True/False
Indicate whether the sentence or statement is true or false- MARK ON YOUR SCANTRON- A FOR TRUE AND B FOR FALSE.

1. In order to qualify as an S-Corporation, a business entity shall have less than 150 employees.
2. Borrowing and repayment of debt, and buying and selling an enterprise's own stock are examples of financing activities.
3. While the balance sheet presents a company’s financial position as of a specified date, the income statement presents the results of their operations for a specified period of time.

Multiple Choice
Identify the letter of the choice that best completes the statement or answers the question. CONTINUE TO RECORD YOUR ANSWERS ON YOUR SCANTRON.

4. The activities of a business enterprise are separated into three categories. These three categories are listed as the three components of the statement of cash flows. They include all but:
   a. Accruing
   b. Operating
   c. Investing
   d. Financing

5. Information that is material means that an error or alternative method of handling a transaction
   a. would possibly affect the judgment of someone relying on the financial statements.
   b. might cause a company to understate its earnings for the accounting period.
   c. would not affect the decisions of users.
   d. could increase the profitability of a company.

6. Which of the following categories on a statement of cash flows is used to report the cash flow effects of buying and selling long-term assets?
   a. Both financing and investing activities
   b. Operating activities
   c. Investing activities
   d. Financing activities

7. XYZ, Inc. paid $12,000 on January 1, 2004 for an insurance policy covering the period from January 1 through December 31, 2004. The following amounts should be reflected on their balance sheet as of July 31, 2004 and as an expense on the income statement for the 7 months ended July 31, 2004, respectively:
   a. No asset and $12,000 expense
   b. $12,000 asset and no expense
   c. $12,000 asset and $7,000 expense
   d. $5,000 asset and $7,000 expense

8. The financial statement which reports changes in all components of stockholders' equity is the
   b. Statement of Retained Earnings.
   c. Statement of Stockholders' Equity.
   d. Balance Sheet.
9. Which set of the following accounts normally would be reported as current liabilities on a classified balance sheet?
   a. Income taxes payable and Salaries payable
   b. Interest payable and Mortgage payable
   c. Accounts payable and Bonds payable
   d. Capital stock and Accounts payable

10. Accounting is a process designed to do all of the following relative to economic information, except:
   a. measure
   b. communicate
   c. identify
   d. project

11. The declaration that the financial statements "in our opinion, present fairly the financial position, operating results, and cash flows, in conformity with generally accepted accounting principles" would be found in which of the following parts of an annual report?
   a. Notes to Financial Statements
   b. Balance Sheet
   c. Management Discussion and Analysis
   d. Auditors’ Report

12. Working capital is defined as
   a. total assets minus total liabilities.
   b. total assets minus current liabilities.
   c. current assets minus current liabilities.
   d. current assets minus total liabilities.

13. Which of the following is a correct expression of one of the three basic financial statement models?
   a. Revenues + Expenses = Net income
   b. Beginning retained earnings + Net income + Dividends = Ending retained earnings
   c. Assets - Liabilities = Owners' equity
   d. Assets - Liabilities = Net income

14. Which of the following is the reason the dollar is used in the preparation of financial statements?
   a. Legal entity
   b. Monetary unit
   c. Going concern
   d. Time period

15. The preparation of financial statements require that the information be understandable
   a. to those willing to spend the time to understand it.
   b. only to those with a Ph.D. in accounting or a CPA.
   c. only to those who take an accounting course.
   d. only to financial analysts.

16. A form of entity ownership which suffers from dual-taxation is:
   a. Partnership
   b. I have no idea (not recommended)
   c. Corporation
   d. Joint-Venture

17. If a company has assets of $350,000, liabilities of $130,000, and retained earnings of $180,000, investments by the owners must be
   a. $310,000.
   b. $295,000.
   c. $40,000.
   d. $220,000.
18. One significant difference between a classified and a non-classified balance sheet is the distinction between
   a. resources invested by owners and resources earned from revenue activities.
   b. current and noncurrent items.
   c. economic resources (assets) and the sources of the assets (liabilities and owners' equity).
   d. liabilities and owners' equity.

19. Premiums Received in Advance for the ABC Insurance Company are considered
   a. stockholders' equity.
   b. liabilities.
   c. revenues.
   d. assets.

