Financial Accounting 5th edition Dyckman Test Bank

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Chapter 2

Constructing Financial Statements

Learning Objectives – coverage by question					
	True/False	**Multiple Choice**	**Exercises**	**Problems**	**Essay Questions**
LO1 Describe and construct the balance sheet and understand how it can be used for analysis. (p. 44)	1-4	1, 3-5, 7, 21	1, 2, 5, 10, 13	1, 4	1-3
LO2 Use the financial statement effects template (FSET) to analyze transactions. (p. 49)	5	6, 9, 14, 15, 17	6, 7	5, 6	
LO3 Describe and construct the income statement and discuss how it can be used to evaluate management performance. (p. 53)	6, 7	8, 10-12	3, 8, 12	2, 3	
LO4 Explain revenue recognition, accrual accounting, and their effects on retained earnings. (p. 54)	8, 9	9, 12-14	7, 10	2, 5, 6	
LO5 Illustrate equity transactions and the statement of stockholders' equity. (p. 60)	10, 11	2	4, 5, 9-11, 13		
LO6 Use journal entries and T-accounts to analyze and record transactions. (p. 62)	12, 13	16, 17	6	5, 6	
LO7 Compute net working capital, the current ratio, and the quick ratio, and explain how they reflect liquidity. (p. 71)	14, 15	18-20	14, 15		

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Chapter 2: Constructing Financial Statements

True/False

Topic: Assets
LO: 1
1. Companies may *not* report internally created assets, such as the value of a successful marketing campaign, design innovations and a highly motivated work force on their balance sheets.

Answer: True
Rationale: Even though these "assets" probably provide future benefits to the company that will be reflected in the company's market value and in future revenues, these amounts cannot be reliably measured. They are excluded from the balance sheet under GAAP.

Topic: Historical cost
LO: 1
2. Assets such as inventory and property, plant, and equipment are reported on the balance sheet at their current market value.

Answer: False
Rationale: These assets are generally reported at historical cost.

Topic: Reporting of assets
LO: 1
3. Assets are listed on the balance sheet in order of liquidity and liabilities are listed in order of amount.

Answer: False
Rationale: Assets are reported in the order of liquidity which reflects the ease of converting into cash. Receivables are reported before inventories, and inventories before PPE. Liabilities are reported in order of maturity, with current liabilities expected to be paid within one year or within the operating cycle, and long-term liabilities expected to be paid over a longer period of time.

Topic: The double-entry accounting system
LO: 1
4. Under the double-entry accounting system, no more than two accounts can be affected by each transaction.

Answer: False
Rationale: Each transaction recorded under the double-entry accounting system must affect at least two accounts. It can affect more than two.

Topic: Transaction analysis
LO: 2
5. If Howard, Inc. purchased inventory on credit from Roan Company, then the transaction recorded by Howard would include an increase in a liability and an increase in asset.

Answer: True
Rationale: The transaction recorded by Howard would include an increase to an asset (inventory) and an increase to a liability (accounts payable).

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Topic: Reporting financial performance
LO: 3
6. Operating expenses include interest expense related to a company's financing activities.

Answer: False
Rationale: Interest expense is considered to be a nonoperating expense.

Topic: Reporting financial performance
LO: 3
7. The income statement is also called the statement of earnings.

Answer: True
Rationale: Another name for the income statement is the statement of earnings.

Topic: Accrual accounting
LO: 4
8. Accrual accounting recognizes revenues only when cash is received and expenses only when cash is paid.

Answer: False
Rationale: Accrual accounting refers to the recognition of revenue when earned and the matching of expenses when incurred. The recognition of revenues and expenses does not always relate to the receipt or payment of cash.

Topic: Matching principle
LO: 4
9. Under the matching principle, the cost of inventory should be reported as an expense in the income statement when it is purchased, even if it is purchased on credit and will not be paid until the next reporting period.

Answer: False
Rationale: Under the matching principle, the cost of inventory should only be reported as expense in the period in which it is used up, typically at the point of sale. Purchased inventories that have not yet been sold are reported as assets. Unpaid amounts to suppliers are reported as liabilities.

Topic: Analyzing and recording equity transactions
LO: 5
10. If Umbrella Company paid $2,000 cash dividends to its shareholders, retained earnings would be reduced by $2,000.

Answer: True
Rationale: A cash dividend results in a reduction of retained earnings.

Topic: Analyzing and recording equity transactions
LO: 5
11. If stockholders' equity is $88,000 on January 1, 2016, and decreases to $64,000 on December 31, 2016, this could only be due to a net loss of $24,000.

Answer: False
Rationale: A reduction in stockholders' equity could also be due to a declared cash dividend.

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Topic: Debit and credit system
LO: 6
12. A compound entry dues not necessarily have to maintain total debits equal to total credits.

Answer: False
Rationale: A compound entry must adhere to the rule: total debits equal total credits.

