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Student: _____

1. Accounting is a system that collects and processes financial information about an organization and reports that information to decision makers.
True False
2. The purpose of the statement of financial position is to report the financial position (amount of assets, liabilities, and shareholders' equity) of an accounting entity at a particular point in time.
True False
3. In accounting and reporting for a business entity, the accounting and reporting for the business must be kept separate from other economic affairs of its owners.
True False
4. The debts of a corporation can be generally viewed as debts of its owners.
True False
5. A balance sheet should be dated for a period (such as "For the year ended December 31, 20A"), whereas an income statement should be dated at a point in time (such as "December 31, 20A").
True False
6. The accounting period in which service revenue is recognized (i.e., revenue for services rendered) is generally the period in which the cash is collected.
True False
7. If expenses are understated on the income statement, shareholders' equity is overstated on the balance sheet.
True False
8. Total assets are \$60,000, total liabilities, \$30,000, and share capital is \$20,000; therefore, retained earnings is \$5,000.
True False
9. Assets are measured and reported on the balance sheet at their current market value at the date of the balance sheet.
True False
10. The payment of a cash dividend to shareholders reduces shareholders' equity.
True False
11. The report of management indicates management's primary responsibility for financial statement information and the steps to ensure the accuracy of the company's records.
True False
12. The organization for which financial data are to be collected and reported is called an accounting entity.
True False
13. The accounting model for the balance sheet is: $\text{Assets} + \text{Liabilities} - \text{Shareholders' Equity}$.
True False
14. One feature of the cash flow statement is to show the change in cash for the period.
True False
15. Profit (also called net income or net earnings) is the excess of total revenues over total expenses incurred to generate revenue during a specific period.
True False
16. The financial statements prepared by a corporation include a balance sheet, income statement, cash flow statement, and statement of money.
True False
17. A banker who is considering making a loan to a corporation would be one of the corporation's internal decision makers.
True False

18. Assets are economic resources controlled by the entity as a result of past business events and from which future economic benefits can be obtained.

True False

19. The financial statement that shows an entity's economic resources and its liabilities is the statement of retained earnings.

True False

20. The statement of comprehensive income reports the change in shareholders' equity during a period from business activities other than investments by shareholders or distributions to shareholders.

True False

21. A note payable is a borrowing instrument that generally does not involve the payment of interest.

True False

22. If a corporation does not pay its obligations when they are due, its creditors may be able to force the sale of the business's assets to pay their claims.

True False

23. When a company ships products to a customer and bills the customer, the company should recognize revenue as earned.

True False

24. The amount of cash paid by a business for office rent would be reported on the cash flow statement as a financing activity.

True False

25. Repayment of a bank loan is classified on the cash flow statement as an operating activity.

True False

26. Liabilities are the entity's legal obligations that result from past business events.

True False

27. International Financial Accounting Standards are produced by the International Accounting Standards Board (IASB), which is an independent standard-setting board consisting of 15 members from nine countries.

True False

28. Accounting is based on man-made rules that sometimes undergo change.

True False

29. Primary responsibility for the information in the financial statements lies with management.

True False

30. The AcSB is currently the body responsible for establishing accounting standards.

True False

31. The Accounting Standards Board (AcSB) is an agency of the federal government that establishes generally accepted accounting principles for businesses.

True False

32. Generally accepted accounting principles (GAAP) are essentially identical in most developed countries.

True False

33. Independent CAs in the public practice of accounting are viewed as employees of their clients.

True False

34. An audit involves the examination of the financial reports (prepared by the management of the company) to ensure that they represent what they claim and conform with IFRS.

True False

35. Many opportunities exist for managers to intentionally prepare misleading financial reports.

True False

36. Failure to comply with professional rules of conduct can result in serious penalties for professional accountants, but not the rescinding of the professional designation of an offending member.

True False

37. In terms of economic importance, the sole proprietorship is the dominant form of organization in Canada because of its ease of formation.

True False

38. One of the disadvantages of a corporation when compared to a partnership is the limited liability of the owners.

True False

39. A partnership is an incorporated entity that has more than one owner.

True False

40. Accountants generally must meet educational requirements, pass a rigorous exam, and meet experience requirements before becoming licensed CAs, CGAs, or CMAs.

True False

41. What is the primary purpose of the balance sheet?

- A. To measure the net income of a business up to a particular point in time.
- B. To report the difference between cash inflows and cash outflows for the period.
- C. To report the financial position of the reporting entity at a particular point in time.
- D. To report assets at their current market value at a particular point in time.

42. On January 1, 20A, two individuals invested \$150,000 each to form Hornbeck Corporation. Hornbeck had total revenues of \$15,000 during 20A and \$40,000 during 20B. Total expenses for the same periods were \$8,000 and \$22,000, respectively. Cash dividends paid out to shareholders totalled \$6,000 in 20A and \$12,000 in 20B. What was the ending balance in Hornbeck's retained earnings account at the end of 20A and 20B?

- A. \$1,000 and \$6,000 respectively.
- B. \$1,000 and \$7,000, respectively.
- C. \$7,000 and \$19,000 respectively.
- D. \$301,000 and \$306,000 respectively.

43. The BAT Corporation had 20B revenues of \$110,000, expenses of \$85,000, and an income tax rate of 20 percent. What would net income after taxes be?

- A. \$5,000.
- B. \$15,000.
- C. \$20,000.
- D. \$25,000.

44. Brown Corporation reported the following amounts at the end of the first year of operations, December 31, 20A: share capital \$20,000; sales revenue \$95,000; total assets \$85,000, no dividends, and total liabilities \$35,000. What would shareholders' equity and total expenses be?

- A. Shareholders' equity, \$50,000 and expenses \$65,000.
- B. Shareholders' equity, \$60,000 and expenses \$75,000.
- C. Shareholders' equity, \$80,000 and expenses \$40,000.
- D. Shareholders' equity, \$80,000 and expenses \$85,000.

45. Which financial statement reports the financial position of a business?

- A. Income statement.
- B. Balance sheet.
- C. Cash flow statement.
- D. Footnotes to the financial statements.

46. If total liabilities increased by \$25,000 and shareholders' equity increased by \$5,000 during a period of time, then total assets must change by what amount and direction during that same period?

- A. \$20,000 decrease
- B. \$20,000 increase
- C. \$25,000 increase
- D. \$30,000 increase

47. Which of the following reports the cash inflows, cash outflows, and change in cash for a period?

- A. Income statement.
- B. Cash flow statement.
- C. Balance sheet.
- D. Auditor's report.

48. What is the **primary** means that a corporation uses to communicate financial information to its shareholders and creditors?

- A. News stories printed in the business press.
- B. Financial statements.
- C. Letters from management sent to the local newspaper editor.
- D. Information circulated by fraud examiners.

49. External decision makers want answers to all of the following questions except

- A. Will the company be able to pay its debts as they come due?
 - B. Will the company be able to afford employee pay-raises this year?
 - C. How does the company compare in profitability with competitors?
 - D. Is the company earning satisfactory income?
50. For a business, what is an example of an internal decision maker?
- A. A loan officer at a bank.
 - B. A supplier who sells goods to the company on account.
 - C. One of the business's long-term customers.
 - D. One of the business's managers.
51. Which of the following is true of financial accounting?
- A. It provides information primarily for external decision makers.
 - B. It is required for corporations but probably would not be done by other business entities.
 - C. It provides information primarily for the use of managers of the company.
 - D. It has been practiced in this country for approximately the last 15 years.
52. What is accounting information developed primarily for external decision makers called?
- A. Financial accounting.
 - B. Cost accounting.
 - C. Auditing.
 - D. Management accounting.
53. What form does financial accounting information provided by an entity to decision makers generally take?
- A. Financial statements.
 - B. Various forecasts and performance reports.
 - C. An analysis of changes in the price of a corporation's shares.
 - D. Comparisons between the company and its competitors.
54. Retained earnings at the end of the period is equal to
- A. Retained earnings at the beginning of the period plus net earnings minus liabilities.
 - B. Retained earnings at the beginning of the period plus net earnings minus dividends.
 - C. Net earnings.
 - D. Assets plus liabilities.
55. If Bender Corporation recently purchased goods from you on account, which of Bender's financial statements would you look at to determine whether Bender has sufficient resources to be able to pay for the goods when payment is due in 30 days?
- A. income statement.
 - B. balance sheet.
 - C. statement of retained earnings.
 - D. cash flow statement.
56. Which financial statement is prepared first?
- A. Balance sheet.
 - B. Income statement.
 - C. Statement of retained earnings.
 - D. Cash flow statement.
57. What does the separate entity assumption state?
- A. Assets should be recorded at their initial acquisition cost.
 - B. Each business is considered to be part of its owners.
 - C. The monetary unit should be Canadian dollars.
 - D. For measurement purposes, the resources, debts, and activities of a business should be kept separate from those of the owners.
58. Carrington Company owes you \$500 on account due within 15 days. Which of the following amounts on its balance sheet would help you to determine the likelihood that you will be paid in full and on time?
- A. cash and accounts receivable.
 - B. cash and property and equipment.
 - C. cash and inventory.
 - D. share capital and retained earnings.
59. Which of the following is true about a business' assets?
- A. They are equal to liabilities minus shareholders' equity.
 - B. They are the economic resources of the business.
 - C. They are reported on the balance sheet at current market value.
 - D. They are reported on the income statement.
60. Which of the following might be included in the assets of a particular business?
- A. cash, accounts payable, and notes payable.
 - B. cash, retained earnings, and accounts receivable.
 - C. cash, accounts receivable, and inventory.

D. inventories, property and equipment, and share capital.

61. Why can't a business' balance sheet be used to accurately predict what the business might be sold for?

- A. it identifies all the revenues and expenses of the business.
- B. assets are generally listed on the balance sheet at their historical cost, not their current value.
- C. it gives the results of operations for the current period.
- D. some of the assets and liabilities on the balance sheet may actually be those of another entity.

62. Kamil's Car Repair Shop Ltd. started the year with total assets of \$70,000 and total liabilities of \$40,000. During the year, the business recorded \$100,000 in car repair revenues, \$65,000 in expenses, and dividends of \$5,000. Shareholders' equity at the end of the year was

- A. \$60,000.
- B. \$65,000.
- C. \$70,000.
- D. \$75,000.

63. What is the accounting equation (balance sheet equation)?

- A. Assets + Liabilities = Shareholders' equity.
- B. Assets + Shareholders' equity = Liabilities.
- C. Assets = Liabilities + Shareholders' equity.
- D. Revenues - Expenses = Net income.

64. What are business liabilities?

- A. Amounts it expects to collect in the future from customers.
- B. Debts or obligations resulting from past transactions.
- C. The amounts that owners have invested in the business.
- D. The increases in assets that result from profitable operations.

65. Why would Parker Bank, in deciding whether to make a loan to Davis Company, be interested in the amount of liabilities Davis has on its balance sheet?

