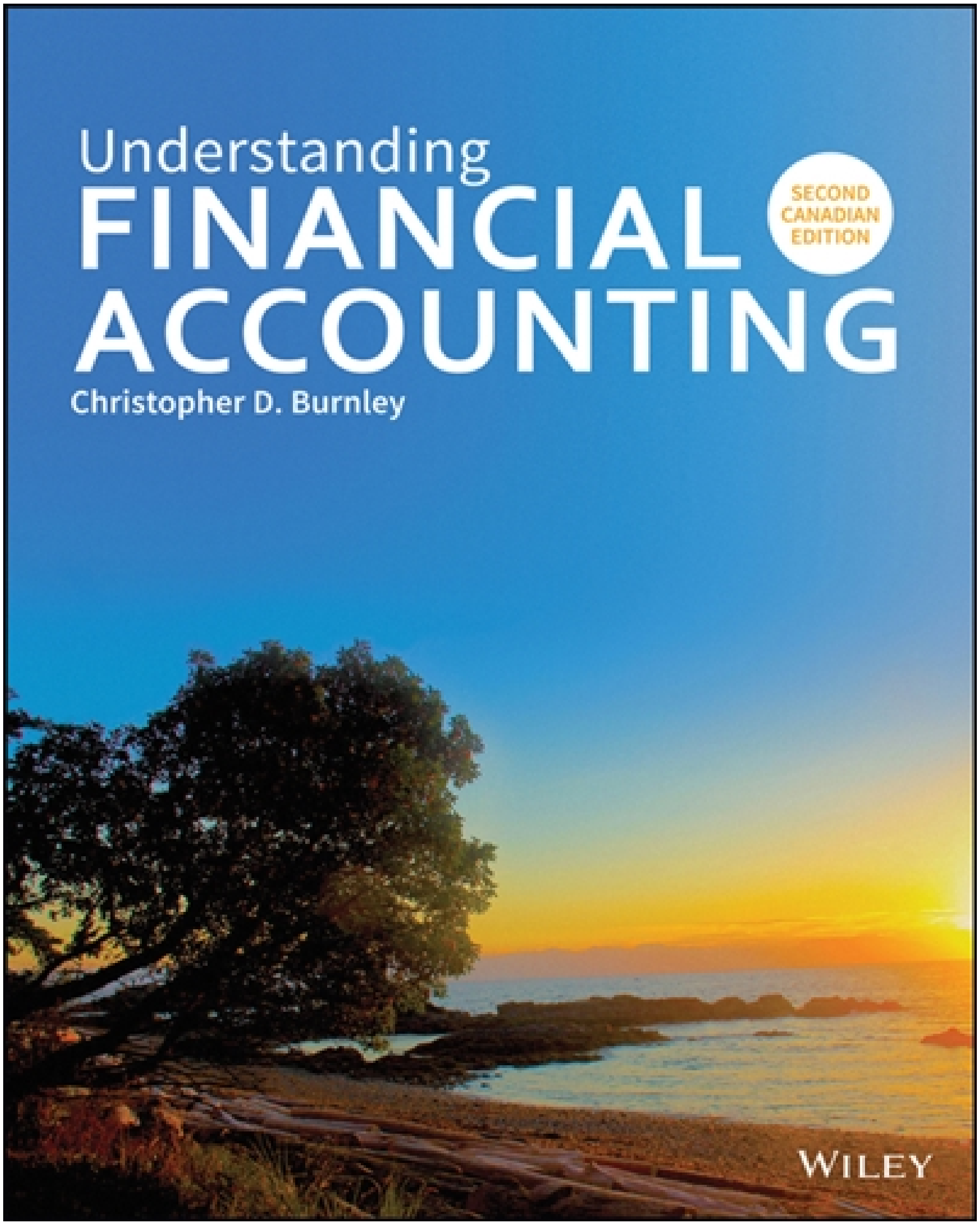
Test Bank for Understanding Financial Accounting 2nd Edition by Burnley



Test Bank

CHAPTER 1

OVERVIEW OF CORPORATE FINANCIAL REPORTING

SUMMARY OF QUESTION TYPES BY LEARNING OBJECTIVE, BLOOM'S TAXONOMY, LEVEL OF DIFFICULTY, AACSB CODES, AND CPA CODES

Item	LO	BT	LOD	AACSB	CPA	Item	LO	BT	LOD	AACSB	CPA	Item	LO	BT	LOD	AACSB	CPA
True-False Statements																	
1.	1	K	M	AN	F	11.	4	K	E	AN	F	21.	5	K	M	AN	F
2.	1	K	E	AN	F	12.	5	K	E	AN	F	22.	5	K	E	AN	F
3.	1,5	K	M	AN	F	13.	5	K	E	AN	F	23.	5	K	E	AN	F
4.	2	K	E	AN	F	14.	5	K	E	AN	F	24.	5	K	M	AN	F
5.	2	K	E	AN	F	15.	5	K	M	AN	F	25.	5	K	E	AN	F
6.	2	K	E	AN	F	16.	5	K	E	AN	F	26.	5	K	M	AN	F
7.	4	K	E	AN	F	17.	5	K	E	AN	F	27.	5	K	M	AN	F
8.	4	K	M	AN	F	18.	5	K	E	AN	F	28.	5	C	E	AN	F
9.	4	K	M	AN	F	19.	5	K	E	AN	F	29.	5	K	E	AN	F
10.	4	K	M	AN	F	20.	5	K	E	AN	F	30.	5	K	M	AN	F

