

## True-False

1. The balance sheet is an expression of the accounting equation.
2. Probable future economic benefits obtained or controlled by an entity as a result of past transactions or events define liabilities.
3. Liquidity refers to the ability of a company to generate sufficient cash flows to maintain its productive capacity and still meet interest and principal payments on long-term debt.
4. The elapsed time beginning with the initiation of production and ending with the cash collection of the receivables from the sale of the product refers to the company's production cycle.
5. Current assets are listed on the balance sheet in descending order of liquidity.
6. Current liabilities are liabilities expected to be settled after twelve months or one operating cycle if it is longer.
7. Accounts Receivable are shown on the balance sheet at net realizable value.
8. Inventories are reported on the balance sheet at historical cost.
9. The Common Stock account is reported on the balance sheet at the current market price of the stock.
10. The Retained Earnings account is comprised of the cumulative earnings less dividends since the inception of the corporation.
11. The Summary of Significant Accounting Policies explains the important accounting choices that the reporting entity uses to account for selected transactions and accounts.
12. A related party transaction occurs when a company enters into a transaction with individuals or other companies that are connected in some way with it or its management.
13. The change in cash during a period is equal to the net income for the period.
14. Operating activities result from the cash effects of producing and delivering goods and services.
15. Investing activities include the cash effects of selling stocks and bonds to raise capital to purchase fixed assets.
16. Paying dividends to stockholders represents a financing activity.
17. The sale of fixed assets represents an investing activity.
18. Issuing capital stock for cash represents an investing activity.
19. Depreciation is added back to net income to determine cash from operating activities under the indirect method.

## Multiple-Choice Questions

Select the best answer from those provided.

20. Probable future economic benefits obtained or controlled by an entity as a result of past transactions or events define
  - a. assets.
  - b. liabilities.
  - c. equity.
  - d. retained earnings.
21. The residual interest in the resources of an entity that remains after deducting its debts to third parties defines
  - a. assets.
  - b. liabilities.
  - c. equity.
  - d. retained earnings.
22. Probable future sacrifices of economic benefits arising from an entity's present obligations to transfer resources or provide services to other entities in the future as a result of past transactions or events define
  - a. assets.
  - b. liabilities.
  - c. equity.
  - d. retained earnings.
23. The balance sheet provides information on all of the following except for
  - a. how management invested its money.
  - b. where the money came from.
  - c. assessing rates of return.
  - d. ascertaining stock market prices.
24. By comparing return on assets to return on common equity, statement users can determine
  - a. if debt financing is being used to enhance the return earned by shareholders.
  - b. past patterns of profitability within divisions.
  - c. if return on investments exceed the current market yield.
  - d. management's investment strategies.
25. How far into the future the obligations of a company will come due refers to the company's
  - a. capital structure.

- b. maturity structure.  
c. solvency.  
d. liquidity.
26. How much of a company's assets are financed from debt versus equity sources refers to the company's  
a. capital structure.  
b. maturity structure.  
c. solvency.  
d. liquidity.
27. Which of the following measures how readily assets can be converted to cash relative to how soon liabilities will have to be paid in cash?  
a. Capital structure  
b. Maturity structure  
c. Solvency  
d. Liquidity
28. Operating and financial flexibility refers to a company's ability to  
a. adjust to unexpected downturns in the economic environment in which it operates or to take advantage of profitable investment opportunities as they arise.  
b. generate sufficient cash flows to maintain its productive capacity and still meet interest and principal payments on long-term debt.  
c. readily convert assets to cash relative to how soon liabilities will have to be paid in cash.  
d. finance debt in ratio to financing through equity sources.
29. Balance sheets prepared in compliance with GAAP reflect a mixture of  
a. historical cost and future cash values.  
b. current value and discounted future cash flows.  
c. discounted cash flows and future values.  
d. historical cost, fair value, net realizable value, and discounted present values.
30. Current assets are assets expected to  
a. be converted to cash within twelve months.  
b. be converted to cash within twelve months or one operating cycle if it is longer than twelve months.  
c. remain on the books for at least twelve months.  
d. remain on the books for at least twelve months or one operating cycle if longer than twelve months.
31. Cash is always measured for the balance sheet at  
a. historical transaction value.  
b. current market price.  
c. realizable future value.  
d. historical cost.
32. Monetary assets are comprised of  
a. cash and cash equivalents.  
b. cash, cash equivalents, and accounts receivable.  
c. cash, cash equivalents, accounts receivable, and notes receivable.  
d. cash, accounts receivable, notes receivable, and inventory.
33. Marketable debt and equity securities that a firm expects to hold as a short-term investment are reported on the balance sheet at  
a. current market value.  
b. historical cost.  
c. amortized current market value.  
d. amortized historical cost.
34. The value of Accounts Receivable is adjusted on the balance sheet by the contra-asset account  
a. Allowance for Amortization.  
b. Allowance for Doubtful Accounts.  
c. Bad Debt Expense.  
d. Doubtful Accounts Expense.
35. Inventories are reported on the balance sheet at  
a. current market value.  
b. historical cost.  
c. net realizable value.  
d. the lower of cost or market.
36. Property, plant and equipment are reported on the balance sheet at  
a. current market value.  
b. historical cost.  
c. historical cost minus accumulated depreciation.  
d. net realizable value.
37. Current liabilities are reported on the balance sheet at  
a. current market value.  
b. historical cost.  
c. discounted present value.  
d. future value.

