

Test Bank for Financial Accounting A Critical Approach CANADIAN Canadian 4th Edition by
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02. Financial Statements: A Window on an Entity

1. Which of the following statements best describes the IFRS conceptual framework?
 - A. It provides a set of rules for accountants to follow.
 - B. It provides concepts, since accounting is based on nature of law.
 - C. It helps equity investors interpret the earnings per share.
 - D. It provides a basis for preparing and presenting financial statements.

2. Financial information is relevant for all of the following reasons *except*:
 - A. for making predictions about the future cash flows
 - B. for making comparisons with industry data.
 - C. to determine the liquidation values of capital assets
 - D. for confirming or correcting past evaluations.

3. The use of a company's financial statements to assess a new share offering would rely most heavily on which of the following characteristics of information?
 - A. Verifiability
 - B. Relevance
 - C. Going concern assumption
 - D. Unit of measure assumption

4. Which of the following is an objective of general purpose financial reporting?
 - A. To provide information about an entity's economic resources, obligations, and equity/net assets.
 - B. To provide information that is helpful to investors, creditors and other users in making resource allocation decisions and/or assessing management stewardship.
 - C. To provide information that is useful in assessing the economic performance of the entity.
 - D. All of these are objectives of financial reporting.

5. Financial information does not demonstrate comparability when:
 - A. companies in the same industry use different accounting policies to account for the same type of transaction.

B. one company changes its estimate of the residual value of a fixed asset while the other company does not

change it.

C. one company fails to adjust its financial statements for changes in the fair value of short term investments, while the other company makes the adjustment.

D. both companies use different suppliers.

6. The transition to International Financial Reporting Standards can be seen as enhancing which of the following qualitative characteristics?

- A. Verifiability
- B. Comparability
- C. Understandability
- D. Timeliness

7. Anvilles Inc. manufactures metal sheets for construction. Mr. Anvilles, the sole shareholder, arranges to transport two hundred metal sheets to the family cottage in Mont Orford. He tells the bookkeeper to record the cost of the metal sheets as cost of goods sold.

Which of the following qualitative characteristics of accounting information has *not* been respected?

- A. Both verifiability and the entity concept
- B. Both the unit of measure assumption and faithful representation
- C. Both faithful representation and the entity concept
- D. Both relevance and the unit of measure assumption

8. Mr. Switch, a local business man, owns two different businesses—a lumber sawmill and a restaurant. The price of lumber has declined and therefore sawmill is in financial difficulty. However, the restaurant is thriving, and Mr. Switch would like to start paying two of the sawmill employees under the restaurant's payroll. His accountant explains that this is *not* in accordance with certain basic principles in accounting. Which principle is he referring to?

- A. Full disclosure
- B. Periodic-reporting assumption
- C. Entity concept
- D. Unit-of-measure assumption

9. One drawback to the unit-of-measure assumption is:

- A. it inhibits an assessment of going concern.
- B. information about individual items being measured is lost.
- C. it makes it easier to measure certain assets, such as intellectual property, human capital, and social costs.
- D. it makes it harder to measure transactions.

10. The assumption that a business enterprise will not be sold or liquidated in the near future is known as the:

- A. entity concept.
- B. unit-of-measure assumption.
- C. going-concern assumption.
- D. periodic-reporting assumption.

11. When assessing general purpose financial statements, the financial analyst takes into consideration the fact that many important assets may not be included in the company's statement of financial position, such as human resource capital, intellectual property and social responsibility. This limitation is the result of applying which of the following characteristics of financial information?

- A. Entity concept
- B. Unit-of-measure assumption
- C. Going-concern assumption
- D. Periodic-reporting assumption

12. Which of the following statements about general purpose financial statements is correct?

- A. General purpose financial statements are designed to meet the information needs of every stakeholder in every situation.
- B. every stakeholder in every situation.
- C. General purpose financial statements provide information to all stakeholders.
- D. General purpose financial statements are intended for specific use only.
- E. The financial statements of non-public companies are general purpose financial statements.

13. How often do companies prepare general purpose financial statements?

- A. At least once a year.
- B. Only when asked for by a stakeholder.
- C. Every time management needs to make a financial decision.
- D. As often as GAAP requires.

14. The best description of the financial statements that a public company prepares is:

- A. tax-based financial statements.
- B. specific purpose financial statements.
- C. general principle financial statements.
- D. general purpose financial statements.

15. General purpose financial statements include which of the following sets of statements?

- A. Balance statement, income statement, statement of long-term debt, cash flow statement
- B. Balance sheet, income statement, statement of shareholders' equity, cash flow statement
- C. Balance sheet, income statement, statement of shareholders' equity, statement of long-term debt
- D. Balance statement, income statement, statement of retained earnings, cash balance

16. What does the term "consolidated" mean when used to describe financial statements?

- A. Consolidated means that financial statements are presented for two years.
- B. Consolidated means that the financial statements have been approved by an auditor.
- C. Consolidated means that the five financial statements have been totalled together.
- D. Consolidated means that the financial statements contain the information of more than one company.

17. Sun Company owns 75% of Moon Inc., how would Sun's financial statements be prepared?

- A. On a consolidated basis.
- B. On a specific purpose basis.
- C. On a subsidiary basis.
- D. On a financial basis.

18. Why are financial statements prepared on a comparative basis?

- A. To provide users with easy comparison with the industry.
- B. To provide users with a perspective on the economy.
- C. Because making comparisons using accounting information can be difficult and misleading.
- D. Because making comparisons significantly contributes to the interpretation of accounting information.

19. Which of the following statements about a fiscal year is true?

- A. It is the same for all companies in the same industry.
- B. It is the financial accounting term used to describe the calendar year.
- C. It is a 12-month period ending any time in the calendar year.
- D. It is the period covered by the balance sheet.

20. Which financial statement is a snapshot at a point in time?

- A. Balance sheet
- B. Income statement
- C. Statement of changes in equity
- D. Cash flow statement

21. Which of the following statements best describes the balance sheet?

- A. It provides information about the financial position of an entity at a specific point in time.
- B. It measures the economic performance of the entity over a period of time.
- C. It summarizes only the changes to retained earnings during a period.
- D. It shows how an entity managed its cash during the reporting period.

22. Which of the following statements best describes the statement of comprehensive income?

- A. It provides information about the financial position of an entity at a specific point in time.
- B. It measures economic events that involve non-owners but affect equity.
- C. It summarizes the changes to shareholders' equity during a period.
- D. It is an extension of the balance sheet.

23. Which of the following statements best describes the income statement?

- A. It provides information about the financial position of an entity at a specific point in time.
- B. It measures the economic performance of the entity over a period of time.
- C. It summarizes the changes to retained earnings during a period.
- D. It shows how an entity managed its cash during the reporting period.

24. Which of the following statements best describes the Statement of Changes in Equity?

- A. It provides information about the financial position of an entity at a specific point in time.
- B. It measures the economic performance of the entity over a period of time.
- C. It summarizes the changes to shareholders' equity during a period.
- D. It shows how an entity managed its cash during the reporting period.

25. Which of the following statements best describes the cash flow statement?

- A. It provides information about the financial position of an entity at a specific point in time.
- B. It measures the economic performance of the entity over a period of time.
- C. It summarizes the changes to retained earnings during a period.
- D. It shows how an entity managed its cash during the reporting period.

26. Which of the following statements about the cash flow statement is true?

- A. The cash flow statement reports what the net income would be if the cash basis of accounting had been followed.
- B. The cash flow statement deals with cash, an asset; therefore, the cash flow statement is a snapshot statement just like the balance sheet.
- C. The cash flow statement does not have to be included in general purpose financial statements.
- D. The cash flow statement shows how the company managed its money for the period from more than just operations.

27. The bookkeeper at Walin Ltd. has prepared a list of all the property, plant and equipment the company owns, including their original cost to the company and how much has been depreciated to date. Where will this information most likely be included in the company's general purpose financial statements?

- A. On the balance sheet.
- B. In the cash flow statement.
- C. In the notes to the financial statements.
- D. This information will not be included in the company's general purpose financial statements.

28. Brantford Business Ltd. (BBL) has a loan outstanding from a Canadian bank. It uses the loan to finance its working capital. The bank has asked for BBL to provide it with monthly listings of their accounts receivables and inventory items. The requested listing is an example of:

- A. a special purpose report.
- B. a general purpose report.
- C. a balance sheet report.
- D. a cash flow report.

29. What is the accounting equation?

- A. $\text{Assets} + \text{Liabilities} = \text{Owners' Equity}$
- B. $\text{Assets} = \text{Liabilities} - \text{Owners' Equity}$
- C. $\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$
- D. $\text{Assets} + \text{Owners' Equity} = \text{Liabilities}$

30. In 2012, Smith's Corner Store had an increase in gross margin of \$28,000; however, the gross margin percentage decreased. This is most likely caused by:

- A. a decrease in volume and a decrease in selling price
- B. an increase in volume and an increase in selling price.
- C. an increase in volume and a decrease in selling price.
- D. a decrease in volume and an increase in selling price.

31. Mats owns and operates a small advertising business from an office. His home is worth \$400,000, his business assets are worth \$275,000, and his business obligations total \$65,000. How much equity does he have in his advertising business?

- A. \$210,000
- B. \$335,000
- C. \$340,000
- D. \$610,000

32. Whitefish Inc. bought a building worth \$750,000. They paid \$150,000 in cash and borrowed the remainder from a bank. What is the effect of this transaction on the accounting equation?

- A. Assets increases by \$750,000 and liabilities increases by \$750,000.
- B. Assets increases by \$750,000 and liabilities increases by \$660,000.
- C. Assets increases by \$600,000 and liabilities increases by \$750,000.
- D. Assets increases by \$600,000 and liabilities increases by \$600,000.

33. Trout Co. ordered and received inventory worth \$45,000 on credit. What is the effect of this transaction on the accounting equation?
- A. Assets increases by \$45,000 and liabilities increases by \$45,000.
 - B. Assets increases by \$45,000 and liabilities decreases by \$45,000.
 - C. Assets decreases by \$45,000 and liabilities increases by \$45,000.
 - D. Assets decreases by \$45,000 and liabilities decreases by \$45,000.
34. A shareholder invested \$75,000, made up of \$50,000 in cash and a vehicle worth \$25,000, in a new company and received shares in exchange. What is the effect of this transaction on the accounting equation?
- A. Assets increases by \$75,000 and owners' equity increases by \$75,000.
 - B. Assets increases by \$75,000 owners' equity increases by \$50,000, and liabilities increases by \$25,000.
 - C. Assets increases by \$50,000 and owners' equity increases by \$50,000.
 - D. Assets increases by \$50,000 and liabilities increases by \$50,000.
35. Sam's Snow Removal received \$500 at the beginning of the winter to cover the fees for the entire winter for cleaning a customer's driveway while they went to Florida for the season. What is the effect of this transaction on the accounting equation?
- A. Assets increases by \$500 and owners' equity increases by \$500.
 - B. Assets increases by \$500 and liabilities increases by \$500.
 - C. Liabilities increases by \$500 and owners' equity increases by \$500.
 - D. The increase and decrease in assets offset each other.
36. If an entity pays off an amount owed to a supplier, what is the effect on the accounting equation?
- A. Assets and liabilities both increase.
 - B. Assets and liabilities both decrease.
 - C. Assets and owners' equity both decrease
 - D. There is no effect on the accounting equation.
37. If an entity receives cash from a customer for payment of an amount owing to them, what is the effect on the accounting equation?
- A. Assets and liabilities both increase.
 - B. Assets and liabilities both decrease.
 - C. Assets and owners' equity both decrease
 - D. There is no effect on the accounting equation.

38. If a company pays rent for the next period in advance, what is the effect of the transaction on the accounting equation?
- A. Assets decrease, and liabilities decrease.
 - B. Assets decrease, and owners' equity decrease.
 - C. Assets increase, and liabilities increase.
 - D. There is no effect on the accounting equation.
39. Which of the following correctly describes an asset?
- A. An obligation of the entity
 - B. An investment the owners have made
 - C. An economic resource that provides future benefits
 - D. An economic sacrifice made to earn revenue
40. Which of the following correctly describes a liability?
- A. An obligation of the entity
 - B. An investment the owners have made
 - C. An economic resource that provides future benefits
 - D. An economic sacrifice made to earn revenue
41. Which of the following would be considered as an asset for accounting purposes?
- A. Employees who work for the company
 - B. Research into new products for the company
 - C. A building owned by the company but rented out
 - D. Advertising spent on attracting customers to the company
42. Which of the following is a non-current asset?
- A. Accounts receivable
 - B. Inventory
 - C. Prepaid rent
 - D. Intangible assets
43. Which of the following statements about current liabilities is true?
- A. Current liabilities are always less than current assets.
 - B. Current liabilities are amounts from non-operating activities only.
 - C. Current liabilities will be paid or satisfied within an operating cycle.
 - D. Current liabilities are legal obligations of the company.

44. Pike Ltd. bought a new delivery truck for its business. The truck sells for \$75,000, because Pike bought a demonstrator model, they paid \$65,000 only. While driving it home from the sales lot, the driver had an accident, and damages were estimated at \$1,000. At what value should the truck be recorded on Pike's statement of financial position?

- A. \$64,000
- B. \$65,000
- C. \$66,000
- D. \$75,000

45. What are direct investments by shareholders in a company called?

- A. Dividends
- B. Capital stock
- C. Retained earnings
- D. Investments

46. What is a payment of cash to a corporation's shareholders called?

- A. A liability
- B. A dividend
- C. A deficit
- D. An expense

47. Which of the following is an indirect investment by a shareholder?

- A. The cash paid for shares.
- B. A plot of land exchanged for shares.
- C. The net income retained by the company.
- D. The dividends paid to shareholders.

