Total Expenses for the year.

C) Net Income for the year.

*ANSWER:* A) $1,005,000
($955,000 Sales Revenue + $50,000 Interest Income = $1,005,000)

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B) $905,000
($700,000 Cost of Sales + $140,000 Salary Expense + $20,000 Income Tax Expense + $45,000 Selling Expense = $905,000)

C) $100,000
($1,005,000 Total Revenue − $905,000 Total Expenses = $100,000)

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

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

*ANSWER:*

Big Tom's Pawn Shops
Income Statement
For the Year Ended December 31

| | | | |
|---|---|---|---|
| Revenues: | | | |
| | Sales | | $225,000 |
| Expenses | | | |
| | Salaries expense | $145,000 | |
| | Rent expense | 12,000 | |
| | Insurance expense | 11,000 | |
| | Income taxes expense | 30,000 | |
| | Total Expenses | | 198,000 |
| Net Income | | | $ 27,000 |

185. **Ben & Terry's Ice Cream**

The accountant prepared the following list from the company's accounting records for the year ended December 31:

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

Using good form, prepare a single-step income statement for Ben & Terry's Ice Cream.

*ANSWER:*

Ben & Terry's Ice Cream
Income Statement
For the Year Ended December 31

| | | | |
|---|---|---|---|
| Revenues: | | | |
| | Sales Revenue | $955,000 | |
| | Interest Income | 50,000 | $1,005,000 |

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| | | | |
|---|---|---|---|
| Expenses: | | | |
| | Cost of Sales | $700,000 | |
| | Salaries Expense | 140,000 | |
| | Selling Expense | 45,000 | |
| | Income taxes Expense | 20,000 | 905,000 |
| Net Income | | | $ 100,000 |

186. Blackbeard's Restaurant began operations on January 1, 2021, with a total investment of $100,000 by its stockholders. The restaurant had a net loss in its first year of business of $15,000. During 2022 and 2023, the business was profitable with net incomes of $25,000 and $50,000, respectively. The company paid $5,000 per year in dividends to its shareholders in 2022 and 2023.

A) In good form, prepare a Retained Earnings Statement for the year ended December 31, 2022.

B) How much is total retained earnings on December 31, 2023?

C) Explain the link between the Retained Earnings Statement and the balance sheet.

*ANSWER:* A)

Blackbeard's Restaurant
Retained Earnings Statement
For the Year Ended December 31, 2022

| | |
|---|---|
| Beginning balance, January 1, 2022 | $(15,000)* |
| Add: Net income for 2022 | 25,000 |
| Less: Dividends paid during the year | (5,000) |
| Ending balance, December 31, 2022 | $ 5,000 |

*$−15,000 Net Loss for 2021 − $0 Dividends paid = $(15,000) Balance, January 1, 2022

B) Retained earnings at December 31, 2023 = $50,000
($5,000 Beginning Balance, January 1, 2023 + $50,000 Net Income for 2023 − $5,000 Dividends paid during the year = $50,000)

C) The ending balance of the retained earnings statement represents the cumulative earnings less all the dividends declared and paid for the life of the business. This amount appears on the balance sheet as a component of stockholders' equity.

187. Assume that you have received copies of the financial statements for Best Buy for two consecutive years. Answer the following questions

A) If you were a banker, why would you need information from the company's financial statements?

B) If you were a potential investor in Best Buy stock, what information would you want from their financial statements?

C) If you were a labor negotiator for a union that represents a group of Best Buy employees, which financial statement would provide you with the most useful information?

*ANSWER:*

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

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

C) A labor negotiator needs to know how much profit the company has made. This information is found on the Income Statement.

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

*ANSWER:* The groups and their decisions are:

| | |
|---|---|
| Stockholders: | Is the company profitable enough to pay dividends?<br>Did the company make a profit for the period? |
| Management: | How should an item be priced? Should we continue operations?<br>Can we give employees raises? |
| Bankers: | Can the company pay interest and principal when it comes due? |
| Creditors: | Can the company pay bills when they are due? |
| Governmental agencies: | How much did the company earn? (i.e., how much taxes should be paid?) |

189. **Baker's Pride Bakery**

Condensed data from the company's current year and prior year financial statements are presented below. The figures are expressed in thousands.