Bloom's: AN = Analytic AP = Application C = Comprehension K = Knowledge
LOD: E = Easy M = Medium H = Hard
AACSB: AN = Analytic
CPA: F = Financial Reporting

SUMMARY OF QUESTION TYPES BY LEARNING OBJECTIVE, BLOOM'S TAXONOMY, LEVEL OF DIFFICULTY, AACSB CODES, AND CPA CODES (CONT'D)

Item	LO	BT	LOD	AACSB	CPA	Item	LO	BT	LOD	AACSB	CPA	Item	LO	BT	LOD	AACSB	CPA
Multiple Choice Questions																	
31.	1	K	E	AN	F	51.	4	C	M	AN	F	71.	5	C	M	AN	F
32.	1	K	M	AN	F	52.	4	C	M	AN	F	72.	5	K	M	AN	F
33.	1	K	M	AN	F	53.	4	C	E	AN	F	73.	5	K	M	AN	F
34.	2	K	E	AN	F	54.	4	C	E	AN	F	74.	5	C	H	AN	F
35.	2	K	E	AN	F	55.	4	C	E	AN	F	75.	5	K	M	AN	F
36.	2	K	M	AN	F	56.	4	C	M	AN	F	76.	5	C	M	AN	F
37.	2	K	E	AN	F	57.	4	C	M	AN	F	77.	5	K	E	AN	F
38.	2	K	M	AN	F	58.	4	C	M	AN	F	78.	5	K	M	AN	F
39.	2	K	E	AN	F	59.	4	C	M	AN	F	79.	5	K	E	AN	F
40.	2,3	C	M	AN	F	60.	4	C	M	AN	F	80.	5	K	M	AN	F
41.	3	C	M	AN	F	61.	4	C	M	AN	F	81.	5	K	M	AN	F
42.	3	C	M	AN	F	62.	4	C	M	AN	F	82.	5	K	E	AN	F
43.	3	K	E	AN	F	63.	5	K	E	AN	F	83.	5	K	M	AN	F
44.	3	K	E	AN	F	64.	5	K	E	AN	F	84.	5	K	M	AN	F
45.	3	K	M	AN	F	65.	5	AP	M	AN	F	85.	5	K	E	AN	F
46.	3	K	M	AN	F	66.	5	K	H	AN	F	86.	5	K	M	AN	F
47.	3	K	M	AN	F	67.	5	K	E	AN	F	87.	5	K	E	AN	F
48.	3	K	M	AN	F	68.	5	C	H	AN	F						
49.	4	K	M	AN	F	69.	5	K	E	AN	F						
50.	4	K	M	AN	F	70.	5	K	M	AN	F						
Exercises																	
88.	5	AP	E	AN	F	90.	5	AP	M	AN	F	92.	5	AN	H	AN	F
89.	5	AP	M	AN	F	91.	5	AN	H	AN	F						
Matching																	
93.	4	C	M	AN	F	94.	5	K	M	AN	F						
Short-Answer Essay																	
95.	2	K	M	AN	F	97.	3	C	M	AN	F	99.	5	C	M	AN	F
96.	3	K	M	AN	F	98.	4	K	M	AN	F	100.	5	K	M	AN	F
Essay																	
101.	4	C	H	AN	F	102.	5	C	M	AN	F						

Bloom's: AN = Analytic AP = Application C = Comprehension K = Knowledge
LOD: E = Easy M = Medium H = Hard
AACSB: AN = Analytic
CPA: F = Financial Reporting

