Financial Accounting 6th edition Rich Test Bank

SKU: 9780357984949-TEST-BANK

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 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 property, plant, and equipment; long-term investments; and 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 on 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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35. Which of the following types of information is used by external users and outside decision-makers?
    a. financial accounting
    b. managerial accounting
    c. cost accounting
    d. internal accounting

ANSWER: a

36. Which of the following types of data analytics recommends a possible course of action?
    a. descriptive
    b. diagnostic
    c. prescriptive
    d. predictive

ANSWER: c

37. Which of the following is **not** one of the three forms of business organizations?
    a. sole proprietorship
    b. individual company
    c. partnership
    d. corporation

ANSWER: b

38. Owners of a corporation who have claims to the corporation's economic resources are called
    a. managers.
    b. members of the board of directors.
    c. creditors.
    d. shareholders.

ANSWER: d

39. Which type of business activity relates to obtaining funds from either issuing stock or borrowing money?
    a. lending
    b. investing
    c. financing
    d. operating

ANSWER: c

40. Which of the following is **not** one of the four basic financial statements?
    a. balance sheet
    b. bank reconciliation statement
    c. income statement
    d. statement of cash flows

ANSWER: b

41. The fundamental accounting equation is
    a. Assets + Stockholders' Equity = Liabilities.

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b. Assets + Liabilities = Stockholders' Equity.
c. Assets = Liabilities – Stockholders' Equity.
d. Assets = Liabilities + Stockholders' Equity.

ANSWER: d

42. An obligation that requires payment beyond 1 year would be categorized on the classified balance sheet as a
a. long-term liability.
b. long-term asset.
c. current liability.
d. current asset.

ANSWER: a

43. What is the purpose of the balance sheet?
a. to report the operating activities of the company
b. to report the cash activities of the company
c. to report the financial position of the company
d. to report the dividends paid to shareholders

ANSWER: c

44. Cash and other assets that are reasonably expected to be converted into cash within 1 year or one operating cycle, whichever is longer, are known as
a. contributed capital.
b. intangible assets.
c. long-term assets.
d. current assets.

ANSWER: d

45. Property, plant, and equipment is classified on the balance sheet as
a. long-term liabilities.
b. current assets.
c. noncurrent assets.
d. current liabilities.

ANSWER: c

46. The liquidity measure that is calculated by subtracting current liabilities from current assets is known as
a. working capital.
b. net income.
c. retained earnings.
d. net loss.

ANSWER: a

47. The ability of a company to pay its debt as it becomes due is referred to as
a. timeliness.
b. liquidity.

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c. solvency.
d. creditworthiness.

ANSWER: b

48. The current ratio is found by
a. multiplying the current assets by the current liabilities.
b. subtracting the current liabilities from the current assets.
c. dividing the current assets by the current liabilities.
d. dividing the current liabilities by the current assets.

ANSWER: c

49. Which financial statement lists revenues, starting with the sales revenue?
a. balance sheet
b. statement of cash flows
c. retained earnings statement
d. income statement

ANSWER: d

50. Which income statement format adds total expenses together and then deducts them from total revenues?
a. classified income statement
b. single-step income statement
c. multiple-step income statement
d. gross margin income statement

ANSWER: b

51. Which two financial statements show net income as a line item?
a. income statement and retained earnings statement
b. income statement and balance sheet
c. balance sheet and retained earnings statement
d. balance sheet and statement of cash flows

ANSWER: a

52. Which financial statement shows both net income and dividends as line items?
a. balance sheet
b. income statement
c. retained earnings statement
d. statement of cash flows

ANSWER: c

53. What are the three categories of cash flow activities shown on the statement of cash flows?
a. operating, investing, selling
b. investing, financing, borrowing
c. operating, investing, financing
d. operating, purchasing, financing

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ANSWER: c

54. Cash flows related to the acquisition or sale of long-term assets are reported as part of cash flows from
    a. investing activities.
    b. financing activities.
    c. borrowing activities.
    d. operating activities.

ANSWER: a

55. The relationships created between financial statements are known as
    a. cohesion.
    b. relevance.
    c. connectivity.
    d. articulation.

