Financial Accounting in an Economic Context 10th edition Pratt Test Bank

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Chapter 2
A Closer Look at the Financial Statements

MULTIPLE CHOICE QUESTIONS

1. When an entrepreneur wishes to start a business, capital must be attracted in the form of:
a. net income.
b. cost of goods sold.
c. operating activities.
d. equity or debt financing.

Ans: D LO 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking, Industry AICPA FN: Measurement

2. The acquisition of equity and debt financing is considered:
a. a financing activity.
b. net income.
c. an investing activity.
d. an operating activity.

Ans: A LO 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

3. Which one of the following is considered an operating activity?
a. Payment to a vendor for supplies.
b. Purchase of company trucks for cash.
c. Payment of dividends to shareholders.
d. Issuing stock to investors.

Ans: A LO 3 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

4. Your bank loaned ten million dollars to Hamilton Stores to finance the construction of a manufacturing plant. In which section of Hamilton's statement of cash flows would you be able to determine whether the company used the cash to build the new plant?
a. Operating activities
b. Owner activities
c. Financing activities
d. Investing activities

Ans: D LO 3 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

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5. Garrison Corporation has the following transactions:

1. Dividends are paid to the shareholders.
2. A utility bill for July is paid in August.
3. A new warehouse facility is purchased.
4. Principal payments on outstanding debt are paid.
5. Employee wages are paid.
6. Forty-five units of inventory are sold for $100 each.
7. Common stock is issued for $230,000 in cash.
8. A delivery van used for 5-years is sold for $12,000, which is its book value.

Which of the above transaction(s) are examples of financing activities?
a. 1,4,7
b. 1,7,8
c. 3,8
d. 1,3,4,7,8

Ans: A LO 3, 4 BT: C Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

6. Garrison Corporation has the following transactions:

1. Dividends are paid to the shareholders.
2. A utility bill for July is paid in August.
3. A new warehouse facility is purchased.
4. Principal payments on outstanding debt are paid.
5. Employee wages are paid.
6. Forty-five units of inventory are sold for $100 each.
7. Common stock is issued for $230,000 in cash.
8. A delivery van used for 5-years is sold for $12,000, which is its book value.

Which of the above transaction(s) are examples of investing activities?
a. 3,4,7,8
b. 1,4,7
c. 4,7
d. 3,8

Ans: D LO 3, 4 BT: C Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

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7. Garrison Corporation has the following transactions:

1. Dividends are paid to the shareholders.
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6. Forty-five units of inventory are sold for $100 each.
7. Common stock is issued for $230,000 in cash.
8. A delivery van used for 5-years is sold for $12,000, which is its book value.

Which of the above transaction(s) are examples of operating activities?
a. 2,3,5
b. 5,6,8
c. 2,3,5,6,8
d. 2,5,6

Ans: D KP 3, 4 BT: C Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

8. Current assets are:
a. all assets except inventory.
b. all assets that provide benefits extending beyond one year.
c. cash, accounts receivable, and buildings.
d. all assets that are expected to be converted to cash in the near future.

Ans: D LO 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

9. Intangible assets are:
a. goodwill, patents, copyrights, and trademarks.
b. property, plant, and equipment.
c. all assets **except** current assets.
d. those assets that an owner can purchase with cash only.

Ans: A LO 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

10. Long-term investments can include all of the following except:
a. notes receivable maturing in nine months.
b. equity securities of another company to be held for more than a year.
c. ten-year debt securities of another company.
d. land to be held beyond one year.

Ans: A LO 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

11. Which one of the following is an asset?
a. A patent of a company's secret formula for reverse osmosis.
b. Retained earnings.
c. Notes payable.
d. Accounts payable.

Ans: A LO 4 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

12. Which one of the following groups of accounts contains only assets?
a. Equipment, patents, accounts receivable.
b. Accounts receivable, building, retained earnings.
c. Accounts payable, notes payable, contributed capital.
d. Retained earnings, goodwill, and accounts payable.

Ans: A LO 4 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

13. Which one of the following groups of accounts contains only assets?
a. Contributed capital, retained earnings, revenues.
b. Cash, contributed capital, retained earnings.
c. Prepaid expenses, land, accounts receivable.
d. Building, equipment, depreciation expense.

Ans: C LO 4 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

14. Which one of the following is a liability?
a. Interest receivable.
b. Contributed capital.
c. Retained earnings.
d. Wages payable.

Ans: D LO 4 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

15. Which one of the following groups of accounts contains only current assets?
a. Inventory, accounts receivable, equipment.
b. Cash, equipment, copyrights.
c. Cash, accounts receivable, merchandise inventory.
d. Patents, copyrights, and trademarks.

Ans: C LO 4 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

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16. Which one of the following creates a decrease in retained earnings?
a. Prepaid assets.
b. Equipment.
c. Dividends.
d. Merchandise inventory not sold.

Ans: C LO 4 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

17. Which account is associated with the sale of inventory?
a. Cost of goods sold.
b. Depreciation.
c. Inventory expense.
d. Equipment.

Ans: A LO 4 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

18. Which account is associated with borrowing money?
a. Interest expense.
b. Goodwill.
c. Cost of goods sold.
d. Depreciation.

Ans: A LO 4 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

19. Which expense is associated with long-term assets?
a. Dividends.
b. Depreciation.
c. Cost of goods sold.
d. Interest.

Ans: B LO 4 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

20. Which expense is associated with the use of patents?
a. Interest.
b. Amortization.
c. Cost of goods sold.
d. Depreciation.

