Test Bank for Financial & Managerial Accounting for Decision Makers 3rd Edition by Dyckman

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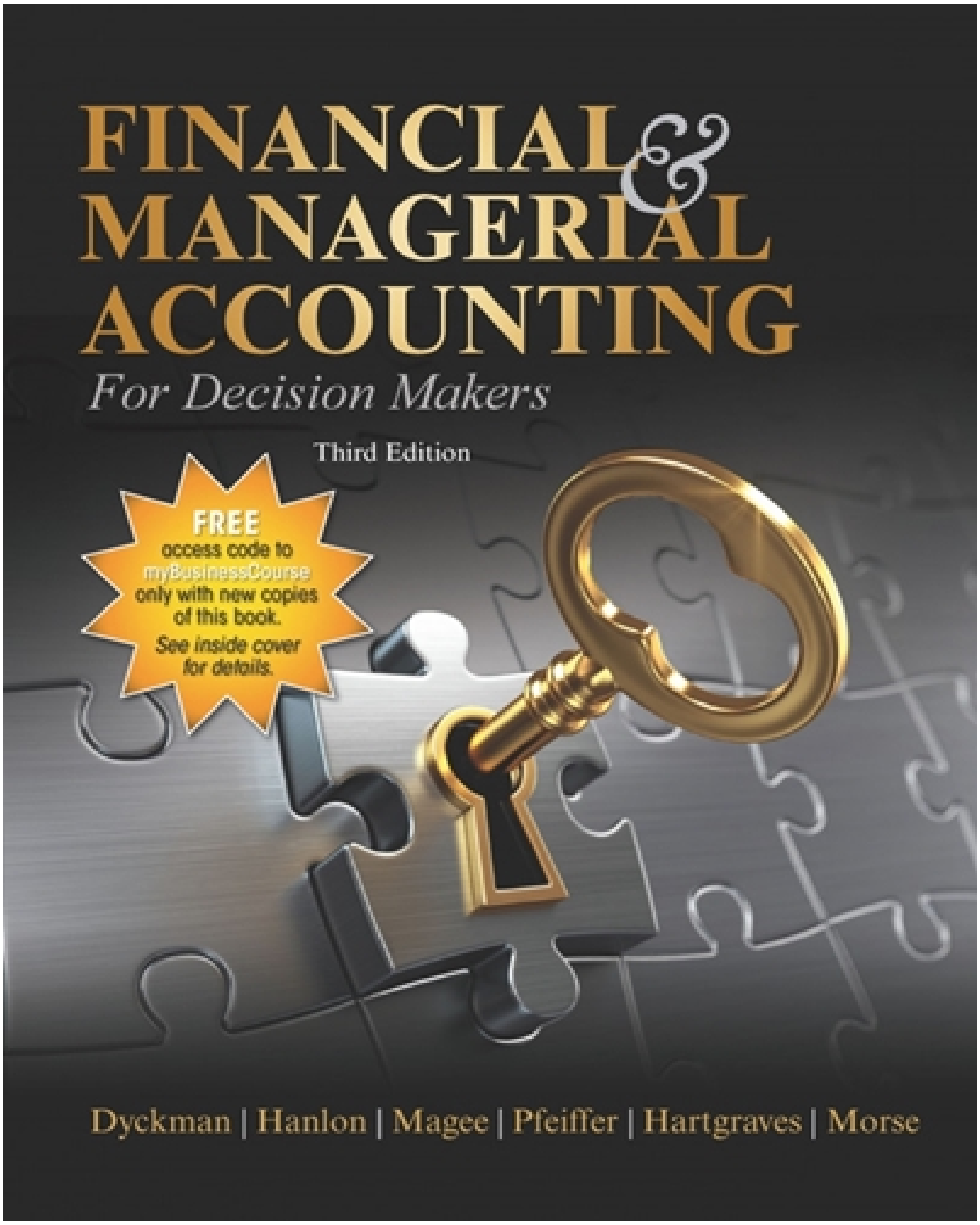

Test Bank

Chapter 1

Introducing Financial Accounting

Learning Objectives – Coverage by Question					
	True/False	Multiple Choice	Exercises	Problems	Essay Questions
LO1 Identify the users of accounting information and discuss the costs and benefits of disclosure.	1, 2	1-3	1, 2		2, 5, 6
LO2 Describe a company's business activities and explain how these activities are represented by the accounting equation.	3-6	4, 5	3		1, 6
LO3 Introduce the four key financial statements including the balance sheet, income statement, statement of stockholders' equity, and statement of cash flows.	7-9	4, 6-11	4-11	1-5	
LO4 Describe the institutions that regulate financial accounting and their role in establishing generally accepted accounting principles.	10-12	12, 19, 20			3, 4
LO5 Compute two key ratios that are commonly used to assess profitability and risk - return on equity and the debt-to-equity ratio.	13,14	13-18	13, 14		
LO6 Appendix 1A: Explain the conceptual framework for financial reporting.	15, 16	21, 22	12		3, 5

Chapter 1: Introducing Financial Accounting

True/False

Topic: Cost and benefits of disclosure
LO: 1

1. One reason companies are motivated to disclose financial information to external decision makers is that it may lower financing and operating costs.