SUMMARY OF LEARNING OBJECTIVES BY QUESTION TYPE

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Learning Objective 1													
1.	TF	2.	TF	3	TF	31.	MC	32.	MC	33.	MC		
Learning Objective 2													
4.	TF	6.	TF	35.	MC	37.	MC	39.	MC	95.	SAE		
5.	TF	34.	MC	36.	MC	38.	MC	40.	MC				
Learning Objective 3													
40.	MC	42.	MC	44.	MC	46.	MC	48.	MC	97.	SAE		
41.	MC	43.	MC	45.	MC	47.	MC	96.	SAE				
Learning Objective 4													
7.	TF	11.	TF	52.	MC	56.	MC	60.	MC	98.	SAE		
8.	TF	49.	MC	53.	MC	57.	MC	61.	MC	101.	Es		
9.	TF	50.	MC	54.	MC	58.	MC	62.	MC				
10.	TF	51.	MC	55.	MC	59.	MC	93.	Ma				
Learning Objective 5													
12.	TF	20.	TF	28.	TF	68.	MC	76.	MC	84.	MC	92.	Ex
13.	TF	21.	TF	29.	TF	69.	MC	77.	MC	85.	MC	94.	Ma
14.	TF	22.	TF	30.	TF	70.	MC	78.	MC	86.	MC	99.	SAE
15.	TF	23.	TF	63.	MC	71.	MC	79.	MC	87.	MC	100.	SAE
16.	TF	24.	TF	64.	MC	72.	MC	80.	MC	88.	Ex	102.	Es
17.	TF	25.	TF	65.	MC	73.	MC	81.	MC	89.	Ex		
18.	TF	26.	TF	66.	MC	74.	MC	82.	MC	90.	Ex		
19.	TF	27.	TF	67.	MC	75.	MC	83.	MC	91.	Ex		

Note: TF = True-False; MC = Multiple Choice; Ex = Exercise; Ma = Matching; SAE = Short-Answer Essay; Es = Essay

CHAPTER LEARNING OBJECTIVES

1. ***Define financial accounting and understand its relationship to economic decision making.***
• Financial accounting is the process by which information on the transactions of an organization is captured, analyzed, and reported to external decision makers.
• These decision makers are referred to as *financial statement users* and include investors and creditors.
• The primary purpose of financial accounting information is to aid these users in making economic decisions related to the reporting organization, such as whether to invest in it or lend it money.

2. ***Identify the main users of financial accounting information and explain how they use this information.***
• The main users of financial accounting information include shareholders, the board of directors, potential investors, creditors (bankers and suppliers), regulators (stock exchanges), taxing authorities (governments), securities analysts, and others.
• Shareholders, the board of directors, and potential investors will use financial accounting information to enable them to assess how well management has run the company; determine whether they should buy, sell, or continue to hold shares in the company; assess the company's share price relative to the financial accounting information; and so on.
• Creditors will use financial accounting information to determine whether they should lend funds to the company, establish credit terms for it, assess a company's ability to meets its obligations, and so on.
• Regulators will use financial accounting information to determine whether a company has met its listing requirements.
• Taxing authorities will use this information in assessing the taxes owed by the organization.

3. ***Describe the major forms of business organization and explain the key distinctions between each form.***
• There are three major forms of business organization: (1) proprietorships, (2) partnerships, and (3) corporations.
• There are public corporations (whose shares trade on a public stock exchange and are widely held) and private corporations (whose shares do not trade on a public exchange and are generally owned by a small number of people).
• Corporations are separate legal entities, whereas proprietorships and partnerships are not. This means the personal assets of owners are protected in the event of legal action against corporations, whereas they are at risk in the case of proprietorships and partnerships. It also means corporations file separate tax returns, whereas the income from proprietorships and partnerships is reported on the personal tax returns of their owners.

4. ***Explain the three categories of business activities and identify examples of transactions related to each category.***
• The three categories of business activities are: (1) operating, (2) investing, and (3) financing activities.

• Operating activities are related to the company's revenues and expenses, such as sales to customers, collections from customers, purchases of inventory, and payments of wages and other expenses.
• Investing activities include buying and selling property, plant, and equipment and buying and selling the shares of other companies.
• Financing activities include borrowing money, issuing shares, repaying loan principal, and paying dividends.

5. ***Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.***
• There are four basic financial statements: (1) the statement of income, (2) the statement of changes in equity, (3) the statement of financial position, and (4) the statement of cash flows.
• The objective of the statement of income is to measure the company's operating performance (its profit) for a period of time. This is measured by subtracting the expenses incurred during the period from the income earned (revenues) in the same period.
• The objective of the statement of changes in equity is to provide details on how each component of shareholders' equity changed during the period. The components of shareholders' equity include share capital (the shares issued by the company) and retained earnings (the company's earnings that have been kept and not distributed as dividends).
• The objective of the statement of financial position is to present information on a company's assets, liabilities, and shareholders' equity at a specific date. Assets must be controlled by the company and embody a future benefit. Examples include cash; accounts receivable; inventory; property, plant, and equipment; land; and so on. Liabilities are obligations of a company that will result in an outflow of resources. Examples include accounts payable, deferred revenue, long-term debt, and so on. Shareholders' equity represents the shareholders' interest in the assets of the company and is referred to as *net assets*. Examples include common shares and retained earnings.
• The objective of the statement of cash flows is to enable financial statement users to assess the company's inflows and outflows of cash related to its operating, investing, and financial activities for a period of time.
• The notes to a company's financial statements are used to provide additional detail and context for items in the financial statements. They enable the financial statements themselves to remain uncluttered, while increasing their usefulness.

TRUE-FALSE STATEMENTS

1. Decision makers are often referred to as users of the financial statements and include investors and creditors.

2. The primary purpose of financial accounting information is to aid users in their economic decision making relative to the organization.