Ans: B LO 4 2 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

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21. The major accounting difference between interest expense for creditors and dividends declared and paid to shareholders is that interest expense:
a. decreases retained earnings and dividends increase retained earnings.
b. impacts cash flows, while dividends do not.
c. is not on the income statement while dividends declared and paid are.
d. is on the income statement and dividends declared and paid are not.

Ans: D LO 4 BT: C Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

22. Which one of the following equations represents retained earnings activity for a year?
a. Beginning balance + expenses – dividends = ending balance.
b. Beginning balance + cash receipts – cash payments = ending balance.
c. Beginning balance + dividends – net income = ending balance.
d. Beginning balance + net income – dividends = ending balance.

Ans: D LO 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

23. Which one of the following appears on the income statement?
a. Inventory.
b. Retained earnings.
c. Dividends.
d. Interest revenue.

Ans: D LO 4 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

24. Which one of the following groups of accounts contains only liabilities?
a. Accounts payable, retained earnings, notes payable.
b. Supplies expense, cost of goods sold, interest expense.
c. Wages payable, mortgage payable, taxes payable.
d. Contributed capital, accounts payable, retained earnings.

Ans: C LO 4 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

25. Smith Corp. earned $300,000 profit during 2018. On which financial statement(s) will the exact dollar amount of the profit be clearly stated?
a. Statement of shareholders' equity and income statement.
b. Income statement only.
c. Balance sheet and income statement.
d. Statement of shareholders' equity, income statement, and the balance sheet.

Ans: A LO 4 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
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26. On which financial statements will you find a company's financial position at a specific point in time?
a. All financial statements combined.
b. Income statement and balance sheet.
c. Balance sheet and statement of shareholders' equity.
d. Balance sheet only.

Ans: D LO 4 BT: C Difficulty: Moderate TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

27. Why are liabilities separated into current and long-term?
a. Users want to know which amounts will be paid using current assets.
b. Because current and long-term classifications are just common sense.
c. This format helps a company determine how much profit was made.
d. The SEC requires companies to do so.

Ans: A LO 4 BT: C Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

28. Which one of the following statements is true?
a. A company's own stock is its most liquid asset.
b. Profits are normally kept in a company's retained earnings until distributed as dividends.
c. Long-term investments will be used to pay current liabilities.
d. Current assets have no physical substance.

Ans: B LO 4 BT: K Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

29. Cash reported on a company's balance sheet represents
a. the profit a company made during the current year.
b. the amount the President of the Company has in his or her personal account.
c. the amount collected from customers during the current year less the amount paid for expenses.
d. the currency a company has access to at the balance sheet date.

Ans: D LO 4 BT: K Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

30. The amount a company expects to collect from its customers is:
a. accounts receivable.
b. short-term equity securities.
c. inventory.
d. accounts payable.

Ans: A LO 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

31. As used in accounting, "notes" may be reported:
a. only as company debt offerings.
b. only as assets on the balance sheet.
c. as either assets or liabilities.
d. on the income statement or the balance sheet.

Ans: C LO 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

32. Property, plant and equipment may include which of the following?
a. Intangible assets and land.
b. Inventory and equipment.
c. Buildings and cash.
d. Land and office buildings.

Ans: D LO 4 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

33. On the balance sheet, a company should report the cost of intangible assets:
a. in the current assets section.
b. as an amount owed to shareholders.
c. as an amount that is estimated by the CFO.
d. at acquired cost less any accumulated amortization.

Ans: D LO 4 BT: K Difficulty: Moderate TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

34. The most common revenue account is:
a. cash.
b. sales.
c. shareholders' equity.
d. liabilities.

Ans: B LO 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

35. Most investors believe that the statement of cash flows is
a. a useful source of information regarding the cash flow of an entity.
b. the only statement in an annual report whose results correlates to stock price value.
c. too complicated.
d. a useful measure of a company's profit.

Ans: A LO 4 BT: K Difficulty: Moderate TOT: 1 min. AACSB: Analytic
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36. The amount reported on a company's balance sheet as retained earnings is the same as the amount reported on the company's:
a. income statement as net income.
b. statement of shareholders' equity as beginning retained earnings.
c. statement of cash flows as cash received from operating activities.
d. statement of shareholders' equity as ending retained earnings.

Ans: D LO 4 BT: C Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

37. Which one of the following is **not** an asset?
a. A company's equity in the common stock of another company.
b. A company's trademarked name for a process.
c. Retained earnings.
d. Notes receivable.

Ans: C LO 4 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

38. Baron Company has six major headings in its income statement, which include Sales, Fees Earned, Other Revenues, Cost of Goods Sold, Operating Expenses, and Other Expenses. Below are some of the income statement accounts for Baron:

1. Sales of inventories
2. Depreciation expense
3. Income from interest on savings account
4. Income from dividends on investments
5. Advertising expense.
6. Loss on sale of building
7. Salespeople commission expense
8. Office salary expense
9. Gain on sale of short-term investments
10. Sales of services provided
11. Cost of sold inventories
12. Interest expense on outstanding loans

Which of these would be found under the heading "Other Revenues"?
a. 1,10
b. 1,3,4
c. 3,4,10
d. 3,4,9

Ans: D LO 4 BT: C Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

39. Baron Company has six major headings in its income statement, which include Sales, Fees Earned, Other Revenues, Cost of Goods Sold, Operating Expenses, and Other Expenses. Below are some of the income statement accounts for Baron:

1. Sales of inventories
2. Depreciation expense
3. Income from interest on savings account
4. Income from interest on investments
5. Advertising expense.
6. Loss on sale of building
7. Salespeople commission expense
8. Insurance expense
9. Gain on sale of short-term investments
10. Sales of services provided
11. Cost of sold inventories
12. Interest expense on outstanding loans