Answer: True
Rationale: For example, when a company applies for a loan, the bank uses the company's financial statements to help determine the appropriate interest rate. Without this financial information, a company may have a higher cost of borrowing or not obtain the loan at all.

Topic: Demand for accounting information
LO: 1

2. Financial accounting is designed primarily for decision makers within the company.

Answer: False
Rationale: Financial accounting is designed primarily to provide information to decision makers outside of the company, while managerial accounting is designed primarily for decision makers within the company.

Topic: Investing activities
LO: 2

3. Investing activities are the acquiring and disposing of liabilities that a company needs in order to finance its operating activities.

Answer: False
Rationale: Investing activities are the acquiring and disposing of assets that a company needs for the production and sale of a company's products and services.

Topic: Accounting equation
LO: 2

4. Assets must always equal liabilities plus stockholders' equity.

Answer: True
Rationale: The accounting equation is Assets = Liabilities + Stockholders' Equity. This relation must always stay in balance.

Topic: Financing activities
LO: 2

5. Other than operating profit, there are three main sources of external financing.

Answer: False
Rationale: There are two main sources of financing: owner (also called shareholder or equity) financing and nonowner (also called creditor or lender) financing.

Topic: Financing and investing activities
LO: 2

6. Financing activities are defined as the acquiring and disposing of resources for the purpose of selling products and services.

Answer: False
Rationale: Financing activities are defined as methods a company uses to raise funds to pay for resources. Investing activities are defined as the acquiring and disposing of resources for the purpose of selling products and services.

Topic: Statement of cash flows
LO: 3

7. A statement of cash flows reports on cash flows for operating, investing and financing activities at a point in time.

Answer: False
Rationale: A statement of cash flows reports on cash flows for operating, investing, and financing activities over a period of time.

Topic: Retained earnings
LO: 3

8. Retained earnings are present on both the income statement and the statement of stockholders' equity.

Answer: False
Rationale: Retained earnings are present in the statement of stockholders' equity and the balance sheet. The income statement represents current period earnings.

Topic: Balance sheet
LO: 3

9. If a company reports retained earnings of $242.6 million on its balance sheet, it will also report $242.6 million in cash.

Answer: False
Rationale: The accounting equation requires total assets to equal total liabilities plus stockholders' equity. That does not imply, however, that liability and equity accounts relate directly to specific assets.

Topic: Regulation and Oversight
LO: 4

10. The goal of the Sarbanes-Oxley Act of 2002 was to increase the level of confidence that external users have in the financial statements.

Answer: True
Rationale: In the wake of scandals, like those that took down Enron, the U.S. Congress passed the Sarbanes-Oxley Act to improve external user confidence in financial statement reporting.

Topic: Global accounting perspective
LO: 4

11. The International Accounting Standards Board (IASB) has legal authority to impose accounting standards on any country.

Answer: False
Rationale: The IASB works with standard setters within many countries, but does not have legal authority to impose IASB standards on any country. It was charged with creating International Financial Reporting Standards with the intention of unifying all public companies under one global set of reporting standards.

Topic: IFRS
LO: 4

12. Foreign companies using international accounting standards must reconcile their financial statements to American rules if they wish to sell securities in the U.S.

Answer: False
Rationale: The SEC adopted a rule in 2007 that allows foreign companies to stop reconciling to American rules.

Topic: Financial statement analysis
LO: 5

13. One key measure of profitability is the debt-to-equity ratio.

Answer: False
Rationale: Return on equity is a key profitability metric. The debt-to-equity ratio is a measure of long-term solvency when looking at credit risk.

Topic: Credit risk analysis
LO: 5

14. The greater the risk of any decision, the greater the expected return.

Answer: True
Rationale: The riskier an investment is, the greater the return demanded by investors.

Topic: Qualitative characteristics of accounting information
LO: 6

15. The qualitative characteristic of accounting information known as comparability means that the same accounting methods should be used from one period to the next, whenever possible.

Answer: False
Rationale: The statement describes consistency. Comparability speaks to firms in the same industry using similar reporting techniques.

Topic: Conceptual framework for financial reporting
LO: 6

16. The conceptual framework developed by the FASB includes a statement of the objectives of financial reporting and a discussion about the qualitative characteristics of accounting information.

Answer: True
Rationale: The conceptual framework includes, among other things, a statement of the objectives of financial reporting along with a discussion about the qualitative characteristics of accounting information that are important to users.

Multiple Choice

Topic: Business organizations
LO: 1

1. Which of the following forms of business organizations exists as a legal entity?
A) A sole proprietorship
B) A partnership
C) A corporation
D) A labor union

Answer: C
Rationale: A corporation is a form of business organization that exists as a legal entity that issues shares of stock to its owners or shareholders in exchange for cash or other resources.