ANSWER: d

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 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 who supervise production workers

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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

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

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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

68. Which 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. Institute of Management Accountants (IMA)
b. Accounting Principles Board (APB)
c. International Accounting Standards Board (IASB)
d. Financial Accounting Standards Board (FASB)

ANSWER: d

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

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

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72. Which 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 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

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. balance sheet
    b. income statement
    c. retained earnings statement
    d. statement of cash flows

ANSWER: a

75. How is unearned revenue classified on a balance sheet?
    a. stockholders' equity
    b. liability
    c. asset
    d. revenue

ANSWER: b

76. Which financial statement would help you determine how much resources (assets) the company owned?
    a. balance sheet
    b. retained earnings statement
    c. income statement
    d. statement of cash flows

ANSWER: a

77. Which of the following financial statements show the end-of-year cash balance for a business entity?
    a. income statement and retained earnings statement
    b. balance sheet and statement of cash flows
    c. retained earnings statement and statement of cash flows
    d. balance sheet and retained earnings statement

ANSWER: b

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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.
    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 1 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 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

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84. Which 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 of the following financial statements reports an entity's financial position at a specific date?
a. balance sheet
b. retained earnings statement
c. income statement
d. both the income statement and the balance sheet

ANSWER: a

Bargain Spot Fabrics

Bargain Spot Fabrics' end-of-year balance sheet consisted of the following amounts:

Cash	$ 75,000	Accounts Receivable	$250,000
Property, plant & equipment	350,000	Long-term debt	200,000
Capital stock	500,000	Accounts payable	100,000
Retained earnings	?	Inventory	175,000

86. 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. 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 stockholders' 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

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

ANSWER: b

Benchmark Surveyors

Benchmark Surveyors had the following balances:

Cash	$234,000	Accounts Payable	$ 97,000
Inventories	121,000	Notes Payable (due 2018)	211,000
Land	453,000	Accounts Receivable	46,000

90. Calculate current assets.
a. $498,000
b. $401,000
c. $854,000
d. $709,000

ANSWER: b

91. Calculate current liabilities.
a. $97,000
b. $211,000
c. $354,000
d. $143,000

ANSWER: a

92. Which one of the following accounts 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

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Calculate current assets.

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 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 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?

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a. assets and liabilities
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

Bass Tours

The following balances were taken from Bass Tours' 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

101. Calculate the total current assets.
a. $842,000
b. $1,022,000
c. $732,000
d. $842,000

ANSWER: c

102. 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. If the average current ratio for similar companies is 2.00 to 1, what does this tell you about Bass' 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. A company has current assets of $2,100,000 and current liabilities of $500,000. Calculate its working capital.

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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 2.00 to 1?
a. $40,000
b. $150,000
c. $180,000
d. $60,000

ANSWER: d

107. A company has experienced an increase in its dollar amount of working capital over the past several years. Which of the following measures should be used to further evaluate the company's short-run liquidity?
a. asset ratio
b. analysis of the company's long-term debt
c. analysis of the return on stockholders' equity
d. current ratio

ANSWER: d

108. Which financial statement reports information helpful in assessing working capital?
a. balance sheet
b. income statement
c. retained earnings statement
d. 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?

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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 2.00 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. Working capital and current ratio are most useful in evaluating a company's
a. liquidity.
b. solvency.
c. profitability.
d. 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. single-step income statement
b. statement of cash flows
c. multiple-step income statement
d. classified balance sheet

ANSWER: d

113. Resources that provide a benefit over a number of years and lack physical substance are classified as
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. cannot be measured in terms of working capital.
c. cannot be assessed by the current ratio.
d. measures the amount of net income over the past year.

ANSWER: a

115. Which of the following would appear on an income statement?
a. unearned revenue

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b. cost of sales
c. retained earnings
d. dividends

ANSWER: b

Beaver Tree Service

Beaver Tree Service reported the following amounts:

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

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

ANSWER: b

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

Bay Camera

Bay Camera 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

119. What amount will be reported as retained earnings on the balance sheet on December 31 of the current year, assuming this is the first year of operations?
a. $22,500
b. $27,500

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c. $42,500
d. cannot be determined from this limited information

ANSWER: b

120. 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
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. balance sheet
b. retained earnings statement
c. income statement
d. statement of cash flows

ANSWER: c

124. Which statement summarizes the results of the company's operations?
a. statement of cash flows
b. retained earnings statement
c. balance sheet
d. income statement

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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

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.

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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, December 31
c. Income Statement, For the year ended December 31
d. Retained Earnings Statement, December 31

ANSWER: c

133. The following list 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

Bellweather Times

Bellweather Times reports the following amounts:

Other Revenue	$180,000	General and Administrative Expense	$320,000
Dividends paid	$220,000	Operating Revenues	$700,000
Selling Expenses	$280,000	Income Tax Expense	$60,000

134. What is the company's income from operations?
a. $280,000
b. $220,000
c. $100,000
d. $40,000

ANSWER: c

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135. What is the company's net income?

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

ANSWER: b

136. 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

Been There Used Furniture

Been There Used Furniture began operation on January 1, 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.

137. If the company's revenues were $500,000 for the 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 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

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Been There Used Furniture

Been There Used Furniture began operation on January 1, 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.