Which of these would be found under the heading "Operating Expenses"?
a. 2,8,12
b. 2,7,8,12
c. 2,5,7,8,11
d. 2,5,11

Ans: C LO 4 BT: C Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

40. Hsu Company has eight major section headings in its balance sheet, which include Current Assets, Long-Term Investments, Property, Plant, and Equipment, Intangible Assets, Current Liabilities, Long-Term Liabilities, and Shareholders' Equity. Below are some of the balance sheet accounts for Hsu:

1. Dividends Payable
2. Prepaid Rent
3. Trademarks
4. Bonds Payable
5. Investment Funds for Plant Expansion
6. Inventories
7. Wages Payable
8. Deferred Revenues
9. Accumulated Depreciation - Building
10. Accounts Receivable
11. Accounts Payable

Which of these would be found under the heading "Current Assets"?
a. 2,10
b. 2,6,8,10
c. 2,6,10
d. 2,5,10

Ans: C LO 4 BT: C Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

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41. Hsu Company has eight major section headings in its balance sheet, which include Current Assets, Long-Term Investments, Property, Plant, and Equipment, Intangible Assets, Current Liabilities, Long-Term Liabilities, and Shareholders' Equity. Below are some of the balance sheet accounts for Hsu:

1. Dividends Payable
2. Prepaid Rent
3. Trademarks
4. Bonds Payable
5. Investment Funds for Plant Expansion
6. Inventories
7. Wages Payable
8. Deferred Revenues
9. Accumulated Depreciation - Building
10. Accounts Receivable
11. Accounts Payable

Which of these would be found under the heading "Property, Plant, and Equipment"?
a. 5,9
b. 5,6,9
c. 3,5,6,9
d. 9

Ans: D LO 4 BT: C Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

42. The information below was taken from the 2018 annual report of Jena Corporation.

	2018	**2017**	**2016**
Beginning cash balance	$ 12,000	?	$5,000
Net cash flow from operating activities	7,987	?	9,100
Net cash flow from investing activities	2,450	4,330	?
Net cash flow from financing activities	?	(9,612)	(7,500)
Ending cash balance	$11,000	?	$12,500

Which of the following is the missing amount for the net cash flow from investing activities for 2016?
a. $5,900
b. $10,900
c. $15,000
d. $4,450

Ans: A LO 3,4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement
Solution: $12,500 + $7,500 – $9,100 – $5,000 = $5,900

43. The information below was taken from the 2018 annual report of Jena Corp.

	2018	2017	2016
Beginning cash balance	$ 12,000	?	$5,000
Net cash flow from operating activities	7,987	?	9,100
Net cash flow from investing activities	2,450	4,330	?
Net cash flow from financing activities	?	(9,612)	(7,500)
Ending cash balance	$11,000	?	$12,500

Which of the following is the missing amount for the beginning cash balance for 2017?
a. $5,925
b. $8,741
c. $12,500
d. $5,282

Ans: C LO 3,4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement
Solution: 2017 beg. cash bal. = 2016 end. cash bal.

44. The information below was taken from the 2018 annual report of Jena Corp.

	2018	2017	2016
Beginning cash balance	$ 12,000	?	$5,000
Net cash flow from operating activities	7,987	?	9,100
Net cash flow from investing activities	2,450	4,330	?
Net cash flow from financing activities	?	(9,612)	(7,500)
Ending cash balance	$11,000	?	$12,500

Which of the following is the missing amount for the net cash flow from operating activities for 2017?
a. $8,110
b. $4,782
c. $8,475
d. $3,874

Ans: B LO 3,4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement
Solution: $12,000 + $9,612 – $4,330 – $12,500 = $4,782

45. The information below was taken from the 2018 annual report of Jena Corp.

	2018	2017	2016
Beginning cash balance	$12,000	?	$5,000
Net cash flow from operating activities	7,987	?	9,100
Net cash flow from investing activities	2,450	4,330	?
Net cash flow from financing activities	?	(9,612)	(7,500)
Ending cash balance	$11,000	?	$12,500

Which of the following is the missing amount for the ending cash balance for 2017?
a. $2,759
b. $7,158
c. $12,703
d. $12,000

Ans: D LO 3, 4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement
Solution: End. 2017 cash bal. = Beg. 2018 Cash bal.

46. The information below was taken from the 2018 annual report of Jena Corp.

	2018	2017	2016
Beginning cash balance	$12,000	?	$5,000
Net cash flow from operating activities	7,987	?	9,100
Net cash flow from investing activities	2,450	4,330	?
Net cash flow from financing activities	?	(9,612)	(7,500)
Ending cash balance	$11,000	?	$12,500

Which of the following is the missing amount for the net cash flow from financing activities for 2018?
a. ($22,437)
b. ($11,437)
c. ($563)
d. ($14,450)

Ans: B LO 3,4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement
Solution: $12,000 + $7,987 + $2,450 – $11,000 = $11,437

47. Which of the above transaction(s) are examples of operating activities?
e. 2,3,5
f. 5,6,8
g. 2,3,5,6,8
h. 2,5,6

Ans: D LO 3,4 BT: C Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

48. At the end of 2017, Campbell Company has total assets and liabilities at $42,000 and $11,000, respectively. Campbell reported net income for 2018 in the amount of $12,000. How much is shareholders' equity at the end of 2018?
a. $30,000
b. $22,000
c. $31,000
d. $43,000