Topic: Financial accounting information users
LO: 1

2. All of the following are proper uses of financial accounting information by a company's board of directors *except*:
A) To review the results of operations
B) To evaluate future strategy
C) To assess management performance
D) To distribute buy/sell recommendations prior to company release of information

Answer: D
Rationale: Providing buy or sell recommendations prior to release by the company is a type of fraud known as insider trading and is not a way that directors should use financial accounting information.

Topic: Financial accounting information users
LO: 1

3. Which one of the following is not an external user of financial information?
A) Stockholders
B) Creditors
C) Internal Revenue Service
D) Top company management

Answer: D
Rationale: Decision makers outside the company include stockholders, creditors, and tax agencies such as the Internal Revenue Service.

Topic: Accounting equation
LO: 2, 3

4. On which statement are assets, liabilities and equity reported?
A) Balance sheet
B) Income statement
C) Statement of stockholders' equity
D) Statement of cash flows

Answer: A
Rationale: A balance sheet reports on investing and financing activities. It lists amounts for assets, liabilities, and equity at a point in time.

Topic: Accounting equation
LO: 2
5. Which of the following is a correct statement of the accounting equation in terms of activities?
A) Investing = Operating assets + Financial assets
B) Investing = Creditor financing + Owner financing
C) Investing = Nonowner financing – Owner financing
D) Nonowner financing = Investing + Operating

Answer: B
Rationale: The accounting equation is Assets = Liabilities + Stockholders' equity.
Another way of viewing this equation is Investing = Creditor financing + Owner financing

Topic Financial statement format
LO: 3
6. Which of the following is **not** part of the standard heading of each financial statement?
A) The company name
B) The statement title
C) The date or time period of the statement
D) The company's industry

Answer: D
Rationale: Each financial statement identifies the company, the statement title, and the date or time period of the statement.

Topic: Balance sheet and income statement
LO: 3
7. Which of the following items are in the balance sheet? (Select all that apply.)
A) Inventory
B) Operating expenses
C) Account receivable
D) Equipment
E) Cash payments

Answer: A, C, and D
Rationale: Statement B) is incorrect – operating expenses are found in the income statement, not the balance sheet. Statement E) is incorrect – cash payments are found on the statement of cash flows.

Topic: Expenses
LO: 3
8. Which of the four basic financial statements would contain a line item for expenses?
A) Balance sheet
B) Income statement
C) Statement of equity
D) Statement of cash flows

Answer: B
Rationale: The income statement reports on the revenues less the expenses over the reporting period. Expenses only appear on the income statement.

Topic: Account classification
LO: 3
9. Which of the following would be reported on a statement of stockholders' equity?
A) Cash
B) Total expenses
C) Dividends
D) Financing cash flows

Answer: C
Rationale: Dividends are a return of capital to stockholders and are found only on the statement of stockholders' equity. Cash is found on the balance sheet. Total expenses is an income statement amount. Financing cash flows are found on the statement of cash flows.

Topic: Articulation of financial statements
LO: 3
10. How are the balance sheet and the statement of cash flows linked?
A) By the cash balance
B) By the amount of total retained earnings
C) By the total shareholder equity
D) By the amount of net income

Answer: A
Rationale: The balance sheet and the statement of cash flows are linked by the cash balance. The statement of cash flows shows the inflows and outflows of cash during the period. Then ending cash balance is on the balance sheet.

Topic: Financial Statement Linkages
LO: 3
11. Which one of the following is *not* a key linkage among the four primary financial statements?
A) The expenses in the income statement link to the total liability balance.
B) The statement of cash flows links to ending cash in the balance sheet.
C) The income statement links to the ending retained earnings in the statement of stockholders' equity.
D) The statement of stockholders' equity links to ending equity in the balance sheet.

Answer: A
Rationale: The expenses in the income statement are not linked to the total liability balance. An unpaid expense might at one point in time be listed as a liability; however, the total of liabilities and expenses is rarely the same.

Topic: Regulation and oversight
LO: 4
12. Which of the following organizations was established by the Sarbanes-Oxley Act to approve auditing standards and monitor the quality of financial statements and audits?
A) The Securities and Exchange Commission
B) The American Institute of Certified Public Accountants
C) The Financial Accounting Standards Board
D) The Public Company Accounting Oversight Board

Answer: D
Rationale: The Sarbanes-Oxley Act of 2002 established the Public Company Accounting Oversight Board to approve auditor standards and monitor the quality of financial statements and audits.

Use the following information to answer questions 13, 14, 15, and 16.