48. What does the term "deficit" mean in the context of general purpose financial statements?

- A. A deficit is when the net income is negative.
- B. A deficit is when the retained earnings balance is negative.
- C. A deficit is when the current liabilities exceed the current assets.
- D. A deficit is when a company borrows money.

49. Which of the following statements about the payment of dividends is true?

- A. They are reported in the cash from operations.
- B. They are reported in the cash from financing activities.
- C. They are reported in the cash from investing activities.
- D. They are reported as an expense on the income statement.

50. If a company made a principal repayment on a long-term loan, which of the following statements about the repayment is true?
- A. It is reported in the cash from operations.
 - B. It is reported in the cash from financing activities.
 - C. It is reported in the cash from investing activities.
 - D. It is reported as an expense on the income statement.
51. Which of the following statements about an operating cycle is true?
- A. For all businesses the operating cycle is a year or less.
 - B. The operating cycle is useful in defining current assets.
 - C. The operating cycle is the difference between revenues and operating expenses.
 - D. An operating cycle is the time it takes from the sale of inventory until the collection of cash.
52. Which of the following industries would most likely have an operating cycle longer than a year?
- A. A grocery store
 - B. A wine producer
 - C. A soft drinks producer
 - D. A car manufacturer
53. Which of the following would be classified as inventory?
- A. Cars in the fleet of a car rental company
 - B. Cars in the fleet of a pizza delivery company
 - C. Land held for expansion by a retail company
 - D. Land on which a retail company owns a building
54. Which of the following is *not* a liability?
- A. The amount owing to a supplier
 - B. A warranty sold with a product
 - C. The amount owing for next month's rent
 - D. A cash deposit received on a sale for next month
55. Which of the following correctly describes an expense?
- A. An obligation of the entity.
 - B. An investment the owners have made in the business.
 - C. An economic resource that provides future benefits.
 - D. An economic sacrifice made to earn revenue.

56. Bass Ltd. borrowed \$100,000 from a bank. They will repay \$10,000 a year for the next ten years plus 5% interest. How would the loan be initially recorded on Bass's statement of financial position?

- A. \$100,000 non-current liability
- B. \$100,000 current liability
- C. \$10,000 current liability and \$90,000 non-current liability
- D. \$15,000 current liability and \$90,000 non-current liability

57. Which of the following can you find in the notes to the financial statements?

- A. A list of all the stakeholders of the entity.
- B. A summary of the entity's significant accounting policies.
- C. A summary of the special purpose reports prepared
- D. Management's discussion of the results of the entity.

58. Gifts Galore is a souvenir shop. They have just paid \$2,000 for the exclusive rights to sell the latest hot fad "Talking Toads". They estimate the fad should last about six months. They also paid \$250,000 to be the exclusive carrier of Olympic souvenirs for the next four years. How would each of these intangible assets be reported on the balance sheet?

Talking Toads	Olympic Souvenirs
A) Current asset	Current asset
B) Current asset	Non-current asset
C) Non-current asset	Current asset
D) Non-current asset	Non-current asset

- A. Option A
- B. Option B
- C. Option C
- D. Option D

59. Yamaska just purchased a restaurant from a company that went out of business. They are going to sell off all the furniture, tables and chairs that came with it, because they are going to redecorate it with a new theme. How would the building and the furniture be reported on the balance sheet?

Building	Furniture
A) Current asset	Current asset
B) Current asset	Non-current asset
C) Non-current asset	Current asset
D) Non-current asset	Non-current asset

- A. Option A
- B. Option B
- C. Option C
- D. Option D

60. Massawippi Inc. owes a supplier \$10,000. They have signed a note payable for the amount, promising to repay it in six months with interest. They also have a loan outstanding that, starting next year, they will repay in annual instalments over the next five years. How would the note payable and the loan be reported on the balance sheet?

Note Payable	Loan
A) Current liability	Current liability
B) Current liability	Non-current liability
C) Non-current liability	Current liability
D) Non-current liability	Non-current liability

- A. Option A
- B. Option B
- C. Option C
- D. Option D

61. Which of the following correctly identifies one of the links among the four financial statements?

- A. Net income from the income statement goes directly to the balance sheet.
- B. Net income from the income statement goes to the statement of changes in equity.
- C. Other comprehensive income goes to the statement of cash flows.
- D. Retained earnings from the balance sheet goes to the income statement.

62. Because of the links among financial statements, they must be prepared in order. Which of the following correctly describes the order of preparation?

- A. Income statement, statement of comprehensive income, statement of changes in equity, and balance sheet.
- B. Income statement, balance sheet, statement of comprehensive income, and statement of changes in equity.
- C. Balance sheet, income statement, and statement of changes in equity.
- D. Balance sheet, statement of changes in equity, income statement, and statement of comprehensive income.

63. The opening balance of retained earnings for Musicala Inc. was \$325,000. During the year, it earned net income of \$52,400 and paid dividends of \$16,000. What is the closing balance of retained earnings?

- A. \$256,600
- B. \$309,000
- C. \$361,400
- D. \$377,400

64. The opening balance of shareholders' equity for Sedona Transport was \$530,000. During the year, Sedona issued 50,000 common shares at market price of \$3.50 per share. The company earned net income of \$152,400, recorded other comprehensive income of (\$2,300), and paid dividends of \$10,000. What is the closing balance of shareholders' equity?
- A. \$670,100
 - B. \$847,400
 - C. \$845,100
 - D. \$877,400
65. Lennox Limited reported sales of \$5,000,000, cost of goods sold of \$3,200,000, operating expenses of \$1,400,000, and income tax expense of \$160,000 for the year. What is the gross profit for the year?
- A. \$240,000
 - B. \$400,000
 - C. \$1,800,000
 - D. \$3,200,000
66. Lennox Limited reported sales of \$5,000,000, cost of goods sold of \$3,200,000, operating expenses of \$1,400,000, and income tax expense of \$160,000 for the year. What was their net income for the year?
- A. \$240,000
 - B. \$400,000
 - C. \$1,800,000
 - D. \$3,200,000
67. The opening balances of capital stock and retained earnings for a company were \$2,200,000 and \$1,325,000, respectively. During the year, they earned net income of \$425,000, the shareholders invested an additional \$500,000 for shares and the company paid dividends of \$42,000. What was the closing amount of shareholders' equity?
- A. \$1,708,000
 - B. \$2,208,000
 - C. \$3,908,000
 - D. \$4,408,000
68. Sherbrooke Inc. reported sales of \$10,000,000, net income of \$800,000, and dividends of \$200,000. What is the increase in their retained earnings for the year?
- A. \$600,000
 - B. \$800,000
 - C. \$1,000,000
 - D. \$10,000 000

69. During the past year Ascot Company made credit sales of \$450,000, cash sales of \$275,000, and collected \$50,000 of deposits on future orders. What amount should they report as revenue on their income statement?
- A. \$275,000
 - B. \$325,000
 - C. \$725,000
 - D. \$775,000

70. Today, a company sold \$1,000 of goods on credit. The customer took the goods with him, but will only pay in 30 days. When would the sale be reflected under the cash basis of accounting and the accrual basis of accounting?

- | <u>Cash Basis</u> | <u>Accrual Basis</u> |
|-------------------|----------------------|
| A) today | today |
| B) today | at collection |
| C) at collection | today |
| D) at collection | at collection |
- A. Option A
 - B. Option B
 - C. Option C
 - D. Option D

71. When a sale on credit is made under the cash basis of accounting, at the time of the sale, how is the transaction recorded?

- A. An increase in assets and an increase in liabilities
- B. An increase in assets and an increase in revenues
- C. An increase in liabilities and an increase in revenues
- D. It is not recorded.

72. When a sale on credit is made under the accrual basis of accounting, at the time of the sale, how is the transaction recorded?

- A. An increase in assets and an increase in liabilities
- B. An increase in assets and an increase in revenues
- C. An increase in liabilities and an increase in revenues
- D. It is not recorded.

73. Which of the following statements about depreciation is true?

- A. Depreciation is the allocation of the cost of equipment to expense.
- B. Depreciation represents the reduction in the market value of the asset.
- C. Depreciation is the cash paid each month to use a piece of equipment.
- D. Depreciation is the same under both cash-based and accrual-based accounting.

74. An employee worked for a small business during the current month but he will not be paid until the next month. If the business uses accrual accounting, what would be the effect on the accounting equation in the current month?
- A. Assets decrease and liabilities decrease.
 - B. Liabilities increase and owners' equity increases.
 - C. Liabilities increase and owners' equity decreases.
 - D. There is no effect at this time.
75. An employee worked for a small business during the current month but will not be paid until the next month. If the business uses cash accounting, what would be the effect on the accounting equation in the current month?
- A. Assets decrease and liabilities decrease.
 - B. Liabilities increase and owners' equity increases.
 - C. Liabilities increase and owners' equity decreases.
 - D. There is no effect at this time.
76. When a company makes a sale under accrual accounting, what is the impact on the balance sheet?
- A. Assets increase
 - B. Assets decrease
 - C. Assets and owners' equity both increase
 - D. The increase and decrease in assets offset each other
77. If an entity suffered a \$2,000 loss for the month, which of the following statements is most likely true?
- A. The company's cash decreased \$2,000.
 - B. The company's shareholders need to invest \$2,000.
 - C. The costs incurred during the month exceeded the benefits.
 - D. Not all of the revenues were collected during the month.
78. Creditors who are expecting to be paid are most interested in which of the following for an entity?
- A. Liquidity
 - B. Operating cycle
 - C. Gross margin
 - D. Profitability
79. What would a creditor calculate to assess liquidity?
- A. Operating cycle
 - B. Gross margin
 - C. Current ratio
 - D. Debt-to-equity ratio

80. A company has current assets of \$200,000 and current liabilities of \$150,000. If they used cash to pay off some accounts payable, what would the effect be on their current ratio?
- The current ratio would increase.
 - The current ratio would decrease.
 - The current ratio would stay the same.
 - The effect on the current ratio would depend on the amount paid.
81. A company has current assets of \$200,000 and current liabilities of \$150,000. If they used cash to pay off some accounts payable what would the effect be on their working capital?
- Their working capital would increase.
 - Their working capital would decrease.
 - Their working capital would stay the same.
 - The effect on the working capital would depend on the amount paid.
82. If a company has a current ratio of 0.82, which of the following statements would be true?
- The company is a serious credit risk and should not be lent money.
 - The company's current ratio is below the industry average.
 - The company's working capital cannot be calculated.
 - The company's working capital is negative.
83. If a stakeholder wanted to measure the risk of a company, which of the following would they calculate?
- Liquidity
 - Operating cycle
 - Profitability
 - Debt-to-equity ratio
84. If a company used some cash and a long-term loan to buy land and a building, what would be the effect on the company's current ratio and debt-to-equity ratio?
- | Current Ratio | Debt-to-Equity Ratio |
|----------------------|-----------------------------|
| A) increase | increase |
| B) increase | decrease |
| C) decrease | increase |
| D) decrease | decrease |
- Option A
 - Option B
 - Option C
 - Option D

85. If a company used some cash to pay off some long-term liabilities, what would be the effect on the company's current ratio and debt-to-equity ratio?

**Current
Ratio**

- A) increase
- B) increase
- C) decrease
- D) decrease

**Debt-to-Equity
Ratio**

- increase
- decrease
- increase
- decrease

- A. increase increase
- B. increase decrease
- C. decrease increase
- D. decrease decrease

86. If a company sold shares for cash, what would be the effect on the company's current ratio and debt-to-equity ratio?

**Current
Ratio**

- A) increase
- B) increase
- C) decrease
- D) decrease

**Debt-to-Equity
Ratio**

- increase
- decrease
- increase
- decrease

- A. Option A
- B. Option B
- C. Option C
- D. Option D

87. If a company bought inventory on account, what would be the effect on the company's current ratio and debt-to-equity ratio?

**Current
Ratio**

- A) increase
- B) increase
- C) decrease
- D) decrease

**Debt-to-Equity
Ratio**

- increase
- decrease
- increase
- decrease

- A. Option A
- B. Option B
- C. Option C
- D. Option D

88. If an analyst wanted to compare the operating performance of two retail companies, which of the following would be most useful?

- A. Current ratio
- B. Operating cycle
- C. Debt-to-equity
- D. Gross margin percentage

89. For which of the following ratios would a *decrease* in the ratio normally imply an improvement in the company's performance?

- A. Current ratio
- B. Profitability ratio
- C. Gross margin percentage
- D. Debt-to-equity ratio

90. Lennox Limited reported sales of \$5,000,000, cost of goods sold of \$3,200,000, operating expenses of \$1,400,000, and income tax expense of \$160,000 for the year. What is the gross profit percentage for the year?

- A. 4.8%
- B. 8%
- C. 36%
- D. 64%

91. Classify each of the following cash transactions as an operating, financing or investing activity:

- A) wages paid to employees
- B) dividends paid to shareholder
- C) loan repaid to shareholder
- D) purchase of office equipment
- E) payment of rent

92. Classify each of the following balance sheet items as a current asset, non-current asset, current liability or non-current liability.

- A) cash
- B) a 10-year loan owing to a bank
- C) an amount owing to a supplier due in 30 days
- D) land purchased for immediate resale by a real estate developer
- E) a delivery truck

93. Classify each of the following balance sheet items as a current asset, non-current asset, current liability, or non-current liability.