Ans: D LO 4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

Solution: $42,000 – $11,000 + $12,000 = $43,000

49. Desert Company has retained earnings of $11,000, total assets totaling $41,000, and total liabilities of $20,000. How much is *total shareholders' equity*?
a. $8,000
b. $19,000
c. $21,000
d. $27,000

Ans: C LO 4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

Solution: $41,000 – $20,000 = $21,000

50. Valley Company has cash, current liabilities, and long-term liabilities of $120,000, $30,000, and $31,000, respectively. Valley has no current assets other than cash. How much cash can Valley use to acquire equipment so that amount of current assets is double the amount of current liabilities?
a. $30,000
b. $60,000
c. $15,000
d. $90,000

Ans: B LO 4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
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Solution: $120,000 – [2 x $30,000] = $60,000

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51. Favre Company has current assets, shareholders' equity, current liabilities, and long-term liabilities of $20,000, $54,000, $8,000, and $16,000, respectively. How much are long-term assets?
a. $24,000
b. $58,000
c. $64,000
d. $92,000

Ans: B LO 4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

Solution: $20,000 + LTA = $8,000 + $16,000 + $54,000
LTA = $58,000

52. If the beginning and ending balances in retained earnings are $15,000 and $10,000, respectively, and dividends during the year are $8,000, then net income for the year is:
a. $10,000.
b. $3,000.
c. $18,000.
d. $32,000.

Ans: B LO 4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

Solution: $15,000 + NI – $8,000 = $10,000
NI = $3,000

53. Kelly Company has total assets, liabilities, and shareholders' equity of $32,000, $17,000, and $15,000, respectively at the beginning of 2018. If Kelly reports revenues of $130,000, expenses of $80,000, and pays dividends of $30,000, how much is shareholders' equity at the end of 2018?
a. $35,000
b. $53,000
c. $44,000
d. Not enough information to determine.

Ans: A LO 4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

Solution: $15,000 + [$130,000 – $80,000] – $30,000 = $35,000

54. Sanchez Corporation has total assets, current liabilities, and long-term liabilities of $40,000, $2,000, and $13,000, respectively. If Sanchez purchases equipment for $5,000 for cash, how much would shareholders' equity be?
a. $25,000
b. $10,000
c. $29,000
d. $11,000

Ans: A LO 4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

Solution: $40,000 – $2,000 – $13,000 + $5,000 – $5,000 = $25,000

55. Below are several accounts from Norel Company's accounting records.

Total assets, end of year	$115,000
Total liabilities, end of year	36,000
Contributed capital, end of year	12,000
Retained earnings, beginning of year	23,000
Dividends for the period	31,000
Net income	75,000

The amount of retained earnings at the end of the year is:
a. $39,000.
b. $45,000.
c. $67,000.
d. $69,000.

Ans: C LO 4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

Solution: $23,000 + $75,000 – $31,000 = $67,000
or $115,000 – $36,000 – $12,000 = $67,000

56. Given below are several accounts from Caterpillar Company's accounting records.

Cash	$ 15,000
Accumulated depreciation	7,000
Retained earnings, beginning of year	22,000
Contributed capital	25,000
Patents	2,000
Dividends	5,000

Net income for the year was $40,000. How much is total shareholders' equity at the end of the year?
a. $86,000.
b. $88,000.
c. $87,000.
d. $82,000.

Ans: D LO 4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

Solution: $22,000 + $25,000 – $5,000 + $40,000 = $82,000

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57. Seuss Company determined its total sales were $500,000, salaries expense was $210,000, dividends paid were $15,000, rent expense was $25,000, other operating expenses were $13,000, and customers still owed $4,000 at the end of the year. How much is net income for the year?

a. $267,000.
b. $252,000.
c. $263,000.
d. $530,000.

Ans: B LO 4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

Solution: $500,000 – $210,000 – $25,000 – $13,000 = $252,000

58. A partnership and a corporation differ in that:

a. a partnership is a legal entity, while a corporation is not.
b. the equity sections of partnership and corporation balance sheets report different items.
c. partnerships always have more cash than corporations.
d. a corporation has an income statement and a partnership does not.

Ans: B LO 6 BT: K Difficulty: Difficult TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

MATCHING QUESTIONS

1. For each statement listed in 1 through 5 below, state whether it is correct or not by writing 'Yes' or 'No' in the space provided.

	1. Property differs from plant and equipment in that property has no physical substance, while plant and equipment does.
	2. Current assets of a major retailer, such as Sears, typically exceed 50 percent of total assets because of merchandise inventory.
	3. Goodwill is common on many major U.S. companies' balance sheets because of the numerous mergers and acquisitions that occur.
	4. Yard Mart Company owes $4,700. If Yard Mart uses assets listed in the current asset section of the balance sheet to pay off this debt next year, Yard Mart must report the $4,700 in the current liability section of its current year balance sheet.
	5. Haloid, Inc. issued common stock for cash. This is an investing activity.

.

Solution:
1. No 2. Yes 3. Yes 4. Yes 5. No

LO 3,4 BT: C Difficulty: Moderate TOT: 3 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

2. For each item numbered 1 through 6 below, identify which accounting element(s) listed in **A** through **H** each statement describes. You may use each letter more than once or not at all.

Accounting Elements

A. Assets	E. Revenues
B. Liabilities	F. Expenses
C. Contributed capital	G. Net income
D. Retained earnings	H. Dividends

1.	Total past earnings not distributed to the owners
2.	Inflow of assets from the regular operating activities
3.	Obligations which must be met at some future date
4.	That which will be used to generate future economic benefits
5.	The net growth during a period of time measured as revenues less expenses
6.	Amount invested by equity investors

Solution:
1. D 2. E 3. B 4. A 5. G 6. C

LO 4 BT: K Difficulty: Easy TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

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3. For each financial statement item listed in 1 through 5 below, identify the best description by selecting from items **a** through **f** below. You may use each letter more than once or not at all. Write the letter 'X' for each item for which no description is listed.