- A. The liabilities represent resources that could be used to repay the loan.
- B. If Davis already has many other obligations, it might not be able to repay the loan.
- C. Existing liabilities give an indication of how profitable Davis has been in the past.
- D. Parker would be interested in the amount of Davis's assets but not the amount of liabilities.

66. What are the two categories of shareholders' equity usually found on the balance sheet of a corporation?

- A. share capital and long-term liabilities.
- B. share capital and property, plant, and equipment.
- C. retained earnings and notes payable.
- D. share capital and retained earnings.

67. Allentown Corporation has on its balance sheet the following amounts:

Assets	\$3,500,000
Liabilities	500,000
Share capital	1,000,000

What is the amount of retained earnings that should appear on Allentown's balance sheet?

- A. \$2,000,000.
- B. \$3,000,000.
- C. \$4,000,000.
- D. \$5,000,000.

68. Which financial statement for a business would you look at to determine the company's performance during an accounting period?

- A. balance sheet.
- B. statement of retained earnings.
- C. income statement.
- D. cash flow statement.

69. Which of the following is *not* a principal type of business activity?

- A. Operating
- B. Investing
- C. Financing
- D. Delivering

70. How do most businesses earn revenues?

- A. When they collect accounts receivable.
- B. Through sales of goods or services to customers.
- C. By borrowing money from a bank.
- D. By selling shares to shareholders.

71. During 20B, its second year in operation, Banner Company delivered goods to customers for which customers paid or promised to pay \$5,850,000. The amount of cash collected from customers was \$5,960,000. The amount of accounts receivable at the beginning of 20B was \$1,200,000. What is the amount of sales revenue that Banner should report on its income statement for 20B?

- A. \$4,650,000.
 B. \$4,760,000.
 C. \$5,850,000.
 D. \$5,960,000.
72. During 20B, its second year in operation, Banner Company delivered goods to customers for which customers paid or promised to pay \$5,850,000. Assume all sales were on account and the amount of cash collected from customers was \$5,960,000. The amount of accounts receivable at the beginning of 20B was \$1,200,000. Based on this information, what is the amount of accounts receivable that Banner would report at the end of 20B?
- A. \$110,000.
 B. \$1,090,000.
 C. \$1,310,000.
 D. \$5,850,000.
73. What is the amount of revenue recognized in the income statement by a company that sells goods to customers?
- A. The cash collected from customers during the current period.
 B. Total sales, both cash and credit sales, for the period.
 C. Total sales minus beginning amount of accounts receivable.
 D. The amount of cash collected plus the beginning amount of accounts receivable.
74. The cash flow statement and the balance sheet are interrelated because
- A. the ending amount of cash on the cash flow statement must agree with the amount in the statement of retained earnings.
 B. the ending amount of cash on the cash flow statement must agree with the amount in the balance sheet.
 C. both disclose the corporation's net earnings.
 D. the ending amount of cash on the cash flow statement must agree with the amount on the statement of earnings.
75. On January 1, 20A, Taylor Corporation had retained earnings of \$6,500,000. During 20A, Taylor had net income of \$1,050,000 and dividends of \$450,000. What is the amount of Taylor's retained earnings at the end of 20A?
- A. \$6,050,000.
 B. \$6,950,000.
 C. \$7,100,000.
 D. \$7,550,000.
76. What are the categories of cash flows that appear on a cash flow statement?
- A. cash flows from investing, financing, and service activities.
 B. cash flows from operating, production, and internal activities.
 C. cash flows from financing, production, and growth activities.
 D. cash flows from operating, investing, and financing activities.
77. Borrowing money is an example of a(n)
- A. delivering activity.
 B. financing activity.
 C. investing activity.
 D. operating activity.
78. On the cash flow statement, how would a company report the purchase of machinery?
- A. As cash used in operating activities.
 B. As cash used in financing activities.
 C. As cash used in purchasing activities.
 D. As cash used in investing activities.
79. When would a company report a net loss?
- A. When retained earnings decreased due to paying dividends to shareholders.
 B. When its assets decreased during an accounting period.
 C. When its liabilities increased during an accounting period.
 D. When its expenses exceeded its revenues for an accounting period.
80. Which of the following is the amount of rent expense reported on the income statement?
- A. The amount of cash paid for rent in the current period.
 B. The amount of cash paid for rent in the current period less any unpaid rent at the end of the period.
 C. The amount of rent used up in the current period to earn revenue.
 D. An increase in net income.
81. What events cause changes in a corporation's retained earnings?
- A. net income or net loss and declaration of dividends.
 B. declaration of dividends and issuance of shares to new shareholders.
 C. net income, issuance of shares, and borrowing from a bank.
 D. declaration of dividends and purchase of new machinery.
82. The balance sheet
- A. reports the changes in assets, liabilities, and shareholders' equity over a period of time.

- B. reports the assets, liabilities, and shareholders' equity at a specific date.
 C. presents the revenues and expenses for a specific period of time.
 D. summarizes the changes in retained earnings for a specific period of time.
83. If you wanted to know how much of its net income a corporation distributed as dividends, which financial statement would you look at?
- A. balance sheet.
 B. income statement.
 C. cash flow statement.
 D. statement of retained earnings.
84. Why is the operating activities section often believed to be the most important part of a cash flow statement?
- A. it gives the most information about how operations have been financed.
 B. it shows the dividends that have been paid to shareholders.
 C. it indicates a company's ability to generate cash from sales to meet current cash needs.
 D. it shows the net increase or decrease in cash during the period.
85. If you wanted to know what accounting rules a company follows related to its inventory, where would you look?
- A. the balance sheet.
 B. the income statement.
 C. the notes to the financial statements.
 D. the headings to the financial statements.
86. During 20A, Burton Company delivered products to customers for which customers paid or promised to pay \$3,820,000. The company collected \$3,670,000 in cash from customers during the year. Indicate which of these amounts will appear on the income statement and which on the cash flow statement.
- A. \$3,670,000 appears on both the income statement and the cash flow statement.
 B. \$3,670,000 appears on the cash flow statement, and \$3,820,000 appears on the income statement.
 C. \$3,820,000 appears on both the income statement and the cash flow statement.
 D. \$3,820,000 appears on the cash flow statement, and \$3,670,000 appears on the income statement.
87. At the beginning of 20B, Rodriguez Corporation had assets of \$820,000 and liabilities of \$340,000. During the year, assets increased by \$40,000 and liabilities decreased by \$8,000. What was the total amount of shareholders' equity at the end of 20B?
- A. \$432,000.
 B. \$480,000.
 C. \$528,000.
 D. \$1,208,000.
88. What term is used for probable future economic benefits owned by an entity as a result of past transactions?
- A. assets.
 B. liabilities.
 C. revenues.
 D. retained earnings.
89. What results from the purchase of goods or services on credit and from borrowing?
- A. Assets.
 B. Liabilities.
 C. Share capital.
 D. Revenues.
90. How are the differing claims of creditors and investors recognized by a corporation?
- A. The claims of creditors are liabilities; those of investors are assets.
 B. The claims of both creditors and investors are liabilities, but only the claims of investors are considered to be long term.
 C. The claims of creditors are liabilities; the claims of investors are recorded as shareholders' equity.
 D. The claims of creditors and investors are considered to be essentially equivalent.
91. In what order are assets are listed on a balance sheet?
- A. dollar amount (largest first).
 B. date of acquisition (earliest first).
 C. ease of conversion to cash.
 D. importance to the operation of the business.
92. In what order would the assets of Mertz Company be listed on their balance sheet?
- A. Cash, Accounts Receivable, Inventory, Plant and Equipment.
 B. Cash, Inventory, Accounts Receivable, Plant and Equipment.
 C. Cash, Accounts Receivable, Marketable Securities, Inventory.
 D. Cash, Accounts Receivable, Plant and Equipment, Inventory.
93. The ending retained earnings balance of the Brown Hat restaurant chain increased by \$4.3 billion from the beginning of the year. The company had declared a dividend of \$1.5 billion. What was the net income earned during the year?
- A. \$2.8 billion.
 B. \$3.0 billion.

- C. \$5.8 billion.
D. There is no way to determine net income as not enough information was given.
94. What section of the cash flow statement do bankers consider to be the most important?
- A. Investing.
B. Operating.
C. Financing.
D. All the sections are equally important.
95. Which of the following statements regarding private enterprises is TRUE?
- A. Private enterprises must use IFRS for external reporting.
B. Private enterprises may choose to not follow either IFRS or the accounting standards prescribed for private enterprises for external reporting.
C. Private enterprises that are not dependent on significant external sources of financing for their operations must use IFRS for external reporting.
D. Private enterprises must use the accounting standards prescribed for private enterprises for external reporting.
96. Which of the following activities would cause investors to overpay for the acquisition of a company from its current owners?
- A. Understated accounts payable and overstated inventory.
B. Understated revenues and overstated expenses.
C. Understated assets and overstated expenses.
D. Understated assets and overstated revenues.
97. Which of the following statements is true about the price earnings (P/E) ratio?
- A. It is a ratio of importance to creditors.
B. A high P/E ratio indicates investors have little confidence in the future earnings potential of the company.
C. The P/E ratio could be used to approximate the value investors would be willing to pay for the company's acquisition from existing owners.
D. The P/E ratio increases as net income increases.
98. Which government regulatory agency has the legal authority to prescribe financial reporting requirements for corporations that sell their securities in commerce in the province of Ontario?
- A. AcSB.
B. CRA.
C. OSC.
D. CICA.
99. Which part of the provincial government in the province of Ontario has broad powers to determine measurement rules for financial statements of publicly traded companies on the Toronto Stock Exchange?
- A. the Canada Revenue Agency.
B. the Ontario Securities Commission.
C. the Federal Accounting Office.
D. the Supreme Court.
100. With whom does primary responsibility for the information in a corporation's financial statements rest?
- A. the shareholders of the corporation.
B. the managers of the corporation.
C. the Ontario Securities Commission.
D. the public accountant who audited the financial statements.
101. What is an examination of the financial statements of a business to ensure that they conform with generally accepted accounting principles called?
- A. a certification.
B. an audit.
C. a verification.
D. a validation.
102. What is the purpose of an audit?
- A. to prove the accuracy of an entity's financial statements.
B. to lend credibility to an entity's financial statements.
C. to endorse the quality of leadership that managers provide for a corporation.
D. to establish that a corporation's shares are a sound investment.
103. Why do the managers of a corporation hire independent auditors?
- A. To guarantee annual and quarterly financial statements.
B. To handle some personnel issues and problems.
C. To audit and report on the fairness of financial statement presentation.
D. To lobby the AcSB for changes in generally accepted accounting principles.
104. Why is the auditor's role in performing audits important to our society?
- A. auditors provide direct financial advice to potential investors.

- B. auditors have the primary responsibility for the information contained in financial statements.
- C. auditors issue reports on the accuracy of each financial transaction.
- D. an audit of financial statements helps investors and others to know that they can rely on the information presented in the financial statements.