| **Statement A** | Current year | Prior year |
|---|---|---|
| **Assets:** | | |
| Total current assets | $219,560 | $198,088 |
| Property, plant, & equipment (net of accumulated depreciation) | 18,320 | 13,996 |
| Investments | 3,370 | 1,167 |
| Other assets | 12,220 | 11,667 |
| Total assets | $253,470 | $224,918 |
| **Liabilities:** | | |
| Total current liabilities | $ 92,990 | $ 95,260 |
| Long-term debt | 15,160 | 22,172 |
| Total liabilities | $108,150 | $117,432 |
| Stockholders' equity: | | |
| Contributed capital | $ 53,680 | $ 35,475 |
| Retained Earnings | 91,640 | 72,011 |
| Total stockholders' equity | $145,320 | $107,486 |
| Total liabilities & stockholders' equity | $253,470 | $224,918 |

| **Statement B** | Current year | Prior year |
|---|---|---|
| Net Sales | $229,301 | $203,171 |
| Cost of sales | 135,453 | 131,212 |
| Gross margin | $ 93,848 | $ 71,959 |
| Selling, general, and administrative expenses | 64,832 | 57,442 |
| Other income (expense) | 693 | (130) |
| Income (loss) before income taxes | $ 29,709 | $ 14,387 |

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| | | |
|---|---|---|
| Income tax expense | 3,534 | 2,320 |
| Net income (loss) | $ 26,175 | $ 12,067 |

Based on the information provided, is the company considered a business or non-business entity? How do you know by examining the financial statements?

*ANSWER:* All businesses engage in activities that can be categorized as financing, investing, or operating activities. The given balance sheet and the income statement show that Baker's Pride Bakery has taken part in all the aforementioned activities and thus is a business entity. It has raised capital from stockholders and creditors and also carried on operations which resulted in sales and net income.

190. **Baker's Pride Bakery**

Condensed data from the company's current year and prior year financial statements are presented below. The figures are expressed in thousands.

| **Statement A** | Current year | Prior year |
|---|---|---|
| **Assets:** | | |
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| Income (loss) before income taxes | $ 29,709 | $ 14,387 |
| Income tax expense | 3,534 | 2,320 |
| Net income (loss) | $ 26,175 | $ 12,067 |

Based on the information provided, is the company legally organized as a sole proprietorship, partnership, or corporation? How can you tell?

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

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

| Item | Proprietorship | Corporation |
|---|---|---|
| Ease of formation | | |
| Ability to raise large sums of capital | | |

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| | | |
|---|---|---|
| Tax advantages | | |
| Extent of owner liability | | |
| Double taxation of profits | | |

*ANSWER:*

| Item | Proprietorship | Corporation |
|---|---|---|
| Ease of formation | Easy | More difficult |
| Ability to raise large sums of capital | Limited | Easier |
| Tax advantages | Yes | No |
| Extent of owner liability | Unlimited | Limited |
| Double taxation of profits | No | Yes |

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

*ANSWER:* 1. The Balance Sheet
2. The Income Statement
3. The Retained Earnings Statement
4. The Statement of Cash Flows

Net income on the income statement increases retained earnings on the Retained Earnings Statement. The balance in the Retained Earnings Statement goes to the balance sheet. The ending balance for cash on the Statement of Cash Flows is also shown on the Balance Sheet. The statement of cash flows explains the change in cash during the year.

193. **Baker's Pride Bakery**

Condensed data from the company's current year and prior year financial statements are presented below. The figures are expressed in thousands.

| **Statement A** | Current year | Prior year |
|---|---|---|
| **Assets:** | | |
| Total current assets | $219,560 | $198,088 |
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| Investments | 3,370 | 1,167 |
| Other assets | 12,220 | 11,667 |
| Total assets | $253,470 | $224,918 |
| **Liabilities:** | | |
| Total current liabilities | $ 92,990 | $ 95,260 |
| Long-term debt | 15,160 | 22,172 |
| Total liabilities | $108,150 | $117,432 |
| Stockholders' equity: | | |
| Contributed capital | $ 53,680 | $ 35,475 |
| Retained Earnings | 91,640 | 72,011 |
| Total stockholders' equity | $145,320 | $107,486 |
| Total liabilities & stockholders' equity | $253,470 | $224,918 |

| **Statement B** | Current year | Prior year |
|---|---|---|
| Net Sales | $229,301 | $203,171 |
| Cost of sales | 135,453 | 131,212 |
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| Selling, general, and administrative expenses | 64,832 | 57,442 |

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| | | |
|---|---|---|
| Other income (expense) | 693 | (130) |
| Income (loss) before income taxes | $ 29,709 | $ 14,387 |
| Income tax expense | 3,534 | 2,320 |
| Net income (loss) | $ 26,175 | $ 12,067 |

Which statement indicates the financial position of the company on a specific date? What information is provided on that statement that indicates the financial position of the company? Explain.