20. Which of the following statements is true?
   a. The income statement reports the cash deposits and cash withdrawals.
   b. Dividends are an expense and are reported on the income statement as a deduction from net income.
   c. The income statement shows the assets, liabilities, and profits of a company.
   d. Profits distributed to the owners are called dividends.

21. Assume that a company purchases merchandise for cash on March 9. It sells the merchandise on credit on April 3, and collects cash from the credit customer on May 4. If this series of transactions is typical for the company, its operating cycle is
   a. too short.
   b. April 3 to May 4.
   c. March 9 to April 3.
   d. March 9 to May 4.

22. The following lists items of financial information presented to users of financial information:

   1. Management’s discussion and analysis
   2. Balance sheet
   3. Income statement
   4. Letter to the shareholders
   5. Statement of cash flows
   6. Summary financial information
   7. Notes to financial statements
   8. Press release
   9. Statement of stockholders equity (or retained earnings)

Using the numbers above, which answer below lists the items required to be included in financial statements prepared in accordance with GAAP?

   a. 1,3,4 & 9
   b. All items listed
   c. All items listed, except 8
   d. 2,3,5,7 & 9

23. Revenues represent
   a. assets used or consumed in selling products or services.
   b. assets received from selling products or services.
   c. the dollar amount of bonds sold to the public.
   d. an outflow of assets resulting from the sale of goods or services.
24. Which of the following items is reported as a current asset on a classified balance sheet?
   a. Accounts receivable
   b. Accounts payable
   c. Land
   d. Common stock

25. Financial statements seek to reflect information which is both:
   a. none of the above
   b. relevant and recordable
   c. relevant and reliable
   d. collectible and conservative

Matching - COMPLETE BY WRITING THE LETTER IN THE SPACE TO THE LEFT OF THE QUESTION.

The following terms are appropriate for answering the questions that follow, assuming the use of accounting principles generally accepted in the United States of America (GAAP):

a. Earned  e. Historical Cost
b. Matching  f. Accrual
c. Benefit derived  g. Going concern
d. Conservatism  h. Materiality

26. Expenses are recorded when this has occurred

27. Recording expenses in the period that associated revenue has been recorded is an example of this fundamental accounting principle.

28. Revenue is recorded when it is.

29. GAAP records transactions in a fashion which attempts to reflect the substance of the transaction. The timing of such recordation may not reflect the time at which cash is received or paid. This basis of accounting is the _______ basis of accounting.

30. Assets are recorded at the value originally paid and not adjusted upward for increases in their fair-value.

31. GAAP requires that contingent losses be immediately recorded. This is because of this constraint.

32. A Company may elect to not present certain financial information because the benefit of the additional information would not impact the decision-making of a reasonably informed financial statement user. This is because of the principle of _______.

33. When preparing financial statements, assets and liabilities are not valued at their liquidation values because they are not assumed to be liquidated within the next year. This assumption is known as:

Completion

Complete each sentence or statement. - write your answer in the space provided.

34. Another term for the balance sheet is a statement of ____________ ____________.
35. XYZ, Inc. had the following balances as of December 31, 2004 and activity for the year ended December 31, 2004 before “closing-out” retained earnings.

- Cash: 100,000
- Accounts receivable: 75,000
- Inventory: 275,000
- Fixed assets: 1,000,000
- Accounts payable: 500,000
- Long-term debt: 750,000
- Common stock: 10,000
- Retained Earnings - Not closed: 50,000
- Sales (all on credit): 1,000,000
- Cost of goods sold: 750,000
- Selling & administrative expense: 100,000
- Interest expense: 10,000

Based on the information above, prepare a classified balance sheet (including all required subtotals) as of December 31, 2004 and a multiple-step income statement (including all required subtotals) for the year ended December 31, 2004. Remember to close-out retained earnings in order for your balance sheet to balance. There is no tax provision in this exercise because this is a classroom and it makes your life easier that way.

**PART II:**
Assume that the accounts receivable balance at the beginning of the year was $65,000 and the inventory balance at the beginning of the year was $265,000.