- A) Dividends declared but not yet paid to shareholders
- B) Wages owing to employees
- C) A loan owing to a shareholder that will be repaid in two years
- D) Land purchased for expansion by a retailer
- E) An amount owing from a customer due in 15 months

94. Why is the cash basis of accounting not used when preparing general purpose financial statements? What is used instead?

95. Differentiate between an asset and an expense. Use the example of a table and chairs and explain how each could be either an asset or an expense.

96. Tim has decided to run a lawn service business for the summer. He charges customers \$100 per month to mow and maintain their lawns. In May he was able to get 10 contracts signed, for services starting June 1st. On June 1st he collected \$100 from each of seven customers and \$300 from the other three, who will all be out of town for the summer so have paid for all three months at once. Tim bought a second-hand mower for the summer for \$240, which he picked up in May but didn't pay for until June, when he had some cash available. He estimates that it will be completely worn out by the end of the summer. He mowed and maintained the lawns for June and paid \$50 for gas for his mower.

Required:

- A) What is Tim's net income for June under the cash basis of accounting?
- B) What is Tim's net income for June under the accrual basis of accounting?
- C) What is Tim's expected net income for the summer under the cash basis of accounting?
- D) What is Tim's expected net income for the summer under the accrual basis of accounting?
- E) Which method is more appropriate for Tim? Support your answer.

97. Prepare a proper balance sheet for Wawa Corporation from the following list of accounts on June 30, 2012:

Accounts payable	105,000	Land	175,000
Accounts receivable	52,500	Long-term loan	150,000
Advances received from customers in advance	35,000	Plant and equipment	375,000
Capital Stock	250,000	Rent paid in advance	15,000
Cash	15,000	Retained earnings	144,000
Current portion of long-term loan	50,000	Wages and salaries owing	18,500
Inventory	120,000		

98. Wasago is in its first year of operation, and the bookkeeper has prepared the following summary of all of their accounts and balances as at August 31, 2012. Prepare a proper balance sheet for Wasago Corporation.

Accounts payable	26,000	Investment by	
Accounts receivable	36,000	shareholders	25,000
Bank loan, short-term	12,000	Loans made to company	
Cash	2,000	by shareholders	25,000
Income tax expense	7,500	Operating expenses	182,500
Income taxes payable	7,500	Office equipment	45,000
Insurance paid in advance	5,000	Sales revenues	212,500
Inventory	30,000		

99. The following is a list of accounts for Carleton Corporation for the year ended October 31, 2012.

Advertising expense	\$130,000
Amortization expense	90,000
Cost of sales	545,000
General and administrative expenses	158,000
Income tax expense	105,000
Interest expense	60,000
Research expense	100,000
Sales revenue	1,900,000
Sales commissions	190,000
Salaries expense	376,000

Required:

- Prepare an income statement for Carleton for the year.
- What is Carleton's gross margin for the year?
- What is Carleton's gross margin percentage for the year?

100. Emily has been out of school and working as a physiotherapist for four years. She is in the process of buying a condo and is applying for a mortgage from the Canadian Bank. The bank has asked for a personal balance sheet for Emily before making its decision. She has come to you for help and has provided you with the following information:

- i) Emily bought a car four years ago for \$15,000. She borrowed the money from her parents, interest free, and still owes them \$3,000 and makes monthly payments of \$250. She estimates the car is worth about \$5,000 now.
- ii) Emily has \$1,800 in her checking account and \$12,000 in Canada Savings Bonds (CSBs), which she will use for the down payment on the condo.
- iii) Emily owns some jewellery given to her after her grandmother passed away. Although it is priceless to Emily the local jeweller says it is worth \$3,500.
- iv) Emily worked some overtime at another clinic over the recent holidays and is owed \$2,500 for it.
- v) Emily has a music player and CD collection worth about \$1,000.
- vi) Emily has old furniture in her current apartment that she paid \$500 for but is hoping to buy some new things to go with her new place. She hopes a charity will come and take all of the old stuff away.
- vii) Emily has a \$500 balance on her credit card but pays it off every month.

Required:

- A) Prepare a personal balance sheet for Emily. She wants you to explain why things were or were not included so that she could do it herself next time.
- B) How will the Canadian Bank use the information to help it make a decision?
- C) What, if any, other information would the bank like to have?

101. Below are partial income statements for Haliburton Ltd. for three years.

Haliburton Ltd
Income Statement
For the year ended August 31,
(in thousands of dollars)

	2013	2012	2011
Revenue	\$26,200	\$25,000	\$ <input type="text"/>
Cost of sales	<input type="text"/>	<u>15,000</u>	<u>12,760</u>
Gross profit	10,280	<input type="text"/>	<input type="text"/>
Expenses:			
Salaries	\$3,000	2,900	2,500
General and administrative	<input type="text"/>	2,500	2,500
Amortization	1,500	1,400	<input type="text"/>
Interest	<u>500</u>	<input type="text"/>	<u>400</u>
Total expenses	<u>\$7,750</u>	<u>7,300</u>	<u>6,400</u>
Income before taxes	<input type="text"/>	2,700	2,840
Income taxes	<u>1,265</u>	<u>1,350</u>	<input type="text"/>
Net Income	<u>\$1,265</u>	\$ <input type="text"/>	<u>\$1,420</u>

Required:

- A) Fill in the missing amounts.
- B) Is Haliburton's operating performance improving? Support your answer.

102. Below are partial balance sheets for Bancroft Inc. for three years.

Bancroft Inc			
Balance Sheet			
As at August 31			
(in thousands of dollars)			
	2013	2012	2011
Current Assets:			
Cash	\$500	\$600	\$ <input type="text"/>
Accounts receivable	<input type="text"/>	1,800	1,600
Inventory	<u>5,000</u>	<input type="text"/>	4,800
	<u>7,500</u>	<u>7,200</u>	<input type="text"/>
Non-Current Assets:			
Property and equipment	<u>45,000</u>	<input type="text"/>	<u>35,000</u>
Total assets	<u>\$ <input type="text"/></u>	<u>\$53,200</u>	<u>\$41,900</u>
Current Liabilities:			
Accounts payable	\$ <input type="text"/>	\$4,900	\$4,850
Current portion long-term debt	<u>1,000</u>	<u>1,000</u>	<input type="text"/>
	6,000	<input type="text"/>	4,850
Long-term liabilities:			
Long-term debt	<input type="text"/>	<u>10,000</u>	<u>0</u>
	16,000	15,900	4,850
Shareholders' equity:			
Capital Stock	20,000	<input type="text"/>	20,000
Retained Earnings	<input type="text"/>	<u>17,300</u>	<u>17,050</u>
	<u>37,500</u>	<u>37,300</u>	<u>37,050</u>
Total liabilities and shareholders' equity	<u>\$52,500</u>	<u>\$53,200</u>	<u>\$ <input type="text"/></u>

Required:

A) Fill in the missing amounts.

B) Are Bancroft's liquidity and risk improving? Support your answer. If you were a shareholder in Bancroft, would you be concerned?

103. Show the effect that each of the following independent transactions has on the elements of the accounting equation. Specify the type of asset, liability or owners' equity account that would be affected.

<u>Transaction</u>	<u>Assets</u>	<u>= Liabilities</u>	<u>+ Equity</u>
example: Shareholders pay cash for shares \$20,000	+ Cash + 20,000		+ Capital Stock + 20,000

- A) Sells \$100,000 worth of goods, 60% on credit, the rest for cash
- B) Buys \$55,000 of goods on account
- C) Collects \$25,000 owing from customers.
- D) Makes \$10,000 loan payment
- E) Borrows \$35,000 from shareholders

104. Show the effect that each of the following independent transactions has on the elements of the accounting equation. Specify the type of asset, liability or owners' equity account that would be affected.

<u>Transaction</u>	<u>Assets</u>	<u>= Liabilities</u>	<u>+ Equity</u>
example: Borrows \$50,000 from bank	+ Cash +50,000	+ Bank loan +50,000	

- A) Employees work and earn \$12,500, to be paid next week
- B) Shareholder buys shares for 75,000
- C) Pays \$3,000 for current month's rent
- D) Buys land for \$15,000 cash and \$85,000 loan
- E) Sells \$80,000 worth of goods on credit

105. Prepare an income statement and balance sheet for Nipissing Ltd. from the following list of accounts as at April 30, 2012.

Accounts payable	108,000	Income tax expense	135,000
Accounts receivable	305,000	Income taxes payable	34,000
Accrued wages	15,500	Interest expense	65,000
Amortization expense	105,000	Inventory	125,000
Capital Stock	200,000	Mortgage payable (non-current portion)	550,000
Cash	15,000	Patents	200,000
Cost of sales	678,500	Prepaid expenses	6,000
Current portion of mortgage payable	25,000	Property, plant and equipment	850,000
Dividends	30,000	Sales for cash	250,000
Dividends payable	7,500	Sales on credit	1,825,000
General, administrative and selling expenses	804,000	Retained earnings (beginning of the year balance)	303,500

106. Indicate whether each of the following independent events would be included in a calculation of net income on the cash basis, the accrual basis or both. Provide a brief explanation for your treatment. Use the following format.

<u>Transaction</u>	<u>Net income on the cash basis & explanation</u>	<u>Net income on the accrual basis & explanation</u>
A)		
B)		

Transactions:

- A) Company sells goods for cash.
- B) Company pays wages for work done last period.
- C) Inventory is purchased in current period and sold, but not yet paid for.
- D) Purchased and paid for a 5-year license for exclusive rights to sell a product.
- E) Company agrees to hire a new salesman to start work next period.

107. The following is a partial list of accounts and balances for Hatley Hotels Ltd. for the year ended October 31, 2013.

Capital stock	\$1,500,000
Dividends paid	\$60,000
Net income for the year	\$600,000
Retained earnings balance November 1, 2012	\$2,755,400

- A) Prepare the Retained Earnings section of the Statement of Changes in Equity for Hatley for the year.
- B) What portion of their earnings did they pay out to shareholders in 2013?
- C) How much of their income was retained in the business?
- D) What was the shareholders' total direct investment in Hatley? What has been their total indirect investment on the company?
- E) How do you think companies decide how much of their income to pay out?

108. The following is a partial list of accounts and balances for Hatley Hotels Ltd. for the year ended June 30, 2013.

Capital stock	\$1,480,000
Other comprehensive income for the year	\$20,000
Dividends declared during the year	\$60,000
Net income for the year	\$600,000
Retained earnings balance July 1, 2012	\$2,505,400
Accumulated other comprehensive income balance July 1, 2012	\$250,000

- A) Prepare a Statement of Changes in Equity for Hatley for the year ended June 30, 2013.
- B) Briefly explain the purpose of Other Comprehensive Income

109. Below are the income statements and balance sheets for Cookshire Cookware Corp. (CCC) for 2012 and 2013.

Cookshire Cookware Corp.
Income Statement
For the years ended June 30
(in thousands)

	<u>2013</u>	<u>2012</u>
Revenue	\$ 5,200	\$ 4,400
Cost of goods sold	2,850	2,500
Operating expenses	1,120	970
Amortization expense	300	250
Interest expense	100	120
Tax expense	<u>290</u>	<u>200</u>
Net income	\$ 540	\$ 360

Cookshire Cookware Corp.
Balance Sheet
For the years ended June 30
(in thousands)

	<u>2013</u>	<u>2012</u>
Assets:		
Cash	\$ 10	18
Accounts Receivable	520	440
Inventory	560	500
Other current assets	100	100
Property, Plant and Equipment (net of accumulated amortization)	1,800	1,700
Other non-current assets	<u>150</u>	<u>150</u>
Total Assets:	<u>\$ 3,140</u>	<u>\$ 2,908</u>
Liabilities:		
Bank loan	100	150
Accounts payable	480	370
Other current liabilities	70	80
Long-term debt	<u>970</u>	<u>1,200</u>
	1,620	1,800
Shareholders' Equity:		
Capital Stock	500	500
Retained Earnings	<u>1,020</u>	<u>608</u>
	<u>1,520</u>	<u>1,308</u>
Total Liabilities and Shareholders' Equity	<u>\$ 3,140</u>	<u>\$ 2,908</u>

Required:

A) Calculate the following ratios for Cookshire Cookware Corp for 2012 and 2013:

- i) current ratio
- ii) debt-to-equity ratio
- iii) gross margin percentage

B) Explain any changes in the ratios from year to year.

C) If you were a potential investor, how would the changes from 2012 to 2013 affect your decision to buy

shares in CCC?

02 Key

1. (p. 36) Which of the following statements best describes the IFRS conceptual framework?

- A. It provides a set of rules for accountants to follow.
- B. It provides concepts, since accounting is based on nature of law.
- C. It helps equity investors interpret the earnings per share.
- D. It provides a basis for preparing and presenting financial statements.**

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #1

Learning Objective: 02-01 Understand the objectives of general purpose financial reporting and the qualitative characteristics of useful financial information as described in the IFRS conceptual framework.

2. (p. 36) Financial information is relevant for all of the following reasons *except*:

- A. for making predictions about the future cash flows
- B. for making comparisons with industry data.
- C. to determine the liquidation values of capital assets**
- D. for confirming or correcting past evaluations.

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #2

Learning Objective: 02-01 Understand the objectives of general purpose financial reporting and the qualitative characteristics of useful financial information as described in the IFRS conceptual framework.

3. (p. 36) The use of a company's financial statements to assess a new share offering would rely most heavily on which of the following characteristics of information?