*ANSWER:* The classified balance sheet provides information about the financial position of the company. It is expressed in terms of the accounting equation. When total liabilities are subtracted from total assets, the difference is stockholders' equity.

194. **Baker's Pride Bakery**

Condensed data from the company's current year and prior year financial statements are presented below. The figures are expressed in thousands.

| **Statement A** | Current year | Prior year |
|---|---|---|
| **Assets:** | | |
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| Total assets | $253,470 | $224,918 |
| **Liabilities:** | | |
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| Total stockholders' equity | $145,320 | $107,486 |
| Total liabilities & stockholders' equity | $253,470 | $224,918 |

| **Statement B** | Current year | Prior year |
|---|---|---|
| Net Sales | $229,301 | $203,171 |
| Cost of sales | 135,453 | 131,212 |
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| Other income (expense) | 693 | (130) |
| Income (loss) before income taxes | $ 29,709 | $ 14,387 |
| Income tax expense | 3,534 | 2,320 |
| Net income (loss) | $ 26,175 | $ 12,067 |

How much of the company is financed by the owners at the end of the current year?

*ANSWER:* The amount of financing by the owners for the current year is represented by the amount of stockholders' equity, $145,320.

195. **Baker's Pride Bakery**

Condensed data from the company's current year and prior year financial statements are presented below. The figures are

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expressed in thousands.

| **Statement A** | Current year | Prior year |
|---|---|---|
| **Assets:** | | |
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| Total assets | $253,470 | $224,918 |
| **Liabilities:** | | |
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| Total liabilities | $108,150 | $117,432 |
| Stockholders' equity: | | |
| Contributed capital | $ 53,680 | $ 35,475 |
| Retained Earnings | 91,640 | 72,011 |
| Total stockholders' equity | $145,320 | $107,486 |
| Total liabilities & stockholders' equity | $253,470 | $224,918 |

| **Statement B** | Current year | Prior year |
|---|---|---|
| Net Sales | $229,301 | $203,171 |
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| Other income (expense) | 693 | (130) |
| Income (loss) before income taxes | $ 29,709 | $ 14,387 |
| Income tax expense | 3,534 | 2,320 |
| Net income (loss) | $ 26,175 | $ 12,067 |

How much of the company is financed by creditors at the end of the current year?

*ANSWER:* The amount of financing provided by creditors for the current year is the amount of liabilities reported on the balance sheet, $108,150. For the prior year, the amount was $117,432. Total liabilities decreased by $9,282, or 8.58%, from the prior year to the current year.

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

*ANSWER:* Investors are most interested in cash receipts from dividends and the profitability trend of the company. Creditors are most interested in cash to be received for interest payments and the repayment of the principal. If a company does not have sufficient cash flows, investors and creditors could suffer as a result. The financial position, shown on the company's Balance Sheet, is also a concern for both investors and creditors because even though the company may have what appears to be sufficient cash flows for the current period, the long-term cash flow could be weak.

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

*ANSWER:* The classification helps the users know how a company obtained its resources and whether a company will be able to pay its obligations when they become due. 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.

198. How are current liabilities closely related to current assets?

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*ANSWER:* Current liabilities are obligations that will be satisfied within the operating cycle or within 1 year if the cycle is shorter than 1 year. These can be satisfied through the payment of cash or by providing goods or services. Current assets will be converted into cash, or sold, or consumed during the operating cycle or within 1 year if the cycle is shorter. For most companies, both current assets and liabilities are reported on the balance sheet using a 1-year time period.

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

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

A) 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.

*ANSWER:*

A) Stockholders are interested in net income and dividends. They want to make sure the company is profitable. If a company is incurring losses, it may not pay dividends.

B) Lenders are most interested in the company's ability to pay bills when they become due. Cash can be a big problem if a company does not have enough to pay its bills. This includes the company's ability to repay the lender.