Data from the financial statements of The Grocer Company and FoodValu, Inc., two national grocery chains are presented below:

	The Grocer Co.	FoodValu, Inc.
Total liabilities, 2016	$30,020	$20,064
Total liabilities 2015	36,414	24,836
Total assets, 2016	46,952	24,106
Total assets 2015	47,010	27,516
Revenue, 2016	180,478	72,200
Net income (loss), 2016	1,204	(2,080)

Topic: Profitability analysis
LO: 5
13. To the nearest hundredth of a percent, what is the 2016 return on equity ratio for The Grocer Company?
A) 4.00%
B) 13.11%
C) 8.75%
D) Not enough information provided

Answer: C
Rationale: ROE = Net income / Average stockholders' equity
= $ 1,204 / [($16,932+ $ $10,596)/2] = $1,204 / 13,764= 8.75%
Shareholders' equity 2016 = $46,952 - 30,020 = $16,932
Shareholders' equity 2015 = $47,010 - 36,414 = $10,596

Topic: Credit risk analysis
LO: 5
14. To the nearest hundredth, what is the 2016 debt-to-equity ratio for The Grocer Company?
A) 2.41
B) 4.92
C) 1.77
D) 44.16

Answer: C
Rationale: Debt-to-equity = Total liabilities / Total stockholders' equity
= $30,020/ $16,932 = 1.77
Stockholders' equity 2016 = $46,952 - 30,020= $16,932

Topic: Profitability analysis
LO: 5
15. To the nearest hundredth of a percent, what is the return on equity ratio 2016 for FoodValu?
A) 21.48%
B) (61.89)%
C) (152.83)%
D) Not enough information is provided

Answer B
Rationale: ROE = Net income / Average stockholders' equity
= $ (2,080) / [($4,042+ $2,680)/2] = $ (2,080) / $3,361 = (61.89)%
Stockholders' equity 2016 = $24,106 – $20,064 = $ 4,042
Stockholders' equity 2015 = $27,516 – $24,836 = $ 2,680

Topic: Credit risk analysis
LO: 5

16. To the nearest hundredth, what is the 2016 debt-to-equity ratio for FoodValu?
A) 0.21
B) 6.68
C) 572.95
D) 4.96

Answer: D
Rationale: Debt-to-equity = Total liabilities / Total stockholders' equity
= $20,064 / $4,042 = 4.96
Stockholders' equity 2016 = $ 24,106 – $ 20,064 = $ 4,042

Topic: Financial statement analysis
LO: 5

17. Arrow, Inc. has an ROE of 15.45% and Clip Company has an ROE of 18.3%. Which of the following statements is *true*?
A) Clip reported more dollars of profit than Arrow
B) Clip has more of the firm financed with debt than Arrow does
C) Clip is able to bring its product to market more efficiently than Arrow
D) Arrow would likely be able to borrow money at a lower interest rate than would Clip

Answer: C
Rationale: ROE measures profitability and how efficiently a company markets its products to produce profit. The debt-to-equity ratio measures the extent to which a company relies on debt versus owner financing. Clip shows a higher return on equity, which means that it is able to bring its product to market more efficiently than Arrow.

Topic: Financial statement analysis
LO: 5

18. Arrow, Inc. has a debt-to-equity ratio of 0.26 and Clip Company has 0.49. Which of the following statements is *true*?
A) Clip reported more dollars of profit than Arrow
B) Clip has more total debt than does Arrow
C) Clip is able to bring its product to market more efficiently than Arrow
D) Arrow would likely be able to borrow money at a lower interest rate than would Clip

Answer: D
Rationale: Arrow, Inc., is the lower risk borrower of these two companies with a lower debt-to-equity ratio. Arrow would likely be able to borrow money at a lower interest rate than Clip. Clip's higher debt-to-equity means that the firm relies more on creditor financing than Arrow.

Topic: Generally Accepted Accounting Principles
LO: 4
19. Which of the following statements is true regarding generally accepted accounting principles (GAAP)?
A) GAAP is a set of laws
B) GAAP is subject to change as conditions warrant
C) Under GAAP, if two companies engage in the same transactions, they must choose the same accounting methods
D) U.S. GAAP is the same as GAAP in other countries

Answer: B
Rationale: Specific rules under GAAP are altered or new practices are formulated to fit changes in underlying economic circumstances of business transactions.

Topic: IFRS
LO: 4
20. Which statement is true about IFRS?
A) It has legal authority to impose accounting standards world-wide
B) It is working to reduce diversity in financial reporting practices across the world
C) It has replaced GAAP financial accounting standards
D) It is under the control of the SEC

Answer: B
Rationale: U.S. GAAP reporting still exists and has no control over the IASB who creates IFRS's accounting standards.

Topic: Assumptions for the preparation of financial statements
LO: 6
21. Which of the following assumptions that underlies the preparation of financial statements assumes that companies will continue their operations over time?
A) Separate economic entity
B) Going concern
C) Accounting period
D) Measuring unit

Answer: B
Rationale: Under the going concern assumption, companies are assumed to have continuity in that they can be expected to continue in operations over time.

Topic: Qualitative characteristics of accounting information
LO: 6
22. Which one of the following is **not** a quality of relevant accounting information?
A) Timeliness
B) Predictive value
C) Feedback value
D) Understandability

Answer: D
Rationale: Accounting information is relevant when it is timely, predictive about future performance and provides feedback value about the past. Accounting information can still be relevant, even though it may not be understandable to all users.