- A. Verifiability
- B. Relevance**
- C. Going concern assumption
- D. Unit of measure assumption

Blooms Level: Comprehension

Difficulty: Easy

Friedlan - Chapter 02 #3

Learning Objective: 02-01 Understand the objectives of general purpose financial reporting and the qualitative characteristics of useful financial information as described in the IFRS conceptual framework.

4. (p. 36) Which of the following is an objective of general purpose financial reporting?

- A. To provide information about an entity's economic resources, obligations, and equity/net assets.
- B. To provide information that is helpful to investors, creditors and other users in making resource allocation decisions and/or assessing management stewardship.
- C. To provide information that is useful in assessing the economic performance of the entity.
- D. All of these are objectives of financial reporting.**

Blooms Level: Comprehension

Difficulty: Easy

Friedlan - Chapter 02 #4

Learning Objective: 02-01 Understand the objectives of general purpose financial reporting and the qualitative characteristics of useful financial information as described in the IFRS conceptual framework.

5. (p. 37) Financial information does not demonstrate comparability when:

- A. companies in the same industry use different accounting policies to account for the same type of transaction.**
- B. one company changes its estimate of the residual value of a fixed asset while the other company does not change it.
- C. one company fails to adjust its financial statements for changes in the fair value of short term investments, while the other company makes the adjustment.
- D. both companies use different suppliers.

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #5

Learning Objective: 02-01 Understand the objectives of general purpose financial reporting and the qualitative characteristics of useful financial information as described in the IFRS conceptual framework.

6. (p. 37) The transition to International Financial Reporting Standards can be seen as enhancing which of the following qualitative characteristics?

- A. Verifiability
- B. Comparability**
- C. Understandability
- D. Timeliness

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #6

Learning Objective: 02-01 Understand the objectives of general purpose financial reporting and the qualitative characteristics of useful financial information as described in the IFRS conceptual framework.

7. (p. 37) Anvilles Inc. manufactures metal sheets for construction. Mr. Anvilles, the sole shareholder, arranges to transport two hundred metal sheets to the family cottage in Mont Orford. He tells the bookkeeper to record the cost of the metal sheets as cost of goods sold.

Which of the following qualitative characteristics of accounting information has *not* been respected?

- A. Both verifiability and the entity concept
- B. Both the unit of measure assumption and faithful representation
- C. Both faithful representation and the entity concept**
- D. Both relevance and the unit of measure assumption

Blooms Level: Comprehension

Difficulty: Easy

Friedlan - Chapter 02 #7

Learning Objective: 02-01 Understand the objectives of general purpose financial reporting and the qualitative characteristics of useful financial information as described in the IFRS conceptual framework.

8. (p. 38) Mr. Switch, a local business man, owns two different businesses—a lumber sawmill and a restaurant. The price of lumber has declined and therefore sawmill is in financial difficulty. However, the restaurant is thriving, and Mr. Switch would like to start paying two of the sawmill employees under the restaurant's payroll. His accountant explains that this is *not* in accordance with certain basic principles in accounting. Which principle is he referring to?

- A. Full disclosure
- B. Periodic-reporting assumption
- C. Entity concept**
- D. Unit-of-measure assumption

Blooms Level: Comprehension

Difficulty: Easy

Friedlan - Chapter 02 #8

Learning Objective: 02-02 Recognize the basic accounting assumptions that are fundamental to contemporary accounting.

9. (p. 38) One drawback to the unit-of-measure assumption is:

- A. it inhibits an assessment of going concern.
- B. information about individual items being measured is lost.**
- C. it makes it easier to measure certain assets, such as intellectual property, human capital, and social costs.
- D. it makes it harder to measure transactions.

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #9

Learning Objective: 02-02 Recognize the basic accounting assumptions that are fundamental to contemporary accounting.

10. (p. 38) The assumption that a business enterprise will not be sold or liquidated in the near future is known as the:

- A. entity concept.
- B. unit-of-measure assumption.
- C. going-concern assumption.**
- D. periodic-reporting assumption.

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #10

Learning Objective: 02-02 Recognize the basic accounting assumptions that are fundamental to contemporary accounting.

11. (p. 38) When assessing general purpose financial statements, the financial analyst takes into consideration the fact that many important assets may not be included in the company's statement of financial position, such as human resource capital, intellectual property and social responsibility. This limitation is the result of applying which of the following characteristics of financial information?

- A. Entity concept
- B. Unit-of-measure assumption**
- C. Going-concern assumption
- D. Periodic-reporting assumption

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #11

Learning Objective: 02-02 Recognize the basic accounting assumptions that are fundamental to contemporary accounting.

12. (p. 39) Which of the following statements about general purpose financial statements is correct?

- A. General purpose financial statements are designed to meet the information needs of
- B. every stakeholder in every situation.
- C. General purpose financial statements provide information to all stakeholders.**
- D. General purpose financial statements are intended for specific use only.
- E. The financial statements of non-public companies are general purpose financial statements.

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #12

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

13. (p. 39) How often do companies prepare general purpose financial statements?

- A. **At least once a year.**
- B. Only when asked for by a stakeholder.
- C. Every time management needs to make a financial decision.
- D. As often as GAAP requires.

Blooms Level: Knowledge

Difficulty: Moderate

Friedlan - Chapter 02 #13

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

14. (p. 39) The best description of the financial statements that a public company prepares is:

- A. tax-based financial statements.
- B. specific purpose financial statements.
- C. general principle financial statements.
- D. **general purpose financial statements.**

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #14

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

15. (p. 39) General purpose financial statements include which of the following sets of statements?

- A. Balance statement, income statement, statement of long-term debt, cash flow statement
- B. **Balance sheet, income statement, statement of shareholders' equity, cash flow statement**
- C. Balance sheet, income statement, statement of shareholders' equity, statement of long-term debt
- D. Balance statement, income statement, statement of retained earnings, cash balance

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #15

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

16. (p. 39) What does the term "consolidated" mean when used to describe financial statements?

- A. Consolidated means that financial statements are presented for two years.
- B. Consolidated means that the financial statements have been approved by an auditor.
- C. Consolidated means that the five financial statements have been totalled together.
- D. **Consolidated means that the financial statements contain the information of more than one company.**

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #16

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

17. (p. 39) Sun Company owns 75% of Moon Inc., how would Sun's financial statements be prepared?

- A. On a consolidated basis.
- B. On a specific purpose basis.
- C. On a subsidiary basis.
- D. On a financial basis.

Blooms Level: Knowledge

Difficulty: Moderate

Friedlan - Chapter 02 #17

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

18. (p. 39) Why are financial statements prepared on a comparative basis?

- A. To provide users with easy comparison with the industry.
- B. To provide users with a perspective on the economy.
- C. Because making comparisons using accounting information can be difficult and misleading.
- D. Because making comparisons significantly contributes to the interpretation of accounting information.

Blooms Level: Knowledge

Difficulty: Moderate

Friedlan - Chapter 02 #18

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

19. (p. 41) Which of the following statements about a fiscal year is true?

- A. It is the same for all companies in the same industry.
- B. It is the financial accounting term used to describe the calendar year.
- C. It is a 12-month period ending any time in the calendar year.
- D. It is the period covered by the balance sheet.

Blooms Level: Knowledge

Difficulty: Moderate

Friedlan - Chapter 02 #19

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

20. (p. 44) Which financial statement is a snapshot at a point in time?

- A. Balance sheet
- B. Income statement
- C. Statement of changes in equity
- D. Cash flow statement

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #20

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

21. (p. 44) Which of the following statements best describes the balancesheet?

- A. It provides information about the financial position of an entity at a specific point in time.
- B. It measures the economic performance of the entity over a period of time.
- C. It summarizes only the changes to retained earnings during a period.
- D. It shows how an entity managed its cash during the reporting period.

Blooms Level: Comprehension

Difficulty: Easy

Friedlan - Chapter 02 #21

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

22. (p. 56) Which of the following statements best describes the statement of comprehensive income?

- A. It provides information about the financial position of an entity at a specific point in time.
- B. It measures economic events that involve non-owners but affect equity.
- C. It summarizes the changes to shareholders' equity during a period.
- D. It is an extension of the balance sheet.

Blooms Level: Knowledge

Difficulty: Moderate

Friedlan - Chapter 02 #22

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

23. (p. 51) Which of the following statements best describes the incomestatement?

- A. It provides information about the financial position of an entity at a specific point in time.
- B. It measures the economic performance of the entity over a period of time.
- C. It summarizes the changes to retained earnings during a period.
- D. It shows how an entity managed its cash during the reporting period.

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #23

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

24. (p. 57) Which of the following statements best describes the Statement of Changes in Equity?

- A. It provides information about the financial position of an entity at a specific point in time.
- B. It measures the economic performance of the entity over a period of time.
- C. It summarizes the changes to shareholders' equity during a period.**
- D. It shows how an entity managed its cash during the reporting period.

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #24

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

25. (p. 58) Which of the following statements best describes the cash flow statement?

- A. It provides information about the financial position of an entity at a specific point in time.
- B. It measures the economic performance of the entity over a period of time.
- C. It summarizes the changes to retained earnings during a period.
- D. It shows how an entity managed its cash during the reporting period.**

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #25

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

26. (p. 58) Which of the following statements about the cash flow statement is true?

- A. The cash flow statement reports what the net income would be if the cash basis of accounting had been followed.
- B. The cash flow statement deals with cash, an asset; therefore, the cash flow statement is a snapshot statement just like the balance sheet.
- C. The cash flow statement does not have to be included in general purpose financial statements.
- D. The cash flow statement shows how the company managed its money for the period from more than just operations.**

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #26

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

27. (p. 60) The bookkeeper at Walin Ltd. has prepared a list of all the property, plant and equipment the company owns, including their original cost to the company and how much has been depreciated to date. Where will this information most likely be included in the company's general purpose financial statements?

- A. On the balance sheet.
- B. In the cash flow statement.
- C. In the notes to the financial statements.
- D. This information will not be included in the company's general purpose financial statements.

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #27

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

28. (p. 63) Brantford Business Ltd. (BBL) has a loan outstanding from a Canadian bank. It uses the loan to finance its working capital. The bank has asked for BBL to provide it with monthly listings of their accounts receivables and inventory items. The requested listing is an example of:

- A. a special purpose report.
- B. a general purpose report.
- C. a balance sheet report.
- D. a cash flow report.

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #28

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

29. (p. 44) What is the accounting equation?

- A. $\text{Assets} + \text{Liabilities} = \text{Owners' Equity}$
- B. $\text{Assets} = \text{Liabilities} - \text{Owners' Equity}$
- C. $\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$
- D. $\text{Assets} + \text{Owners' Equity} = \text{Liabilities}$

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #29

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

30. (p. 55) In 2012, Smith's Corner Store had an increase in gross margin of \$28,000; however, the gross margin percentage decreased. This is most likely caused by:

- A. a decrease in volume and a decrease in selling price
- B. an increase in volume and an increase in selling price.
- C. an increase in volume and a decrease in selling price.
- D. a decrease in volume and an increase in selling price.

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #30

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

31. (p. 44) Mats owns and operates a small advertising business from an office. His home is worth \$400,000, his business assets are worth \$275,000, and his business obligations total \$65,000. How much equity does he have in his advertising business?

- A. \$210,000
- B. \$335,000
- C. \$340,000
- D. \$610,000

Equity = \$210,000 (\$275,000 - \$65,000)

Blooms Level: Application

Difficulty: Moderate

Friedlan - Chapter 02 #31

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

32. (p. 44) Whitefish Inc. bought a building worth \$750,000. They paid \$150,000 in cash and borrowed the remainder from a bank. What is the effect of this transaction on the accounting equation?

- A. Assets increases by \$750,000 and liabilities increases by \$750,000.
- B. Assets increases by \$750,000 and liabilities increases by \$660,000.
- C. Assets increases by \$600,000 and liabilities increases by \$750,000.
- D. Assets increases by \$600,000 and liabilities increases by \$600,000.

Both assets and liabilities increased by \$600,000 (\$750,000 - \$150,000)

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #32

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

33. (p. 44) Trout Co. ordered and received inventory worth \$45,000 on credit. What is the effect of this transaction on the accounting equation?

- A. Assets increases by \$45,000 and liabilities increases by \$45,000.
- B. Assets increases by \$45,000 and liabilities decreases by \$45,000.
- C. Assets decreases by \$45,000 and liabilities increases by \$45,000.
- D. Assets decreases by \$45,000 and liabilities decreases by \$45,000.

Blooms Level: Comprehension

Difficulty: Easy

Friedlan - Chapter 02 #33

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

34. (p. 44) A shareholder invested \$75,000, made up of \$50,000 in cash and a vehicle worth \$25,000, in a new company and received shares in exchange. What is the effect of this transaction on the accounting equation?

- A. Assets increases by \$75,000 and owners' equity increases by \$75,000.
- B. Assets increases by \$75,000 owners' equity increases by \$50,000, and liabilities increases by \$25,000.
- C. Assets increases by \$50,000 and owners' equity increases by \$50,000.
- D. Assets increases by \$50,000 and liabilities increases by \$50,000.

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #34

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

35. (p. 44, 47) Sam's Snow Removal received \$500 at the beginning of the winter to cover the fees for the entire winter for cleaning a customer's driveway while they went to Florida for the season. What is the effect of this transaction on the accounting equation?

- A. Assets increases by \$500 and owners' equity increases by \$500.
- B. Assets increases by \$500 and liabilities increases by \$500.
- C. Liabilities increases by \$500 and owners' equity increases by \$500.
- D. The increase and decrease in assets offset each other.

a liability is created since the work will be completed in the future.