105. What is one of the disadvantages of a corporation when compared to a partnership?

- A. the shareholders have limited liability.
- B. the shareholders are treated as a separate legal entity from the corporation.
- C. the corporation and its shareholders are subject to double taxation.
- D. the corporation provides continuity of life.

106. Which of the following statements is true about a sole proprietorship?

- A. The owner and the business are separate legal entities but not separate accounting entities.
- B. The owner and the business are separate accounting entities but not separate legal entities.
- C. The owner and the business are separate legal entities and separate accounting entities.
- D. Most large businesses in this country are organized as sole proprietorships.

107. For a business organized as a general partnership, which statement is true?

- A. The owners and the business are separate legal entities.
- B. Each partner is potentially responsible for the debts of the business.
- C. Formation of a partnership requires getting a charter from the province of incorporation.
- D. A partnership is not considered to be a separate accounting entity.

108. For what reason might a group of people establishing a business prefer to set it up as a corporation rather than a partnership?

- A. to have limited liability.
- B. to avoid double taxation.
- C. because of ease of formation.
- D. because a corporation is considered to be a separate business entity and a partnership is not.

109. Using the income statement model and the balance sheet model, fill-in the missing amounts for each independent case below. Assume the amounts given are at the end of the first full year of operations of the company.

Company Name	Total Revenue	Total Assets	Total Expenses	Total Liabilities	Net Inc. (Loss)	Shareholders' Equity
Shenkel	\$500,000	\$300,000	\$425,000	\$110,000	\$	\$
Dirks	75,000			70,000	15,000	55,000
Moehler		145,000	70,000		(10,000)	90,000
Shenk	250,000	375,000	200,000	60,000		
Johnson			64,000	88,000	3,000	65,000

110. Plants Supreme, Inc., a small retail store which sells house plants, started business on January 1, 20A. At the end of January, 20A, the following information was available:

Sales of plants for cash	\$50,000
Sales of plants for credit	3,000
Cost of plants which were sold and paid for during January	30,000

Cash expenditures during January:

Salaries	4,500
Telephone	100
Office Supplies (all used)	100
Electricity	200
Rent on the store for January, 20A (will not be paid until February, 20A)	800

- A. Using the above information, prepare the income statement for Plants Supreme for the month ended January 31, 20A.
- B. What is the amount of cash flows provided by operating activities to be presented on the statement of cash flows?

111.

Indicate on which financial statement you would expect to find each of the following. The first is done for you.

	Balance Sheet
Cash	
Accounts payable	
Salaries expense	
Sales revenue	
Cost of goods sold	
Accounts receivable	
Income tax expense	
Dividends	
Land	
Share capital	
Selling expense	

112. For each of the following items that appear on the balance sheet, identify each as an asset (A), liability (L), or element of shareholders' equity (SE). For any item that would not appear on the balance sheet, write the letter, N.

Retained earnings	
Accounts payable	
Selling expense	
Share capital	
Accounts receivable	
Income tax expense	
Dividends	
Property and equipment	

113. Lopez Corporation began operations at the start of 20C. During the year, it made cash and credit sales totalling \$974,000 and collected \$860,000 in cash from its customers. It purchased inventory costing \$508,000, paid \$25,000 for dividends and the cost of goods sold was \$445,000. The corporation incurred the following expenses:

Salary expense	\$180,000
Interest expense	15,000
Insurance expense	10,000
Supplies expense	18,000
Income tax expense	65,000

Required:

1. Prepare an income statement showing revenues, expenses, pretax income, income tax expense, and net income for the year ended December 31, 20C.
 2. Based on the above information, what is the amount of accounts receivable on the balance sheet prepared at the end of 20C?
 3. Based on the above information, what is the amount of retained earnings on the balance sheet prepared at the end of 20C?
114. Delft Corporation was established on December 31, 20A, by a group of investors who invested a total of \$100,000 for shares of the new corporation. During the month of January, 20B, Delft provided services to customers for which the total revenue was \$40,000. Of this amount, \$4,500 had not been collected by the end of January. Delft recorded salary expense of \$17,000, of which 90% had been paid by the end of the month; rent expense of \$3,000, which had been paid on January 1, 20B; and other expenses of \$8,500, which had been paid by check. On January 31, 20B, Delft purchased a van by paying cash of \$25,000. There were no other events that affected cash.
- Required:
1. In which section of the cash flow statement would the amount of cash paid for salaries be reported?
 2. In which section of the cash flow statement would the amount of cash paid for the van be reported?
 3. By how much did Delft's cash increase or decrease during January?
 4. Assuming that the amount of cash was \$100,000 at the beginning of January, how much cash did Delft have at the end of the month?
 5. What was Delft's net income or net loss (after income tax expense) for the month of January? The income tax rate was 25%.
 6. Explain why the net increase or decrease in cash for a business generally will be different than the net income, or net loss, for the same period.

115.

Pool Supply, Inc., reported the following items for the year ended December 31, 20C:

Wages and salary expense	\$ 825,000
Cost of goods sold	1,400,000
Rent expense	490,000
Sales revenue	3,417,000
Interest expense	50,000
Income tax expense	161,000
Accounts receivable	25,000

Required:

Prepare an income statement for the year.

116. Empire Stores, Ltd., reported the following amounts on its balance sheet on December 31, 20B:

Inventory	\$710,000
Notes payable	160,000
Cash	300,000
Share capital	900,000
Net property, plant and equipment	425,000
Accounts receivable	88,000
Accounts payable	131,000
Retained earnings	?

Required:

1. What is the amount of Empire's total assets at the end of 20B?
2. Identify the items listed above that are liabilities.
3. What is the amount of Empire's retained earnings at the end of 20B?
4. Prepare a balance sheet for Empire Stores as of December 31, 20B.
5. Empire Stores wishes to purchase merchandise from your company on account. The amount of the purchases would probably be about \$5,000 per month, and the terms would require Empire to make payment in full within 30 days. Would you recommend that your company grant credit to Empire under these terms? Explain the reasoning for your response.

117. During 20B, Wilmont Company performed services for which customers paid or promised to pay \$286,000. Of this amount, \$270,000 had been collected by year end. Wilmont paid \$125,000 in cash for employee wages and owed the employees \$5,000 at the end of the year for work that had been done but had not paid for. Wilmont paid interest expense of \$1,700 and \$80,000 for other service expenses. The income tax rate was 25%, and income taxes had not yet been paid at the end of the year. Wilmont declared and paid dividends of \$6,000. There were no other events that affected cash.

Required:

1. What was the amount of the increase or decrease in cash during the year?
2. Prepare an income statement for Wilmont for the year.
3. At the start of 20B, Wilmont reported retained earnings totalling \$940,000. Prepare a statement of retained earnings.

118. Alfred Company manufactures men's clothing. During 20B, the company reported the following items that affected cash. Indicate whether each of these items is a cash flow from operating activities (O), investing activities (I), or financing activities (F).

Purchased equipment by paying cash: ____

Collected cash on account from customers: ____

Paid dividends to shareholders: ____

Paid cash for supplies: ____

Paid suppliers for fabric: ____

Borrowed money from bank on a long-term note: ____

Paid interest to bank on the note: ____

Paid wages to employees: ____

Sold shares to new shareholders: ____

119. Fulton Company was established on January 1, 20D when several investors paid a total of \$200,000 to purchase Fulton shares. No additional investments in shares were made during the year. By the end of that year, Fulton had cash on hand of \$45,000, office equipment (net) of \$40,000, inventories of \$156,000, and accounts payable of \$10,000. Sales for the year were \$812,000. Of this amount, customers still owed \$20,000. Fulton paid dividends of \$25,000 to its investors.

Required:

1. Based on the information above, prepare a balance sheet for Fulton Company as at December 31, 20D. In the process of preparing the balance sheet, you must calculate the ending balance in retained earnings.
2. Prepare a statement of retained earnings. (The beginning amount of retained earnings was \$0.)
3. What was the amount of Fulton's net income for the year?
4. Was Fulton successful during its first year in operation?

120. For Baggerly Fashions, the following information is available for the year ended December 31, 20C:

Sales revenue	\$5,500,000
Cost of goods sold	2,800,000
Salaries expense	1,100,000
Rent expense	620,000
Administrative expense	490,000

The income tax rate is 35%.

Required:

Prepare an income statement for Baggerly Fashions.

121. Baseline Corporation was formed two years ago to manufacture fitness equipment. It has been profitable and is growing rapidly. It currently has 150 shareholders and 90 employees; most of the employees own at least a few shares of Baseline's shares. The company has received financing from two banks. It will sell additional shares within the next three months and will also seek additional loans and hire new employees to support its continued growth.

Required:

1. Explain who relies on the information in financial statements prepared by Baseline Corporation.
2. Why is compliance with generally accepted accounting principles and accuracy in accounting important for Baseline?
3. A new accountant who tried to prepare Baseline's financial statements at the end of the current year made several errors. For each of the following items, indicate how the income statement and balance sheet are affected by the error and the nature of the effect. (For example, an error might cause revenues and net income on the income statement and retained earnings and assets on the balance sheet to be overstated). Ignore the effects of income taxes.
 - A. The company had sales for cash of \$3,000,000. It also had sales on account of \$1,800,000 that had been collected by the end of the year, and sales on account of \$200,000 that are expected to be collected early the following year. The accountant reported total sales revenue of \$4,800,000.
 - B. The company had total inventories of \$600,000 at the end of the year. Of this amount, inventory reported at \$30,000 was obsolete and will have to be scrapped. The balance sheet prepared by the accountant showed total inventories of \$600,000.
 - C. The company has a bank loan for which interest expense during the year of \$10,000 will be paid early in January of the next year. The accountant did not record either the interest expense or the related liability.
 - D. An insurance policy was listed as an asset of \$6,000 at the beginning of the year. The entire amount of the policy was for the current year and the policy has expired. The accountant took no action to recognize the expiration of the policy.

122. Lloyd Company ends the first year of operations with \$2.2 million in retained earnings when no dividends were paid out. Since the company began operations on January 1st, 20B of the current year ending December 31st, 20B calculate the amount of beginning retained earnings and explain your answer.

123. Alcorn Corp. has just published their financial information for the year on the company's website. Their reported earnings are \$25.0 million and average common shares outstanding are 5.0 million. Answer the following:

- (a) How much is earnings per share on the common shares?
- (b) If the website shows the common shares is currently trading at \$75 per share, what is the price earnings (P/E) ratio?
- (c) A group of investors is seeking to buy all the Alcorn shares. Using the above information, determine an offering price.

124. Match the model with the financial statement by inserting the proper letter in the space to the left.

(A = Assets, L = Liabilities, SE = Shareholders' equity, R = Revenue, NI = Net Income, E = Expenses)

- | | | |
|-----------------------------------|------------------------------|-------|
| 1. Balance sheet | R - E = NI | _____ |
| 2. Income statement | None of the above is correct | _____ |
| 3. Statement of cash flows | A = L + SE | _____ |
| 4. Statement of retained earnings | None of the above is correct | _____ |

125. Match each definition with its related term or abbreviation by entering the appropriate letter in the space provided.