3. The section of an annual report that contains management's discussion of the company's operating results is referred to as the Statement of Management's Responsibility.

4. The shareholders are an example of an internal user of annual report information.

5. Information contained in the financial statements of a company is of use to both internal and external users.

6. There may be a single shareholder in the case of a public company or many shareholders in the case of a private company.

7. A firm's activities can be divided into borrowing, investing, and operating.

8. If an investor owns 10% of the shares of a company, they normally own 10 shares of the company.

9. Dividends are payments made by the company to distribute future profits.

10. A gain or increase in the value of shares is known as capital appreciation.

11. Creditors are entities that lend money to a company rather than buying shares of a company.

12. The financial statements of a company are prepared by the shareholders.

13. Assets are listed in the order of their liquidity on the classified Statement of Financial Position.

14. Prepaid expenses can be found on the Statement of Income.

15. The statement of financial position measures cash inflows and outflows of a company over a period of time.

16. Profit is determined by subtracting the income earned during the period from the expenses incurred during the same period.

17. Income can also include gains that a company generates from sales that are outside their normal course of operations.

18. Expenses are defined as increases in economic benefits.

19. Gross profit is equal to the sales received from goods and the operating expenses incurred during the period.

20. Net earnings is the amount of the company's revenue that remains after all of its expenses are accounted for.

21. Retained earnings is the earnings that have been kept and **not** paid out as dividends.

22. Liquidity refers to how long something will be received, realized, or consumed.

23. Canadian companies use a 12-month period to distinguish between items that are current from those that are non-current.

24. Working capital measures the company's ability to meet its short-term obligations using its non-current assets.

25. Deferred revenue represents customer deposits.

26. Shareholders' equity is often referred to as the net assets of the company.

27. Share capital records the amount that investors have received in the form of dividends.

28. Companies that are growing normally have negative cash flows from investing activities.

29. IFRS are the financial reporting standards that must be followed by Canadian public

companies.

30. The MD&A provides a discussion of the risks facing the company and information about future plans.

ANSWERS TO TRUE-FALSE STATEMENTS

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	T	9.	F	17.	T	25.	T
2.	T	10.	T	18.	F	26.	T
3.	F	11.	T	19.	F	27.	F
4.	F	12.	F	20.	T	28.	T
5.	T	13.	T	21.	T	29.	T
6.	F	14.	F	22.	F	30.	T
7.	F	15.	F	23.	T		
8.	F	16.	F	24.	F		

MULTIPLE CHOICE QUESTIONS

31. The annual report includes everything, **except** for
a) managerial statements.
b) management discussion and analysis.
c) financial statements.
d) notes to the financial statements.
e) all of the above

32. Financial Accounting is also referred to as
a) internal reporting.
b) management reporting.
c) external financial reporting.
d) all of the above

33. In which section of the annual report does management comment on the company and its operating results?
a) report to the shareholders
b) management's discussion and analysis
c) corporate profile
d) selected financial data

34. Which of the following is an internal user of annual report information?
a) creditors
b) board of directors
c) regulators
d) shareholders

35. The shareholders typically elect which of the following to represent their interests?
a) senior management
b) independent auditors
c) board of directors
d) chief operating officer

36. All of the following are external users **except**
a) labour unions.
b) management.
c) regulators.
d) journalists.

37. Those who lend money or otherwise extend credit rather than invest it directly are known as
a) investors.
b) regulators.

c) creditors.
d) unions.

38. Publicly traded corporations that fail to comply with securities regulations related to statement presentation and timing, may
a) be fraudulent.
b) be delisted.
c) face criminal charges.
d) have a questionable management team.

39. Creditors include which of the following?
a) suppliers
b) financial institutions
c) employees
d) all of the above

40. Privately held corporations
a) always have multiple shareholders.
b) always require a board of directors to represents its interests.
c) raise capital through the sale of shares.
d) none of the above

41. The form of business ownership that most effectively limits the risk of ownership is
a) sole proprietorship.
b) general partnership.
c) corporation.
d) none of the above, all forms of business ownership are equally risky.

42. Jennifer is a university student looking to earn some cash for tuition over the summer months (April–August). She has decided to start a lawn care business, what business structure would best suit her needs?
a) private corporation
b) public corporation
c) general partnership
d) sole proprietorship

43. A corporation whose shares are held by a small number of individuals is referred to as a
a) proprietorship.
b) publicly traded corporation.
c) small business corporation.
d) privately held corporation.

44. Businesses can be operated in a number of different forms, such as a
a) corporation.

b) partnership.
c) proprietorship.
d) all of the above.

45. Which statement is **incorrect** in regards to the characteristics of a corporation?
a) It is a separate legal entity.
b) It can be sued.
c) Shareholders liability is limited to their investment.
d) It cannot be publicly accountable.