200. **You Decide Essay**

A friend of yours is seeking advice on which stocks to buy. Right now, she is looking for a stock that pays cash dividends on a regular basis. She has obtained 6 years' worth of financial statements for the two stocks under consideration. Describe at least one item on each financial statement that she should study to determine which stock is more likely to pay future cash dividends.

*ANSWER:* The Income statement: Trend of profitable operations
The Retained earnings statement: The payment of cash dividends in the past
The Balance sheet: The existence of sufficient cash from which to pay dividends
The Cash flow statement: Trend of positive cash flows from operations

201. **Baker's Pride Bakery**

Condensed data from the company's current year and prior year financial statements are presented below. The figures are expressed in thousands.

| **Statement A** | Current year | Prior year |
|---|---|---|
| **Assets:** | | |
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| Other assets | 12,220 | 11,667 |
| Total assets | $253,470 | $224,918 |
| **Liabilities:** | | |

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| | | |
|---|---|---|
| Total current liabilities | $ 92,990 | $ 95,260 |
| Long-term debt | 15,160 | 22,172 |
| Total liabilities | $108,150 | $117,432 |
| Stockholders' equity: | | |
| Contributed capital | $ 53,680 | $ 35,475 |
| Retained Earnings | 91,640 | 72,011 |
| Total stockholders' equity | $145,320 | $107,486 |
| Total liabilities & stockholders' equity | $253,470 | $224,918 |

| **Statement B** | Current year | Prior year |
|---|---|---|
| Net Sales | $229,301 | $203,171 |
| Cost of sales | 135,453 | 131,212 |
| Gross margin | $ 93,848 | $ 71,959 |
| Selling, general, and administrative expenses | 64,832 | 57,442 |
| Other income (expense) | 693 | (130) |
| Income (loss) before income taxes | $ 29,709 | $ 14,387 |
| Income tax expense | 3,534 | 2,320 |
| Net income (loss) | $ 26,175 | $ 12,067 |

A) What is the name of Statement A?

B) What is the name of Statement B?

*ANSWER:* A) Statement A is the Classified Balance Sheet.

B) Statement B is the Multiple-Step Income Statement.

202. Each of the four statements that comprise a full set of financial statements has an underlying equation or formula. List the statements in the order they are prepared and the underlying equation of each.

*ANSWER:* 1. Income statement: Revenues - Expenses = Net income (net loss)
2. Retained earnings statement: Beginning retained earnings + net income (net loss) - dividends = ending retained earnings
3. Balance sheet: Assets = Liabilities + Stockholders' equity
4. Statement of cash flows: Beginning cash +/- operating cash flows +/-investing cash flows +/- financing cash flows = ending cash

203. **Baker's Pride Bakery**

Condensed data from the company's current year and prior year financial statements are presented below. The figures are expressed in thousands.

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| | | |
|---|---|---|
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| **Statement B** | Current year | Prior year |
|---|---|---|
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| Income (loss) before income taxes | $ 29,709 | $ 14,387 |
| Income tax expense | 3,534 | 2,320 |
| Net income (loss) | $ 26,175 | $ 12,067 |

Was the company profitable in both the years? What are the amounts of the total revenues and total expenses, respectively, for current year? Which financial statement provides this information to you?

*ANSWER:* The company was profitable in both the years.
For the current year, total revenues include net sales of $229,301 and other income $693, for a total of $229,994.
Total expenses for the current year include cost of sales of $135,453, selling, general, and administrative expenses of $64,832, and income tax expense of $3,534, or a total of $203,819.
Information about revenues, expenses, and profitability is reported on the income statement.

204. What is the purpose of an income statement?

*ANSWER:* An income statement reports the company's revenues and expenses for a period of time and shows the company's operating performance and profitability (or lack of).

205. **You Decide Essay**

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

*ANSWER:* First, point out that retained earnings is an important source of financing for NuWave. Then explain that you believe that it is in the shareholders' best interest to reinvest the company's earnings into the many profitable growth opportunities available rather than pay dividends. If a firm has been profitable for many years and if its stockholders have been willing to forgo large dividends, retained earnings may be a large portion of equity. Remind them that the reinvestment of the earnings hopefully will result in increased wealth for them in the future as the company profits from its growth.

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