1. Cost A system that collects and processes financial information about an

principle	organization and reports that information to decision makers.	_____
2. Separate entity	The organization for which financial data are to be collected (separate and distinct from its owners).	_____
3. Publicly traded	A report that describes the auditors' opinion of the fairness of the financial statement presentations and the evidence gathered to support that opinion.	_____
4. Unit of measure	Initial recording of financial statement elements at acquisition cost.	_____
5. Audit report	Measurement of information about an entity in the monetary unit—dollars or other national currency	_____
6. Accounting	Company that can be bought and sold by investors on established stock exchanges	_____

126. Match each element with its financial statement by entering the appropriate letter in the space provided.

1. Cash flow from operations	Cash Flow Statement	_____
2. Dividends	Balance Sheet	_____
3. Assets	Income Statement	_____
4. Liabilities	Balance Sheet	_____
5. Revenues	Cash Flow Statement	_____
6. Cash flow from financing	Income Statement	_____
7. Expenses	Balance Sheet	_____
8. Cash flow from investments	Cash Flow Statement	_____
9. Shareholders' Equity	Statement of Retained Earnings	_____

127. Match each definition with its related term or abbreviation by entering the appropriate letter in the space provided.

1. CICA	Ontario Securities Commission	_____
2. AcSB	Canadian Institute of Chartered Accountants.	_____
3. GAAP	Financial Accounting Standards Board	_____
4. OSC	Chartered Accountant	_____
5. CA	Generally accepted accounting principles	_____

128. Match the characteristics with the type of business by inserting the proper letter in the space to the left.

1. Sole proprietorship	Ownership is represented by shares.	_____
2. Corporation	Ownership is limited to one person.	_____
3. Partnership	Each owner is responsible for the debts of the entity.	_____

129. Match the definition with the form of organization by inserting the proper letter in the space to the left.

1. Sole proprietorship	Each owner has unlimited liability for the debts of the entity.	_____
2. Partnership	The owners are known as shareholders and enjoy limited liability.	_____
3. Corporation	The manager is often the owner and does not enjoy limited liability.	_____

1 KEY

1. Accounting is a system that collects and processes financial information about an organization and reports that information to decision makers.

TRUE

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #1*

2. The purpose of the statement of financial position is to report the financial position (amount of assets, liabilities, and shareholders' equity) of an accounting entity at a particular point in time.

TRUE

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #2*

3. In accounting and reporting for a business entity, the accounting and reporting for the business must be kept separate from other economic affairs of its owners.

TRUE

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #3*

4. The debts of a corporation can be generally viewed as debts of its owners.

FALSE

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #4*

5. A balance sheet should be dated for a period (such as "For the year ended December 31, 20A"), whereas an income statement should be dated at a point in time (such as "December 31, 20A").

FALSE

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #5*

6. The accounting period in which service revenue is recognized (i.e., revenue for services rendered) is generally the period in which the cash is collected.

FALSE

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #6*

7. If expenses are understated on the income statement, shareholders' equity is overstated on the balance sheet.

TRUE

*Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #7*

8. Total assets are \$60,000, total liabilities, \$30,000, and share capital is \$20,000; therefore, retained earnings is \$5,000.

FALSE

Calculation: $\$60,000 - \$30,000 - \$20,000 = \$10,000$

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #8*

9. Assets are measured and reported on the balance sheet at their current market value at the date of the balance sheet.

FALSE

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #9*

10. The payment of a cash dividend to shareholders reduces shareholders' equity.

TRUE

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #10*

11. The report of management indicates management's primary responsibility for financial statement information and the steps to ensure the accuracy of the company's records.

TRUE

*Difficulty: Easy
Learning Objective: 3
Libby - Chapter 01 #11*

12. The organization for which financial data are to be collected and reported is called an accounting entity.

TRUE

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #12*

13. The accounting model for the balance sheet is: Assets + Liabilities - Shareholders' Equity.

FALSE

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #13*

14. One feature of the cash flow statement is to show the change in cash for the period.

TRUE

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #14*

15. Profit (also called net income or net earnings) is the excess of total revenues over total expenses incurred to generate revenue during a specific period.

TRUE

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #15*

16. The financial statements prepared by a corporation include a balance sheet, income statement, cash flow statement, and statement of money.

FALSE

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #16*

17. A banker who is considering making a loan to a corporation would be one of the corporation's internal decision makers.

FALSE

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #17*

18. Assets are economic resources controlled by the entity as a result of past business events and from which future economic benefits can be obtained.

TRUE

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #18*

19. The financial statement that shows an entity's economic resources and its liabilities is the statement of retained earnings.

FALSE

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #19*

20. The statement of comprehensive income reports the change in shareholders' equity during a period from business activities other than investments by shareholders or distributions to shareholders.

TRUE

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #20*

21. A note payable is a borrowing instrument that generally does not involve the payment of interest.

FALSE

*Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #21*

22. If a corporation does not pay its obligations when they are due, its creditors may be able to force the sale of the business's assets to pay their claims.

TRUE

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #22*

23. When a company ships products to a customer and bills the customer, the company should recognize revenue as earned.

TRUE

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #23*

24. The amount of cash paid by a business for office rent would be reported on the cash flow statement as a financing activity.

FALSE

*Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #24*

25. Repayment of a bank loan is classified on the cash flow statement as an operating activity.

FALSE

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #25*

26. Liabilities are the entity's legal obligations that result from past business events.

TRUE

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #26*

27. International Financial Accounting Standards are produced by the International Accounting Standards Board (IASB), which is an independent standard-setting board consisting of 15 members from nine countries.

TRUE

*Difficulty: Easy
Learning Objective: 2
Libby - Chapter 01 #27*

28. Accounting is based on man-made rules that sometimes undergo change.

TRUE

*Difficulty: Easy
Learning Objective: 2
Libby - Chapter 01 #28*

29. Primary responsibility for the information in the financial statements lies with management.

TRUE

*Difficulty: Medium
Learning Objective: 2
Libby - Chapter 01 #29*

30. The AcSB is currently the body responsible for establishing accounting standards.

TRUE

*Difficulty: Medium
Learning Objective: 2
Libby - Chapter 01 #30*

31. The Accounting Standards Board (AcSB) is an agency of the federal government that establishes generally accepted accounting principles for businesses.

FALSE

*Difficulty: Medium
Learning Objective: 2
Libby - Chapter 01 #31*

32. Generally accepted accounting principles (GAAP) are essentially identical in most developed countries.

FALSE

*Difficulty: Medium
Learning Objective: 2
Libby - Chapter 01 #32*

33. Independent CAs in the public practice of accounting are viewed as employees of their clients.

FALSE

*Difficulty: Medium
Learning Objective: 3
Libby - Chapter 01 #33*

34. An audit involves the examination of the financial reports (prepared by the management of the company) to ensure that they represent what they claim and conform with IFRS.

TRUE

*Difficulty: Medium
Learning Objective: 3
Libby - Chapter 01 #34*

35. Many opportunities exist for managers to intentionally prepare misleading financial reports.

TRUE

Difficulty: Medium
Learning Objective: 3
Libby - Chapter 01 #35

36. Failure to comply with professional rules of conduct can result in serious penalties for professional accountants, but not the rescinding of the professional designation of an offending member.

FALSE

Difficulty: Medium
Learning Objective: 4
Libby - Chapter 01 #36

37. In terms of economic importance, the sole proprietorship is the dominant form of organization in Canada because of its ease of formation.

FALSE

Difficulty: Medium
Learning Objective: Appendix 1A
Libby - Chapter 01 #37

38. One of the disadvantages of a corporation when compared to a partnership is the limited liability of the owners.

FALSE

Difficulty: Easy
Learning Objective: Appendix 1A
Libby - Chapter 01 #38

39. A partnership is an incorporated entity that has more than one owner.

FALSE

Difficulty: Easy
Learning Objective: Appendix 1A
Libby - Chapter 01 #39

40. Accountants generally must meet educational requirements, pass a rigorous exam, and meet experience requirements before becoming licensed CAs, CGAs, or CMAs.

TRUE

Difficulty: Medium
Learning Objective: Appendix 1B
Libby - Chapter 01 #40

41. What is the primary purpose of the balance sheet?

- A. To measure the net income of a business up to a particular point in time.
- B. To report the difference between cash inflows and cash outflows for the period.
- C.** To report the financial position of the reporting entity at a particular point in time.
- D. To report assets at their current market value at a particular point in time.

Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #41

42. On January 1, 20A, two individuals invested \$150,000 each to form Hornbeck Corporation. Hornbeck had total revenues of \$15,000 during 20A and \$40,000 during 20B. Total expenses for the same periods were \$8,000 and \$22,000, respectively. Cash dividends paid out to shareholders totalled \$6,000 in 20A and \$12,000 in 20B. What was the ending balance in Hornbeck's retained earnings account at the end of 20A and 20B?

- A.** \$1,000 and \$6,000 respectively.
- B. \$1,000 and \$7,000, respectively.
- C. \$7,000 and \$19,000 respectively.
- D. \$301,000 and \$306,000 respectively.

Calculation: $\$15,000 - \$8,000 - \$6,000 = \$1,000$; $\$40,000 - \$22,000 - \$12,000 = \$6,000$

Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #42

43. The BAT Corporation had 20B revenues of \$110,000, expenses of \$85,000, and an income tax rate of 20 percent. What would net income after taxes be?

- A. \$5,000.
- B. \$15,000.
- C.** \$20,000.
- D. \$25,000.

Calculation: $(\$110,000 - \$85,000) \times 80\% = \$20,000$

Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #43

44. Brown Corporation reported the following amounts at the end of the first year of operations, December 31, 20A: share capital \$20,000; sales revenue \$95,000; total assets \$85,000, no dividends, and total liabilities \$35,000. What would shareholders' equity and total expenses be?

- A.** Shareholders' equity, \$50,000 and expenses \$65,000.
- B. Shareholders' equity, \$60,000 and expenses \$75,000.
- C. Shareholders' equity, \$80,000 and expenses \$40,000.

D. Shareholders' equity, \$80,000 and expenses \$85,000.

Calculation: $\$85,000 - \$35,000 = \$50,000$; $\$20,000 + \$95,000 - \$50,000 = \$65,000$

*Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #44*

45. Which financial statement reports the financial position of a business?

- A. Income statement.
- B.** Balance sheet.
- C. Cash flow statement.
- D. Footnotes to the financial statements.

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #45*

46. If total liabilities increased by \$25,000 and shareholders' equity increased by \$5,000 during a period of time, then total assets must change by what amount and direction during that same period?

- A. \$20,000 decrease
- B. \$20,000 increase
- C. \$25,000 increase
- D.** \$30,000 increase

Calculation: $\$25,000 + \$5,000 = \$30,000$

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #46*

47. Which of the following reports the cash inflows, cash outflows, and change in cash for a period?

- A. Income statement.
- B.** Cash flow statement.
- C. Balance sheet.
- D. Auditor's report.