46. Which of the following statements best describes a proprietorship?
a) can be single or multiple owners
b) taxed separately
c) most expensive to establish
d) owner is responsible for debt of the company

47. Which of the following statements best describes a partnership?
a) separate legal entity
b) single owner
c) most expensive to establish
d) owners are responsible for debt of the company

48. Which of the following statements best describes a corporation?
a) can be single or multiple owners
b) taxed separately
c) most expensive to establish
d) all of the above

49. What is the initial investment by the shareholders in a company called?
a) owners' capital
b) shareholders' capital
c) retained earnings
d) shareholders' equity

50. The fundamental types of business activities that a firm typically engages in include all of the following **except**
a) operating.
b) borrowing.
c) investing.
d) financing.

51. Which of the following is an example of an operating activity?
a) paying dividends
b) sale of investment in other companies' shares

c) purchase of property, plant, and equipment
d) payment of interest expense

52. Which of the following is a typical financing activity?
a) purchasing property, plant or equipment
b) purchasing another company's shares
c) paying interest expense
d) paying dividends

53. All of the following are investing activities **except**
a) earning interest income.
b) purchasing property, plant, and equipment.
c) purchasing other companies' shares.
d) selling property, plant, and equipment.

54. Which of the following is a typical financing activity?
a) payment of dividends
b) payment of interest expense
c) payment of wages
d) purchases of inventory

55. Operating activities include all of the following **except**
a) collections of accounts receivable.
b) payment of tax expense.
c) payment of dividends.
d) payment of interest expense.

56. Which of the following is **not** a typical operating activity?
a) payment of accounts payable
b) payment of long-term notes payable
c) payment of wages
d) collection of accounts receivable

57. An example of a financing activity is
a) purchase of property.
b) issuing shares.
c) sales to customers.
d) payment of taxes.

58. An example of an investing activity is
a) purchase of inventory.
b) collections of amounts owed by customers.
c) purchase of shares of other companies.
d) payment of taxes.

59. An example of an operating activity is
a) repaying loan principal.
b) paying dividends.
c) purchase of shares of other companies.
d) payments of taxes owed to the government.

60. A friend is looking to purchase shares as an investment, but would like information about whether or **not** the company has paid dividends in the last year. Where would your friend find this information in the financial statements?
a) Income Statement
b) Operating Activities on the Cash Flow Statement
c) Investing Activities on the Cash Flow Statement
d) Financing Activities on the Cash Flow Statement

61. A positive ___ represents an internal source of funding.
a) Cash flow
b) Retained earnings
c) Dividends account
d) Share capital account

62. Capital Appreciation refers to
a) sale of shares at a price higher than the purchase price
b) the gain on the sale of an asset
c) the allocation of the value of an asset over its useful life
d) all of the above

63. Which of the following statements best describes financial accounting?
a) An information system in which the underlying transactions of organization are captured, analyzed, and reported.
b) The reports that management prepares for the owners of the company summarizing how the company performed during the period.
c) An information system in which all transactions with the company are accurately reported.
d) The reports that management prepares for use in making decisions related to the financing, investing, and operating activities of a company.

64. Where would the information about company operations be found?
a) on the Statement of Income
b) on the Statement of Financial Position
c) in the notes of the financial statements
d) in the statement of management responsibility

65. In 2020 Muller Ltd. earned gross revenues of $2,500,000 and had net income of $480,000. During 2020 the company had 200,000 common shares outstanding and its average

shareholders' equity was $1,000,000. Muller's basic earnings per share for 2020 is
a) $2.50.
b) $2.40.
c) $12.50.
d) $0.48.

66. All of the following can be found on an Statement of Income **except**
a) Interest expense.
b) Depreciation expense.
c) Prepaid rent expense.
d) Other income.

67. Which of the financial statements provides information about the company's financial position?
a) Statement of Income
b) Statement of Financial Position
c) Statement of Cash Flows
d) Statement of Changes in Equity

68. Which of the following is the proper order to list current assets on the Statement of Financial Position?
a) Cash, Short-Term Investments, Inventory, Prepaid Expenses
b) Cash, Short-Term Investments, Prepaid Expenses, Accounts Receivable
c) Cash, Inventory, Accounts Receivable, Short-Term Investments
d) Cash, Accounts Receivable, Short-Term Investments, Inventory

69. Which of the following is the basic accounting equation?
a) Assets = liabilities – shareholders' equity
b) Assets = liabilities × shareholders' equity
c) Assets = liabilities ÷ shareholders' equity
d) Assets = liabilities + shareholders' equity

70. Which of the following are the two components of Shareholders' equity?
a) Dividends and Retained Earnings
b) Share Capital and Retained Earnings
c) Share Capital and Net Income
d) Net Income and Dividends

71. The change in retained earnings can be calculated as follows:
a) Net Income – Dividends
b) Net Income + Dividends
c) Net Income – Interest
d) Net Income + Interest

72. Dividends are paid when approved by the
a) board of directors.
b) management.
c) shareholders.
d) creditors.

73. The following information is **not** found on the Statement of Income:
a) EPS.
b) Depreciation Expense.
c) Goodwill.
d) Cost of Goods Sold.