Descriptions
a. Amount of net income or loss less distributions to the owners of the company
b. Must be settled within one year
c. Converted to cash within one year
d. Amount of owners' investment
e. Portion of equity to which dividends reduce
f. Land used as a site for production

1.	Current liability
2.	The property part of property, plant, and equipment
3.	Retained earnings
4.	Contributed capital
5.	Current asset

Solution:
1. b 2. f 3. a, e 4. d 5. c

LO 4 BT: K Difficulty: Easy TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

4. For items 1 through 3, select the appropriate section of the balance sheet in which the item would be reported.

Sections
A Long-term Investments
B Property, Plant, & Equipment
C Current Liabilities
D Long-term Liabilities
E Shareholders' Equity

Section	**Balance Sheet Item**
	1. Amounts owed for purchasing inventory from creditors (due next month).
	2. Cumulative profits retained by the company since operations began.
	3. Cost of a building expected to be used by the company for ten more years.

Solution: 1. C 2. E 3. B

LO 4 BT: C Difficulty: Easy TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

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5. For each financial statement item listed in 1 through 5 below, identify in which balance sheet category (listed in **a** through **h**) it should be reported. You may use each letter more than once or not at all.

Financial Statement Categories
a. Current assets
b. Long-term investments
c. Property, plant, and equipment
d. Intangible assets
e. Current liabilities
f. Long-term liabilities
g. Shareholders' equity
h. Not disclosed on the balance sheet

1.	Contributed capital
2.	Prepaid insurance
3.	Accounts payable
4.	Sales revenue
5.	Delivery truck

Solution:
1. g 2. a 3. e 4. h 5. c

LO 4 BT: C Difficulty: Easy TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

6. For each statement listed in 1 through 5 below, state whether it is correct or not by writing 'Yes' or 'No' in the space provided.

	1. Financing activities involve the sale of goods and services of a business.
	2. The income statement is often referred to as a statement of financial condition.
	3. The most liquid of all assets is cash.
	4. The asset sections found on a classified balance sheet include current assets, current liabilities, and owners' equity.
	5. Dividends payable, Inventories, Contributed capital, and Accumulated Depreciation all appear on a company's balance sheet.

.

Solution:
1. No 2. No 3. Yes 4. No 5. Yes

LO 4 BT: C Difficulty: Moderate TOT: 3 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

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7. For each financial statement item listed in 1 through 7 below, identify in which balance sheet category (listed in **a** through **h**) it should be reported. You may use each letter more than once or not at all.

Financial Statement Categories
a. Current assets
b. Long-term investments
c. Property, plant, and equipment
d. Intangible assets
e. Current liabilities
f. Long-term liabilities
g. Shareholders' equity
h. Not disclosed on the balance sheet

1.	Accumulated depreciation
2.	Accounts receivable
3.	Trademarks
4.	Investment in bonds
5.	Retained earnings
6.	Short-term investments
7.	Prepaid insurance

Solution:
1. c 2. a 3. d 4. b 5. g 6. a 7. a

LO 4 BT: C Difficulty: Easy TOT: 3 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

SHORT PROBLEMS

1. Given below are several accounts from Kramer Company's accounting records.

Cash	$12,500
Accumulated depreciation	8,000
Retained earnings, beginning of year	17,000
Contributed capital	14,000
Patents	3,000
Dividends	3,000

Net income for the year was $30,000. How much is total shareholders' equity at the end of the year?

Solution:
$14,000 + $17,000 – $3,000 + $30,000 = $58,000

LO 4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

2. Below are several amounts from Netcom Company's accounting records. Answer the questions that follow.

Total assets, end of year	$190,000
Total liabilities, end of year	88,000
Contributed capital, end of year	20,000
Retained earnings, beginning of year	65,000
Dividends for the period	15,000
Net income	32,000

A. Calculate the amount of retained earnings at the end of the year.

B. If revenue amounts to $200,000, how much is 'total expenses'?

C. How do you know the company has been profitable since it began operations?

Solution:
A. $65,000 + $32,000 – $15,000 = $82,000

B. $200,000 – X = $32,000
Expenses = X = $168,000

C. Retained earnings, which represents the total profits since the company began operations, less all amounts distributed as dividends, has a positive balance.

LO 4 BT: AN Difficulty: Moderate TOT: 5 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Measurement

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3. Following are several items from Arbor Company's financial statements. Use this information to calculate the amounts for the questions that follow.

Cost of goods sold	$2,400
Sales revenue	8,600
Operating expenses	500
Income taxes	600
Dividends	400
Accounts receivable	800

A. Calculate the dollar amount of net income.

B. How much is inventory expense?

C. Was the company profitable during the current year? How do you know?

Solution:
a. $8,600 – $2,400 – $500 – $600 = $5,100
(Sal. Rev. – Cogs – Op. exp. – Inc. tax.)
b. $2,400
c. Yes. The amount of expenses is less than the amount of revenue.