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #35

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

36. (p. 47) If an entity pays off an amount owed to a supplier, what is the effect on the accounting equation?

- A. Assets and liabilities both increase.
- B. Assets and liabilities both decrease.**
- C. Assets and owners' equity both decrease
- D. There is no effect on the accounting equation.

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #36

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

37. (p. 46) If an entity receives cash from a customer for payment of an amount owing to them, what is the effect on the accounting equation?

- A. Assets and liabilities both increase.
- B. Assets and liabilities both decrease.
- C. Assets and owners' equity both decrease
- D. There is no effect on the accounting equation.**

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #37

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

38. (p. 47) If a company pays rent for the next period in advance, what is the effect of the transaction on the accounting equation?

- A. Assets decrease, and liabilities decrease.
- B. Assets decrease, and owners' equity decrease.
- C. Assets increase, and liabilities increase.
- D. There is no effect on the accounting equation.**

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #38

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

39. (p. 45) Which of the following correctly describes an asset?

- A. An obligation of the entity
- B. An investment the owners have made
- C. An economic resource that provides future benefits**
- D. An economic sacrifice made to earn revenue

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #39

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

40. (p. 47) Which of the following correctly describes liability?

- A. An obligation of the entity
- B. An investment the owners have made
- C. An economic resource that provides future benefits
- D. An economic sacrifice made to earn revenue

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #40

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

41. (p. 45) Which of the following would be considered as an asset for accounting purposes?

- A. Employees who work for the company
- B. Research into new products for the company
- C. A building owned by the company but rented out
- D. Advertising spent on attracting customers to the company

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #41

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

42. (p. 47) Which of the following is a non-current asset?

- A. Accounts receivable
- B. Inventory
- C. Prepaid rent
- D. Intangible assets

Blooms Level: Comprehension

Difficulty: Easy

Friedlan - Chapter 02 #42

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

43. (p. 47) Which of the following statements about current liabilities is true?

- A. Current liabilities are always less than current assets.
- B. Current liabilities are amounts from non-operating activities only.
- C. Current liabilities will be paid or satisfied within an operating cycle.
- D. Current liabilities are legal obligations of the company.

Blooms Level: Comprehension

Difficulty: Difficult

Friedlan - Chapter 02 #43

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

44. (p. 46) Pike Ltd. bought a new delivery truck for its business. The truck sells for \$75,000, because Pike bought a demonstrator model, they paid \$65,000 only. While driving it home from the sales lot, the driver had an accident, and damages were estimated at \$1,000. At what value should the truck be recorded on Pike's statement of financial position?

- A. \$64,000
- B. \$65,000**
- C. \$66,000
- D. \$75,000

Blooms Level: Application

Difficulty: Difficult

Friedlan - Chapter 02 #44

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

45. (p. 50) What are direct investments by shareholders in a company called?

- A. Dividends
- B. Capital stock**
- C. Retained earnings
- D. Investments

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #45

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

46. (p. 50) What is a payment of cash to a corporation's shareholders called?

- A. A liability
- B. A dividend**
- C. A deficit
- D. An expense

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #46

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

47. (p. 50) Which of the following is an indirect investment by a shareholder?

- A. The cash paid for shares.
- B. A plot of land exchanged for shares.
- C. The net income retained by the company.**
- D. The dividends paid to shareholders.

Blooms Level: Comprehension

Difficulty: Difficult

Friedlan - Chapter 02 #47

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

48. (p. 50) What does the term "deficit" mean in the context of general purpose financial statements?

- A. A deficit is when the net income is negative.
- B. A deficit is when the retained earnings balance is negative.**
- C. A deficit is when the current liabilities exceed the current assets.
- D. A deficit is when a company borrows money.

Blooms Level: Knowledge

Difficulty: Moderate

Friedlan - Chapter 02 #48

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

49. (p. 58) Which of the following statements about the payment of dividends is true?

- A. They are reported in the cash from operations.
- B. They are reported in the cash from financing activities.**
- C. They are reported in the cash from investing activities.
- D. They are reported as an expense on the income statement.

Blooms Level: Knowledge

Difficulty: Moderate

Friedlan - Chapter 02 #49

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

50. (p. 58) If a company made a principal repayment on a long-term loan, which of the following statements about the repayment is true?

- A. It is reported in the cash from operations.
- B. It is reported in the cash from financing activities.**
- C. It is reported in the cash from investing activities.
- D. It is reported as an expense on the income statement.

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #50

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

51. (p. 47) Which of the following statements about an operating cycle is true?

- A. For all businesses the operating cycle is a year or less.
- B. The operating cycle is useful in defining current assets.**
- C. The operating cycle is the difference between revenues and operating expenses.
- D. An operating cycle is the time it takes from the sale of inventory until the collection of cash.

Blooms Level: Knowledge

Difficulty: Difficult

Friedlan - Chapter 02 #51

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

52. (p. 47) Which of the following industries would most likely have an operating cycle longer than a year?

- A. A grocery store
- B. A wine producer**
- C. A soft drinks producer
- D. A car manufacturer

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #52

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

53. (p. 46) Which of the following would be classified as inventory?

- A. Cars in the fleet of a car rental company**
- B. Cars in the fleet of a pizza delivery company
- C. Land held for expansion by a retail company
- D. Land on which a retail company owns a building

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #53

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

54. (p. 47) Which of the following is not liability?

- A. The amount owing to a supplier
- B. A warranty sold with a product
- C. The amount owing for next month's rent**
- D. A cash deposit received on a sale for next month

Blooms Level: Comprehension

Difficulty: Difficult

Friedlan - Chapter 02 #54

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

55. (p. 53) Which of the following correctly describes an expense?

- A. An obligation of the entity.
- B. An investment the owners have made in the business.
- C. An economic resource that provides future benefits.
- D. An economic sacrifice made to earn revenue.**

Blooms Level: Comprehension

Difficulty: Easy

Friedlan - Chapter 02 #55

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

56. (p. 47) Bass Ltd. borrowed \$100,000 from a bank. They will repay \$10,000 a year for the next ten years plus 5% interest. How would the loan be initially recorded on Bass's statement of financial position?

- A. \$100,000 non-current liability
- B. \$100,000 current liability
- C. \$10,000 current liability and \$90,000 non-current liability
- D. \$15,000 current liability and \$90,000 non-current liability

Blooms Level: Application

Difficulty: Moderate

Friedlan - Chapter 02 #56

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

57. (p. 60) Which of the following can you find in the notes to the financial statements?

- A. A list of all the stakeholders of the entity.
- B. A summary of the entity's significant accounting policies.
- C. A summary of the special purpose reports prepared
- D. Management's discussion of the results of the entity.

Blooms Level: Knowledge

Difficulty: Moderate

Friedlan - Chapter 02 #57

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

58. (p. 47) Gifts Galore is a souvenir shop. They have just paid \$2,000 for the exclusive rights to sell the latest hot fad "Talking Toads". They estimate the fad should last about six months. They also paid \$250,000 to be the exclusive carrier of Olympic souvenirs for the next four years. How would each of these intangible assets be reported on the balance sheet?

Talking Toads	Olympic Souvenirs
A) Current asset	Current asset
B) Current asset	Non-current asset
C) Non-current asset	Current asset
D) Non-current asset	Non-current asset

- A. Option A
- B. Option B
- C. Option C
- D. Option D

Blooms Level: Comprehension

Difficulty: Difficult

Friedlan - Chapter 02 #58

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

59. (p. 47) Yamaska just purchased a restaurant from a company that went out of business. They are going to sell off all the furniture, tables and chairs that came with it, because they are going to redecorate it with a new theme. How would the building and the furniture be reported on the balance sheet?

- | Building | Furniture |
|----------------------|-------------------|
| A) Current asset | Current asset |
| B) Current asset | Non-current asset |
| C) Non-current asset | Current asset |
| D) Non-current asset | Non-current asset |
- A. Option A
B. Option B
C. Option C
D. Option D

Blooms Level: Application

Difficulty: Difficult

Friedlan - Chapter 02 #59

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

60. (p. 47) Massawippi Inc. owes a supplier \$10,000. They have signed a note payable for the amount, promising to repay it in six months with interest. They also have a loan outstanding that, starting next year, they will repay in annual instalments over the next five years. How would the note payable and the loan be reported on the balance sheet?

- | Note Payable | Loan |
|--------------------------|-----------------------|
| A) Current liability | Current liability |
| B) Current liability | Non-current liability |
| C) Non-current liability | Current liability |
| D) Non-current liability | Non-current liability |
- A. Option A
B. Option B
C. Option C
D. Option D

Blooms Level: Comprehension

Difficulty: Easy

Friedlan - Chapter 02 #60

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

61. (p. 58) Which of the following correctly identifies one of the links among the four financial statements?

- A. Net income from the income statement goes directly to the balance sheet.
- B. Net income from the income statement goes to the statement of changes in equity.**
- C. Other comprehensive income goes to the statement of cash flows.
- D. Retained earnings from the balance sheet goes to the income statement.

Blooms Level: Knowledge

Difficulty: Moderate

Friedlan - Chapter 02 #61

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

62. (p. 59) Because of the links among financial statements, they must be prepared in order. Which of the following correctly describes the order of preparation?

- A. Income statement, statement of comprehensive income, statement of changes in equity, and balance sheet.**
- B. Income statement, balance sheet, statement of comprehensive income, and statement of changes in equity.
- C. Balance sheet, income statement, and statement of changes in equity.
- D. Balance sheet, statement of changes in equity, income statement, and statement of comprehensive income.

Blooms Level: Knowledge

Difficulty: Moderate

Friedlan - Chapter 02 #62

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

63. (p. 57) The opening balance of retained earnings for Musicala Inc. was \$325,000. During the year, it earned net income of \$52,400 and paid dividends of \$16,000. What is the closing balance of retained earnings?

- A. \$256,600
- B. \$309,000
- C. \$361,400**
- D. \$377,400

Blooms Level: Application

Difficulty: Moderate

Friedlan - Chapter 02 #63

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

64. (p. 59) The opening balance of shareholders' equity for Sedona Transport was \$530,000. During the year, Sedona issued 50,000 common shares at market price of \$3.50 per share. The company earned net income of \$152,400, recorded other comprehensive income of (\$2,300), and paid dividends of \$10,000. What is the closing balance of shareholders' equity?

- A. \$670,100
- B. \$847,400
- C. \$845,100**
- D. \$877,400

Blooms Level: Application

Difficulty: Difficult

Friedlan - Chapter 02 #64

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

65. (p. 52) Lennox Limited reported sales of \$5,000,000, cost of goods sold of \$3,200,000, operating expenses of \$1,400,000, and income tax expense of \$160,000 for the year. What is the gross profit for the year?

- A. \$240,000
- B. \$400,000
- C. \$1,800,000**
- D. \$3,200,000

Blooms Level: Application

Difficulty: Moderate

Friedlan - Chapter 02 #65

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

66. (p. 52) Lennox Limited reported sales of \$5,000,000, cost of goods sold of \$3,200,000, operating expenses of \$1,400,000, and income tax expense of \$160,000 for the year. What was their net income for the year?

- A. \$240,000**
- B. \$400,000
- C. \$1,800,000
- D. \$3,200,000

Blooms Level: Application

Difficulty: Easy

Friedlan - Chapter 02 #66

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

67. (p. 59) The opening balances of capital stock and retained earnings for a company were \$2,200,000 and \$1,325,000, respectively. During the year, they earned net income of \$425,000, the shareholders invested an additional \$500,000 for shares and the company paid dividends of \$42,000. What was the closing amount of shareholders' equity?

- A. \$1,708,000
- B. \$2,208,000
- C. \$3,908,000
- D. \$4,408,000**

Blooms Level: Application

Difficulty: Moderate

Friedlan - Chapter 02 #67

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

68. (p. 59) Sherbrooke Inc. reported sales of \$10,000,000, net income of \$800,000, and dividends of \$200,000. What is the increase in their retained earnings for the year?

- A. \$600,000**
- B. \$800,000
- C. \$1,000,000
- D. \$10,000 000

Blooms Level: Application

Difficulty: Moderate

Friedlan - Chapter 02 #68

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

69. (p. 52-53) During the past year Ascot Company made credit sales of \$450,000, cash sales of \$275,000, and collected \$50,000 of deposits on future orders. What amount should they report as revenue on their income statement?

- A. \$275,000
- B. \$325,000
- C. \$725,000**
- D. \$775,000

Blooms Level: Application

Difficulty: Moderate

Friedlan - Chapter 02 #69

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

70. (p. 52-53) Today, a company sold \$1,000 of goods on credit. The customer took the goods with him, but will only pay in 30 days. When would the sale be reflected under the cash basis of accounting and the accrual basis of accounting?

Cash Basis

- A) today
- B) today
- C) at collection
- D) at collection

Accrual Basis

- today
- at collection
- today
- at collection

- A. Option A
- B. Option B
- C. Option C**
- D. Option D

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #70

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

71. (p. 52) When a sale on credit is made under the cash basis of accounting, at the time of the sale, how is the transaction recorded?

- A. An increase in assets and an increase in liabilities
- B. An increase in assets and an increase in revenues
- C. An increase in liabilities and an increase in revenues
- D. It is not recorded.**

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #71

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

72. (p. 52) When a sale on credit is made under the accrual basis of accounting, at the time of the sale, how is the transaction recorded?