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #47*

48. What is the **primary** means that a corporation uses to communicate financial information to its shareholders and creditors?

- A. News stories printed in the business press.
- B.** Financial statements.
- C. Letters from management sent to the local newspaper editor.
- D. Information circulated by fraud examiners.

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #48*

49. External decision makers want answers to all of the following questions except

- A. Will the company be able to pay its debts as they come due?
- B.** Will the company be able to afford employee pay-raises this year?
- C. How does the company compare in profitability with competitors?
- D. Is the company earning satisfactory income?

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #49*

50. For a business, what is an example of an internal decision maker?

- A. A loan officer at a bank.
- B. A supplier who sells goods to the company on account.
- C. One of the business's long-term customers.
- D.** One of the business's managers.

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #50*

51. Which of the following is true of financial accounting?

- A.** It provides information primarily for external decision makers.
- B. It is required for corporations but probably would not be done by other business entities.
- C. It provides information primarily for the use of managers of the company.
- D. It has been practiced in this country for approximately the last 15 years.

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #51*

52. What is accounting information developed primarily for external decision makers called?

- A.** Financial accounting.
- B. Cost accounting.
- C. Auditing.

D. Management accounting.

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #52*

53. What form does financial accounting information provided by an entity to decision makers generally take?

- A.** Financial statements.
- B. Various forecasts and performance reports.
- C. An analysis of changes in the price of a corporation's shares.
- D. Comparisons between the company and its competitors.

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #53*

54. Retained earnings at the end of the period is equal to

- A. Retained earnings at the beginning of the period plus net earnings minus liabilities.
- B.** Retained earnings at the beginning of the period plus net earnings minus dividends.
- C. Net earnings.
- D. Assets plus liabilities.

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #54*

55. If Bender Corporation recently purchased goods from you on account, which of Bender's financial statements would you look at to determine whether Bender has sufficient resources to be able to pay for the goods when payment is due in 30 days?

- A. income statement.
- B.** balance sheet.
- C. statement of retained earnings.
- D. cash flow statement.

*Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #55*

56. Which financial statement is prepared first?

- A. Balance sheet.
- B.** Income statement.
- C. Statement of retained earnings.
- D. Cash flow statement.

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #56*

57. What does the separate entity assumption state?

- A. Assets should be recorded at their initial acquisition cost.
- B. Each business is considered to be part of its owners.
- C. The monetary unit should be Canadian dollars.
- D.** For measurement purposes, the resources, debts, and activities of a business should be kept separate from those of the owners.

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #57*

58. Carrington Company owes you \$500 on account due within 15 days. Which of the following amounts on its balance sheet would help you to determine the likelihood that you will be paid in full and on time?

- A.** cash and accounts receivable.
- B. cash and property and equipment.
- C. cash and inventory.
- D. share capital and retained earnings.

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #58*

59. Which of the following is true about a business' assets?

- A. They are equal to liabilities minus shareholders' equity.
- B.** They are the economic resources of the business.
- C. They are reported on the balance sheet at current market value.
- D. They are reported on the income statement.

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #59*

60. Which of the following might be included in the assets of a particular business?

- A. cash, accounts payable, and notes payable.
- B. cash, retained earnings, and accounts receivable.
- C.** cash, accounts receivable, and inventory.
- D. inventories, property and equipment, and share capital.

*Difficulty: Medium
Learning Objective: 1*

61. Why can't a business' balance sheet be used to accurately predict what the business might be sold for?
- A. it identifies all the revenues and expenses of the business.
 - B.** assets are generally listed on the balance sheet at their historical cost, not their current value.
 - C. it gives the results of operations for the current period.
 - D. some of the assets and liabilities on the balance sheet may actually be those of another entity.

Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #61

62. Kamil's Car Repair Shop Ltd. started the year with total assets of \$70,000 and total liabilities of \$40,000. During the year, the business recorded \$100,000 in car repair revenues, \$65,000 in expenses, and dividends of \$5,000. Shareholders' equity at the end of the year was
- A.** \$60,000.
 - B. \$65,000.
 - C. \$70,000.
 - D. \$75,000.

Calculation: $\$100,000 - \$65,000 - \$5,000 + \$30,000 = \$60,000$

Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #62

63. What is the accounting equation (balance sheet equation)?
- A. Assets + Liabilities = Shareholders' equity.
 - B. Assets + Shareholders' equity = Liabilities.
 - C.** Assets = Liabilities + Shareholders' equity.
 - D. Revenues - Expenses = Net income.

Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #63

64. What are business liabilities?
- A. Amounts it expects to collect in the future from customers.
 - B.** Debts or obligations resulting from past transactions.
 - C. The amounts that owners have invested in the business.
 - D. The increases in assets that result from profitable operations.

Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #64

65. Why would Parker Bank, in deciding whether to make a loan to Davis Company, be interested in the amount of liabilities Davis has on its balance sheet?
- A. The liabilities represent resources that could be used to repay the loan.
 - B.** If Davis already has many other obligations, it might not be able to repay the loan.
 - C. Existing liabilities give an indication of how profitable Davis has been in the past.
 - D. Parker would be interested in the amount of Davis's assets but not the amount of liabilities.

Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #65

66. What are the two categories of shareholders' equity usually found on the balance sheet of a corporation?
- A. share capital and long-term liabilities.
 - B. share capital and property, plant, and equipment.
 - C. retained earnings and notes payable.
 - D.** share capital and retained earnings.

Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #66

67. Allentown Corporation has on its balance sheet the following amounts:

Assets	\$3,500,000
Liabilities	500,000
Share capital	1,000,000

What is the amount of retained earnings that should appear on Allentown's balance sheet?

- A.** \$2,000,000.
- B. \$3,000,000.
- C. \$4,000,000.
- D. \$5,000,000.

Calculation: $\$3,500,000 - \$500,000 - \$1,000,000 = \$2,000,000$

Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #67

68. Which financial statement for a business would you look at to determine the company's performance during an accounting period?
- A. balance sheet.

- B. statement of retained earnings.
- C.** income statement.
- D. cash flow statement.

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #68*

69. Which of the following is *not* a principal type of business activity?

- A. Operating
- B. Investing
- C. Financing
- D.** Delivering

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #69*

70. How do most businesses earn revenues?

- A. When they collect accounts receivable.
- B.** Through sales of goods or services to customers.
- C. By borrowing money from a bank.
- D. By selling shares to shareholders.

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #70*

71. During 20B, its second year in operation, Banner Company delivered goods to customers for which customers paid or promised to pay \$5,850,000. The amount of cash collected from customers was \$5,960,000. The amount of accounts receivable at the beginning of 20B was \$1,200,000. What is the amount of sales revenue that Banner should report on its income statement for 20B?

- A. \$4,650,000.
- B. \$4,760,000.
- C.** \$5,850,000.
- D. \$5,960,000.

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #71*

72. During 20B, its second year in operation, Banner Company delivered goods to customers for which customers paid or promised to pay \$5,850,000. Assume all sales were on account and the amount of cash collected from customers was \$5,960,000. The amount of accounts receivable at the beginning of 20B was \$1,200,000. Based on this information, what is the amount of accounts receivable that Banner would report at the end of 20B?

- A. \$110,000.
- B.** \$1,090,000.
- C. \$1,310,000.
- D. \$5,850,000.

Calculation: $\$1,200,000 + \$5,850,000 - \$5,960,000 = \$1,090,000$

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #72*

73. What is the amount of revenue recognized in the income statement by a company that sells goods to customers?

- A. The cash collected from customers during the current period.
- B.** Total sales, both cash and credit sales, for the period.
- C. Total sales minus beginning amount of accounts receivable.
- D. The amount of cash collected plus the beginning amount of accounts receivable.

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #73*

74. The cash flow statement and the balance sheet are interrelated because

- A. the ending amount of cash on the cash flow statement must agree with the amount in the statement of retained earnings.
- B.** the ending amount of cash on the cash flow statement must agree with the amount in the balance sheet.
- C. both disclose the corporation's net earnings.
- D. the ending amount of cash on the cash flow statement must agree with the amount on the statement of earnings.

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #74*

75. On January 1, 20A, Taylor Corporation had retained earnings of \$6,500,000. During 20A, Taylor had net income of \$1,050,000 and dividends of \$450,000. What is the amount of Taylor's retained earnings at the end of 20A?

- A. \$6,050,000.
- B. \$6,950,000.
- C.** \$7,100,000.
- D. \$7,550,000.

Calculation: $\$6,500,000 + \$1,050,000 - \$450,000 = \$7,100,000$

*Difficulty: Medium
Learning Objective: 1*

76. What are the categories of cash flows that appear on a cash flow statement?

- A. cash flows from investing, financing, and service activities.
- B. cash flows from operating, production, and internal activities.
- C. cash flows from financing, production, and growth activities.
- D.** cash flows from operating, investing, and financing activities.

Difficulty: Easy
Learning Objective: 1
 Libby - Chapter 01 #76

77. Borrowing money is an example of a(n)

- A. delivering activity.
- B.** financing activity.
- C. investing activity.
- D. operating activity.

Difficulty: Medium
Learning Objective: 1
 Libby - Chapter 01 #77

78. On the cash flow statement, how would a company report the purchase of machinery?

- A. As cash used in operating activities.
- B. As cash used in financing activities.
- C. As cash used in purchasing activities.
- D.** As cash used in investing activities.

Difficulty: Medium
Learning Objective: 1
 Libby - Chapter 01 #78

79. When would a company report a net loss?

- A. When retained earnings decreased due to paying dividends to shareholders.
- B. When its assets decreased during an accounting period.
- C. When its liabilities increased during an accounting period.
- D.** When its expenses exceeded its revenues for an accounting period.

Difficulty: Easy
Learning Objective: 1
 Libby - Chapter 01 #79

80. Which of the following is the amount of rent expense reported on the income statement?

- A. The amount of cash paid for rent in the current period.
- B. The amount of cash paid for rent in the current period less any unpaid rent at the end of the period.
- C.** The amount of rent used up in the current period to earn revenue.
- D. An increase in net income.

Difficulty: Medium
Learning Objective: 1
 Libby - Chapter 01 #80

81. What events cause changes in a corporation's retained earnings?

- A.** net income or net loss and declaration of dividends.
- B. declaration of dividends and issuance of shares to new shareholders.
- C. net income, issuance of shares, and borrowing from a bank.
- D. declaration of dividends and purchase of new machinery.

Difficulty: Medium
Learning Objective: 1
 Libby - Chapter 01 #81

82. The balance sheet

- A. reports the changes in assets, liabilities, and shareholders' equity over a period of time.
- B.** reports the assets, liabilities, and shareholders' equity at a specific date.
- C. presents the revenues and expenses for a specific period of time.
- D. summarizes the changes in retained earnings for a specific period of time.