38. Long-term debt is reported on the balance sheet at
- current market value.
  - net realizable value.
  - discounted present value.
  - future value.
39. The balance sheet amount reported for a long-term debt on the issue date is the
- discounted present value of the future principal repayment.
  - discounted present value of the periodic interest payments.
  - sum of the future value of principal repayment and the periodic interest payments.
  - sum of the discounted present values of the future principal repayments and the periodic interest payments.
40. The unpaid amount of income taxes due to the government for a given year are found on the
- balance sheet in the account Deferred Income Taxes.
  - balance sheet in the account Income Taxes Payable.
  - income statement in the account Income Tax Expense Current.
  - income statement in the account Income Tax Expense Deferred.
41. The amount of income taxes recognized on the income statement but not yet payable to the government are found on the
- balance sheet in the account Deferred Income Taxes.
  - balance sheet in the account Income Taxes Payable.
  - income statement in the account Income Tax Expense Current.
  - income statement in the account Income Tax Expense Deferred.
42. All of the following are true for trust preferred securities (TPS) except
- shares pay monthly or quarterly dividends.
  - there is a mandatory redemption feature.
  - they are classified in current liabilities.
  - they are considered a hybrid security.
43. The Common Stock account is reported on the balance sheet at the
- historical par value of the stock.
  - current market value of the stock.
  - net realizable value of the stock.
  - discounted present value of the future dividends.
44. The Additional Paid-In Capital account is reported on the balance sheet at the
- current market value of the stock minus par value.
  - historical sales price of the stock minus the par value.
  - net realizable value of the stock minus par value.
  - discounted present value of the future dividends minus par value.
45. The Retained Earnings account is comprised of
- cash retained in the business.
  - cash reinvested in the business by shareholders.
  - the cumulative earnings less dividends since the inception of the corporation.
  - the earnings of the corporation for the current year.
46. Retained earnings are reported on the balance sheet at
- historical cost.
  - current market value.
  - net realizable value.
  - a mixture of different bases.
47. In a common-size balance sheet, each balance sheet is expressed as a percentage of total
- liabilities.
  - assets.
  - shareholders' equity.
  - assets plus shareholders' equity.
48. In the United States, assets are presented in decreasing order of liquidity. In the United Kingdom and other European countries
- fixed assets are presented first followed by the current assets displayed in increasing order of liquidity.
  - the current assets are displayed in increasing order of liquidity.
  - investments are listed first in descending order of maturity.
  - each company decides on the order of its own assets.
49. All of the following disclosures would appear in the Summary of Significant Accounting Policies except
- inventory method.
  - depreciation method.
  - long-term construction contract method.
  - financing method.
50. Which one of the following equations explains why successive balance

sheets can be used to prepare a firm's cash flow statement?

