S05 MT1

**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.*

1. 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. $220,000.
   b. $295,000.
   c. $310,000.
   d. $40,000.

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

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

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

5. 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. Operating activities
   b. Investing activities
   c. Financing activities
   d. Both financing and investing activities

6. Which of the following items is reported as a current asset on a classified balance sheet?
   a. Accounts receivable
   b. Common stock
   c. Accounts payable
   d. Land

7. Revenues represent
   a. an outflow of assets resulting from the sale of goods or services.
   b. assets received from selling products or services.
   c. assets used or consumed in selling products or services.
   d. the dollar amount of bonds sold to the public.

8. Which of the following is the reason the dollar is used in the preparation of financial statements?
   a. Monetary unit
   b. Going concern
   c. Time period
   d. Legal entity
9. Which set of the following accounts normally would be reported as current liabilities on a classified balance sheet?
   a. Accounts payable and Bonds payable
   b. Interest payable and Mortgage payable
   c. Income taxes payable and Salaries payable
   d. Capital stock and Accounts payable

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

11. 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. would not affect the decisions of users.
   c. might cause a company to understate its earnings for the accounting period.
   d. could increase the profitability of a company.

12. 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. Operating
   b. Financing
   c. Accruing
   d. Investing

13. 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. Balance Sheet
   b. Management Discussion and Analysis
   c. Notes to Financial Statements
   d. Auditors’ Report

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

15. Which of the following is a correct expression of one of the three basic financial statement models?
   a. Assets - Liabilities = Net income
   b. Assets - Liabilities = Owners' equity
   c. Revenues + Expenses = Net income
   d. Beginning retained earnings + Net income + Dividends = Ending retained earnings
16. One significant difference between a classified and a non-classified balance sheet is the distinction between
   a. economic resources (assets) and the sources of the assets (liabilities and owners' equity).
   b. current and noncurrent items.
   c. liabilities and owners' equity.
   d. resources invested by owners and resources earned from revenue activities.

17. 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. $5,000 asset and $7,000 expense
   b. $12,000 asset and $7,000 expense
   c. $12,000 asset and no expense
   d. No asset and $12,000 expense

18. The financial statement which reports changes in all components of stockholders' equity is the
   a. Statement of Retained Earnings.
   b. Balance Sheet.
   d. Statement of Stockholders' Equity.

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

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

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

22. 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
   b. April 3 to May 4.
   c. March 9 to April 3.
   d. too short.

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

23. 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.

24. In order to qualify as an S-Corporation, a business entity shall have less than 150 employees.

25. Borrowing and repayment of debt, and buying and selling an enterprise's own stock are examples of financing activities.
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 

b. Matching 

c. Benefit derived 

d. Conservatism 

e. Historical Cost 

f. Accrual 

g. Going concern 

h. Materiality

____ 26. 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.

____ 27. 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:

____ 28. Assets are recorded at the value originally paid and not adjusted upward for increases in their fair-value.

____ 29. Revenue is recorded when it is.

____ 30. Recording expenses in the period that associated revenue has been recorded is an example of this fundamental accounting principle.

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

____ 32. Expenses are recorded when this has occurred

____ 33. 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 ________.

Completion

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

34. Another term for the balance sheet is a statement of ____________ ____________.
Problem-complete in your blue-book or in the space provided, whichever you prefer.

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

MULTIPLE CHOICE

1. ANS: D DIF: 3 REF: p. 19-22 OBJ: 2
2. ANS: A
3. ANS: A DIF: 3 REF: p. 19-20 OBJ: 2
4. ANS: B DIF: 1 REF: p. 56 OBJ: 2
5. ANS: B DIF: 1 REF: p. 70-71 OBJ: 8
6. ANS: A DIF: 1 REF: p. 63 OBJ: 3
7. ANS: B DIF: 2 REF: p. 9 OBJ: Intro
8. ANS: A DIF: 2 REF: p. 22-23 OBJ: 3
9. ANS: C DIF: 2 REF: p. 64-65 OBJ: 3
10. ANS: D DIF: 1 REF: p. 65 OBJ: 4
11. ANS: A DIF: 2 REF: p. 59 OBJ: 2
12. ANS: C
13. ANS: D DIF: 2 REF: p. 75-78 OBJ: 9
14. ANS: B
15. ANS: B DIF: 2 REF: p. 17 OBJ: 2
16. ANS: B DIF: 1 REF: p. 63 OBJ: 3
17. ANS: A
18. ANS: D DIF: 1 REF: p. 70 OBJ: 7
19. ANS: B DIF: 2 REF: p. 64-65 OBJ: 3
20. ANS: B
21. ANS: B
22. ANS: A DIF: 2 REF: p. 61-62 OBJ: 3

TRUE/FALSE

23. ANS: T
24. ANS: F
   Should have less than 75 employees
25. ANS: T

MATCHING

26. ANS: F
27. ANS: G
28. ANS: E
29. ANS: A
30. ANS: B
31. ANS: D
32. ANS: C
33. ANS: H
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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</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>100,000</td>
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</tr>
<tr>
<td>Accounts receivable</td>
<td>75,000</td>
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<tr>
<td>Inventory</td>
<td>275,000</td>
<td></td>
</tr>
<tr>
<td>Current assets</td>
<td>450,000</td>
<td></td>
</tr>
<tr>
<td>Fixed assets</td>
<td>1,000,000</td>
<td></td>
</tr>
<tr>
<td>Total Assets</td>
<td>1,450,000</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>LIABILITIES &amp; STOCKHOLDERS EQUITY</th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts payable</td>
<td>500,000</td>
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<tr>
<td>Current liabilities</td>
<td>500,000</td>
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<tr>
<td>Long-term debt</td>
<td>750,000</td>
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<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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</tbody>
</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>
<tr>
<td>Cost of goods sold</td>
<td>750,000</td>
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<tr>
<td>Gross Profit</td>
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<tr>
<td>Selling &amp; administrative expense</td>
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<tr>
<td>Interest expense</td>
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<tr>
<td>Net Income</td>
<td>140,000</td>
<td></td>
</tr>
</tbody>
</table>

PART II:

1) A/R Turnover: sales/ Average accounts receivable

\[
A/R \text{ Turnover} = \frac{1,000,000}{(75,000 + 65,000)/2} = 14.285714
\]

Convert to days (365/ratio) 26 days

2) Inventory Turnover: COGS/ Average accounts receivable

\[
\text{Inventory Turnover} = \frac{750,000}{(275,000 + 285,000)/2} = 2.777778
\]

Convert to days (365/ratio) 131 days

3) Operating cycle: A/R turnover + Inventory turnover

157 days

4) Gross profit ratio: gross profit/ sales

25%

5) Gross profit ratio: net income/ sales

14%