Difficulty: Easy
Learning Objective: 1
 Libby - Chapter 01 #82

83. If you wanted to know how much of its net income a corporation distributed as dividends, which financial statement would you look at?

- A. balance sheet.
- B. income statement.
- C. cash flow statement.
- D.** statement of retained earnings.

Difficulty: Medium
Learning Objective: 1
 Libby - Chapter 01 #83

84. Why is the operating activities section often believed to be the most important part of a cash flow statement?

- A. it gives the most information about how operations have been financed.
- B. it shows the dividends that have been paid to shareholders.

- C.** it indicates a company's ability to generate cash from sales to meet current cash needs.
D. it shows the net increase or decrease in cash during the period.

*Difficulty: Hard
 Learning Objective: 1
 Libby - Chapter 01 #84*

85. If you wanted to know what accounting rules a company follows related to its inventory, where would you look?
- A. the balance sheet.
 B. the income statement.
C. the notes to the financial statements.
 D. the headings to the financial statements.

*Difficulty: Easy
 Learning Objective: 1
 Libby - Chapter 01 #85*

86. During 20A, Burton Company delivered products to customers for which customers paid or promised to pay \$3,820,000. The company collected \$3,670,000 in cash from customers during the year. Indicate which of these amounts will appear on the income statement and which on the cash flow statement.
- A. \$3,670,000 appears on both the income statement and the cash flow statement.
B. \$3,670,000 appears on the cash flow statement, and \$3,820,000 appears on the income statement.
 C. \$3,820,000 appears on both the income statement and the cash flow statement.
 D. \$3,820,000 appears on the cash flow statement, and \$3,670,000 appears on the income statement.

*Difficulty: Easy
 Learning Objective: 1
 Libby - Chapter 01 #86*

87. At the beginning of 20B, Rodriguez Corporation had assets of \$820,000 and liabilities of \$340,000. During the year, assets increased by \$40,000 and liabilities decreased by \$8,000. What was the total amount of shareholders' equity at the end of 20B?
- A. \$432,000.
 B. \$480,000.
C. \$528,000.
 D. \$1,208,000.

Calculation: $(\$820,000 + \$40,000) - (\$340,000 - \$8,000) = \$528,000$

*Difficulty: Hard
 Learning Objective: 1
 Libby - Chapter 01 #87*

88. What term is used for probable future economic benefits owned by an entity as a result of past transactions?
- A.** assets.
 B. liabilities.
 C. revenues.
 D. retained earnings.

*Difficulty: Easy
 Learning Objective: 1
 Libby - Chapter 01 #88*

89. What results from the purchase of goods or services on credit and from borrowing?
- A. Assets.
B. Liabilities.
 C. Share capital.
 D. Revenues.

*Difficulty: Easy
 Learning Objective: 1
 Libby - Chapter 01 #89*

90. How are the differing claims of creditors and investors recognized by a corporation?
- A. The claims of creditors are liabilities; those of investors are assets.
 B. The claims of both creditors and investors are liabilities, but only the claims of investors are considered to be long term.
C. The claims of creditors are liabilities; the claims of investors are recorded as shareholders' equity.
 D. The claims of creditors and investors are considered to be essentially equivalent.

*Difficulty: Easy
 Learning Objective: 1
 Libby - Chapter 01 #90*

91. In what order are assets are listed on a balance sheet?
- A. dollar amount (largest first).
 B. date of acquisition (earliest first).
C. ease of conversion to cash.
 D. importance to the operation of the business.

*Difficulty: Medium
 Learning Objective: 1
 Libby - Chapter 01 #91*

92. In what order would the assets of Mertz Company be listed on their balance sheet?
- A.** Cash, Accounts Receivable, Inventory, Plant and Equipment.
 B. Cash, Inventory, Accounts Receivable, Plant and Equipment.

- C. Cash, Accounts Receivable, Marketable Securities, Inventory.
- D. Cash, Accounts Receivable, Plant and Equipment, Inventory.

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #92*

93. The ending retained earnings balance of the Brown Hat restaurant chain increased by \$4.3 billion from the beginning of the year. The company had declared a dividend of \$1.5 billion. What was the net income earned during the year?
- A. \$2.8 billion.
 - B. \$3.0 billion.
 - C. \$5.8 billion.**
 - D. There is no way to determine net income as not enough information was given.

Calculation: $\$4.3 \text{ billion} + \$1.5 \text{ billion} = \$5.8 \text{ billion}$

*Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #93*

94. What section of the cash flow statement do bankers consider to be the most important?
- A. Investing.
 - B. Operating.**
 - C. Financing.
 - D. All the sections are equally important.

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #94*

95. Which of the following statements regarding private enterprises is TRUE?

- A. Private enterprises must use IFRS for external reporting.
- B. Private enterprises may choose to not follow either IFRS or the accounting standards prescribed for private enterprises for external reporting.**
- C. Private enterprises that are not dependent on significant external sources of financing for their operations must use IFRS for external reporting.
- D. Private enterprises must use the accounting standards prescribed for private enterprises for external reporting.

*Difficulty: Hard
Learning Objective: 4
Libby - Chapter 01 #95*

96. Which of the following activities would cause investors to overpay for the acquisition of a company from its current owners?

- A. Understated accounts payable and overstated inventory.**
- B. Understated revenues and overstated expenses.
- C. Understated assets and overstated expenses.
- D. Understated assets and overstated revenues.

*Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #96*

97. Which of the following statements is true about the price earnings (P/E) ratio?

- A. It is a ratio of importance to creditors.
- B. A high P/E ratio indicates investors have little confidence in the future earnings potential of the company.
- C. The P/E ratio could be used to approximate the value investors would be willing to pay for the company's acquisition from existing owners.**
- D. The P/E ratio increases as net income increases.

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #97*

98. Which government regulatory agency has the legal authority to prescribe financial reporting requirements for corporations that sell their securities in commerce in the province of Ontario?

- A. AcSB.
- B. CRA.
- C. OSC.**
- D. CICA.

*Difficulty: Easy
Learning Objective: 2
Libby - Chapter 01 #98*

99. Which part of the provincial government in the province of Ontario has broad powers to determine measurement rules for financial statements of publicly traded companies on the Toronto Stock Exchange?

- A. the Canada Revenue Agency.
- B. the Ontario Securities Commission.**
- C. the Federal Accounting Office.
- D. the Supreme Court.

*Difficulty: Easy
Learning Objective: 2
Libby - Chapter 01 #99*

100. With whom does primary responsibility for the information in a corporation's financial statements rest?

- A. the shareholders of the corporation.
- B.** the managers of the corporation.
- C. the Ontario Securities Commission.
- D. the public accountant who audited the financial statements.

Difficulty: Easy
Learning Objective: 2
Libby - Chapter 01 #100

101. What is an examination of the financial statements of a business to ensure that they conform with generally accepted accounting principles called?

- A. a certification.
- B.** an audit.
- C. a verification.
- D. a validation.

Difficulty: Easy
Learning Objective: 3
Libby - Chapter 01 #101

102. What is the purpose of an audit?

- A. to prove the accuracy of an entity's financial statements.
- B.** to lend credibility to an entity's financial statements.
- C. to endorse the quality of leadership that managers provide for a corporation.
- D. to establish that a corporation's shares are a sound investment.

Difficulty: Easy
Learning Objective: 3
Libby - Chapter 01 #102

103. Why do the managers of a corporation hire independent auditors?

- A. To guarantee annual and quarterly financial statements.
- B. To handle some personnel issues and problems.
- C.** To audit and report on the fairness of financial statement presentation.
- D. To lobby the AcSB for changes in generally accepted accounting principles.

Difficulty: Easy
Learning Objective: 3
Libby - Chapter 01 #103

104. Why is the auditor's role in performing audits important to our society?

- A. auditors provide direct financial advice to potential investors.
- B. auditors have the primary responsibility for the information contained in financial statements.
- C. auditors issue reports on the accuracy of each financial transaction.
- D.** an audit of financial statements helps investors and others to know that they can rely on the information presented in the financial statements.

Difficulty: Easy
Learning Objective: 3
Libby - Chapter 01 #104

105. What is one of the disadvantages of a corporation when compared to a partnership?

- A. the shareholders have limited liability.
- B. the shareholders are treated as a separate legal entity from the corporation.
- C.** the corporation and its shareholders are subject to double taxation.
- D. the corporation provides continuity of life.

Difficulty: Medium
Learning Objective: Appendix 1A
Libby - Chapter 01 #105

106. Which of the following statements is true about a sole proprietorship?

- A. The owner and the business are separate legal entities but not separate accounting entities.
- B.** The owner and the business are separate accounting entities but not separate legal entities.
- C. The owner and the business are separate legal entities and separate accounting entities.
- D. Most large businesses in this country are organized as sole proprietorships.

Difficulty: Medium
Learning Objective: Appendix 1A
Libby - Chapter 01 #106

107. For a business organized as a general partnership, which statement is true?

- A. The owners and the business are separate legal entities.
- B.** Each partner is potentially responsible for the debts of the business.
- C. Formation of a partnership requires getting a charter from the province of incorporation.
- D. A partnership is not considered to be a separate accounting entity.

Difficulty: Medium
Learning Objective: Appendix 1A
Libby - Chapter 01 #107

108. For what reason might a group of people establishing a business prefer to set it up as a corporation rather than a partnership?

- A.** to have limited liability.
- B. to avoid double taxation.
- C. because of ease of formation.

D. because a corporation is considered to be a separate business entity and a partnership is not.

Difficulty: Medium
Learning Objective: Appendix 1A
Libby - Chapter 01 #108

109. Using the income statement model and the balance sheet model, fill-in the missing amounts for each independent case below. Assume the amounts given are at the end of the first full year of operations of the company.

Company Name	Total Revenue	Total Assets	Total Expenses	Total Liabilities	Net Inc. (Loss)	Shareholders' Equity
Shenkel	\$500,000	\$300,000	\$425,000	\$110,000	\$	\$
Dirks	75,000			70,000	15,000	55,000
Moehler		145,000	70,000		(10,000)	90,000
Shenk	250,000	375,000	200,000	60,000		
Johnson			64,000	88,000	3,000	65,000

Individual Case	Total Revenue	Total Assets	Total Expenses	Total Liabilities	Net Income (Loss)	Shareholders' Equity
A					\$75,000	\$190,000
B		\$125,000	\$60,000			
C	\$60,000			\$55,000		
D					\$50,000	\$315,000
E	\$67,000	\$153,000				

Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #109

110. Plants Supreme, Inc., a small retail store which sells house plants, started business on January 1, 20A. At the end of January, 20A, the following information was available:

Sales of plants for cash	\$50,000
Sales of plants for credit	3,000
Cost of plants which were sold and paid for during January	30,000

Cash expenditures during January:

Salaries	4,500
Telephone	100
Office Supplies (all used)	100
Electricity	200
Rent on the store for January, 20A (will not be paid until February, 20A)	800

A. Using the above information, prepare the income statement for Plants Supreme for the month ended January 31, 20A.

B. What is the amount of cash flows provided by operating activities to be presented on the statement of cash flows?

A.