- a. Assets = Liabilities – Equity
  - b. Cash – Noncash assets = Liabilities – Equity
  - c.  $\Delta \text{Cash} = \Delta \text{Liabilities} - \Delta \text{Noncash assets} + \Delta \text{Stockholders' equity}$
  - d.  $\Delta \text{Cash} = \Delta \text{Liabilities} + \Delta \text{Stockholders' equity}$
51. Operating activities result from the cash effects of
- a. producing and delivering goods and services.
  - b. purchasing and disposing of fixed assets used in production of revenue.
  - c. borrowing and repaying loans used in the production of revenue.
  - d. selling stocks and bonds to raise capital for the production of revenue.
52. Investing activities include the cash effects of
- a. producing and delivering goods and services.
  - b. purchasing and disposing of fixed assets used in production of revenue.
  - c. borrowing and repaying loans used to purchase fixed assets.
  - d. selling stocks and bonds to raise capital to purchase fixed assets.
53. Financing activities include the cash effects of
- a. producing and delivering goods and services.
  - b. purchasing and disposing of fixed assets used in production of revenue.
  - c. purchasing and disposing of debt securities.
  - d. selling stocks and bonds to raise capital for the production of revenue.
54. Companies that are considered to be in stronger financial health and better credit risks, are able to satisfy most of their cash needs from
- a. operating activities.
  - b. investing activities.
  - c. financing activities.
  - d. investing and financing activities.

Table 4-1

Selected data the Dot Corporation's comparative balance sheets for Year 1 and Year 2 are as follows:

Assets	Yar 1	Year 2
Cash	100,000	\$(50,000)
Accounts receivable (net)	50,000	100,000
Inventory	200,000	250,000
Equipment (net)	300,000	350,000
Total Assets	<u>\$550,000</u>	<u>\$650,000</u>

### Liabilities and Equity

Accounts payable	\$150,000	\$100,000
Income taxes payable	80,000	30,000
Bonds payable	100,000	80,000
Common stock	100,000	200,000
Retained earnings	120,000	240,000
Total Liabilities and Equity	<u>\$550,000</u>	<u>\$650,000</u>

A brief income statement for Year 2 shows the following:

Sales		900,000
Cost of goods sold	\$500,000	
Operating expenses	100,000	
Depreciation	50,000	
Income tax expense	100,000	750,000
Net Income		<u>\$150,000</u>

55. Refer to Table 4-1. How much cash did Dot collect from customers during Year 2?
- a. \$150,000
  - b. \$750,000
  - c. \$850,000
  - d. \$900,000
56. Refer to Table 4-1. How much cash did Dot pay to suppliers for inventory during Year 2?
- a. \$150,000
  - b. \$400,000
  - c. \$500,000
  - d. \$600,000
57. Refer to Table 4-1. How much did Dot pay in dividends to shareholders in Year 2?
- a. \$ 30,000
  - b. \$ 120,000
  - c. \$ 150,000
  - d. \$ 330,000
58. Refer to Table 4-1. How much did Dot pay in income taxes to the government in Year 2?
- a. \$ 30,000
  - b. \$ 80,000
  - c. \$ 110,000

d. \$ 150,000

**59.** Refer to Table 4-1. What are Dot's cash flows from operating activities for Year 2?

- a. \$ 0
- b. \$ 50,000 outflow
- c. \$ 150,000 outflow
- d. \$ 400,000 inflow

**60.** Refer to Table 4-1. What are Dot's cash flows from investing activities for Year 2?

- a. \$ 0
- b. \$ 100,000 inflow
- c. \$ 100,000 outflow
- d. \$ 350,000 outflow

**61.** Refer to Table 4-1. What are Dot's cash flows from financing activities for Year 2?

- a. \$ 0
- b. \$ 50,000 inflow
- c. \$ 50,000 outflow
- d. \$ 150,000 outflow

### Table 4-2

The Hampshire Company provides the following information from its Year 3 and Year 4 balance sheets:

	<u>Year 3</u>	<u>Year 4</u>
Accounts receivable	\$115,000	\$97,500
Inventory	120,000	130,000
Prepaid insurance	7,500	1,500
Prepaid rent	40,000	15,000
Accounts payable	55,000	65,000