Exercises

Topic: Financial accounting information
LO: 1

1. Match each of the following terms (1-8) on the left with related explanations (A – H) on the right.

______	1.	Partnership	A.	Corporations with stock traded on public exchanges
______	2.	Board of directors	B.	The common form of business ownership used by lawyers and CPAs
______	3.	Managerial accounting	C.	Lenders of resources
______	4.	Stock market regulators	D.	Designed primarily for decision makers outside of the company
______	5.	Creditors	E.	Elected by the shareholders to oversee management
______	6.	Shareholders	F.	Owners of a corporation
______	7.	Financial accounting	G.	Securities and Exchange Commission
______	8.	Publicly traded corporations	H.	Designed primarily for decision makers within the company

Answer:

1. B   2. E   3. H   4. G   5. C   6. F   7. D   8. A

Topic: Financial accounting information
LO: 1

2. Match the following decision makers with the most likely decisions they seek to answer from accounting information. Use each answer only once.

______	1.	Suppliers and customers	A.	Launch a new product or not?
______	2.	Productions and operations	B.	Purchase/sell goods from/to the company?
______	3.	Creditors	C.	Develop a new company strategy?
______	4.	Investors and analysts	D.	Lend to the company or not?
______	5.	Top management	E.	Manage operations?
______	6.	Marketing teams	F.	Buy or sell stock of the company?

Answer:

1. B   2. E   3. D   4. F   5. C   6. A

Topic: Applying the accounting equation
LO: 2
3. Compute the missing financial amounts (a) and (b):

($ millions)	Assets	Liabilities	Equity
Company A	$ 23,200	(a)	$17,000
Company B	$89,000	$ 71,200	(b)

Answer:

(a) Liabilities = Assets – Equity = $23,200 - $17,000= $6,200
(b) Equity = Assets – Liabilities = $89,000 - $71,200 = $17,800

Topic: Links between financial statements
LO: 3
4. To which financial statements are each of the following financial values linked, and how are they linked?

A. Retained earnings
B. Net income
C. Cash

Answer:

A. Retained earnings is linked to the income statement, the statement of shareholder's equity, and the balance sheet. Net income on the income statement appears as an amount added to beginning retained earnings on the statement of stockholders' equity. Ending retained earnings on the statement of stockholders' equity is an amount in the stockholders' equity section of the balance sheet.

B. Net income is linked to the income statement and the statement of stockholder's equity. Net income on the income statement appears as an amount added to beginning retained earnings on the statement of stockholders' equity.

C. Cash is linked to the statement of cash flows and the balance sheet. The ending balance is on the balance sheet and the changes in cash are shown on the statement of cash flows.

Topic: Constructing a balance sheet
LO: 3
5. Construct a balance sheet from the financial statements components listed below.

Cash	$18,400
Noncash assets	56,800
Other expenses	15,200
Retained earnings	30,200
Liabilities	23,400
Contributed capital	21,600
Operating cash flows	10,000
Revenues	25,600
Cost of goods sold	7,200

Answer:

Balance Sheet			
Assets		Liabilities and Equity	
Cash	$18,400	Liabilities	$23,400
Noncash assets	56,800		
		Equity	
		Contributed capital	21,600
		Retained earnings	30,200
		Stockholders' equity	51,800
Total Assets	$75,200	Total liabilities and equity	$ 75,200

Topic: Compute stockholders' equity
LO: 3

6. At January 30, 2016, the end of Dot, Inc.'s financial period in 2016, Dot's retained earnings were $88,440 million. During the following year, Dot reported net income of $28,666 million and paid a dividend of $2,690 million. Determine Dot's retained earnings as of January 29, 2017.

Answer:

$88,440+ $28,666 – $2,690 = $114,416 million

Topic: Identifying sources of key financial data
LO: 3

7. Match each item with the financial statement in which each item would most likely appear:
Use (I) for Income Statement, (B) for Balance Sheet and (CF) for Statement of Cash Flow.

_______ a. Cost of goods sold
_______ b. Revenue
_______ c. Liabilities
_______ d. Contributed capital
_______ e. Retained earnings
_______ f. Cash from investing activities
_______ g. Net change in cash

Answer:

a. I e. B
b. I f. CF
c. B g. CF
d. B

Topic: Statement of cash flows
LO: 3

8. Prepare a statement of cash flows for Doggie, Inc. for 2016 given its information below (amounts in millions):

Net income	$2,866
Operating cash flows	7,812
Investing cash flows	(7,618)
Net increase in cash	9,132
Financing cash flows	?

Answer:

Operating cash flows + Investing cash flows + Financing cash flows = Net increase in cash
$7,812 – $7,618,+ Financing cash flows = $ 9,132
Financing cash flows = $ 8,938

Operating cash flows	$7,812
Investing cash flows	(7,618)
Financing cash flows	8,938
Net increase in cash	$9,132

Topic: Financial statement relationships
LO: 3

9. At the beginning of 2016 Hotels International, Inc. had $11,820 million in assets and $1,562 million in equity. During 2016, Hotels International's assets increased by $864 million while its equity decreased by $1,008 million.

How much were Hotels International's liabilities at the beginning and end of 2016?

Answer:

Beginning liabilities = $11,820 million – $1,562 million = $10,258 million.
Ending liabilities = ($11,820 million + $864 million) – ($1,562 million – $ 1,008 million) = $12,130 million.