Plants Supreme, Inc.
Income Statement
For the Month Ended January 1, 20A

Revenue (\$50,000 + \$3,000).....		\$53,000
Expenses:		
Cost of goods sold.....	\$30,000	
Salaries.....	4,500	
Telephone.....	100	
Office supplies used.....	100	
Electricity.....	200	
Rent.....	800	
		35,700
Net income.....		\$17,300

B. $17,300 - 3,000 + 800 = \$15,100$ OR $\$50,000 - 30,000 - 4,500 - 100 - 100 - 200 = \$15,100$

Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #110

111. Indicate on which financial statement you would expect to find each of the following. The first is done for you.

Cash	<u>Balance Sheet</u>
Accounts payable	_____
Salaries expense	_____
Sales revenue	_____
Cost of goods sold	_____
Accounts receivable	_____
Income tax expense	_____
Dividends	_____
Land	_____
Share capital	_____
Selling expense	_____

Cash	Balance sheet
Accounts payable	Balance sheet
Salaries expense	Income statement
Sales revenue	Income statement
Cost of goods sold	Income statement
Accounts receivable	Balance sheet
Income tax expense	Income statement
Dividends	Statement of retained earnings
Land	Balance sheet
Contributed capital	Balance sheet
Selling expense	Income statement

Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #111

112. For each of the following items that appear on the balance sheet, identify each as an asset (A), liability (L), or element of shareholders' equity (SE). For any item that would not appear on the balance sheet, write the letter, N.

Retained earnings	
Accounts payable	
Selling expense	
Share capital	
Accounts receivable	
Income tax expense	
Dividends	
Property and equipment	

Retained earnings	SE
Accounts payable	L
Selling expense	N
Share capital	SE
Accounts receivable	A
Income tax expense	N
Dividends	N
Property and equipment	A

Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #112

113. Lopez Corporation began operations at the start of 20C. During the year, it made cash and credit sales totalling \$974,000 and collected \$860,000 in cash from its customers. It purchased inventory costing \$508,000, paid \$25,000 for dividends and the cost of goods sold was \$445,000. The corporation incurred the following expenses:

Salary expense	\$180,000
Interest expense	15,000
Insurance expense	10,000
Supplies expense	18,000
Income tax expense	65,000

Required:

- Prepare an income statement showing revenues, expenses, pretax income, income tax expense, and net income for the year ended December 31, 20C.
- Based on the above information, what is the amount of accounts receivable on the balance sheet prepared at the end of 20C?
- Based on the above information, what is the amount of retained earnings on the balance sheet prepared at the end of 20C?

1.

Lopez Corporation
Income Statement
For the Year Ended December 31, 20C

Revenues:		
Sales	\$974,000	
Total revenues		\$974,000
Expenses:		
Cost of goods sold	445,000	
Salary expense	180,000	
Supplies expense	18,000	
Interest expense	15,000	
Insurance expense	10,000	
Total expenses		668,000
Pretax income		306,000
Income tax expense		65,000
Net income		\$241,000

- $\$974,000 - 860,000 = \$114,000$ Accounts receivable at the end of the year.
- $\$0$ beginning amount + $\$241,000$ net income - $\$25,000$ dividends = $\$216,000$.

Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #113

114. Delft Corporation was established on December 31, 20A, by a group of investors who invested a total of \$100,000 for shares of the new corporation. During the month of January, 20B, Delft provided services to customers for which the total revenue was \$40,000. Of this

amount, \$4,500 had not been collected by the end of January. Delft recorded salary expense of \$17,000, of which 90% had been paid by the end of the month; rent expense of \$3,000, which had been paid on January 1, 20B; and other expenses of \$8,500, which had been paid by check. On January 31, 20B, Delft purchased a van by paying cash of \$25,000. There were no other events that affected cash. Required:

1. In which section of the cash flow statement would the amount of cash paid for salaries be reported?
2. In which section of the cash flow statement would the amount of cash paid for the van be reported?
3. By how much did Delft's cash increase or decrease during January?
4. Assuming that the amount of cash was \$100,000 at the beginning of January, how much cash did Delft have at the end of the month?
5. What was Delft's net income or net loss (after income tax expense) for the month of January? The income tax rate was 25%.
6. Explain why the net increase or decrease in cash for a business generally will be different than the net income, or net loss, for the same period.

1. Cash used in operating activities.	
2. Cash used in investing activities.	
3. Amount collected from customers	\$35,500
Payment of salaries	(15,300)
Payment of rent	(3,000)
Payment of other expenses	(8,500)
Payment for van	(25,000)
Decrease in cash	\$(16,300)

4. Amount of cash at the end of January:
\$100,000 – 16,300 = \$83,700

5. Revenues		\$40,000
Less expenses:		
Salaries expense	\$17,000	
Rent expense	3,000	
Other expenses	8,500	28,500
Income before taxes		11,500
Income taxes		2,875
Net income		\$ 8,625

6. Net income or net loss for a period is equal to revenues minus expenses; it is not equal to the change in cash. Revenues are reported on the income statement when the goods or services are sold to the customer, which may be before or after the period in which cash is received from the customer. Expenses are reported on the income statement in the period they are used to earn revenues. Again, the payment of cash may occur before or after the period when an expense appears on the income statement.

*Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #114*

115. Pool Supply, Inc., reported the following items for the year ended December 31, 20C:

Wages and salary expense	\$ 825,000
Cost of goods sold	1,400,000
Rent expense	490,000
Sales revenue	3,417,000
Interest expense	50,000
Income tax expense	161,000
Accounts receivable	25,000

Required:

Prepare an income statement for the year.

Pool Supply, Inc.
Income Statement
For the Year Ended December 31, 20C
(in dollars)

Revenue:		
Sales revenue	\$3,417,000	
Total revenues		\$3,417,000
Expenses:		
Cost of goods sold	1,400,000	
Wages and salary expense	825,000	
Rent expense	490,000	
Interest expense	50,000	
Total expenses		2,765,000
Pretax income		652,000
Income tax expense		161,000
Net income		\$ 491,000

Note: Accounts receivable of \$25,000 would appear on the balance sheet, not the income statement.

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #115*

116. Empire Stores, Ltd., reported the following amounts on its balance sheet on December 31, 20B:

Inventory	\$710,000
Notes payable	160,000
Cash	300,000
Share capital	900,000
Net property, plant and equipment	425,000
Accounts receivable	88,000
Accounts payable	131,000
Retained earnings	?

Required:

1. What is the amount of Empire's total assets at the end of 20B?
2. Identify the items listed above that are liabilities.
3. What is the amount of Empire's retained earnings at the end of 20B?
4. Prepare a balance sheet for Empire Stores as of December 31, 20B.
5. Empire Stores wishes to purchase merchandise from your company on account. The amount of the purchases would probably be about \$5,000 per month, and the terms would require Empire to make payment in full within 30 days. Would you recommend that your company grant credit to Empire under these terms? Explain the reasoning for your response.

1. Total assets = \$710,000 + 300,000 + 425,000 + 88,000 = \$1,523,000
2. Liabilities: Accounts payable and Notes payable.
3. Assets = Liabilities + Shareholder's equity
 $\$1,523,000 - (131,000 + 160,000 + \text{Shareholder's equity})$
Shareholder's equity = \$1,232,000 = Share capital + retained earnings
 $\$900,000 + \text{retained earnings} = \$1,232,000$
Retained earnings = \$332,000
- 4.

Empire Stores, LTD
Balance Sheet
At December 31, 20B
(in dollars)

Assets	
Cash	\$300,000
Accounts receivable	88,000
Inventory	710,000
Net property, plant and equipment	<u>425,000</u>
Total assets	<u>\$1,523,000</u>
Liabilities	
Accounts payable	\$131,000
Notes payable (Long-term)	<u>160,000</u>
Total liabilities	\$ 291,000
Shareholders' equity	
Share capital	\$900,000
Retained earnings	<u>332,000</u>
Total shareholders' equity	<u>\$1,232,000</u>
Total liabilities and shareholders' equity	<u>\$1,523,000</u>

5. The balance sheet of Empire Stores shows that the company is capable of paying its short-term liabilities. There is cash of \$300,000, more than enough to settle the accounts payable of \$131,000. I would recommend that my company grant credit to Empire Stores.

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #116*

117. During 20B, Wilmont Company performed services for which customers paid or promised to pay \$286,000. Of this amount, \$270,000 had been collected by year end. Wilmont paid \$125,000 in cash for employee wages and owed the employees \$5,000 at the end of the year for work that had been done but had not paid for. Wilmont paid interest expense of \$1,700 and \$80,000 for other service expenses. The income tax rate was 25%, and income taxes had not yet been paid at the end of the year. Wilmont declared and paid dividends of \$6,000. There were no other events that affected cash.

Required:

1. What was the amount of the increase or decrease in cash during the year?
2. Prepare an income statement for Wilmont for the year.
3. At the start of 20B, Wilmont reported retained earnings totalling \$940,000. Prepare a statement of retained earnings.

1. Amount of increase or decrease in cash:

\$270,000	Collected from customers
-125,000	Paid to employees
- 1,700	Interest expense
- 80,000	Other service expense
- 6,000	Dividends
\$ 57,300	Increase in cash

2.

Wilmont Company
Income Statement
For the Year Ended December 31, 20B
(in dollars)

Revenues:		
Service revenues	\$286,000	
Total revenues		\$286,000
Expenses:		
Wages expense	130,000	
Service expense	80,000	
Interest expense	1,700	
Total expenses		211,700
Pretax income		74,300
Income tax expense		18,575
Net income		\$ 55,725

3.

Wilmont Company
Statement of Retained Earnings
For the Year Ended December 31, 20B
(in dollars)

Retained earnings, January 1, 20B		\$940,000
Net income		55,725
Dividends		(6,000)
Retained earnings, December 31, 20B		\$989,725

*Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #117*

118. Alfred Company manufactures men's clothing. During 20B, the company reported the following items that affected cash. Indicate whether each of these items is a cash flow from operating activities (O), investing activities (I), or financing activities (F).
- Purchased equipment by paying cash: ____
- Collected cash on account from customers: ____
- Paid dividends to shareholders: ____
- Paid cash for supplies: ____
- Paid suppliers for fabric: ____
- Borrowed money from bank on a long-term note: ____
- Paid interest to bank on the note: ____
- Paid wages to employees: ____
- Sold shares to new shareholders: ____

Purchased equipment by paying cash: I
 Collected cash on account from customers: O
 Paid dividends to shareholders: F
 Paid cash for supplies: O
 Paid suppliers for fabric: O
 Borrowed money from bank on a long-term note: F
 Paid interest to bank on the note: O
 Paid wages to employees: O
 Sold shares to new shareholders: F

*Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #118*

119. Fulton Company was established on January 1, 20D when several investors paid a total of \$200,000 to purchase Fulton shares. No additional investments in shares were made during the year. By the end of that year, Fulton had cash on hand of \$45,000, office equipment (net) of \$40,000, inventories of \$156,000, and accounts payable of \$10,000. Sales for the year were \$812,000. Of this amount, customers still owed \$20,000. Fulton paid dividends of \$25,000 to its investors.