- A. An increase in assets and an increase in liabilities
- B. An increase in assets and an increase in revenues**
- C. An increase in liabilities and an increase in revenues
- D. It is not recorded.

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #72

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

73. (p. 53) Which of the following statements about depreciation is true?

- A. Depreciation is the allocation of the cost of equipment to expense.
- B. Depreciation represents the reduction in the market value of the asset.
- C. Depreciation is the cash paid each month to use a piece of equipment.
- D. Depreciation is the same under both cash-based and accrual-based accounting.

Blooms Level: Knowledge

Difficulty: Difficult

Friedlan - Chapter 02 #73

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

74. (p. 53) An employee worked for a small business during the current month but he will not be paid until the next month. If the business uses accrual accounting, what would be the effect on the accounting equation in the current month?

- A. Assets decrease and liabilities decrease.
- B. Liabilities increase and owners' equity increases.
- C. Liabilities increase and owners' equity decreases.
- D. There is no effect at this time.

Blooms Level: Comprehension

Difficulty: Difficult

Friedlan - Chapter 02 #74

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

75. (p. 53) An employee worked for a small business during the current month but will not be paid until the next month. If the business uses cash accounting, what would be the effect on the accounting equation in the current month?

- A. Assets decrease and liabilities decrease.
- B. Liabilities increase and owners' equity increases.
- C. Liabilities increase and owners' equity decreases.
- D. There is no effect at this time.

Blooms Level: Comprehension

Difficulty: Difficult

Friedlan - Chapter 02 #75

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

76. (p. 53) When a company makes a sale under accrual accounting, what is the impact on the balancesheet?

- A. Assets increase
- B. Assets decrease
- C. Assets and owners' equity both increase
- D. The increase and decrease in assets offset each other

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #76

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

77. (p. 53) If an entity suffered a \$2,000 loss for the month, which of the following statements is most likely true?

- A. The company's cash decreased \$2,000.
- B. The company's shareholders need to invest \$2,000.
- C. The costs incurred during the month exceeded the benefits.
- D. Not all of the revenues were collected during the month.

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #77

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

78. (p. 48) Creditors who are expecting to be paid are most interested in which of the following for an entity?

- A. Liquidity
- B. Operating cycle
- C. Gross margin
- D. Profitability

Blooms Level: Knowledge

Difficulty: Easy

Friedlan - Chapter 02 #78

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

79. (p. 49) What would a creditor calculate to assess liquidity?

- A. Operating cycle
- B. Gross margin
- C. Current ratio
- D. Debt-to-equity ratio

Blooms Level: Knowledge

Difficulty: Moderate

Friedlan - Chapter 02 #79

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

80. (p. 49) A company has current assets of \$200,000 and current liabilities of \$150,000. If they used cash to pay off some accounts payable, what would the effect be on their current ratio?

- A. The current ratio would increase.
- B. The current ratio would decrease.
- C. The current ratio would stay the same.
- D. The effect on the current ratio would depend on the amount paid.

Blooms Level: Comprehension

Difficulty: Difficult

Friedlan - Chapter 02 #80

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

81. (p. 49) A company has current assets of \$200,000 and current liabilities of \$150,000. If they used cash to pay off some accounts payable what would the effect be on their working capital?

- A. Their working capital would increase.
- B. Their working capital would decrease.
- C. Their working capital would stay the same.
- D. The effect on the working capital would depend on the amount paid.

Blooms Level: Comprehension

Difficulty: Easy

Friedlan - Chapter 02 #81

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

82. (p. 49) If a company has a current ratio of 0.82, which of the following statements would be true?

- A. The company is a serious credit risk and should not be lent money.
- B. The company's current ratio is below the industry average.
- C. The company's working capital cannot be calculated.
- D. The company's working capital is negative.

Blooms Level: Comprehension

Difficulty: Difficult

Friedlan - Chapter 02 #82

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

83. (p. 51) If a stakeholder wanted to measure the risk of a company, which of the following would they calculate?

- A. Liquidity
- B. Operating cycle
- C. Profitability
- D. Debt-to-equity ratio

Blooms Level: Comprehension

Difficulty: Easy

Friedlan - Chapter 02 #83

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

84. (p. 49, 51) If a company used some cash and a long-term loan to buy land and a building, what would be the effect on the company's current ratio and debt-to-equity ratio?

- | Current Ratio | Debt-to-Equity Ratio |
|----------------------|-----------------------------|
| A) increase | increase |
| B) increase | decrease |
| C) decrease | increase |
| D) decrease | decrease |
- A. Option A
B. Option B
C. Option C
D. Option D

Blooms Level: Comprehension

Difficulty: Difficult

Friedlan - Chapter 02 #84

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

85. (p. 49, 51) If a company used some cash to pay off some long-term liabilities, what would be the effect on the company's current ratio and debt-to-equity ratio?

- | Current Ratio | Debt-to-Equity Ratio |
|----------------------|-----------------------------|
| A) increase | increase |
| B) increase | decrease |
| C) decrease | increase |
| D) decrease | decrease |
- A. increase increase
B. increase decrease
C. decrease increase
D. decrease decrease

Blooms Level: Comprehension

Difficulty: Difficult

Friedlan - Chapter 02 #85

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

86. (p. 49, 51) If a company sold shares for cash, what would be the effect on the company's current ratio and debt-to-equity ratio?

- | Current Ratio | Debt-to-Equity Ratio |
|----------------------|-----------------------------|
| A) increase | increase |
| B) increase | decrease |
| C) decrease | increase |
| D) decrease | decrease |
- A. Option A
B. Option B
C. Option C
D. Option D

Blooms Level: Comprehension

Difficulty: Difficult

Friedlan - Chapter 02 #86

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

87. (p. 49, 51) If a company bought inventory on account, what would be the effect on the company's current ratio and debt-to-equity ratio?

- | Current Ratio | Debt-to-Equity Ratio |
|----------------------|-----------------------------|
| A) increase | increase |
| B) increase | decrease |
| C) decrease | increase |
| D) decrease | decrease |
- A. Option A
B. Option B
C. Option C
D. Option D

Blooms Level: Comprehension

Difficulty: Difficult

Friedlan - Chapter 02 #87

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

88. (p. 55) If an analyst wanted to compare the operating performance of two retail companies, which of the following would be most useful?

- A. Current ratio
- B. Operating cycle
- C. Debt-to-equity
- D. Gross margin percentage

Blooms Level: Comprehension

Difficulty: Easy

Friedlan - Chapter 02 #88

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

89. (p. 51) For which of the following ratios would a *decrease* in the ratio normally imply an improvement in the company's performance?

- A. Current ratio
- B. Profitability ratio
- C. Gross margin percentage
- D. Debt-to-equity ratio

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #89

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

90. (p. 55) Lennox Limited reported sales of \$5,000,000, cost of goods sold of \$3,200,000, operating expenses of \$1,400,000, and income tax expense of \$160,000 for the year. What is the gross profit percentage for the year?

- A. 4.8%
- B. 8%
- C. 36%
- D. 64%

Blooms Level: Application

Difficulty: Moderate

Friedlan - Chapter 02 #90

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

91. (p. 58) Classify each of the following cash transactions as an operating, financing or investing activity:

- A) wages paid to employees
- B) dividends paid to shareholder
- C) loan repaid to shareholder
- D) purchase of office equipment
- E) payment of rent

- A) wages paid to employees - **Operating**
- B) dividends paid to shareholder - **Financing**
- C) loan repaid to shareholder - **Financing**
- D) purchase of office equipment - **Investing**
- E) payment of rent - **Operating**

Blooms Level: Comprehension

Difficulty: Easy

Friedlan - Chapter 02 #91

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

92. (p. 47) Classify each of the following balance sheet items as a current asset, non-current asset, current liability or non-current liability.

- A) cash
- B) a 10-year loan owing to a bank
- C) an amount owing to a supplier due in 30 days
- D) land purchased for immediate resale by a real estate developer
- E) a delivery truck

- A) cash - **Current asset**
- B) a 10-year loan owing to a bank - **Non-current liability**
- C) an amount owing to a supplier due in 30 days - **Current liability**
- D) land purchased for immediate resale by a real estate developer - **Current asset**
- E) a delivery truck - **Non-current asset**

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #92

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

93. (p. 47) Classify each of the following balance sheet items as a current asset, non-current asset, current liability, or non-current liability.

- A) Dividends declared but not yet paid to shareholders
- B) Wages owing to employees
- C) A loan owing to a shareholder that will be repaid in two years
- D) Land purchased for expansion by a retailer
- E) An amount owing from a customer due in 15 months

- A) Dividends declared but not yet paid to shareholders - **Current liability**
- B) Wages owing to employees - **Current liability**
- C) A loan owing to a shareholder that will be repaid in two years - **Non-current liability**
- D) Land purchased for expansion by a retailer - **Non-current asset**
- E) An amount owing from a customer due in 15 months - **Non-current asset**

Blooms Level: Comprehension

Difficulty: Difficult

Friedlan - Chapter 02 #93

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

94. (p. 52) Why is the cash basis of accounting not used when preparing general purpose financial statements? What is used instead?

The cash basis of accounting is limiting and provides an incomplete measure of performance. The cash basis reflects transactions when the cash has been received or paid and this method does not always correspond to economic effort and performance. For example, if a company made an item and sold it on credit, allowing the customer to pay at a later date, the sale would not be recorded when the event and effort had taken place, but would be recorded at a later date, when the cash was collected. It is possible to manipulate net income when using the cash basis by asking customers to pay early or to give a deposit or by delaying paying your bills. In general purpose financial statements, a broader measure of performance is more useful to the stakeholders than that provided by cash. Accountants prefer to use accrual basis accounting.

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #94

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

95. (p. 46, 53) Differentiate between an asset and an expense. Use the example of a table and chairs and explain how each could be either an asset or an expense.

An asset is an economic resource, controlled by the company, which will provide future benefits to an entity when carrying out its business activities. When the benefit of the asset is used up or has expired, then it normally becomes an expense of the company.

An expense is an economic sacrifice made or cost incurred to earn revenue. A table and chairs would be an asset for a business like a restaurant or for many businesses as part of their office furniture. As the future benefit gets used up (as the table wears out or becomes less useful), then the cost of the benefits used up are reflected as amortization expense.

A table and chairs would be an expense for a furniture store that is selling them as part of their inventory to earn their revenues. When purchased they would initially be included as part of inventory (an asset) and, when sold, would become part of cost of goods sold.

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #95

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

96. (p. 52-53) Tim has decided to run a lawn service business for the summer. He charges customers \$100 per month to mow and maintain their lawns. In May he was able to get 10 contracts signed, for services starting June 1st. On June 1st he collected \$100 from each of seven customers and \$300 from the other three, who will all be out of town for the summer so have paid for all three months at once. Tim bought a second-hand mower for the summer for \$240, which he picked up in May but didn't pay for until June, when he had some cash available. He estimates that it will be completely worn out by the end of the summer. He mowed and maintained the lawns for June and paid \$50 for gas for his mower.

Required:

- A) What is Tim's net income for June under the cash basis of accounting?
- B) What is Tim's net income for June under the accrual basis of accounting?
- C) What is Tim's expected net income for the summer under the cash basis of accounting?
- D) What is Tim's expected net income for the summer under the accrual basis of accounting?
- E) Which method is more appropriate for Tim? Support your answer.

A) Revenue (7*100 + 3* 300)	1,600
Expenses (50 + 240)	<u>290</u>
Net income for June	<u>\$1,310</u>

B) Revenue (10*100)	1,000
Expenses	50
Amortization of the mower (240/3)	<u>80</u>
Net income for June	<u>\$870</u>

C) Revenue (10* 300)	3,000
Expenses 3*50 + 240	<u>390</u>
Net income for summer	<u>\$2,610</u>

D) Revenue (10* 300)	3,000
Expenses 3*50 + 240	150
Amortization	<u>240</u>
Net income for summer	<u>\$2,610</u>

E) Over the life of a company, the cash method and accrual method will give the same results. Because Tim's business has such a short life span (3 months) and he is not reporting his income to anyone else during the life of the business, he would be indifferent about choosing between the two methods. As the cash basis is easier for him to do—it does not require any estimates (for example, about the use of the mower) and would mirror his bank account—it would be satisfactory for Tim to use it.

Blooms Level: Application

Blooms Level: Comprehension

Difficulty: Moderate

Friedlan - Chapter 02 #96

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

97. (p. 44-47) Prepare a proper balance sheet for Wawa Corporation from the following list of accounts on June 30, 2012:

Accounts payable	105,000	Land	175,000
Accounts receivable	52,500	Long-term loan	150,000
Advances received from customers in advance	35,000	Plant and equipment	375,000
Capital Stock	250,000	Rent paid in advance	15,000
Cash	15,000	Retained earnings	144,000
Current portion of long-term loan	50,000	Wages and salaries owing	18,500
Inventory	120,000		

Wawa Corporation
Balance Sheet
as at June 30, 2012

Current Assets:		Current Liabilities:	
Cash	15,000	Accounts payable	105,000
Accounts receivable	52,500	Wages and salaries payable	18,500
Inventory	120,000	Advances received	35,000
Prepaid rent	<u>15,000</u>	Current portion of long-term debt	<u>50,000</u>
	<u>202,500</u>		
Non-Current Assets:	208,500		
		Long-term liabilities:	
Plant and equipment	375,000	Long-term loan	<u>150,000</u>
Land	<u>175,000</u>		358,500
	<u>550,000</u>		
Total assets:	<u>\$752,500</u>	Shareholders' Equity:	
		Capital stock	250,000
		Retained earnings	<u>144,000</u>
			<u>394,000</u>
		Total Liabilities and Shareholders' Equity	<u>\$752,500</u>

Blooms Level: Application

Difficulty: Difficult

Friedlan - Chapter 02 #97

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

98. (p. 44-47, 50) Wasago is in its first year of operation, and the bookkeeper has prepared the following summary of all of their accounts and balances as at August 31, 2012. Prepare a proper balance sheet for Wasago Corporation.