Topic: Retained earnings
LO: 3

10. In its 2016 annual report, Lego Pizza reported net income of $46,820 thousand, retained earnings at the beginning of 2016 of $91,670 thousand, and dividends of $33,908 thousand.

What is the amount of Domino's retained earnings at the end of 2016?

Answer:

Retained earnings beginning + Net income – Dividends = Retained earnings ending
= $91,670 + $46,820 - $33,908 = $104,582 thousand

Topic: Other financial information
LO: 3

11. In addition to the financial statements, list 3 other sources of information reported to external stakeholders?

Answer:

- Management Discussion and Analysis (MD&A)
- Management report
- Auditor report
- Explanatory notes to financial statements
- Proxy statements
- Various regulatory filings

Topic: Conceptual framework for financial reporting
LO: 6

12. Match each of the following statements to the *best* qualitative characteristic or underlying assumption of accounting information that should be considered. Each answer is used only once.

_____ 1.	Consistency	A.	Although several accounting methods are acceptable, company management chooses a single method and follows that each year.
_____ 2.	Relevance	B.	The company's accountant ignores a $1.60 error in recording an invoice, discovered after the final financial statements were prepared.
_____ 3.	Benefits > Costs	C.	The accountant estimates the value of accounts receivable, based on recent information about economic forecasts and prior collection trends applicable to the company.
_____ 4.	Going concern	D.	Before each board meeting, the company prepares a number of reports that are time-consuming and expensive that are never used.
_____ 5.	Separate economic entity	E.	In estimating the life of a new piece of equipment, the accounting department assumes that the business will last indefinitely.
_____ 6.	Materiality	F.	George Bush, a stockholder of Halliburton, owes a debt to Union Bank for $3,000. This $3,000 is not a debt of Halliburton.

Answer:

1. A	3. D	5. F
2. C	4. E	6. B

Topic: Return on equity and debt-to equity ratio
LO: 5
13. Anka Audio reported the following amounts in its December 31, 2016, and 2015 financial statements.

	2016	2015
Sales revenue	$290,000	$312,000
Cost of sales	162,000	168,000
Net income	5,200	6,800
Total assets	67,000	70,400
Stockholders' equity	26,400	43,000

Calculate to the nearest hundredth:
A. Return on equity for 2016.
B. Debt-to-equity ratio as of December 31, 2016

Answer:

A. ROE = Net Income / Average stockholders' equity = $5,200 / [($26,400+ $43,000)/2] = 14.99%

B. Debt-to-equity = Total liabilities / Total stockholders' equity = $ 40,600/ $26,400= 1.54
Total liabilities = $67,000– $26,400 = $ 40,600

Topic: Return on equity and debt-to equity ratio
LO: 5
14. Lorraine, Inc. has a debt-to-equity ratio of 0.49 and a ROE of 16.8%. The median ROE for similar companies in the same industry as Lorraine is about 15.1%. The median debt-to-equity ratio for similar companies in the same industry is 0.36. Based on this industry information, how does Lorraine compare to similar companies and what are the causes of these differences?

Answer:

As the return on equity shows, Lorraine is outperforming similar companies in its industry as far as its ability to generate profit for its stockholders at 16.8%. This is due to its ability to be more efficient in bringing its product or service to the market and produce a product or service that the market values. In addition, Lorraine's debt-to-equity ratio, as compared to similar companies in its industry, indicates that the company is more aggressive with debit financing approach. Since Lorraine has a ratio that is near 0.50, this indicates that the company is using approximately one part debt and two parts equity financing, contributing to more credit risk and less solvency than the industry average which is well below 0.50.

Problems

Topic: Preparation of financial statements
LO: 3

1. The following is selected financial information of Gleeson Group, Inc. for the year ended December 31, 2016.

Cash assets	$ 84,000
Operating cash flows	78,000
Sales	163,600
Stockholders' equity	169,400
Cost of goods sold	104,000
Financing cash flows	(10,800)
Total liabilities	64,000
Noncash assets	149,400
Investing cash flows	(4,800)
Other expenses	40,000
Net income	19,600
Cash at beginning of the year	21,600

Prepare an income statement, balance sheet and statement of cash flows for Gleeson Group, Inc. at December 31, 2016.

Answer:

Gleeson Group Inc. Income Statement For Year Ended December 31, 2016	
Sales	$163,600
Cost of goods sold	104,000
Gross profit	59,600
Expenses	40,000
Net income	$ 19,600

Gleeson Group Inc. Balance Sheet December 31, 2016			
Assets		Liabilities and Equity	
Cash assets	$ 84,000	Total liabilities	$ 64,000
Noncash assets	149,400	Equity	
		Stockholders' equity	169,400
Total assets	$ 233,400	Total liabilities and equity	$ 233,400

Gleeson Group, Inc. Statement of Cash Flows For Year Ended December 31, 2016	
Operating cash flows	$ 78,000
Investing cash flows	(4,800)
Financing cash flows	(10,800)
Net change in cash	62,400
Cash, January 31	21,600
Cash, December 31	$ 84,000

Topic: Preparation of statement of stockholders' equity
LO: 3

2. The following is selected financial information for Maurermart, Inc. for its year ending January 31, 2016:

Retained earnings, January 31, 2015 …………..	$137,382
Contributed capital, January 31, 2015 ………….	7,384
Dividends ………………………………………..	10,722
Net income ……………………………………….	35,366
Stock repurchase ………………………………….	(15,418)
Other …………………………………………….	2,728
Other, January 31, 2015 ………………………..	6,756

Prepare a statement of stockholders' equity for 2016 for Mauermart.