Required:

1. Based on the information above, prepare a balance sheet for Fulton Company as at December 31, 20D. In the process of preparing the balance sheet, you must calculate the ending balance in retained earnings.
2. Prepare a statement of retained earnings. (The beginning amount of retained earnings was \$0.)
3. What was the amount of Fulton's net income for the year?
4. Was Fulton successful during its first year in operation?

1.

Fulton Company
Balance Sheet
At December 31, 20D
(in dollars)

Assets	
Cash	\$ 45,000
Accounts receivable	20,000
Inventories	156,000
Office equipment	<u>40,000</u>
Total assets	<u>\$261,000</u>
Liabilities	
Accounts payable	\$ 10,000
Shareholders' equity	
Share capital	\$200,000
Retained earnings	<u>51,000</u>
Total shareholders' equity	<u>251,000</u>
Total liabilities and shareholders' equity	<u>\$261,000</u>

2.

Fulton Company
Statement of Retained Earnings
For the Year Ended December 31, 20D
(in dollars)

Retained earnings, January 1, 20D	\$ -0-
Net income	76,000
Dividends to shareholders	(25,000)
Retained earnings, December 31, 20D	\$51,000

3. \$76,000 (see statement of retained earnings above)

4. Yes, Fulton's first year was successful. The company earned a healthy amount of income, and many new companies have losses during their early years of operations. Also, it was able to pay dividends to its shareholders. At the end of the first year, the company has just \$10,000 in liabilities. It appears to be in sound financial condition.

*Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #119*

120. For Baggerly Fashions, the following information is available for the year ended December 31, 20C:

Sales revenue	\$5,500,000
Cost of goods sold	2,800,000
Salaries expense	1,100,000
Rent expense	620,000
Administrative expense	490,000

The income tax rate is 35%.

Required:

Prepare an income statement for Baggerly Fashions.

Baggerly Fashions
Income Statement
For the Year Ended December 31, 20C
(in dollars)

Revenue:	
Sales revenue	\$5,500,000
Total revenue	\$5,500,000
Expenses (excluding income taxes):	
Cost of goods sold	2,800,000
Salaries expense	1,100,000
Rent expense	620,000
Administrative expense	490,000
Total expenses	5,010,000
Pretax income	490,000
Less income tax expense	171,500
Net income	\$ 318,500

*Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #120*

121. Baseline Corporation was formed two years ago to manufacture fitness equipment. It has been profitable and is growing rapidly. It currently has 150 shareholders and 90 employees; most of the employees own at least a few shares of Baseline's shares. The company has received financing from two banks. It will sell additional shares within the next three months and will also seek additional loans and hire new employees to support its continued growth.

Required:

1. Explain who relies on the information in financial statements prepared by Baseline Corporation.

2. Why is compliance with generally accepted accounting principles and accuracy in accounting important for Baseline?

3. A new accountant who tried to prepare Baseline's financial statements at the end of the current year made several errors. For each of the following items, indicate how the income statement and balance sheet are affected by the error and the nature of the effect. (For example, an error might cause revenues and net income on the income statement and retained earnings and assets on the balance sheet to be overstated). Ignore the effects of income taxes.

- A. The company had sales for cash of \$3,000,000. It also had sales on account of \$1,800,000 that had been collected by the end of the year, and sales on account of \$200,000 that are expected to be collected early the following year. The accountant reported total sales revenue of \$4,800,000.
- B. The company had total inventories of \$600,000 at the end of the year. Of this amount, inventory reported at \$30,000 was obsolete and will have to be scrapped. The balance sheet prepared by the accountant showed total inventories of \$600,000.
- C. The company has a bank loan for which interest expense during the year of \$10,000 will be paid early in January of the next year. The accountant did not record either the interest expense or the related liability.
- D. An insurance policy was listed as an asset of \$6,000 at the beginning of the year. The entire amount of the policy was for the current year and the policy has expired. The accountant took no action to recognize the expiration of the policy.

1. Various external decision makers rely on the financial statements of a corporation. For Baseline, these decision makers include the bankers who have loaned money to the company. These creditors would monitor the performance of Baseline to estimate the likelihood that Baseline will be able to repay existing loans when they come due, and to decide whether to make additional loans to Baseline in the future. Current shareholders would want to review Baseline's financial statements to decide whether they wanted to continue to own Baseline's shares. Potential shareholders and creditors would use the information to decide whether they wanted to purchase Baseline's shares or loan money to the company in the future. Baseline anticipates hiring additional workers in the near future; potential employees might use information in the financial statements to evaluate the company as an employer.
2. Compliance with generally accepted accounting principles and accuracy in accounting are important to Baseline because they are important to the people who use Baseline's financial statements. To maintain the credibility of its financial statements, Baseline must comply with GAAP and must ensure the accuracy of its accounting records.
- 3.
- A. On the income statement, revenues are understated by \$200,000 and net income is understated. On the balance sheet, accounts receivable and retained earnings are understated.
- B. On the balance sheet, inventory and retained earnings are overstated by \$30,000. On the income statement, expenses are understated and the net income is overstated.
- C. On the income statement, expenses are understated and net income is overstated by \$10,000. On the balance sheet, interest payable is understated and retained earnings are overstated.
- D. On the balance sheet, prepaid insurance and retained earnings are overstated by \$6,000. On the income statement, expenses are understated and net income is overstated.

Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #121

122. Lloyd Company ends the first year of operations with \$2.2 million in retained earnings when no dividends were paid out. Since the company began operations on January 1st, 20B of the current year ending December 31st, 20B calculate the amount of beginning retained earnings and explain your answer.

The beginning balance of retained earnings is zero because a new business would not have generated income from prior operations. Retained earnings represents the net income generated through operations not distributed in the form of a dividend. A company just beginning operations could not have any earnings so there would always be a zero beginning balance for new companies.

Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #122

123. Alcorn Corp. has just published their financial information for the year on the company's website. Their reported earnings are \$25.0 million and average common shares outstanding are 5.0 million. Answer the following:
- (a) How much is earnings per share on the common shares?
- (b) If the website shows the common shares is currently trading at \$75 per share, what is the price earnings (P/E) ratio?
- (c) A group of investors is seeking to buy all the Alcorn shares. Using the above information, determine an offering price.

(a) The earnings per share is \$5 per share computed by dividing the net income of \$25 million by the number of shares outstanding, 5.0 million shares. (b) The price earnings ratio is 15 to 1 computed by dividing the market price per share by the earnings per share amount (\$75 divided by \$5). (c) The investors could take the current level of earnings \$25 million multiplied times the price earnings ratio of 15 to estimate a beginning price in negotiating the purchase of the company of \$375 million.

Difficulty: Hard
Learning Objective: 1
Libby - Chapter 01 #123

124. Match the model with the financial statement by inserting the proper letter in the space to the left.
 (A = Assets, L = Liabilities, SE = Shareholders' equity, R = Revenue, NI = Net Income, E = Expenses)

- | | | |
|-----------------------------------|------------------------------|----------|
| 1. Balance sheet | R - E = NI | <u>2</u> |
| 2. Income statement | None of the above is correct | <u>3</u> |
| 3. Statement of cash flows | A = L + SE | <u>1</u> |
| 4. Statement of retained earnings | None of the above is correct | <u>4</u> |

Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #124

125. Match each definition with its related term or abbreviation by entering the appropriate letter in the space provided.

- | | | |
|--------------------|---|----------|
| 1. Cost principle | A system that collects and processes financial information about an organization and reports that information to decision makers. | <u>6</u> |
| 2. Separate entity | The organization for which financial data are to be collected (separate and distinct from its owners). | <u>2</u> |
| 3. Publicly traded | A report that describes the auditors' opinion of the fairness of the financial statement presentations and the evidence gathered to support that opinion. | <u>5</u> |
| 4. Unit of measure | Initial recording of financial statement elements at acquisition cost. | <u>1</u> |
| 5. Audit report | Measurement of information about an entity in the monetary unit—dollars or other national currency | <u>4</u> |
| | Company that can be bought and sold by investors on established stock | |

6. Accounting

exchanges 3

Difficulty: Medium
Learning Objective: 1
Libby - Chapter 01 #125

126. Match each element with its financial statement by entering the appropriate letter in the space provided.

1. Cash flow from operations	Cash Flow Statement	<u>1</u>
2. Dividends	Balance Sheet	<u>4</u>
3. Assets	Income Statement	<u>5</u>
4. Liabilities	Balance Sheet	<u>3</u>
5. Revenues	Cash Flow Statement	<u>8</u>
6. Cash flow from financing	Income Statement	<u>7</u>
7. Expenses	Balance Sheet	<u>9</u>
8. Cash flow from investments	Cash Flow Statement	<u>6</u>
9. Shareholders' Equity	Statement of Retained Earnings	<u>2</u>

Difficulty: Easy
Learning Objective: 1
Libby - Chapter 01 #126

127. Match each definition with its related term or abbreviation by entering the appropriate letter in the space provided.

1. CICA	Ontario Securities Commission	<u>4</u>
2. AcSB	Canadian Institute of Chartered Accountants.	<u>1</u>
3. GAAP	Financial Accounting Standards Board	<u>2</u>
4. OSC	Chartered Accountant	<u>5</u>
5. CA	Generally accepted accounting principles	<u>3</u>

Difficulty: Easy
Learning Objective: 2
Libby - Chapter 01 #127

128. Match the characteristics with the type of business by inserting the proper letter in the space to the left.

1. Sole proprietorship	Ownership is represented by shares.	<u>2</u>
2. Corporation	Ownership is limited to one person.	<u>1</u>
3. Partnership	Each owner is responsible for the debts of the entity.	<u>3</u>

Difficulty: Easy
Learning Objective: Appendix 1A
Libby - Chapter 01 #128

129. Match the definition with the form of organization by inserting the proper letter in the space to the left.

1. Sole proprietorship	Each owner has unlimited liability for the debts of the entity.	<u>2</u>
2. Partnership	The owners are known as shareholders and enjoy limited liability.	<u>3</u>
3. Corporation	The manager is often the owner and does not enjoy limited liability.	<u>1</u>

Difficulty: Medium
Learning Objective: Appendix 1A
Libby - Chapter 01 #129

1 Summary

<u>Category</u>	<u># of Questions</u>
Difficulty: Easy	56
Difficulty: Hard	20
Difficulty: Medium	53
Learning Objective: 1	99
Learning Objective: 2	10
Learning Objective: 3	8
Learning Objective: 4	2
Learning Objective: Appendix 1A	9
Learning Objective: Appendix 1B	1
Libby - Chapter 01	129