Topic: T-account
LO: 6
13. The typical form of a T-account shows debits on the right and credits on the left.

Answer: False
Rationale: A T-account tracks debits on the left and credits on the right.

Topic: Net working capital
LO: 7
14. Net working capital = Current assets + Current liabilities

Answer: False
Rationale: Net working capital = Current assets less current liabilities.

Topic: Assessing Liquidity
LO: 7
15. Quick ratio is another name for a current ratio.

Answer: False
Rationale: The quick ratio differs from the current ratio in that the numerator only contains cash, short-term securities, and accounts receivable.

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Multiple Choice

Topic: Current assets
LO: 1
1. Which one of the following is included in current assets?

A) Accounts receivable
B) Taxes payable
C) Automobiles
D) Common stock

Answer: A
Rationale: Accounts receivable is included in current assets as it represents amount owed by customers that are expected to be paid within one year or the operating cycle.

Topic: Stockholders' equity
LO: 5
2. Which of the following is *not* shown in the statement of stockholder's equity?

A) Unearned revenue
B) Dividends
C) Retained earnings
D) Common stock

Answer: A
Rationale: Unearned revenue is a liability that represents amounts collected in advance from customers. It is an obligation that must be satisfied with a future cash payment or delivery of goods or services.

Topic: Reporting of assets
LO: 1
3. Assets are recorded in the balance sheet in order of:

A) Market value
B) Historic value
C) Liquidity
D) Maturity

Answer: C
Rationale: Liquidity refers to the ease of conversation to cash. Current assets are to be used during the current operating cycle (starting with cash, short-term investments, accounts receivables, inventories and other assets). Market value and historic value refer to the measurement of assets. Maturity refers to the order in which liabilities are recorded in the balance sheet.

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Topic: Liabilities
LO: 1
4. Which one of the following is *not* a current liability?

A) Taxes payable
B) Accounts payable
C) Wages payable
D) Wage expense

Answer: D
Rationale: Wages expense is an income statement account, not a balance sheet account. Current liabilities are amounts owed and due to be repaid within one year or within one operating cycle.

Topic: Reporting of assets
LO: 1
5. What are probable future sacrifices called and how are they reported?

A) Assets on the balance sheet
B) Stockholders' equity on the balance sheet
C) Dividends on the statement of stockholders' equity
D) Liabilities on the balance sheet

Answer: D
Rationale: Liabilities are probably future economic sacrifices resulting from a current or past event. They are obligations that must be satisfied with a future cash payment or delivery of goods or services.

Topic: Chart of accounts
LO: 2
6. Account titles are commonly grouped into what five categories in the chart of accounts?

A) Current assets, Current liabilities, Noncurrent assets, Noncurrent liabilities, Stockholders' equity
B) Assets, Liabilities, Equity, Revenue, Expenses
C) Common stock, Additional paid-in capital, Treasury stock, Retained earnings, Accumulated other comprehensive income or loss
D) Cash, Marketable securities, Accounts payable, Long-term debt, Common stock

Answer: B
Rationale: In the chart of accounts, account titles are commonly grouped into the five categories of: Assets, Liabilities, Equity, Revenues, and Expenses.

Topic: Stockholders' equity
LO: 1
7. Which one of the following *does not* impact retained earnings directly?

A) Net income
B) Net loss
C) Dividends
D) Stock issuances

Answer: D
Rationale: Stock issuances impact stockholders' equity through the common stock account.

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Topic: Income statement
LO: 3
8. An income statement *does not* include which of the following?

A) Operating expenses
B) Cost of goods sold
C) Retained earnings
D) Sales

Answer: C
Rationale: Retained earnings represent accumulated earnings from previous accounting periods that has not been distributed to stockholders as dividends.

Topic: Effects of accrued wages
LO: 2, 4
9. An accrual of wages expense would produce what effect on the balance sheet?

A) Increase liabilities and decrease equity
B) Decrease liabilities and increase equity
C) Increase assets and increase liabilities
D) Decrease assets and decrease liabilities

Answer: A
Rationale: An accrual of wages expense produces an increase in wages payable (liability) and a decrease in retained earnings (stockholders' equity), resulting in a decrease of profit.

Topic: Gross profit
LO: 3
10. Sales less cost of goods sold equals:

A) Net income
B) Net profit margin
C) Gross profit
D) Gross profit margin

Answer: C
Rationale: Sales – Cost of goods sold = Gross profit.
The gross profit margin is gross profit divided by sales.

Topic: Reporting financial performance
LO: 3
11. Hopewell Industries recorded and paid $1,800 advertising for the current month. Which occurred?

A) Current assets increase.
B) Gross profit decreases.
C) Operating income decreases.
D) Retained earnings increases.

Answer: C
Rationale: Assets (cash) decrease and Advertising Expense (an operating expense) increases, causing operating income to decrease.