LO 4 BT: AN Difficulty: Moderate TOT: 4 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Measurement

4. At the beginning of 2018, Kristol Company sold stock and began operations. Information from Kristol's accounting records for the year ending December 31, 2018, follows:

Sales	$490,000
Selling expenses	220,000
Cost of goods sold	190,000
Dividends	100,000
General and administrative expenses	50,000
Contributed capital	60,000

A. Circle the names of any accounts above that **would not** be reported on the income statement.

B. Determine the amount of net income.

Solution:
a. Circled accounts should be: Dividends and Contributed Capital
b. $490,000 – $220,000 – $190,000 – $50,000 = $30,000
(Sales – sell. exp. – Cogs – Genladm. exp.)
LO 4 BT: AN Difficulty: Moderate TOT: 4 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

5. The following are account balances of Phineas Company on 12/31/18.

Accounts payable	$ 2,000
Accounts receivable	7,000
Buildings and equipment	54,000
Contributed capital	20,000
Bonds payable	15,300
Cash	8,800
Retained earnings	17,000
Accumulated depreciation	(24,000)
Inventory	5,500
Patents	3,000

Prepare a classified balance sheet for Phineas Company on December 31, 2018.

Solution:

Phineas Company
Classified Balance Sheet
December 31, 2018

Assets		
Current assets:		
Cash	$ 8,800	
Accounts receivable	7,000	
Inventory	5,500	
Total current assets		$21,300
Property, plant, and equipment:		
Buildings and equipment	$54,000	
Less: Accumulated depreciation	24,000	
Total property, plant, and equipment		30,000
Intangible assets:		
Patents		3,000
Total assets		$54,300
Liabilities & Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 2,000	
Total current liabilities		$ 2,000
Long-term liabilities:		
Bonds payable	15,300	
Total long-term liabilities		15,300
Shareholders' equity:		
Contributed capital	$20,000	
Retained earnings	17,000	
Total shareholders' equity		37,000
Total liabilities & shareholders' equity		$54,300

LO 4 BT: AP Difficulty: Difficult TOT: 10 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Reporting

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6. The following is the balance sheet of Able Corporation immediately prior to deciding how to finance the purchase of a $300 addition to its building.

Able Corporation
Balance Sheet
December 31, 2018

Assets	
Cash	$ 310
Accounts receivable	260
Building	380
Land	370
Total assets	$1,320
Liabilities and Shareholders' Equity	
Accounts payable	$ 190
Long-term bonds payable	620
Contributed capital	340
Retained earnings	170
Total liabilities & shareholders' equity	$1,320

The bonds payable contract agreement requires current assets to be twice as much as current liabilities. Assume the $300 addition to the building is to be paid in cash and financed by issuing more stock. Calculate and explain the maximum cash that Able can pay and still honor its debt agreement.

Solution: Able's current liabilities are $190. Under the bond agreement, its current assets must be at least $380. If Almond used $190 of cash to purchase the building addition, then it would have the $380 of current assets required by the debt covenant ($190 × 2). Therefore, Able can pay $190 and issue stock for $110 in order to finance the building project.

LO 4 BT: AN Difficulty: Difficult TOT: 8 min. AACSB: Analytic, Communication AICPA BB: Critical Thinking AICPA FN: Measurement, Decision modeling

Use the information that follows concerning Ulrich Computer for the year ending December 31, 2018 for problems 7 through 10.

Several accounts and amounts from the financial statements of Ulrich Computer appear below for the year ending December 31, 2018.

Cash	$ 11,000
Sales Revenue	140,000
Notes Receivable, 6-month	90,000
Cost of goods sold	60,000
Taxes Payable	31,000
Salaries Expense	8,000
Accounts Receivable	34,000
Dividends	42,000
Equipment	150,000
Accounts Payable	8,000
Contributed Capital	30,000
Retained Earnings	40,000
Rent and Utilities Expense	4,000
Income Tax Expense	20,000
Inventory	21,000

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7. What is the total amount owed to Ulrich by its customers at the end of 2018?

Solution: $34,000

LO 4 BT: AN Difficulty: Easy TOT: 1 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

8. Calculate total expenses for Ulrich.

Solution:
$60,000 + $8,000 + $4,000 + $20,000 = $92,000

LO 4 BT: AN Difficulty: Moderate TOT: 3 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

9. Calculate Ulrich's total current assets.

Solution:
$11,000 + $34,000 + $90,000 + $21,000 = $156,000

LO 4 BT: AN Difficulty: Moderate TOT: 3 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

10. How much must Ulrich pay out during its next accounting period for amounts owed?

Solution:
$8,000 + $31,000 = $39,000

LO 4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

11. Below is all of the account information from Chamber Company's balance sheet, with the exception of Retained Earnings.

Cash	$13,000
Inventory	16,000
Equipment	51,000
Accounts Payable	17,000
Long-term Payable	10,000
Contributed capital	30,000

Using this information, please calculate the following:

A. The total amount of retained earnings for Chamber Company.

B. The total amount of shareholders' equity for the company at the end in the year.

Solution:
A. ($13,000 + $16,000 + $51,000) – $17,000 – $10,000 – $30,000 = $23,000
B. $30,000 + $23,000 = $53,000

LO 4 BT: AN Difficulty: Moderate TOT: 8 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

12. The following information is shown on Morris Company's balance sheet. Answer the questions that follow.

Cash	$12,000
Inventory	15,000
Equipment	80,000
Accounts Payable	15,000
Bonds Payable	45,000
Contributed capital	30,000

A. How much did debt investors provide to Morris Company?

B. What is the amount of money provided by equity investors to Morris Company?

C. How much would be classified as property, plant, and equipment?

Solution:
A. $45,000
B. $30,000
C. $80,000

LO 4 BT: AN Difficulty: Easy TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

13. Autry Company determined its total sales were $400,000, salaries expense was $110,000, dividends paid were $8,000, rent expense was $14,000, other operating expenses were $20,000, and customers still owed $2,000 at the end of the year. How much is net income for the year?