The following information is available from the Year 4 income statement:

Sales	\$425,000
Cost of goods sold	225,000
Insurance expense	12,000
Rent expense	25,000

**62.** Refer to Table 4-2. How much cash did Hampshire collect from customers in Year 4?

- a. \$115,000

b. \$407,500

c. \$425,000

d. \$442,500

**63.** Refer to Table 4-2. How much cash did Hampshire pay for inventory during Year 4?

- a. \$130,000
- b. \$215,000
- c. \$225,000
- d. \$235,000

**64.** Refer to Table 4-2. How much cash did Hampshire pay for insurance during Year 4?

- a. \$ 6,000
- b. \$ 9,000
- c. \$ 12,000
- d. \$ 18,000

**65.** Refer to Table 4-2. How much cash did Hampshire pay for rent during Year 4?

- a. \$ 0
- b. \$ 15,000
- c. \$ 25,000
- d. \$ 40,000

**66.** Refer to Table 4-2. Assuming that the information provided from the income statement represents all of the pre-tax income of Hampshire Company, what is the difference between the accrual-basis and cash-basis income in Year 4?

- a. Accrual exceeds cash basis by \$16,500.
- b. Cash exceeds accrual basis by \$23,500.
- c. Accrual exceeds cash basis by \$25,000.
- d. Cash exceeds accrual basis by \$48,500.

### Essay and Computational Questions

**67.** What indication for the following firm behavior can be found in the statement of cash flows?

- a. Difficulties in cash collections
- b. Decrease in investments in long term assets

**68.** Below are the condensed balance sheets and income statement for the

Beltway Company, Inc. Assuming there were no disposals of fixed assets during the year 2005, provide the following items for the year ended December 31st, 2005:

- a. Collections from customers
- b. Payments to suppliers
- c. Insurance premium payment
- d. Interest payment
- e. Utility payments
- f. Wages payment
- g. Capital expenditures

**Condensed balance sheet December 31st**

	2004	2005
<b>Assets</b>		
Current assets		
Cash	8	15
Accounts receivable	53	58
Inventory	52	40
Prepaid insurance	5	3
Property plant and equipment	140	150
Accumulated depreciation	(45)	(55)
Net PP&E	95	95
<b>Total assets</b>	<b>213</b>	<b>211</b>
<b>Liabilities</b>		
Accounts payable	35	21
Wages payable	12	16
Interest payable	5	2
Taxes payable	3	4
Long-term debt	92	92
Common stock	50	50
Retained earnings	16	26
	213	211

**Condensed income statement for year ended December 31st, 2005**

Sales	480
COGS	328
Operating expenses	
Wages	103
Utilities	11
Insurance	3
Depreciation	10

Operating income	25
Interest	12
Income before tax	13
Tax	3
<b>Net income</b>	<b>10</b>

69. Below are the condensed balance sheet and income statement for the Beltway Company, Inc. Assuming there were no disposals of fixed assets during the year 2005, provide a statement of cash flows using the indirect method for the year ended December 31st, 2005.

**Condensed balance sheet December 31st**

	2004	2005
<b>Assets</b>		
Current assets		
Cash	8	15
Accounts receivable	53	58
Inventory	52	40
Prepaid insurance	5	3
Property plant and equipment	140	150
Accumulated depreciation	(45)	(55)
Net PP&E	95	95
<b>Total assets</b>	<b>213</b>	<b>211</b>
<b>Liabilities</b>		
Accounts payable	35	21
Wages payable	12	16
Interest payable	5	2
Taxes payable	3	4
Long-term debt	92	92
Common stock	50	50
Retained earnings	16	26
	213	211

**Condensed income statement for year ended December 31st, 2005**

Sales	480
COGS	328
Operating expenses	
Wages	103
Utilities	11
Insurance	3

Depreciation	10
Operating income	25
Interest	12
Income before tax	13
Tax	3
<hr/> Net income	<hr/> 10