Using the balance sheet and income statement you prepared above, compute the following for XYZ, Inc.:

1) Accounts receivable turnover ratio in days (assume 365 days/year and round to the nearest day)
2) Inventory turnover ratio in days (assume 365 days/year and round to the nearest day)
3) Operating cycle in days
4) Profit margin ratio as a percentage
5) Profit ratio as a percentage
S05 MT1
Answer Section

TRUE/FALSE

1. ANS: F
   Should have less than 75 employees
2. ANS: T
3. ANS: T

MULTIPLE CHOICE

4. ANS: A
5. ANS: A  DIF: 2  REF: p. 59  OBJ: 2
6. ANS: C  DIF: 1  REF: p. 70-71  OBJ: 8
7. ANS: D
8. ANS: C  DIF: 1  REF: p. 70  OBJ: 7
9. ANS: A  DIF: 2  REF: p. 64-65  OBJ: 3
10. ANS: D
11. ANS: D  DIF: 2  REF: p. 75-78  OBJ: 9
12. ANS: C  DIF: 1  REF: p. 65  OBJ: 4
13. ANS: C  DIF: 2  REF: p. 17  OBJ: 2
14. ANS: B  DIF: 2  REF: p. 22-23  OBJ: 3
15. ANS: A  DIF: 1  REF: p. 56  OBJ: 2
16. ANS: C
17. ANS: C  DIF: 3  REF: p. 19-22  OBJ: 2
18. ANS: B  DIF: 1  REF: p. 63  OBJ: 3
19. ANS: B  DIF: 2  REF: p. 64-65  OBJ: 3
20. ANS: D  DIF: 3  REF: p. 19-20  OBJ: 2
22. ANS: D
23. ANS: B  DIF: 2  REF: p. 9  OBJ: Intro
24. ANS: A  DIF: 1  REF: p. 63  OBJ: 3
25. ANS: C

MATCHING

26. ANS: C
27. ANS: B
28. ANS: A
29. ANS: F
30. ANS: E
31. ANS: D
32. ANS: H
33. ANS: G
COMPLETION

34. ANS: Financial Position

PROBLEM

35. ANS:

XYZ, INC.
BALANCE SHEET
AS OF 12/31/04

<table>
<thead>
<tr>
<th>ASSETS</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Cash</td>
<td>100,000</td>
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</tr>
<tr>
<td>Accounts receivable</td>
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<tr>
<td>Inventory</td>
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<tr>
<td>Current assets</td>
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</tr>
<tr>
<td>Fixed assets</td>
<td>1,000,000</td>
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<td></td>
</tr>
<tr>
<td>Total Assets</td>
<td>1,450,000</td>
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</table>

<table>
<thead>
<tr>
<th>LIABILITIES &amp; STOCKHOLDERS EQUITY</th>
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</thead>
<tbody>
<tr>
<td>Accounts payable</td>
<td>500,000</td>
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</tr>
<tr>
<td>Current liabilities</td>
<td>500,000</td>
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<td></td>
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<tr>
<td>Long-term debt</td>
<td>750,000</td>
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</tr>
<tr>
<td>Common stock</td>
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<tr>
<td>Retained Earnings</td>
<td>190,000</td>
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<tr>
<td>Equity</td>
<td>200,000</td>
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<tr>
<td>Total liabilities &amp; stockholders equity</td>
<td>1,450,000</td>
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</table>

XYZ, INC.
INCOME STATEMENT
FOR THE YEAR ENDED 12/31/04

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>Sales</td>
<td>1,000,000</td>
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<tr>
<td>Cost of goods sold</td>
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<tr>
<td>Gross Profit</td>
<td>250,000</td>
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<td>Selling &amp; administrative expense</td>
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</tr>
<tr>
<td>Interest expense</td>
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</tr>
<tr>
<td>Net Income</td>
<td>140,000</td>
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</tbody>
</table>

PART II:
(1) A/R Turnover = Sales / Average accounts receivable
   A/R Turnover = 1,000,000 / (75,000 + 65,000) / 2
   = 14.285714
   Convert to days (365 / ratio) = 26 days

(2) Inventory Turnover = COGS / Average accounts receivable
   Inventory Turnover = 750,000 / (275,000 + 265,000) / 2
   = 2.7777778
   Convert to days (365 / ratio) = 131 days

(3) Operating cycle = A/R turnover + Inventory turnover
   157

(4) Gross profit ratio = gross profit / sales
   25%

(5) Gross profit ratio = net income / sales
   14%