Solution: $400,000 – $110,000 – $14,000 – $20,000 = $256,000

LO 4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

14. If cash inflows from operating activities were $2,000, cash outflows for financing activities were $2,500, and the net increase in cash was $4,000, how much are cash flows from investing activities?

Solution: $4,000 – (-$2,500) - $2,000 = $4,500

LO 4 BT: AN Difficulty: Moderate TOT: 2 min. AACSB: Analytic
AICPA BB: Critical Thinking AICPA FN: Measurement

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15. The following is the balance sheet of Columbus Corporation immediately prior to deciding how to finance the purchase of an additional $210,000 parcel of land. Answer the question that follows.

Columbus Corporation
Balance Sheet
December 31, 2018

Assets	
Cash	$ 180,000
Accounts receivable	60,000
Land	270,000
Total assets	$510,000
Liabilities and Shareholders' Equity	
Accounts payable	$ 90,000
Contributed capital	250,000
Retained earnings	170,000
Total liabilities & shareholders' equity	$510,000

REQUIRED: Columbus will finance the $210,000 investment in land by issuing either $210,000 of common stock or using $210,000 of additional accounts payable that will be due in 90 days. Indicate which method of financing is preferable for Columbus. Consider the effects on short-term solvency positions.

Solution: If Columbus financed the land through accounts payable, its current liabilities would exceed its current assets by $60,000. This would question Columbus's capability to pay its current liabilities when they are due. However, if Columbus financed the investment in land by issuing common stock, its current assets would exceed its current liabilities by $150,000. This would enhance its short-term solvency position. Therefore, Columbus should issue common stock to finance the purchase of land.

LO 4 BT: AN Difficulty: Difficult TOT: 8 min. AACSB: Analytic, Communication, Reflective AICPA BB: Critical Thinking AICPA FN: Measurement, Decision modeling

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SHORT ESSAY QUESTIONS

1. Describe operating activities.

Solution: Operating activities involve the sale of goods and services and the related cost of providing the goods and services. These activities produce additional capital that can be reinvested in producing assets, used to pay debt, or distributed to the owners in the form of dividends.

LO 3 BT: K Difficulty: Easy TOT: 2 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Reporting

2. Which business activity occurs first for a business? Why does this business activity occur first?

Solution: Financing activities typically occur first in a business. A business must acquire cash or other operating capital before any investments can be made.

LO 3 BT: C Difficulty: Easy TOT: 2 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Reporting

3. What business aspect does the income statement measure?

Solution: The income statement measures operating performance over a particular period.

LO 4 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Measurement

4. Which asset is more liquid, inventory or accounts receivable? Why?

Solution: Since amounts in the Accounts Receivable account represent inventory that is already sold, this account will generate cash more quickly than inventory that has not yet been sold. Therefore, accounts receivable is more liquid than inventory.

LO 4 BT: C Difficulty: Moderate TOT: 2 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Measurement

5. What business aspect does the statement of shareholders' equity measure?

Solution: The statement of shareholders' equity measures changes in 1) the contributed capital accounts, representing the value of owners' investments in the business, and in 2) the retained earnings account, which measures the extent to which the business reinvests its earnings and pays dividends.

LO 4 BT: C Difficulty: Moderate TOT: 2 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Measurement

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Use the information provided from Haloid Company's accounting records to answer questions 6 and 7.

For the Years Ended December 31, 2018, and 2017

	2018	2017
Assets		
Cash	$ 80	$60
Accounts receivable	40	40
Short-term investment in property	40	60
Property, plant, and equipment	350	310
Total assets	$510	$470
Liabilities and Shareholders' Equity		
Accounts payable	$ 85	$90
Contributed capital	310	300
Retained earnings	115	80
Total liabilities & shareholders' equity	$510	$470
Income Statement:		
Sales revenue	$850	
Expenses	800	
Net Income	$ 50	

6. How is it possible that Haloid reports "property" in two different places on its balance sheet?

Solution: 'Short-term investment in property' is property that Haloid owns with the intention of selling in the future. However, property in 'property, plant, and equipment' is space that is being used for "supporting" the operations in Haloid's business.

LO 4 BT: C Difficulty: Moderate TOT: 5 min. AACSB: Analytic, Communication, Reflective AICPA BB: Critical Thinking AICPA FN: Reporting

7. Comment on the following statement: "On December 31, 2018, Haloid's accounts payable exceeds its cash by $5. If Haloid needs additional money to pay its accounts payable, it can use the $115 stashed in its retained earnings".

Solution: The amount in the retained earnings account does not represent stashes of money or other tangible items. This amount simply communicates that Haloid earned and retained $115 of income in its business since it began operations. The difference between assets and liabilities is total shareholders' equity. Retained earnings is part of shareholders' equity. It represents earnings retained in a business—a residual amount. It is not cash.

LO 4 BT: E Difficulty: Difficult TOT: 8 min. AACSB: Analytic, Communication, Reflective AICPA BB: Critical Thinking AICPA FN: Decision modeling

9. Explain the concept of liquidity.

Solution: Liquidity is a representation of how close an asset is to cash. Assets are listed in order of liquidity on the balance sheet, with the most liquid assets first. Since cash is the most liquid asset, it is presented as the first item in the asset section of the balance sheet.

LO 4 BT: C Difficulty: Easy TOT: 2 min. AACSB: Analytic, Communication AICPA BB: Critical Thinking AICPA FN: Measurement

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10. Give an example of a prepaid expense. Why would a company use this account?