1. E; True
2. E; False
3. M; False
4. M; False
5. E; True
6. E; False
7. M; True
8. M; False
9. M; False
10. M; True
11. M; True
12. M; True
13. M; False
14. M; True
15. M; False
16. M; True
17. M; True
18. M; False
19. M; True

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20. E; (a)
  21. E; (c)
  22. E; (b)
  23. M; (d)
  24. D; (a)
  25. M; (b)
  26. M; (a)
  27. M; (d)
  28. M; (a)
  29. M; (d)
  30. M; (b)
  31. D; (b)
  32. D; (c)
  33. M; (a)
  34. E; (b)
  35. M; (d)
  36. M; (c)

37. E; (b)
38. D; (c)
39. M; (d)
40. M; (b)
41. M; (a)
42. D; (c)
43. M; (a)
44. M; (b)
45. M; (c)
46. M; (d)
47. D; (b)
48. M; (a)
49. M; (d)
50. M; (c)
51. M; (a)
52. M; (b)
53. M; (d)
54. D; (a)
55. M; (c)
56. D; (d)
57. D; (a)
58. M; (d)
59. D; (a)
60. D; (c)
61. D; (b)
62. M; (d)
63. M; (c)
64. M; (a)
65. M; (a)
66. D; (d)

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Explanation to Selected Multiple-Choice Questions

**55.** \$900,000 sales – \$50,000 increase in A/R = \$850,000

**56.** \$500,000 + \$50,000 + \$50,000 = \$600,000  
COGS inventory increase A/P increase

**57.** \$120,000 + \$150,000 – \$240,000 = \$30,000  
beg. bal. R/E net income end. bal. R/E

**58.** \$100,000 tax expense + \$50,000 decrease in taxes payable = \$150,000

**59.** Net income \$150,000  
Depreciation 50,000  
Increase in A/R (50,000)  
Increase in inventory (50,000)

Decrease in A/P	(50,000)
Decrease in taxes payable	(50,000)
Operating cash flow	<u>\$ -0-</u>

60. \$350,000 + \$50,000 - \$300,000 = \$100,000 out flow  
 end. equip. depre. beg. equip. for equipment purchase

61. Sale of stock	\$100,000
Payment of bonds	(20,000)
Dividends paid	(30,000)
Financing cash inflows	<u>\$(50,000)</u>

62. \$425,000 sales + \$17,500A/R decrease = \$442,500

63. \$225,000 - \$10,000 + \$10,000 = \$225,000  
 COGS increase in Inventory increase in A/P

64. \$12,000 - \$6,000 = \$6,000  
 insurance decrease in expense prepaid insurance

65. \$25,000 rent expense - \$25,000 decrease in prepaid insurance = \$0

	Accrual Basis	Cash Basis
66. Revenue	\$425,000	\$442,500
Cost of goods sold	(225,000)	(225,000)
Insurance	(12,000)	(6,000)
Rent	(25,000)	-0-
<b>Net income</b>	<b>\$163,000</b>	<b>\$211,500</b>

Cash basis net income is \$48,500 more than accrual basis.

d. Interest payment	12 + 3 = 15	
e. Utility payments	11	
f. Wages payment	103 - 4 = 99	
g. Capital expenditures	10	DM

69. Suggested Answer:

Net income	10
Depreciation	10
	<hr/>
	20

Increase in A/R	-5
Decrease in inventory	12
Decrease in prepaid insurance	2
Decrease in A/P	-14
Increase in wages payable	4
Decrease in interest payable	-3
Increase in taxes payable	1
	<hr/>
Net cash provided by operating activity	17

PP&E acquisitions	-10
	<hr/>
Cash flow from investing	-10

Cash flow from financing 0

Change in cash balance	7
Cash balance 12/31/2004	8
sh balance 12/31/2004	15
	<hr/>
	DL

67. Suggested Answer:

- a. Relative decrease in Cash flow from operations coupled with increase in Accounts Rceivables.
- b. Relative increase in Cash flow from Investing activity - less negative (potentially lower than depreciation expense) DL

68. Suggested Answer:

- a. Collections from customers 480 - 5 = 475
- b. Payments to suppliers 328 - 12 + 14 = 330
- c. Insurance premium payment 3 - 2 = 1