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Topic: Recognition of costs as expense
LO: 3, 4
12. As inventory and PPE assets on the balance sheet are consumed, they are reflected:

A) As a revenue on the income statement
B) As an expense on the income statement
C) As common stock on the balance sheet
D) Assets are never consumed

Answer: B
Rationale: As assets are consumed (used up), their cost is transferred into the income statement as an expense.

Topic: Analyzing and recording income statement transactions
LO: 4
13. Which of the following will properly record the payment of a one-year insurance policy?

A) Increase assets and increase retained earnings
B) Increase liabilities and decrease retained earnings
C) Increase and decrease assets
D) Decrease assets and decrease liabilities

Answer: C
Rationale: Prepaid insurance in increased and cash is decreased, both of which are assets.

Topic: Collection of a receivable
LO: 2, 4
14. Cash collected on accounts receivable would produce what effect on the balance sheet?

A) Increase liabilities and decrease equity
B) Decrease liabilities and increase equity
C) Increase assets and decrease assets
D) Decrease assets and decrease liabilities

Answer: C
Rationale: Cash collected on accounts receivable produces an increase in cash and a decrease in accounts receivable, both asset accounts. There is no impact on profit and on equity.

Topic: Transaction analysis
LO: 2
15. Which of the following is one effect of a purchase of $1,000 of inventory on credit?

A) It would increase liabilities by $1,000
B) It would decrease retained earnings by $1,000
C) It would decrease liabilities by $1,000
D) It would decrease cash asset $5,000

Answer: A
Rationale: The purchase on credit creates an account payable. It would increase liabilities by $1,000. In addition, the inventory account in the asset section of the balance sheet would also increase.

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Topic: Journalizing and posting transactions
LO: 6
16. The Cash t-account has a beginning balance of $64,000. During the year, $488,000 was debited and $498,000 was credited to the account.

What is the ending balance of cash?

A) ($10,000)
B) $74,000
C) $54,000
D) Cannot be determined from the information given.

Answer: C
Rationale: $64,000 + $488,000 - $498,000 = $54,000

Topic: Journalizing and posting transactions
LO: 2, 6
17. On January 1, 2016, Lorraine Company paid a $32,000 cash security deposit to rent office space.

Which of the following would be the correct journal entry to record this transaction?

A)	Rent expense	32,000	
	Cash		32,000
B)	Security deposit	32,000	
	Cash		32,000
C)	Cash	32,000	
	Rent expense		32,000
D)	Cash	32,000	
	Security deposit		32,000

Answer: B
Rationale: Security deposit is debited and Cash is credited for $32,000.

Topic: Net working capital
LO: 7
18. Net working capital is defined as:

A) Assets – liabilities
B) Current assets
C) Current assets – Current liabilities
D) Market value – Book value

Answer: C
Rationale: Net working capital = Current assets – Current liabilities

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Topic: Assessing liquidity
LO: 7
19. Which of the following statements is *true* regarding the current ratio?

A) A company with a high current ratio cannot have liquidity problems
B) A low current ratio suggests inefficient use of resources
C) The current ratio can be improved by paying creditors immediately prior to the preparation of financial statements
D) The current ratio presents a more conservative liquidity measure than does the quick ratio

Answer: C
Rationale: A current ratio can be manipulated by management and improved if creditors are paid immediately prior to the close of a financial statement period.

Topic: Assessing Liquidity
LO: 7
20. If Foster Toys has a current ratio of 2.5 and working capital of $2,200,000, which of the following will cause both the current ratio and working capital to decrease?

A) Paid accounts payable in the amount of $60,000
B) Recorded unpaid salaries in the amount of $160,000
C) Borrowed $200,000 from a bank to be repaid in 90-days
D) Purchased $30,000 of inventory on credit

Answer: B
Rationale: Working capital will remain the same in A, C, and D. Only option B will show a decrease in both the current ratio and working capital.

Topic: Measuring assets
LO: 1
21. Which of the following is the justification of reporting certain assets at historical cost?

A) Executory
B) Reliability
C) Relevance
D) Accrual

Answer: B
Rationale: Historical cost is used because it is objective and reliable. It can easily be verified as it represents the cost originally paid.

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Exercises

Topic: Balance sheet accounts
LO: 1
1. Identify the following as an asset (A), liability (L), or equity (E) by writing the letter of the correct classification in the space provided.