140. Calculate the retained earnings balance at December 31.

a. $150,000
b. $200,000
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 a company’s net income 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

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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

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

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

146. What was the economic effect of the dividend payment?

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

ANSWER: c

147. 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

Been There Used Furniture

Been There Used Furniture began operation on January 1, 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.

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148. 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.

ANSWER: c

149. Which 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. Which category of the statement of cash flows 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
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

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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.

Backus Tractor Sales

The accountant for Backus Tractor Sales 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 and 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	?

154. 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 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 latter 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?

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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
Less: 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. The following selected data are from a balance sheet:

Current assets	$250,000
Property, plant, and 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 Total Long-Term Debt + $275,000 Total Stockholders' Equity = $975,000 Total Assets
$975,000 Total Assets − $250,000 Current Assets − $700,000 Property, Plant, and

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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 (stockholders' equity)

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

Total liabilities, end of year	$920,000	Total assets, end of year	$1,430,000
Common stock, end of year	160,000	Retained earnings, beginning of year	150,000
Dividends for period	200,000	Net income for year	400,000

A) What 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 Year + $400,000 Net Income − $200,000 Dividends for Period = $350,000
OR
$1,430,000 Total Assets, End of Year − $920,000 Total Liabilities, End of Year − $160,000 Common Stock, End of Year = $350,000

B) $1,430,000 Total Assets, End of Year = $920,000 Total Liabilities, End of Year + $510,000 Stockholders' Equity, End of Year
OR
$160,000 Common Stock, End of Year + $350,000 Retained Earnings, End of 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**

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	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

	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	Stockholders' Equity
January 1	$1,500,000	$540,000	$_____
December 31	1,810,000	_____	1,400,000

A) What is the amount of stockholders' equity at January 1?

B) What is the amount of liabilities at December 31?

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

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C) $1,060,000
$960,000 Beginning Stockholders' Equity + X − $620,000 Dividends = $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.

Backus Tractor Sales

The accountant for Backus Tractor Sales 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 and 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	?

161. 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.

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162. Prepare a balance sheet for Backus Tractor Sales in good form.

ANSWER:

Backus Tractor Sales
Balance Sheet
December 31

Assets		Liabilities and Stockholders' Equity	
Cash	$ 300,000	Accounts payable	$ 120,000
Accounts receivable	140,000	Income taxes payable	50,000
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 and stockholders' equity	$1,100,000

Jen & Terry's Ice Cream

The accountant for Jen & Terry's Ice Cream 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

163. Determine the following amounts for Jen & 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 Inventory + $50,000 Prepaid Expenses + $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. Using good form, prepare a balance sheet for Jen & Terry's Ice Cream.

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ANSWER:

Jen & Terry's Ice Cream
Balance Sheet
December 31

Assets		Liabilities and 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 and 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 beginning of year) − $240,000 Total Liabilities (at beginning of year) = $1,160,000 Total Stockholders' Equity (at beginning of year)
$1,160,000 Total Stockholders' Equity (at beginning of year) + $1,000,000 Net Income − $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. The following amounts were taken from the accounting records at December 31:

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

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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

167. 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) At 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 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 cash flows from financing activities.

Balloon-E-Tunes

Balloon-E-Tunes reported the following balances from the company's records:

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

168. 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

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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.

169. 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.

170. 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.

171. 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.

172. 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 +

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$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.

B-There Transportation

B-There Transportation calculated the following current ratios for the year ending December 31, current year and prior year.

	Current Year	Prior Year
Current Ratio	4.00 to 1	2.00 to 1

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

ANSWER: The current ratio increased from 2.00 to 1 to 4.00 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.

174. 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: As 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.

175. 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

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

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

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

ANSWER: Prepaid insurance is not as liquid as accounts receivable

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since it will be consumed as time passes.

A)Current ratio: 6.00 to 1 ($225,000 Cash + $110,000 Accounts Receivable + $80,000 Inventory + $5,000 Prepaid insurance) ÷ ($60,000 Accounts Payable + $10,000 Salaries Payable) = 6.00 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 as 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.

176. The following amounts were taken from the accounting records at December 31:

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, January 1	400,000
Utilities expense	19,000	Notes payable	30,000
Income tax payable	4,000	Income tax expense	110,000

A) Calculate net income for the year.

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

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

B) $535,000
$400,000 Retained Earnings, January 1 + $185,000 Net Income − $50,000 Dividends Paid = $535,000

177. The following selected data are from the accounting records for the year:

Sales	$900,000
Income tax expense	80,000
Cost of sales	550,000
Operating expenses	150,000
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.

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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.

Backus Tractor Sales

The accountant for Backus Tractor Sales 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 and 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	?