Answer:

Mauermart, Inc.
Statement of Stockholders' Equity
For Year Ended January 31, 2016

	Contributed Capital	Retained Earnings	Other	Total
Balance, January 31, 2015	$ 7,384	$ 137,382	$6,756	$151,522
Stock repurchase	(15,418)			(15,418)
Other			2,728	2,728
Net income		35,366		35,366
Dividends	0	(10,722)		(10,722)
Balance, January 31, 2016	$(8,034)	$162,026	$9,484	$163,476

Topic: Preparation of balance sheet and statement of cash flows
LO: 3

3. The following is selected financial information from Pink Whale, Inc. for 2016.

Cash assets	$1,826
Operating cash flows	1,320
Sales	5,808
Stockholders' equity	814
Cost of goods sold	8,598
Financing cash flows	(1,040)
Total liabilities	14,906
Noncash assets	13,894
Investing cash flows	(174)
Other expenses	282

Construct a balance sheet and statement of cash flows for Pink Whale for 2016.

Answer:

Pink Whale, Inc. Balance Sheet December 31, 2016			
Assets		Liabilities and Equity	
Cash assets	$ 1,826	Total liabilities	$ 14,906
Noncash assets	13,894	Equity	
		Stockholders' equity	814
Total assets	$ 15,720	Total liabilities and equity	$ 15,720

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Pink Whale, Inc. Statement of Cash Flows For Year Ended December 31, 2016	
Operating cash flows	$1,320
Investing cash flows	(174)
Financing cash flows	(1,040)
Net change in cash	106
Cash, January 31, 2016	1,720
Cash, December 31, 2016	$1,826

Topic: Preparation of the financial statements
LO: 3

4. The following is selected financial information for Soup Company from its Form 10-K filed with the SEC for the year ended July 31, 2016:

Cash assets	$670
Operating cash flows	2,240
Sales	15,414
Stockholders' equity	1,796
Cost of goods sold	9,430
Financing cash flows	(1,840)
Total liabilities	11,264
Noncash assets	12,390
Investing cash flows	(646)
Other expenses	4,436

Prepare each of the following financial statements for Soup Company in proper form:

- Income statement
- Balance sheet
- Statement of cash flows

Answer:

Soup Company Income Statement For Year Ended July 31, 2016	
Sales	$15,414
Cost of goods sold	9,430
Gross profit	5,984
Other expenses	4.436
Net income	$1,548

Soup Company Balance Sheet July 31, 2016			
Assets		Liabilities and Equity	
Cash assets	$670	Total liabilities	$11,264
Noncash assets	12,390	Equity	
Total assets	$13,060	Stockholders' equity	1,796
		Total liabilities and equity	$13,060

Soup Company Statement of Cash Flows For Year Ended July 31, 2016	
Operating cash flows	$2,240
Investing cash flows	(646)
Financing cash flows	(1,840)
Net change in cash	(246)
Cash, July 31, 2015	916
Cash, July 31, 2016	$670

Topic: Preparing a statement of stockholders' equity
LO: 3

5. Soup Company reported the following selected information at July 31, 2016:

Contributed capital, July 31, 2015	(15,340)
Stock purchased (net) during, July 31, 2015 to July 31, 2016	(480)
Retained Earnings, July 31, 2015	18,370
Net income	1,548
Dividends	750
Other, July 31, 2015	(838)
Other	(714)

Use this information to prepare a statement of stockholders' equity for Soup Company's year ending July 31, 2016.

Answer:

Soup Company
Statement of Stockholders' Equity
For Year Ended July 31, 2016

	Contributed Capital	Retained Earnings	Other	Total
Balance, July 31, 2015	$(15,340)	$18,370	$(838)	$2,192
Stock issuances	(480)			(480)
Other			(714)	(714)
Net income		1,548		1,548
Dividends		(750)		(750)
Balance July 31, 2016	$(15,820)	$19,168	$(1,552)	$1,796

Essays

Topic: Business activities
LO: 2

1. Describe the four basic business activities conducted by a company in the production and sale of its products and services.

Answer:
The four activities include planning, financing, operating and investing.

The planning activities are part of the creation of the company's business plan, which is used to articulate and describe the company's strategy for operations and earning income.

Financing activities include all activities to acquire the capital used to pay for resources such as property, equipment and buildings. This financing can be either owner financing (i.e., money invested by the owner of the company), or non-owner financing (i.e., money contributed by those other than the owner).