	Account	Classification
A.	Accounts payable	
B.	Office equipment	
C.	Accounts receivable	
D.	Common stock	
E.	Cash	
F.	Contributed capital	
G.	Wages payable	
H.	Unearned revenue	

Answer:

A. Liability
B. Asset
C. Asset
D. Equity
E. Asset
F. Equity
G. Liability
H. Liability

Topic: Balance sheet relations
LO: 1
2. Compute the missing amounts in the table below:

	Year 1	Year 2
Total assets	$170,000	B
Common stock	A	$7,200
Retained earnings	$16,800	$37,600
Total liabilities	$125,200	$72,000
Liabilities and equity	$170,000	$116,800

Answer:

A. Liabilities and equity – equity = Liabilities
$170,000 – equity = $125,200
Equity = $44,800

Common stock + retained earnings = Equity
Common stock + $16,800 = $44,800
Common stock = $28,000

B. Total assets = Liabilities and equity
$? = $116,800
Total assets = $116,800

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Topic: Prepare an income statement
LO: 3

3. Prepare an income statement for the month ended July 31, 2016 for Bargain Books. Bargain's account balances for the month ending July 31, 2016 are:

Cash	$ 2,800	Rent expense	$33,200
Accounts receivable	37,000	Utilities expense	1,060
Office supplies	6,200	Salaries expense	32,000
Office equipment	58,300	Miscellaneous expenses	290
Land	140,000	Retained earnings, July 1	24,300
Sales	110,000	Common stock	152,250
Cash dividends	5,300	Accounts payable	29,600

Answer:

Bargain Books Income Statement For the Month Ended July 31, 2016		
Revenues		
Sales		$110,000
Expenses		
Salaries expense	$32,000	
Rent expense	33,200	
Utilities expense	1,060	
Miscellaneous. expense	290	
Total expenses		66,550
Net income		$43,450

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Topic: Prepare a statement of stockholders' equity
LO: 5

4. Prepare a statement of stockholders' equity for the month ended July 31, 2016 for Bargain Books. Assume no changes in contributed capital during the month. Bargain's account balances for the month ending July 31, 2016 are:

Cash	$ 2,800	Rent expense	$33,200
Accounts receivable	37,000	Utilities expense	1,060
Office supplies	6,200	Salaries expense	32,000
Office equipment	58,300	Miscellaneous expenses	290
Land	140,000	Retained earnings, July 1	24,300
Sales	110,000	Common stock	152,250
Cash dividends	5,300	Accounts payable	29,600

Answer:

Bargain Books
Statement of Stockholders' Equity
For the Month Ended July 31, 2016

	Contributed Capital	Retained Earnings	Total Equity
Balance, July 1, 2016	$152,250	$24,300	$176,550
Common stock issued	0		0
Add: Net income		43,450	43,450
Less: Dividends	0	(5,300)	(5,300)
Balance, July 31, 2016	$152,250	$ 62,450	$214,700

Net Income: $110,000 – $32,000 – $33,200 – 1,060 – $290 = $ 43,450

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Topic: Prepare a balance sheet
LO: 1, 5

5. Prepare a balance sheet for Bargain Books as of July 31, 2016. Bargain's account balances for the month ending July 31, 2016 are:

Cash	$ 2,800	Rent expense	$33,200
Accounts receivable	37,000	Utilities expense	1,060
Office supplies	6,200	Salaries expense	32,000
Office equipment	58,300	Misc. expenses	290
Land	140,000	Retained earnings, July 1	24,300
Sales	110,000	Common stock	152,250
Cash dividends	5,300	Accounts payable	29,600

Answer:

Bargain Books
Balance Sheet
July 31, 2016

Assets		**Liabilities**	
Cash	$ 2,800	Accounts payable	$ 29,600
Accounts receivable	37,000		
Office supplies	6,200	**Equity**	
Total current assets	46,000	Common stock	152,250
Office equipment	58,300	Retained earnings	62,450
Land	140,000	Total equity	214,700
Total noncurrent assets	$198,300		
Total assets	$244,300	Total liabilities and equity	$244,300

Topic: Identifying transactions that yield statement effects
LO: 2, 6

6. Provide an example of a transaction that creates each of following effects:

A. Increase assets and increase equity
B. Decrease asset and decrease liability
C. Decrease asset and decrease equity
D. Increase asset and increase liability

Answer:

A. Owner invests cash into business
B. Pay cash to settle a liability in accounts payable
C. Business incurs an expense and it is paid with cash
D. Business buys a new machine on credit

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Topic: Transaction analysis
LO: 2, 4
7. Record the effects of each transaction or event in the table below:

	Balance Sheet						Income Statement			
Transaction	**Cash Asset**	**+ Noncash Assets**	**= Liabilities**	**+ Contrib. Capital**	**+ Earned Capital**		**Revenues**	**- Expenses**	**= Net Income**	
(1) Purchase $16,000 of inventory on credit			=						=	
(2) Employees earn $12,000 in wages that are not paid in cash			=						=	
(3) Paid $8,000 cash for rent expense			=						=	
(4) Collected $96,000 cash from accounts receivable			=						=	
(5) Paid $28,000 cash toward accounts payable			=						=	
(6) Received $44,000 from cash sales			=						=	

Answer:

	Balance Sheet						Income Statement			
Transaction	**Cash Asset**	**+ Noncash Assets**	**= Liabilities**	**+ Contrib. Capital**	**+ Earned Capital**		**Revenues**	**- Expenses**	**= Net Income**	
(1) Purchase $16,000 of inventory on credit		**+16,000** Inventory	=	**+16,000** Accounts Payable					=	
(2) Employees earn $12,000 in wages that are not paid in cash			=	**+12,000** Wages Payable	**-12,000** Retained Earnings			**+12,000** Wages Expense	=	**-12,000**
(3) Paid $8,000 cash for rent expense	**-8,000** Cash		=		**-8,000** Retained Earnings			**+8,000** Rent Expense	=	**-8,000**
(4) Collected $96,000 cash from accounts receivable	**+96,000** Cash	**-96,000** Accounts Receivable	=						=	
(5) Paid $28,000 cash toward accounts payable	**-28,000** Cash		=	**-28,000** Accounts Payable					=	
(6) Received $44,000 from cash sales	**+44,000** Cash		=		**+44,000** Retained Earnings		**+44,000** Sales Revenue		=	**+44,000**

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Topic: Preparing income statement
LO: 3
8. The following items and amounts are taken from the 2016 financial records of Retrieval Co.:

Security deposit……..	$ 12,800	Salaries payable……..	$ 12,000
Equipment……..	58,000	Common stock……	21,000
Salaries expense…….	168,000	Supplies expense ……	18,800
Utilities expense…….	4,400	Retained earnings, Jan. 1, 2016……	24,000
Dividends……..…	30,400	Insurance expense……..	8,800
Accounts payable……	40,800	Service revenue…….……..	300,000
Cash……	39,600	Repair expense……	18,000
Accounts receivable…….	39,000		

Prepare an income statement for the year ending December 31, 2016:

Answer:

Retrieval Co. Income Statement For the Year Ended December 31, 2016		
Revenues		
Service revenue		$ 300,000
Expenses		
Salaries expense	$168,000	
Utilities expense	4,400	
Supplies expense	18,800	
Repair expense	18,000	
Insurance expense	8,800	
Total expense		218,000
Net Income		$ 82,000

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Topic: Preparing a statement of stockholders' equity
LO: 5
9. The following items and amounts are taken from the 2016 financial records of Retrieval Co.:

Security deposit……..	$ 12,800	Salaries payable……..	$ 12,000
Equipment……..	58,000	Common stock…….	21,000
Salaries expense…….	168,000	Supplies expense ……	18,800
Utilities expense…….	4,400	Retained earnings, Jan. 1, 2016……	24,000
Dividends……..…	30,400	Insurance expense……..	8,800
Accounts payable……	40,800	Service revenue……..……..	300,000
Cash……	39,600	Repair expense……	18,000
Accounts receivable…….	39,000		

Prepare a statement of stockholders' equity for Retrieval Co. for the year ending December 31, 2016. Assume no changes in common stock during the year.

Answer:

Retrieval Co.
Statement of Stockholders' Equity
For the Year Ended December 31, 2016

	Contributed Capital	Retained Earnings	Total Equity
Balance, January 1, 2016	$21,000	$24,000	$45,000
Common stock issued	0		0
Add: Net income		82,000	82,000
Less: Dividends	0	(30,400)	(30,400)
Balance, December 31, 2016	$21,000	$ 75,600	$ 96,600

Net Income: $300,000 – $168,000 – $4,400 – 18,800 – $18,000 –$8,800 = $ 82,000

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Topic: Preparing a balance sheet
LO: 1, 4, 5
10. The following items and amounts are taken from the 2016 financial records of Retrieval Co.:

Security deposit……..	$ 12,800	Salaries payable……..	$ 12,000
Equipment……..	58,000	Common stock…….	21,000
Salaries expense…….	168,000	Supplies expense ……	18,800
Utilities expense…….	4,400	Retained earnings, Jan. 1, 2016……	24,000
Dividends……..….	30,400	Insurance expense……..	8,800
Accounts payable…….	40,800	Service revenue……..……..	300,000
Cash……	39,600	Repair expense……	18,000
Accounts receivable…….	39,000		

Prepare a balance sheet for Retrieval Co. for the year ending December 31, 2016.