Accounts payable	26,000	Investment by	
Accounts receivable	36,000	shareholders	25,000
Bank loan, short-term	12,000	Loans made to company	
Cash	2,000	by shareholders	25,000
Income tax expense	7,500	Operating expenses	182,500
Income taxes payable	7,500	Office equipment	45,000
Insurance paid in advance	5,000	Sales revenues	212,500
Inventory	30,000		

Wawa Corporation
Balance Sheet
as at August 31, 2012

Current Assets:		Current Liabilities:	
Cash	2,000	Bank loan	12,000
Accounts receivable	36,000	Accounts payable	26,000
Inventory	30,000	Income taxes payable	<u>7,500</u>
Prepaid insurance	<u>5,000</u>		45,500
	<u>73,000</u>	Long-term liabilities:	
Non-Current Assets:		Shareholder loans	<u>25,000</u>
Office equipment	<u>45,000</u>		70,500
Total assets	<u>\$118,000</u>	Shareholders' Equity	
		Capital stock	25,000
		Retained earnings*	<u>22,500</u>
			<u>47,500</u>
		Total Liabilities and	
		Shareholders Equity	<u>\$118,000</u>

* Retained earnings needs to be calculated and would be equal to the first year's net income.
 $\text{Sales} - \text{operating expenses} - \text{income tax expense} = 212,500 - 182,500 - 7,500 = 22,500$

Blooms Level: Application

Difficulty: Difficult

Friedlan - Chapter 02 #98

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

99. (p. 52-56) The following is a list of accounts for Carleton Corporation for the year ended October 31, 2012.

Advertising expense	\$130,000
Amortization expense	90,000
Cost of sales	545,000
General and administrative expenses	158,000
Income tax expense	105,000
Interest expense	60,000
Research expense	100,000
Sales revenue	1,900,000
Sales commissions	190,000
Salaries expense	376,000

Required:

- A) Prepare an income statement for Carleton for the year.
- B) What is Carleton's gross margin for the year?
- C) What is Carleton's gross margin percentage for the year?

A)

Carleton Corporation
Income Statement
For the year ended October 31, 2012.

Revenue:	\$1,900,000
Cost of sales	<u>545,000</u>
Gross profit	<u>\$1,355,000</u>
Expenses:	
Salaries	\$376,000
General and Administrative	158,000
Sales commissions	190,000
Research	100,000
Amortization	90,000
Interest	<u>60,000</u>
Total expenses	<u>\$974,000</u>
Income before taxes	381,000
Income taxes	<u>105,000</u>
Net Income	<u>\$276,000</u>

B) Gross margin is the same as gross profit \$1,355,000

C) Gross margin percentage $1,355,000/1,900,000 = 71.3\%$

Blooms Level: Application

Difficulty: Difficult

Friedlan - Chapter 02 #99

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

100. (p. 43, 44) Emily has been out of school and working as a physiotherapist for four years. She is in the process of buying a condo and is applying for a mortgage from the Canadian Bank. The bank has asked for a personal balance sheet for Emily before making its decision. She has come to you for help and has provided you with the following information:

- i) Emily bought a car four years ago for \$15,000. She borrowed the money from her parents, interest free, and still owes them \$3,000 and makes monthly payments of \$250. She estimates the car is worth about \$5,000 now.
- ii) Emily has \$1,800 in her checking account and \$12,000 in Canada Savings Bonds (CSBs), which she will use for the down payment on the condo.
- iii) Emily owns some jewellery given to her after her grandmother past away. Although it is priceless to Emily the local jeweller says it is worth \$3,500.
- iv) Emily worked some overtime at another clinic over the recent holidays and is owed \$2,500 for it.
- v) Emily has a music player and CD collection worth about \$1,000.
- vi) Emily has old furniture in her current apartment that she paid \$500 for but is hoping to buy some new things to go with her new place. She hopes a charity will come and take all of the old stuff away.
- vii) Emily has a \$500 balance on her credit card but pays it off every month.

Required:

- A) Prepare a personal balance sheet for Emily. She wants you to explain why things were or were not included so that she could do it herself next time.
- B) How will the Canadian Bank use the information to help it make a decision?
- C) What, if any, other information would the bank like to have?

Emily's Personal Balance Sheet

Assets:		Liabilities:	
Cash	\$1,800	Credit card	\$500
CSBs	12,000	Car loan	3,000
Wages receivable	2,500		
CD collection	1,000	Emily's equity	<u>22,300</u>
Car	5,000	Total liabilities and equity	\$25,800
Jewellery	<u>3,500</u>		
Total Assets	<u>\$25,800</u>		

Assets are items that could have future benefit to Emily; they should be valued at the value of those expected future benefits or what she paid for them, whichever is more reliable and relevant for the decision. The cash and CSBs are worth their face values; there may be some accrued interest owing to her on the CSBs that she has not identified. The wages are also valued at the monetary amount that she will receive. Her music player and CD collection are valued at what she thinks they are worth; it is not clear if this was the cost or their value, but if they are relatively current CDs their two values will be very close. The car is valued at its current estimated value, not what she paid for it. She could not sell it for that original cost so its benefit to her is the net realizable value. The jewellery, although priceless to her, is valued at the appraised value. She would only get \$3,500 for it if she had to sell it, and that is the more relevant value than the cost to her, which was zero. The old furniture was not included, as it has a value approaching zero if it is to be given to charity and holds no future benefit to her.

Liabilities are obligations arising from past transactions. For Emily, her only obligation is the car loan to her parents, which she could easily pay off from her CSBs and cash.

Note that the balance sheet was not divided into current and non-current sections, as Emily is an individual and the concept of an operating cycle does not apply. But the assets are still presented in order of liquidity and the distinction could be made if it helped the decision-making process.

B) The Canadian bank wants to assess the risk of lending money to her. It can see if she owes anyone else money (only a small amount to her parents and her credit card company) and use the balance sheet to assess how she has managed her money in the past. As she has a net worth of \$25,300 only four years out of school, she appears to be a good money manager. She has only gone into debt for items that last a long time—her car—and her other obligation, the credit card, is paid off every month. They can assess her risk by looking at the ratio of debt-to-equity, which is very low ($3,500/22,300 = .157$) and her liquidity by looking at short-term assets to short-term debts ($16,300/500 = 32.6$).

C) The bank would want information about her ability to repay the loan and interest expense, which are better assessed from an income statement. For an individual, it would want to know her annual salary (it would probably confirm it with her employer) and an estimate of her future living expenses once she owns the condo. Her current expenses may not be a good predictor of future ones, since she may incur many more or different costs when owning a property rather than in her current situation.

Blooms Level: Analysis

Blooms Level: Application

Difficulty: Difficult

Friedlan - Chapter 02 #100

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

101. (p. 51-55) Below are partial income statements for Haliburton Ltd. for three years.

Haliburton Ltd
Income Statement
For the year ended August 31,
(in thousands of dollars)

	2013	2012	2011
Revenue	\$26,200	\$25,000	\$ <input type="text"/>
Cost of sales	<input type="text"/>	<u>15,000</u>	<u>12,760</u>
Gross profit	10,280	<input type="text"/>	<input type="text"/>
Expenses:			
Salaries	\$3,000	2,900	2,500
General and administrative	<input type="text"/>	2,500	2,500
Amortization	1,500	1,400	<input type="text"/>
Interest	<u>500</u>	<input type="text"/>	<u>400</u>
Total expenses	<u>\$7,750</u>	<u>7,300</u>	<u>6,400</u>
Income before taxes	<input type="text"/>	2,700	2,840
Income taxes	<u>1,265</u>	<u>1,350</u>	<input type="text"/>
Net Income	<u>\$1,265</u>	\$ <input type="text"/>	<u>\$1,420</u>

Required:

- A) Fill in the missing amounts.
- B) Is Haliburton's operating performance improving? Support your answer.

A)

Haliburton Ltd
Income Statement
For the year ended August 31,
(in thousands of dollars)

	2013	2012	2011
Revenue	\$26,200	25,000	<u>22,000</u>
Cost of sales	<u>15,920</u>	<u>15,000</u>	<u>12,760</u>
Gross profit	10,280	<u>10,000</u>	<u>9,240</u>
Expenses:			
Salaries	\$3,000	2,900	2,500
General and administrative	<u>2,750</u>	2,500	2,500
Amortization	1,500	1,400	<u>1,000</u>
Interest	<u>500</u>	<u>500</u>	<u>400</u>
Total expenses	\$7,750	7,300	6,400
Income before taxes	<u>2,530</u>	2,700	2,840
Income taxes	<u>1,265</u>	<u>1,350</u>	<u>1,420</u>
Net Income	<u>\$1,265</u>	<u>\$1,350</u>	<u>\$1,420</u>

B) Gross Margin %	10,280/26,200 39.2%	10,000/25,000 40%	9,240/22,000 42%
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Although Haliburton's sales are growing, their gross margin percentage is decreasing over the period in a relative amount. The actual dollars of gross margin are increasing, but the gross margin percentage shows that cost of sales are increasing at a faster rate than the sales are. Their net income is declining on an absolute basis, so when you factor in the increasing sales, the drop in net income is very serious. (Some students will try a net income % calculation.)

Net income percentage	1,265/26,200 4.8%	1,350/25,000 5.4%	1,420/22,000 6.4%
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Blooms Level: Analysis

Blooms Level: Application

Difficulty: Difficult

Friedlan - Chapter 02 #101

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

102. (p. 44-48) Below are partial balance sheets for Bancroft Inc. for three years.

Bancroft Inc			
Balance Sheet			
As at August 31			
(in thousands of dollars)			
	2013	2012	2011
Current Assets:			
Cash	\$500	\$600	\$ <input type="text"/>
Accounts receivable	<input type="text"/>	1,800	1,600
Inventory	<u>5,000</u>	<input type="text"/>	4,800
	<u>7,500</u>	<u>7,200</u>	<input type="text"/>
Non-Current Assets:			
Property and equipment	<u>45,000</u>	<input type="text"/>	<u>35,000</u>
Total assets	<u>\$ <input type="text"/></u>	<u>\$53,200</u>	<u>\$41,900</u>
Current Liabilities:			
Accounts payable	\$ <input type="text"/>	\$4,900	\$4,850
Current portion long-term debt	<u>1,000</u>	<u>1,000</u>	<input type="text"/>
	6,000	<input type="text"/>	4,850
Long-term liabilities:			
Long-term debt	<input type="text"/>	<u>10,000</u>	<u>0</u>
	16,000	15,900	4,850
Shareholders' equity:			
Capital Stock	20,000	<input type="text"/>	20,000
Retained Earnings	<input type="text"/>	<u>17,300</u>	<u>17,050</u>
	<u>37,500</u>	<u>37,300</u>	<u>37,050</u>
Total liabilities and shareholders' equity	<u>\$52,500</u>	<u>\$53,200</u>	<u>\$ <input type="text"/></u>

Required:

A) Fill in the missing amounts.

B) Are Bancroft's liquidity and risk improving? Support your answer. If you were a shareholder in Bancroft, would you be concerned?

Bancroft Inc
Balance Sheet
As at August 31
(in thousands of dollars)

	2013	2012	2011
Current Assets:			
Cash	500	600	500
Accounts receivable	2,000	1,800	1,600
Inventory	5,000	4,800	4,800
	<u>7,500</u>	<u>7,200</u>	<u>6,900</u>
Non-Current Assets:			
Property and equipment	45,000	46,000	35,000
Total assets	<u>\$52,500</u>	<u>53,200</u>	<u>41,900</u>
Current Liabilities:			
Accounts payable	5,000	4,900	4,850
Current portion long-term debt	1,000	1,000	0
	<u>6,000</u>	<u>5,900</u>	<u>4,850</u>
Long-term liabilities:			
Long-term debt	9,000	10,000	0
	<u>15,000</u>	<u>15,900</u>	<u>4,850</u>
Shareholders' equity:			
Capital Stock	20,000	20,000	20,000
Retained Earnings	17,500	17,300	17,050
	<u>37,500</u>	<u>37,300</u>	<u>37,050</u>
Total liabilities and shareholders' equity	<u>\$52,500</u>	<u>\$53,200</u>	<u>\$41,900</u>
 B) Current ratios	 7,500/6,000	 7,200/5,900	 6,900/4,850
	1.25	1.22	1.42
Debt-to-equity ratio	15,000/37,500	15,900/37,300	4,850/37,050
	.40	.43	.13

Both the current ratio and the debt-to-equity ratio have deteriorated. Both seem to be related to the addition of significant debt in 2012, which coincides with the increase in property and equipment. It appears they have borrowed money to purchase assets and presumably expand operations. The current portion of the debt has led to a small, steady decrease in the current ratio. The large increase in the debt-to-equity ratio is also a result of the debt. As they are starting to pay off the debt in 2013, the ratio decreases again.

The company still has a lot of equity relative to its debt, so the dramatic change in ratios is not a cause for major shareholder concern.