74. Which of the following statements is true?
a) The market value and the book value of a company's shareholders' equity are usually the same.
b) The market value is usually less than the book value of a company's shareholders' equity.
c) The market value is usually more than the book value of a company's shareholders' equity.
d) The value of the shareholders' equity on the Statement of Financial Position is based on the value of the company's shares in the market.

75. Which of the following is a section found in the Statement of Cash Flows?
a) cash from lending activities
b) cash from shareholder activities
c) cash from financing activities
d) cash from borrowing activities

76. On the Statement of Cash Flows, the repayment of long-term obligations would be considered
a) a financing activity.
b) an investing activity.
c) an operating activity.
d) a reduction in a liability.

77. The starting point in the operating activities section of the cash flow statement is
a) Sales Revenue.
b) Retained Earnings.
c) Beginning Cash Balance.
d) Net Income.

78. Where in the financial statements would a user find out which accounting policies management has selected to use?
a) Statement of Management Responsibility
b) Notes to the Financial Statements
c) Auditors' Report
d) Management Discussion and Analysis

79. The Statement of Income is also known as
a) Statement of Operations.
b) Statement of Earnings.
c) Statement of Profit or Loss.
d) all of the above

80. Who determines how much of earnings will be paid as dividends?
a) management
b) board of directors
c) shareholders
d) regulators

81. The working capital equation is
a) Working Capital = Current Assets – Current Liabilities.
b) Working Capital = Current Assets + Current Liabilities.
c) Working Capital = Current Assets – Non-Current Liabilities.
d) Working Capital = Non-current Assets + Current Liabilities.

82. The accounting equation is
a) Assets = Liabilities – Shareholders' Equity.
b) Assets + Liabilities = Shareholders' Equity.
c) Assets = Liabilities + Shareholders' Equity.
d) Shareholders' Equity – Liabilities = Assets.

83. A characteristic of an asset is
a) a resource controlled by an entity.
b) a future economic outflow.
c) an event that will happen in the future.
d) none of the above.

84. Licences, patents, trademarks, and copyrights are all examples of
a) current assets.
b) goodwill.
c) intangible assets.
d) short-term investments.

85. Goods held for resale to customers are called
a) Inventory.
b) Prepaid Deposits.
c) Property, Plant, and Equipment.
d) Intangible Assets.

86. Amounts owed to customers for advance payments until the related goods or services have been provided are called
a) Accounts Payable.
b) Deferred Revenue.
c) Accrued Liabilities.
d) Deferred Income Taxes.

87. Measures the resources controlled by a company and the claims on resources at a given point in time.
a) Statement of Financial Position
b) Statement of Income
c) Statement of Cash Flows
d) Statement of Changes in Equity

ANSWERS TO MULTIPLE CHOICE QUESTIONS

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
31.	a	41.	c	51.	d	61.	d	71.	a	81.	a
32.	c	42.	d	52.	d	62.	a	72.	a	82.	c
33.	b	43.	d	53.	a	63.	a	73.	c	83.	a
34.	b	44.	d	54.	a	64.	a	74.	c	84.	c
35.	c	45.	d	55.	c	65.	b	75.	c	85.	a
36.	b	46.	d	56.	b	66.	c	76.	a	86.	b
37.	c	47.	d	57.	b	67.	b	77.	d	87.	a
38.	b	48.	d	58.	c	68.	a	78.	b		
39.	d	49.	d	59.	d	69.	d	79.	d		
40.	d	50.	b	60.	d	70.	b	80.	b		

EXERCISES

88. The following data was taken from the books of Peanut Inc. as of December 31, 2020:

Cost of goods sold	$ 15,300	Selling & administrative expense	$3,500
Income tax expense	6,120	Accounts payable	12,000
Cash	3,500	Common shares, (3,250 shares)	20,000
Retained earnings (Jan 1)	8,000	Dividends	6,000
Other income	1,500	Interest expense	900
Sales revenue	35,000	Depreciation expense	1,500
Equipment	39,680		

Instructions

a) Calculate total assets.
b) Calculate total revenue and expenses.
c) Calculate total liabilities.

Solution (10 min.)

a) Total Assets

Cash	$3,500
Equipment	39,680
Total	43,180

b) Total revenue

Sales	$35,000
Other income	1,500
Total Revenue	$36,500

Total expenses

Cost of goods sold	$15,300
Selling & administrative expense	3,500
Interest expense	900
Depreciation expense	1,500
Income tax expense	6,120
Total expenses	$27,320

c) Total Liabilities

Accounts payable	$12,000

89. The following data was taken from the books of Debrose Enterprises Ltd. as of December 31, 2020:

Accounts payable	$ 9,000	Income tax payable	$ 36,800
Cost of goods sold	214,000	Selling expense	80,000
Cash	12,000	General expense	50,000
Long-term notes payable	19,000	Accounts receivable	10,000
Sales revenue	480,000	Prepaid rent	2,000
Short-term investment	5,000	Dividends payable	5,000
Inventory	66,000	Income tax expense	40,800

Common shares	60,000	Equipment	100,000
Retained earnings	65,200	Number of common shares	20,000

Instructions
From the list above determine which items should not be reported on the Statement of Financial Position.