Operating activities refer to the processes by which resources owned by the company will be used to develop products and services. These activities will result in revenue (i.e., money coming into the company), and expenses (i.e., money used by the company as part of the operating activities).

Investing activities encompass the steps involved in deciding which assets the company should acquire or sell with the money that was made available as a result of the financing activities. These assets are ultimately used in the operating activities to generate sales and revenues.

Topic: Demand of financial accounting information
LO: 1

2. List three users of financial accounting information and explain the significance of this information for each user.

Answer:
Shareholders and potential shareholders – Shareholders demand financial accounting information to assess the profitability and risks of companies. Shareholders look for information useful in their investment decisions. They use accounting information to evaluate manager performance.

Creditors and suppliers – Creditors and other lenders demand financial accounting information to help decide loan terms, dollar amounts, interest rates and collateral. Suppliers similarly demand financial information to establish credit sales terms and to determine their long-term commitment to supply-chain relations. Both creditors and suppliers use financial information to continuously monitor and adjust their contracts and commitments with a debtor company.

Managers and directors – Managers and directors demand financial information on the financial condition, profitability and prospects of their companies for their own well-being and future earnings potential. They also demand comparative financial information on competing companies and other business opportunities. This permits them to conduct comparative analyses to benchmark company performance and condition. Managers similarly use such information to request further compensation and managerial power from directors. Outside directors are crucial to determining who runs the company, and these directors use accounting information to evaluate manager performance.

continued next page

2. *continued*

<u>Financial analysts</u> – Financial analysts publish financial statistics about companies and disseminate financial information about specific industries.

<u>Labor unions</u> – These groups examine financial statements in order to assess the financial health of firms prior to negotiating labor contracts on behalf of the firms' employees.

<u>Customers</u>– Customers demand accounting information to assess the ability of the company to provide products or services as agreed and to assess the company's staying power and reliability. Customers also wish to estimate the company's profitability to assess fairness of returns on mutual transactions.

<u>Tax agencies</u> –Tax agencies use information to help establish tax policies.

<u>Over government agencies</u>. They use accounting information to develop and enforce regulations, including public protection, price setting, import-export and various other uses.

Topic: Use of estimates in financial reporting
LO: 4, 6

3. Financial statements rely on countless estimates by accountants, including the useful life of building and equipment, the dollar amounts that will be collected from customers who purchase on credit, the prediction of future costs related to warranty claims or future pension obligations. Prepare a short argument to explain why estimates are an acceptable and important ingredient in the preparation of financial statements.

Answer:
Certain financial figures or costs cannot be quantified in exact terms, but still must be disclosed to shareholders in order to provide them with timely financial reporting. A practical way of disclosing such items is to quantify them in terms of conservative estimates. A company can then revise such estimates, prospectively, as future events, or data affect the original estimate.

Topic: The effect of the Sarbanes-Oxley Act
LO: 4

4. Accounting debacles, such as in the case of Enron, brought to light the necessity of accuracy in financial reporting and accountability of management. Describe how the introduction of the Sarbanes-Oxley Act has changed the requirements of financial reporting.

Answer:
Congress introduced the Sarbanes-Oxley act as a way of restoring confidence in the integrity of financial statement reporting of publicly traded companies. The Act requires the chief executive officer and chief financial officer of the company to personally sign-off on the accuracy and completeness of financial statements and the integrity of the company's system of internal controls. This requirement is designed to hold management personally accountable for negligence in financial reporting and encourage vigilance in monitoring the company's financial accounting system.

Topic: Costs and benefits of disclosure
LO: 1, 6

5. Explain the benefits and costs associated with a company's disclosure of information.

Answer:
Supplying information benefits a company by helping it to compete in capital, labor, input, and output markets. Performance of a company hinges on successful business activities and the markets' awareness of that success. Economic incentives exist for those companies that disclose reliable accounting information, especially when good news about products, processes, management, etc. is disclosed. Costs associated with the disclosure of information are associated with its preparation and dissemination. Other costs include competitive disadvantage, litigation potential, and political costs.

Topic: Owner vs. Nonowner financing
LO: 1, 2

6. Businesses rely on financing activities to fund their operating and investments. Explain the difference between owner and non-owner financing, and explain the benefits and risks involved in relying more heavily on each type of financing.

Answer:
Owner financing, also called equity refers to money given to the business in exchange for partial control of the company. Stock is the most common form of owner financing. Companies are not obligated to guarantee a return on owner investments. However, if returns are unacceptable to owners, they may use their power to take the business in different directions. In sum, owner financing provides cash inflow to the company without any guarantee of repayment. Control over the company is vested in the shareholders.

Non-owner financing refers to money given to the business in exchange for a guaranteed repayment, usually with interest. Loans and bonds are very common examples of non-owner investment. The risk to the company lies in potential default if operations decline. The benefit is that the company does not need to cede operational control to its creditors, unless it defaults on its repayment. In sum, non-owner financing allows the current owners to maintain full control of the company, but requires repayment with interest.

Companies that rely more heavily on owner financing are said to be financed conservatively; Companies that rely more heavily on non-owner financing are said to be financed less conservatively.