Answer:

Net Income: $300,000 – $168,000 – $4,400 – 18,800 – $18,000 –$8,800 = $ 82,000
Retained earnings, December 31, 2016: $24,000 + $ 82,000 – $30,400 = $ 75,600

Retrieval Co. Balance Sheet December 31, 2016			
Assets		*Liabilities*	
Cash	$ 39,600	Accounts payable	$40,800
Accounts receivable	39,000	Salaries payable	12,000
Total current assets	78,600	Total liabilities	52,800
Security deposit	12,800	*Equity*	
Equipment	58,000	Common stock	21,000
Total noncurrent assets	70,800	Retained earnings	75,600
		Total equity	96,600
Total assets	$ 149,400	Total liabilities and equity	$ 149,400

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Topic: Statement of stockholders' equity
LO: 5

11. The records of Meadow Corp. show the following information after all transactions are recorded for 2016.

Notes payable	$ 20,000	Supplies	$ 29,000
Service fees earned	184,400	Cash	55,000
Supplies expense	38,800	Advertising expense	6,800
Insurance expense	14,000	Salaries expense	36,000
Miscellaneous expense	600	Rent expense	38,000
Common stock, January 1	22,000	Retained earnings, January 1	25,000
Accounts payable	7,200	Accounts receivable	6,400
Dividends	4,000	Equipment	60,000

Meadow raised $24,000 cash through the issuance of additional common stock during the year. Based on this information, prepare Meadow's statement of stockholders' equity for the year ending December 31, 2016.

Answer:

Meadow Corp
Statement of Stockholders' Equity
For Year Ended December 31, 2016

	Common Stock	Retained Earnings	Total Equity
Balance at January 1, 2016	$22,000	$25,000	$47,000
Stock issuance	24,000		24,000
Dividends		(4,000)	(4,000)
Net income*	_____	50,200	50,200
Balance at December 31, 2016	$ 46,000	$71,200	$ 117,200

*$50,200 = $184,400 – $38,800 – $14,000 – $600 – $6,800 – $36,000 – $38,000

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Topic: Preparing income statement from account balances
LO: 3
12. On December 31, 2016, Sirius Corporation's records show the following selected amounts.

Cash	$ 19,000	Cash dividends	$ 2,000
Accounts receivable	4,000	Sales	84,000
Office supplies	12,000	Rent expense	20,000
Office equipment	40,000	Salaries expense	36,000
Accounts payable	16,000	Telephone expense	3,000
Common stock	2,000	Miscellaneous expense	8,000
Retained earnings, Dec. 31, 2016	62,000		

Prepare an income statement for Sirius for its year ending December 31, 2016.

Answer:

Sirius Corporation Income Statement For the Year Ended December 31, 2016		
Revenues		
Sales		$ 84,000
Expenses		
Salaries expense	$36,000	
Rent expense	20,000	
Telephone expense	3,000	
Miscellaneous expense	8,000	
Total expense		67,000
Net Income		$ 17,000

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Topic: Equity changes
LO: 1, 5
13. At the end of 2016, Lumos Company reported the following amounts on its balance sheet:

Cash	$ 56,200
Accounts receivable	104,800
Equipment	92,000
Land	240,000
Accounts payable	63,000
Common stock	190,000
Retained earnings	240,000

Answer each of the following independent questions:

A. Assume that Lumos' stockholders' equity on January 1, 2016 was $264,000. Lumos did not issue common stock during the year, but it paid $36,000 cash in dividends. How much is Lumos' net income or loss for 2016?

B. Assume that Lumos' stockholders' equity on January 1, 2016 was $236,000, and that Lumos issued additional common stock of $70,000 and paid $44,000 in cash dividends before the end of 2016. What was Lumos' net income or net loss for 2016?

Answer:

A.	Increase in equity ($190,000 + $ 240,000 – $264,000)	$ 166,000
	Add: Dividends	36,000
	Net Income for 2016	$ 202,000
B.	Increase in equity ($190,000 + $240,000 – $236,000)	$ 194,000
	Add: Dividends	44,000
	Less: Additional Investment	(70,000)
	Net Income for 2016	$ 168,000

Topic: Net working capital
LO: 7
14. Lollipop, Inc. has $2,400 net working capital and $6,600 of current assets, what is the amount of the firm's current liabilities?

Answer:

Net working capital = current assets – current liabilities.
$2,400 = $6,600 – Current liabilities
Current liabilities = $4,200

Topic: Operating cycle
LO: 7
15. Companies strive to reduce operating cycles (time between paying cash for goods and receiving cash from customers). List 2 ways by which companies can achieve this.

Answer:
1. Increase trade credit to minimize the cash invested in inventories,
2. Reduce inventory levels from improved production systems and management,
3. Better underwriting and collection of receivables to reduce past due accounts,
4. Offer incentives to customers for early payment of receivables.

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Problems

Topic: Balance sheet accounts
LO: 1

1. In the blank space beside each numbered balance sheet item, enter the letter of its balance sheet classification. If the item should not appear on the balance sheet, enter a Z in the blank.