Solution: Prepaid expenses may include items such as prepaid rent, prepaid insurance, and other amounts of which payment must be made up front.

LO 4 BT: C Difficulty: Moderate TOT: 2 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Reporting

11. What type of assets are included in short-term investments?

Solution: Short-term investments include stock, bonds, and similar investments. Generally these securities are readily marketable and are intended by management to be sold within a short period of time, usually less than one year.

LO 4 BT: K Difficulty: Moderate TOT: 2 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Reporting

12. What is unique about the way plant and equipment appear on the balance sheet?

Solution: Plant and equipment includes the actual costs of acquiring assets such as warehouses, office buildings, equipment, machinery, vehicles, etc. In the balance sheet, total accumulated depreciation is shown as a deduction from the cost of the plant and equipment. The balance in the accumulated depreciation account represents the total cost of the plant and equipment that has been transferred to the income statement (expensed) as it represented an allocation of the cost used up that related to past accounting periods.

LO 4 BT: C Difficulty: Moderate TOT: 4 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Reporting

13. Explain the difference between net income and cash flow from operations.

Solution: Net income, reported on the income statement, consists of revenues and expenses or more general asset and liability inflows and outflows, that may not necessarily include cash. Cash flows from operations, reported on the statement of cash flows, include only the cash inflows and outflows.

LO 4 BT: C Difficulty: Moderate TOT: 4 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Reporting

14. Why would a company use a notes receivable account?

Solution: A notes receivable account arises because companies accept notes in exchange for a sale with extended credit terms. Notes represent amounts that customers or employees have agreed to repay. Notes typically have an interest component.

LO 4 BT: C Difficulty: Easy TOT: 2 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Reporting

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15. What is the account, *Accounts Payable*, used for?

Solution: Accounts payable represents the amount of money a company expects to pays its vendors. The payables arise from the purchase of supplies from vendors/suppliers.

LO 4 BT: C Difficulty: Easy TOT: 2 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Reporting

16. Describe how the amount of net income relates to the balance sheet.

Solution: The balance sheet reports an item called retained earnings that represents an accumulation of all the profits earned by the company since operations began, less all the dividends paid out to shareholders. Net income for the current period is added and dividends declared are subtracted from the beginning retained earnings amount to determine the ending balance of retained earnings, which in turn is reported on the balance sheet.

LO 4 BT: C Difficulty: Moderate TOT: 4 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Reporting

17. Where in a company's financial statements would you locate the 'book value' of the company?

Solution: The dollar amount reported as total shareholders' equity represents the net book value of the company. Shareholders' equity is found on the balance sheet. To calculate the book value, subtract liabilities from assets.

LO 4 BT: C Difficulty: Moderate TOT: 3 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Reporting

18. Which group of financial statement users would be most concerned with the amount of a company's total current assets and current liabilities?

Solution: Creditors, such as bankers in other lenders, would be very interested in the liquidity of a company. Comparing the amount of current assets with current liabilities is a common analysis tool used by those interested in liquidity. If a company has more current liabilities than current assets, it is possible the company will not be able to pay its current bills when they come due.

LO 4 BT: C Difficulty: Moderate TOT: 3 min. AACSB: Analytic, Communication,
Reflective AICPA BB: Critical Thinking AICPA FN: Measurement

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19. Which assets on a company's balance sheet have no physical substance? Explain.

Solution: Intangible assets have no physical substance. They are reported as long-term assets on the balance sheet and represent the legal right to produce and sell certain products. Like other assets, they represent a potential future benefit for the company.

LO 4 BT: C Difficulty: Easy TOT: 2 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Reporting

20. A company sold 10 widgets. How will the amounts the company reports as 'Sales' differ from amounts reported as 'Cost of Goods Sold'?

Solution: The amount reported as sales represents the dollar amount for which the widgets were sold to the customers. Cost of goods sold represents the original cost paid by the company to acquire the inventory item. The difference between the dollar amount of sales and the dollar amount of cost of goods sold represents gross profit for the company.

LO 4 BT: C Difficulty: Moderate TOT: 3 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Reporting

21. What concerns might you have if you examined a company's balance sheet and found a negative amount in retained earnings?

Solution: A negative amount in retained earnings is common for young companies because it often takes several years to become profitable. Retained earnings may also decline and produce a negative balance (if allowed under the respective state laws) if a company pays large dividends. If the dollar amount in retained earnings is negative because of continual losses, there should be a cause for concern.

LO 4 BT: E Difficulty: Difficult TOT: 7 min. AACSB: Analytic, Communication, Reflective AICPA BB: Critical Thinking AICPA FN: Decision modeling

22. Distinguish between the amounts reported on the income statement compared to the amounts reported on the statement of cash flows.

Solution: Amounts reported on the income statement are revenues and expenses. These amounts reflect general asset and liability inflows and outflows. The amounts reported on the statement of cash flows include only the cash received and the cash paid out.

LO 4 BT: C Difficulty: Moderate TOT: 3 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Reporting

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23. Describe how the equity sections of balance sheets differ for each of the three types of business entities.

Solution: The shareholders' equity section of the balance sheet for corporations consists of two components—contributed capital and retained earnings. Partnerships have one capital account for each owner in the owners' equity section of the balance sheet. A proprietorship has only one capital account. Neither a partnership nor a proprietorship has a retained earnings account.

LO 6 BT: C Difficulty: Moderate TOT: 5 min. AACSB: Analytic, Communication
AICPA BB: Critical Thinking AICPA FN: Reporting

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