Solution (10 min.)

Cost of goods sold	214,000
Selling expense	80,000
General expense	50,000
Sales revenue	480,000
Income tax expense	40,800
Number of common shares	20,000

90 The following data was taken from the books as at December 31, 2020 of Marco Inc.:

Cash	$15,000	Common shares	$15,000
Income tax expense	2,300	Cost of goods sold	39,000
Sales revenue	85,000	Retained earnings (as of January 1)	8,500
Inventory	21,500	Notes payable	50,750
Accounts payable	32,000	Equipment	125,000
Operating expenses	28,900	Dividends paid	4,000
Interest expense	5,600	Accounts Receivable	10,000
Prepaid expenses	750		

Instructions
a) Determine the gross profit.
b) List the current assets in order of liquidity.

Solution (10 min.)
a) Gross profit = $85,000 – 39,000 = $46,000

b)

Cash	15,000
Accounts receivable	10,000
Inventory	21,500
Prepaid expenses	750

91. The following data was taken from the books of Polo, Inc. as of December 31, 2020:

Cost of goods sold	$ 35,300	Selling & administrative expense	$9,500
Income tax expense	6,120	Accounts payable	14,225
Cash	4,755	Common shares, (3,250 shares)	20,000
Retained earnings (Jan 1)	8,000	Dividends	3,250
Other income	2,225	Interest expense	250
Sales revenue	57,250	Depreciation expense	2,850
PPE (net)	34,425	Accounts Receivable	5,250

Instructions

a) Calculate total assets.
b) Calculate total revenue, expenses and net income.
c) Calculate total liabilities.
d) Calculate earnings per share.

Solution (15 min.)

a) Total Assets

Cash	$ 4,755
A/R	$ 5,250
PPE	$34,425
TOTAL	$44,430

b) Total revenue

Sales	$57,250
Other income	2,225
Total Revenue	$59,475
Total expenses	
Cost of goods sold	$35,300
Selling & administrative expense	9,500
Interest expense	250
Depreciation expense	2,850
Income Tax Expense	6,120
Total expenses	$54,020

Net Income $59,475 – $54,020 = $5,455

c) Total Liabilities

Accounts payable	$14,225

d) EPS = $5,455 / 3,250 = $1.68

92. The following data was taken from the books as at December 31, 2020 of Jericho Inc.:

Cash	$13,500	Common shares	$15,000
Income tax expense	5,250	Cost of goods sold	59,000
Sales revenue	105,550	Retained earnings (as of January 1)	80,450
Inventory	31,500	Bank Loan payable	50,750
Accounts payable	32,750	Equipment	125,000
Operating expenses	28,900	Dividends paid	5,250
Interest expense	3,600	Accounts Receivable	11,250
Prepaid expenses	1,250		

Instructions

a) Determine the gross profit and net income.
b) Calculate the balance in the retained earnings account as of December 31, 2020.
c) Calculate the working capital.

Solution (18 min.)

a) Gross profit = $105,550 – 59,000 = $46,550
Net Income = $46,550 – 28,900 – 3,600 – 5,250 = $8,800

b) Balance in R/E account: $80,450 + $8,800 – $5,250 = $84,000

c) Current Assets = $13,500 + 11,250 + 31,500 + 1,250 = $57,500
Current Liabilities = $32,750
Working Capital: $57,500 – $32,750 = $24,750

MATCHING

93. Match each of the following activities to the transactions listed below by placing the appropriate letter in the space provided.

ACTIVITIES

a) Operating
b) Investing
c) Financing

___ 1. Borrowing money

___ 2. Payment of salaries and wages

___ 3. Payment of dividends

___ 4. Sale of long-term assets

___ 5. Purchase of another company's shares

___ 6. Receipt of dividends

___ 7. Collections of amounts owed by customers

___ 8. Issuing shares

___ 9. Purchase of another company's bonds

___ 10. Purchase of inventory

___ 11. Sales to customers

___ 12. Share repurchase

Solution (5 min.)

1. c

2. a

3. c

4. b

5. b

6. a

7. a

8. c

9. b

10. a

11. a

12. c

94. Match each of the following financial statement lines to the correct financial statement by placing the appropriate letter in the space provided.

Financial Statement
a) Statement of Financial Position
b) Statement of Income
c) Statement of changes in equity
d) Statement of Cash Flows

___ 1. Income Taxes Payable

___ 2. Cost of Goods Sold

___ 3. Property, plant and equipment

___ 4. Cash from Operating activities

___ 5. Dividends Declared

___ 6. Inventory

___ 7. Operating expenses

___ 8. Gain on machinery

___ 9. Prepaid Expenses

___ 10. Accounts Receivable

___ 11. Net Income

___ 12. Goodwill

Solution (5 min.)
1. a

2. b

3. a

4. d
5. c
6. a
7. b
8. b
9. a
10. a
11. b
12. a

SHORT-ANSWER ESSAY QUESTIONS

95. How do internal users differ from external users of financial statements? Identify two internal and two external users of annual reports.