Blooms Level: Analysis

Blooms Level: Application

Difficulty: Difficult

Friedlan - Chapter 02 #102

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

Learning Objective: 02-07 Use financial statement information to assess the liquidity; risk; and profitability of an entity.

103. (p. 44-48) Show the effect that each of the following independent transactions has on the elements of the accounting equation. Specify the type of asset, liability or owners' equity account that would be affected.

Transaction	Assets	= Liabilities	+ Equity
example: Shareholders pay cash for shares \$20,000	+ Cash + 20,000		+ Capital Stock + 20,000

- A) Sells \$100,000 worth of goods, 60% on credit, the rest for cash
- B) Buys \$55,000 of goods on account
- C) Collects \$25,000 owing from customers.
- D) Makes \$10,000 loan payment
- E) Borrows \$35,000 from shareholders

Transaction	Assets	= Liabilities	+ Equity
example: Shareholders pay cash for shares \$20,000	+ Cash + 20,000		+ Capital Stock + 20,000
A) Sells \$100,000 worth of goods, 60% on credit, the rest for cash	+Cash 60,000 + Accounts receivable 40,000		+ retained earnings 100,000
B) Buys \$55,000 of goods on account	+Inventory +55,000	+ Accounts Payable +55,000	
C) Collects \$25,000 owing from customers	+ Cash 25,000 - Accounts Rec. -25,000		
D) Makes \$10,000 loan payment	- Cash -10,000	- Loan - 10,000	
E) Borrows \$35,000 from Shareholders	+ Cash + 35,000	+ shareholders' loan +35,000	

Blooms Level: Application

Difficulty: Moderate

Friedlan - Chapter 02 #103

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

104. (p. 44-48) Show the effect that each of the following independent transactions has on the elements of the accounting equation. Specify the type of asset, liability or owners' equity account that would be affected.

<u>Transaction</u>	<u>Assets</u>	<u>= Liabilities</u>	<u>+ Equity</u>
example: Borrows \$50,000 from bank	+ Cash +50,000	+ Bank loan +50,000	

- A) Employees work and earn \$12,500, to be paid next week
- B) Shareholder buys shares for 75,000
- C) Pays \$3,000 for current month's rent
- D) Buys land for \$15,000 cash and \$85,000 loan
- E) Sells \$80,000 worth of goods on credit

<u>Transaction</u>	<u>Assets</u>	<u>= Liabilities</u>	<u>+ Equity</u>
example: Borrows \$50,000 from bank	+ Cash +50,000	+ Bank loan +50,000	
A) Employees work and earn \$12,500 to be paid next week.		+ wages payable + 12,500	- retained earnings -12,500
B) Shareholder buys shares for \$75,000	+ cash + 75,000		+ capital stock + 75,000
C) Pays \$3,000 for current month's rent	- cash - 3,000		- retained earnings - 3,000
D) Buys land for \$15,000 cash and an \$85,000 loan	- cash, 15,000 + land 100,000	+ loan 85,000	
E) Sells \$80,000 worth of goods on credit	+ Accounts receivable, 80,000		+ retained earnings 80,000

Blooms Level: Application

Difficulty: Moderate

Friedlan - Chapter 02 #104

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

105. (p. 44-50) Prepare an income statement and balance sheet for Nipissing Ltd. from the following list of accounts as at April 30, 2012.

Accounts payable	108,000	Income tax expense	135,000
Accounts receivable	305,000	Income taxes payable	34,000
Accrued wages	15,500	Interest expense	65,000
Amortization expense	105,000	Inventory	125,000
Capital Stock	200,000	Mortgage payable (non-current portion)	550,000
Cash	15,000	Patents	200,000
Cost of sales	678,500	Prepaid expenses	6,000
Current portion of mortgage payable	25,000	Property, plant and equipment	850,000
Dividends	30,000	Sales for cash	250,000
Dividends payable	7,500	Sales on credit	1,825,000
General, administrative and selling expenses	804,000	Retained earnings (beginning of the year balance)	303,500

Nipissing Ltd
Income Statement
For the year ended April 30, 2012

Revenue:	\$2,075,000
Cost of sales	<u>678,500</u>
Gross profit	\$1,396,500
Expenses:	
General and administrative	804,000
Amortization expense	105,000
Interest expense	<u>65,000</u>
Total expenses	<u>\$974,000</u>
Income before taxes	422,500
Income taxes	<u>135,000</u>
Net Income	<u><u>\$287,500</u></u>

Nipissing
Balance Sheet
as at April 30, 2012

Current Assets:		Current Liabilities:	
Cash	15,000	Accounts payable	108,000
Accounts receivable	305,000	Accrued wages	15,500
Inventory	125,000	Income taxes payable	34,000
Prepaid rent	<u>6,000</u>	Dividends payable	7,500
	<u>451,000</u>	Current portion of mortgage	<u>25,000</u>
			190,000
Non-Current Assets:		Long-term liabilities:	
Property, plant and equipment	850,000	Mortgage payable	<u>550,000</u>
Patents	<u>200,000</u>		
	740,000		
	<u>1,050,000</u>	Shareholders' equity:	
Total assets	<u><u>\$1,501,000</u></u>	Capital stock	200,000
		Retained earnings*	<u>561,000</u>
			<u>761,000</u>
		Total Liabilities and Shareholders Equity	<u><u>\$1,501,000</u></u>

Blooms Level: Application

Difficulty: Difficult

Friedlan - Chapter 02 #105

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

106. (p. 44-48 and 52-53) Indicate whether each of the following independent events would be included in a calculation of net income on the cash basis, the accrual basis or both. Provide a brief explanation for your treatment. Use the following format.

<u>Transaction</u>	<u>Net income on the cash basis & explanation</u>	<u>Net income on the accrual basis & explanation</u>
A)		
B)		

Transactions:

- A) Company sells goods for cash.
- B) Company pays wages for work done last period.
- C) Inventory is purchased in current period and sold, but not yet paid for.
- D) Purchased and paid for a 5-year license for exclusive rights to sell a product.
- E) Company agrees to hire a new salesman to start work next period.

<u>Transaction</u>	<u>Net income on the cash basis & explanation</u>	<u>Net income on the accrual basis & explanation</u>
A) Company sells goods for cash.	Yes – because cash received	Yes – because transaction completed.
B) Company pays wages for work done last period.	Yes – because cash was spent this period.	No – it was an expense of the last period and was included in net income then.
C) Inventory is purchased in current period and sold, but not yet paid for.	No – has been no cash outflow so no expense recognized.	Yes – if the inventory is sold it is included as an expense regardless of when paid for.
D) Purchased and paid for a 5-year license for exclusive rights to sell a product.	Yes – because cash was spent this period.	Only a portion (1/5) of the cost as an expense. The remainder would be expensed over the next four years.
E) Company agrees to hire a new salesman to start work next period.	No – no cash exchanged	No – no transaction has occurred.

Blooms Level: Analysis

Difficulty: Difficult

Friedlan - Chapter 02 #106

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

Learning Objective: 02-06 Differentiate between accrual-basis and cash-basis accounting; and prepare simple income statements using each method.

107. (p. 48) The following is a partial list of accounts and balances for Hatley Hotels Ltd. for the year ended October 31, 2013.

Capital stock	\$1,500,000
Dividends paid	\$60,000
Net income for the year	\$600,000
Retained earnings balance November 1, 2012	\$2,755,400

- A) Prepare the Retained Earnings section of the Statement of Changes in Equity for Hatley for the year.
- B) What portion of their earnings did they pay out to shareholders in 2013?
- C) How much of their income was retained in the business?
- D) What was the shareholders' total direct investment in Hatley? What has been their total indirect investment on the company?
- E) How do you think companies decide how much of their income to pay out?

A)

Hatley Hotels Ltd
Statement of Changes in Equity
Retained Earnings Section
For the year ended October 31, 2013.

Opening retained earnings balance	\$2,755,400
Plus net income for the year	600,000
less dividends paid	<u>(60,000)</u>
Retained earnings balance end of the year	\$3,295,400

B) They paid out 10% $60,000/600,000$.

C) They retained $\$540,000 = 600,000 - 60,000$.

D) direct investment = $\$1,500,000$ indirect investment is the sum of all the undistributed income: $\$3,295,400$

E) It depends on what investment opportunities the companies have. If they have good growth opportunities, they want to retain more money and use it to pursue those opportunities. For companies with lower opportunities, they may pay out more. The shareholders may also be able to exert pressure on management, and the payouts may be geared to their cash flow needs; this would be more likely the case in a private company. Lastly, companies do not like to make large changes in their dividends, as it usually affects the market price of the shares. If a company had to cut back on dividends, it would be a negative signal to the market, and the share price would fall. So managers prefer a dividend payout rate that they know they can maintain.

Blooms Level: Analysis

Blooms Level: Application

Difficulty: Difficult

Friedlan - Chapter 02 #107

Learning Objective: 02-05 Explain the nature of assets; liabilities; owners equity; revenues; and expenses.

108. (p. 56-59) The following is a partial list of accounts and balances for Hatley Hotels Ltd. for the year ended June 30, 2013.

Capital stock	\$1,480,000
Other comprehensive income for the year	\$20,000
Dividends declared during the year	\$60,000
Net income for the year	\$600,000
Retained earnings balance July 1, 2012	\$2,505,400
Accumulated other comprehensive income balance July 1, 2012	\$250,000

- A) Prepare a Statement of Changes in Equity for Hatley for the year ended June 30, 2013.
 B) Briefly explain the purpose of Other Comprehensive Income

A)

Hatley Hotels Ltd
 Statement of Changes in Equity
 For the year ended June 30, 2013.

	<u>Total</u> <u>Equity</u>	<u>Capital Stock</u>	<u>Accumulated Other</u> <u>Comp Income</u>	<u>Retained</u> <u>Earnings</u>
Opening balance	\$4,235,400	\$1,480,000	\$250,000	\$2,505,400
Net income	600,000			600,000
Other comprehensive income	20,000		20,000	
Dividends	(60,000)			(60,000)
Closing balance	<u>\$4,795,400</u>	<u>\$1,480,000</u>	<u>\$270,000</u>	<u>\$3,045,400</u>

B) Other comprehensive income includes those transactions and economic events that involve non-owners and affect equity, but are, for various reasons, excluded from the calculation of net income.

Blooms Level: Application

Difficulty: Difficult

Friedlan - Chapter 02 #108

Learning Objective: 02-03 Identify components that make up a set of general purpose financial statements; understand the information each statement provides; and prepare simple examples of them.

Learning Objective: 02-04 Describe and interpret the accounting equation.

109. (p. 48-49, 50-51, 55-56) Below are the income statements and balance sheets for Cookshire Cookware Corp. (CCC) for 2012 and 2013.

Cookshire Cookware Corp.
Income Statement
For the years ended June 30
(in thousands)

	<u>2013</u>	<u>2012</u>
Revenue	\$ 5,200	\$ 4,400
Cost of goods sold	2,850	2,500
Operating expenses	1,120	970
Amortization expense	300	250
Interest expense	100	120
Tax expense	<u>290</u>	<u>200</u>
Net income	\$ 540	\$ 360

Cookshire Cookware Corp.
Balance Sheet
For the years ended June 30
(in thousands)

	<u>2013</u>	<u>2012</u>
Assets:		
Cash	\$ 10	18
Accounts Receivable	520	440
Inventory	560	500
Other current assets	100	100
Property, Plant and Equipment (net of accumulated amortization)	1,800	1,700
Other non-current assets	<u>150</u>	<u>150</u>
Total Assets:	<u>\$ 3,140</u>	<u>\$ 2,908</u>
Liabilities:		
Bank loan	100	150
Accounts payable	480	370
Other current liabilities	70	80
Long-term debt	<u>970</u>	<u>1,200</u>
	1,620	1,800
Shareholders' Equity:		
Capital Stock	500	500
Retained Earnings	<u>1,020</u>	<u>608</u>
	<u>1,520</u>	<u>1,308</u>
Total Liabilities and Shareholders' Equity	<u>\$ 3,140</u>	<u>\$ 2,908</u>

Required:

A) Calculate the following ratios for Cookshire Cookware Corp for 2012 and 2013:

- i) current ratio
- ii) debt-to-equity ratio
- iii) gross margin percentage

B) Explain any changes in the ratios from year to year.

C) If you were a potential investor, how would the changes from 2012 to 2013 affect your decision to buy

shares in CCC?

A)

i) current ratio:

$$2013 = (10 + 520 + 560 + 100)/(100 + 480 + 70) = 1.83$$

$$2012 = (18 + 440 + 500 + 100)/(150 + 370 + 80) = 1.76$$

ii) debt-to-equity ratio:

$$2013 = 1620/1520 = 1.06$$

$$2012 = 1800/1308 = 1.37$$

iii) gross margin:

$$2013 = (5,200 - 2,850)/5200 = 45\%$$

$$2012 = (4,400 - 2,500)/4,400 = 43.2\%$$

B) The current ratio has increased slightly, implying that CCC has more current assets to cover its current liabilities, and hence, its liquidity has improved slightly.

The debt-to-equity ratio has decreased significantly, implying reduced risk, as the company has less debt outstanding relative to equity. It is a result of the reduction in both the bank loan and the long-term debt and the increase in retained earnings due to the high net income for the year.

The gross margin percentage has also increased over the year. The company has a larger portion of each sales dollar left after cost of sales to pay other costs from. Sales have increased faster than cost of sales, the exact reason for this is not apparent from the information given.

C) All three ratios have improved. CCC is more liquid, less risky and more profitable. Therefore, to an investor, the shares look even more attractive as an investment in 2013 as compared to 2012.