_____	1.	Cash	A. Current assets
_____	2.	Inventory	B. Long-term investments
_____	3.	Land	C. Long-term assets
_____	4.	Machine	D. Intangible assets
_____	5.	Building	E. Current liabilities
_____	6.	Income taxes payable in 30 days	F. Noncurrent liabilities
_____	7.	Utilities payable	G. Equity
_____	8.	Note receivable due in 30 days	
_____	9.	Common Stock	
_____	10.	Goodwill	
_____	11.	Value of company logo	
_____	12.	Wages expense	
_____	13.	Value of land in excess of cost	
_____	14.	Mortgage payable	
_____	15.	Accounts receivable	

Answer:

1.	A	9.	G
2.	A	10.	D
3.	C	11.	Z
4.	C	12.	Z
5.	C	13.	Z
6.	E	14.	F
7.	E	15.	A
8.	A		

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Topic: Transaction analysis
LO: 3, 4

2. Based on the following list of transactions, indicate their effect on Divine Dogs assets, liabilities and equity for his one month of operations.

A. Divine buys a cooler and a George Foreman grill for $1,200 cash.
B. Divine takes out a loan for $3,200.
C. Divine buys 600 hot dogs at $0.50 each, 500 buns at $0.20 each, 800 cans of soft drinks at $0.50 each and a huge bottle of ketchup for $50.
D. Divine sells 160 hot dog / drink combos for $8 each.
E. Divine records the product cost for the sales in (D) above, including ketchup, at $1.50 each.
F. Divine pays his hot dog salesmen $800 for the month.
G. Divine pays $80 of his loan.

	Cash	Inventory	Equipment	Accounts Payable	Loans	Equity
A						
B						
C						
D						
E						
F						
G						

Answer:

	Cash	Inventory	Equipment	Accounts Payable	Loans Payable	Equity
A	(1,200)		+1,200			
B	+3,200				+3,200	
C	(850)	+850				
D	+1,280					+1,280
E		(240)				(240)
F	(800)					(800)
G	(80)				(80)	

C: (600 × $0.50) + (500 × $0.20) + (800 × $0.50) + $50.00 = $850.00
D: 160 × $8.00 = $1,280
E: $1.50× 160 = $240

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Topic: Income statement relations
LO: 3
3. Information concerning Nickolas' earnings for three years appears below.

Nickolas' Income Statement Information ($ millions)			
Year	2016	2015	2014
Sales	$22,750	$20,258	
Cost of goods sold		9,372	7,166
Gross profit	8,986		(1,138)
Operating expenses		4,176	3,650
Other income (loss)	824		(178)
Net income	3,068	5,922	

Calculate the missing amounts.

Answer:

Nickolas' Income Statement Information ($ millions)			
Year	2016	2015	2014
Sales	$22,750	$20,258	$6,028
Cost of goods sold	13,764	9,372	7,166
Gross profit	8,986	10,886	(1,138)
Operating expenses	6,742	4,176	3,650
Other income (exp)	824	(788)	(178)
Net income	$3,068	$5,922	($4,966)

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Topic: Constructing a balance sheet
LO: 1
4. Compute the missing amounts for each of the last 3 years for West Suburban Inc.

(millions)	2016	2015	2014
Current assets	$13,360		$12,006
Noncurrent assets	6,760	7,612	
Total assets		19,038	17,632
Current liabilities	5,422	5,278	4,864
Noncurrent liabilities	3,564		6,728
Total liabilities	8,986	10,078	
Stockholders' equity		8,960	6,040
Liabilities and equity			

Answer:

	2016	2015	2014
Current assets	$13,630	$ 11,426	$12,006
Noncurrent assets	6,760	7,612	5,626
Total assets	$20,390	$19,038	$17,632
Current liabilities	$5,422	$5,278	$4,864
Noncurrent liabilities	3,564	4,800	6,728
Total liabilities	8,986	10,078	11,592
Stockholders' equity	11,404	8,960	6,040
Liabilities and equity	$20,390	$19,038	$17,632

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Topic: Transaction analysis
LO: 2, 4, 6
5. Identify the effects of the following transactions in the table below:

	Balance Sheet							Income Statement			
Transaction	**Cash Asset**	**+**	**Noncash Assets**	**= Liabilities**	**+**	**Contrib Capital**	**+**	**Earned Capital**	**Revenues**	**- Expenses**	**= Net Income**
(1) $600 of employee wages are earned but not yet paid				=							=
(2) $3,000 of inventory is purchased on credit				=							=
(3) Sold goods for $1,500 on account				=							=
(4) Record $700 for the cost of inventory sold in (3) above				=							=
(5) Collected $1,000 cash from transaction (3) above				=							=
(6) $3,000 of equipment is acquired for cash				=							=
(7)Paid $12,000 on a note payable that came due				=							=
(8) Paid $600 cash interest on borrowings				=							=

Answer:

	Balance Sheet							Income Statement			
Transaction	**Cash Asset**	**+**	**Noncash Assets**	**= Liabilities**	**+**	**Contrib Capital**	**+**	**Earned Capital**	**Revenues**	**- Expenses**	**= Net Income**
(1) $600 of employee wages are earned but not yet paid				= **+600** Wages Payable				**-600** Retained Earnings		**+600** Wages Expense	= **-600**
(2) $3,000 of inventory is purchased on credit			**+3,000** Inventory	= **+3,000** Accounts Payable							=
(3) Sold goods for $1,500 on account			**+1,500** Accounts Receivable	=				**+1,500** Retained Earnings	**+1,500** Sales Revenue		= **+1,500**
(4) Record $700 for the cost of inventory sold in (3) above			**-700** Inventory	=				**-700** Retained Earnings		**+700** Cost of Goods Sold	= **-700**
(5) Collected $1,000 cash from transaction (3) above	**+1,000** Cash		**-1,000** Accounts Receivable	=							=
(6) $3,000 of equipment is acquired for cash	**-3,000** Cash		**+3,000** Equipment	=							=
(7)Paid $12,000 on a note payable that came due	**-12,000** Cash			= **-12,000** Note Payable							=
(8) Paid $600 cash interest on borrowings	**-600** Cash			=				**-600** Retained Earnings		**+600** Interest Expense	= **-600**

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Topic: Transaction analysis
LO: 2, 4, 6
6. Identify the effects of the following transactions in the table below:

	Balance Sheet							Income Statement				
Transaction	**Cash Asset**	**+**	**Noncash Assets**	**=**	**Liabilities**	**+**	**Contrib Capital**	**+**	**Earned Capital**	**Revenues**	**-**	**Expenses**	**=**	**Net Income**
(1) Signed a note payable and received $4,000 cash				=									=	
(2) Purchased inventory for $3,000 on credit				=									=	
(3) Sold goods for $3,500 on account				=									=	
(4) Recorded $900 for the cost of merchandise sold in (3) above				=									=	
(5) Collected $2,200 cash from transaction (3) above				=									=	
(6) Paid $600 on the account payable in transaction (2) above				=									=	
(7) Employees earn $900 in wages to be paid the following month				=									=	
(8) Sold gift cards for $300 cash				=									=	

Answer:

	Balance Sheet							Income Statement				
Transaction	**Cash Asset**	**+**	**Noncash Assets**	**=**	**Liabilities**	**+**	**Contrib Capital**	**+**	**Earned Capital**	**Revenues**	**-**	**Expenses**	**=**	**Net Income**
(1) Signed a note payable and received $4,000 cash	**+4,000** Cash			=	**+4,000** Notes Payable								=	
(2) Purchased inventory for $3,000 on credit			**+3,000** Inventory	=	**+3,000** Accounts Payable								=	
(3) Sold goods for $3,500 on account			**+3,500** Accounts Receivable	=					**+3,500** Retained Earnings	**+3,500** Sales Revenue			=	**+3,500**
(4) Recorded $900 for the cost of merchandise sold in (3) above			**-900** Inventory	=					**-900** Retained Earnings			**+900** Cost of Goods Sold	=	**-900**
(5) Collected $2,200 cash from transaction (3) above	**+2,200** Cash		**-2,200** Accounts Receivable	=									=	
(6) Paid $600 on the account payable in transaction (2) above	**-600** Cash			=	**-600** Accounts Payable								=	
(7) Employees earn $900 in wages to be paid the following month				=	**+900** Wages Payable				**-900** Retained Earnings			**+900** Wage Expense	=	**-900**
(8) Sold gift cards for $300 cash	**+300** Cash			=	**+300** Unearned Revenue								=	

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Essays

Topic: Historical cost vs. Market value
LO: 1

1. With few exceptions, why do we report most assets at their original acquisition price (historical cost) and not at current market value?

Answer:
When company valuation is the goal, accurate and current market values of assets are preferred. For some assets like marketable securities, values are readily obtained from online quotes. For other assets like property, plant and equipment, we can only estimate their market values until they are ultimately sold. Allowing companies to report estimates of market values for assets would introduce potential bias into financial reporting, thus lessening financial statement reliability and usefulness.

Topic: Intangible assets vs. Tangible assets
LO: 1

2. Compare and contrast intangible and tangible assets.

Answer:
Intangible assets are similar to property, plant and equipment (PP&E) in that they are owned and controlled by the company and the company expects to realize future benefits from the use of the asset. For example, an internally created intangible asset, such as Mickey Mouse in the case of Walt Disney, is owned and controlled by Walt Disney and the company certainly anticipates that it will generate future sales from Mickey Mouse.

Despite these similarities, Mickey Mouse cannot be capitalized because its historical cost is not reliably measurable. In contrast, the historical cost of PP&E is reliably measurable, and, therefore, can be capitalized on the balance sheet.

Topic: Undervalued assets
LO: 1

3. Prepare a list of two possible undervalued assets on the balance sheet of a company. Indicate how these items can be undervalued.

Answer:
Land is an asset that can often be undervalued on a balance sheet because it is typically an appreciating asset. Inventories are often carried at cost, below their current market price if prices rise since the items were acquired.

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