Solution (5 min.)
Internal users are using the information to make decisions regarding product/service pricing, operational expenses, buy versus lease decisions, and cost control measures.

External users use the information in a variety of ways
- Shareholders – to make buy/sell decisions
- Creditors – to see if the company can fulfill its debt obligations in both the short- and long-term
- Regulators – are looking for corporate compliance
- Tax authorities – tax assessment and compliance

Internal—management and board of directors
External—shareholders, creditors, regulators, taxing authorities, other corporations, security analysts, credit-rating agencies, unions

96. Briefly explain the relationship between the management, the board of directors, and the shareholders in a public company.

Solution (5 min.)
The shareholders are the owners of the company. In a large public company they are generally not involved in the day-to-day operations of the company. The shareholders elect the members of the board of directors to represent them. The board then hires (and fires) senior management to manage the operations of the company.

97. Identify and describe the two main types of corporate structure. What impact, if any, does the structure have on management and financial reporting requirements?

Solution (8 min.)
Publicly traded companies trade on public stock exchanges such as the TSX. Shares are widely held and owned by a large number of individuals and / or entities. Some portion of the ownership will usually change hands every day. Typically a board of directors is elected to represent the interest of the shareholders. The board of directors has the authority to hire a management team who will manage day-to-day operations. The management team periodically reports to the shareholders. Financial statements are typically prepared quarterly. Annual financial statements are prepared and included in the company’s annual report.

Privately held corporations shares are not available through public exchanges. The shares are narrowly held and owned by a small number of shareholders. It is not as easy to transfer ownership and shareholders are often involved in the day-to-day operations of the business.

98. Identify the three types of business activities a firm engages in. Provide an example of an

inflow and outflow for each type of activity. Which type of activity is most critical to the company's success and why?

Solution (10 min)

The three types of activities include:
Operating activities – example of an inflow: collection of A/R, example of an outflow: purchase of inventory
Investing activities – example of an inflow: sale of PPE, example of an outflow: purchase of PPE
Financing activities – example of an inflow: share issue or borrowing, example of an outflow: payment of dividends, loan repayment

Operating activates is considered the most critical to the company's long run success or failure. If the company is not successful at generating cash flows from its operations it will ultimately run out of cash as financing sources dry up because it will not be able to attract new lenders or investors. It would begin selling PPE that is uses, further compromising operations.

99. Identify and describe the three primary financial statements prepared by accountants. How do these statements differ?

Solution (10 min.)
Statement of Income

- Measures the operating activities and performance of a company over a period of time, normally a year. Calculates the net income for a period of time by deducting expenses from sales revenues. Revenues – Expenses = Net Income

Statement of Financial Position

- Can be represented by the equation: Assets = Liabilities + Shareholders' equity.
- Measures the resources controlled by a company (assets) and the claims on those resources (liability and equity holders) at a given point in time.

Statement of Cash Flow

- Measures the cash inflows and outflows or change in cash flow over a period of time, normally a year, and groups the cash flows into operating, investing, and financing activities.

100. List the three types of business activities that are measured and reflected on the cash flow statement and provide three examples of transactions found within each activity.

Solution (5 min.)
Financing

These activities involve raising long-term capital to finance the purchase of long-term assets. Typically this includes borrowing money, repaying loans, issuing shares, repurchasing shares, and paying dividends.

Investing

These activities involve the sale or purchase of long-term assets. This includes purchasing property, plant, and equipment; selling property, plant, and equipment; investing in other companies' shares; selling the investment in other companies' shares.

Operating

These are day-to-day activities the firm engages in, including sales to customers, collections on accounts receivable, purchase of inventory, payments on accounts payable, operating expenses, and taxes.

ESSAY QUESTIONS

101. What are consolidated statements? Do they provide useful information to their users?

Solution (12 min.)
Consolidated statements are the combination of all the elements of the subsidiary's financial statements with that of the parent company. When businesses, they will often establish other companies or buy shares in other companies. This enables them to expand operations and diversify their risk.
When subsidiary companies are similar to the parent company's business, the consolidated financial statements provide much more useful information because they cover the entire group of companies that are under common ownership.
When the business subsidiary is very different from the parent company, it may be difficult to interpret the financial statements due to the complexity.

102. What are the "notes to the financial statements"? Why are they used?

Solution (15 min).
The notes to the financial statements are a critical part of the financial statements. In them management gives more detail about specific items such as the various types of inventory held by the company and details on their long-term assets. By including additional explanations in notes rather than in the financial statements, management keeps the company's statements simple and uncluttered. Note disclosures help to increase the usefulness of the financial statements and enhance the user's understanding of the various components of the statements.

LEGAL NOTICE

MMXVIII iii F2