178. 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 and 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.

D) The company had net income of $150,000 for the period. As 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

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that the ending retained earnings balance is greater than the net income of $150,000. As 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.

179. 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 both single- and multiple-step income statements. Only subtotals and the order the amounts are listed in differ.

Backus Tractor Sales

The accountant for Backus Tractor Sales 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 and 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	?

180. 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	
	Total revenues		$1,680,000
Expenses:			
	Cost of sales	$ 510,000	
	Salaries and wages expense	400,000	
	Selling expenses	440,000	
	Income taxes expense	180,000	
	Total Expenses		(1,530,000)

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Net income	$ 150,000

181. Several amounts from the accounting records of Bike Links for the year ended December 31 follow. 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 income and expenses			
	Interest revenue		8,000
Income before taxes			$ 512,000
Income taxes expense			(160,000)
Net income			$ 352,000

Jen & Terry's Ice Cream

The accountant for Jen & Terry's Ice Cream 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

182. Determine the following amounts for Jen & 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

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$955,000 Sales Revenue + $50,000 Interest Income = $1,005,000

B) $905,000
$700,000 Cost of Sales + $140,000 Salaries Expense + $20,000 Income Taxes Expense + $45,000 Selling Expense = $905,000

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

183. Several amounts from the accounting records of Big Tom's Pawn Shops for the year ended December 31 follow. Prepare a single-step income statement in good form.

Salaries expense	$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

Jen & Terry's Ice Cream

The accountant for Jen & Terry's Ice Cream 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

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

ANSWER:

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Jen & Terry's Ice Cream Income Statement For the Year Ended December 31			
Revenues:			
	Sales revenue	$955,000	
	Interest income	50,000	
	Total revenues		$1,005,000
Expenses:			
	Cost of sales	$700,000	
	Salaries expense	140,000	
	Selling expense	45,000	
	Income taxes expense	20,000	
	Total expenses		905,000
Net income			$ 100,000

185. Blackbeard's Restaurant began operations on January 1, 2024, 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 2025 and 2026, 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 2025 and 2026.

A) In good form, prepare a retained earnings statement for the year ended December 31, 2025.

B) How much is total retained earnings on December 31, 2026?

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, 2025	
Beginning balance, January 1, 2025	$(15,000)*
Add: Net income for 2025	25,000
Less: Dividends paid during the year	(5,000)
Ending balance, December 31, 2025	$ 5,000

*$(15,000) Net Loss for 2024 − $0 Dividends Paid = $(15,000) Balance, January 1, 2025

B) Retained Earnings at December 31, 2026 = $50,000
($5,000 Beginning Balance, January 1, 2026 + $50,000 Net Income for 2026 − $5,000 Dividends Paid During 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.

186. Assume that you have received copies of the financial statements for Best Buy Company for 2 consecutive years. Answer the following questions:

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

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statements?

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

C) If you were a labor negotiator for a union that represents a group of Best Buy Company 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.

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 its 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.

187. 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? Did the company make a profit for the period?
Management:	How should an item be priced? Should we continue operations? 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)?

Baker's Pride Bakery

Condensed data from Baker's Pride Bakery's current year and prior year financial statements follow. Dollar amounts 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

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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

188. Based on the information provided, is the company considered a business or nonbusiness 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 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.

189. 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.

190. 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 on 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.

Baker's Pride Bakery

Condensed data from Baker's Pride Bakery's current year and prior year financial statements follow. Dollar amounts are expressed in thousands.

Statement A	**Current Year**	**Prior Year**
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Income tax expense	(3,534)	(2,320)
Net income (loss)	$ 26,175	$ 12,067

191. 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.

192. 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.

193. 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% ($9,282 ÷ $108,150), from the prior year to the current year.

194. 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.

195. 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.

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

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.

197. Potential stockholders and lenders are interested in a company's financial statements. Use this list of financial statement items to 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	Net income

A) List the two items from this list 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.

198. 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: Income statement: Trend of profitable operations
Retained earnings statement: The payment of cash dividends in the past
Balance sheet: The existence of sufficient cash from which to pay dividends
Statement of cash flows: Trend of positive cash flows from operations

Baker's Pride Bakery

Condensed data from Baker's Pride Bakery's current year and prior year financial statements follow. Dollar amounts 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

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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

199. 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.

200. 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

Baker's Pride Bakery

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Stockholders' equity:		
Contributed capital	$ 53,680	$ 35,475
Retained Earnings	91,640	72,011
Total stockholders' equity	$145,320	$ 107,486

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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

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

ANSWER: The company was profitable in both 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, for a total of $203,819.
Information about revenues, expenses, and profitability is reported on the income statement.

202. 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 thereof).

203. 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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