

# Test Bank for Financial Accounting The Impact on Decision Makers 7th Edition by Gary A.Porter, Curtis L.Norton

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## Chapter 1: Accounting as a Form of Communication

1. The three forms of business entities are:

- A. Government, cooperatives, and philanthropic organizations
- B. Financing, investing, and operating
- C. Sole proprietorships, partnerships, and corporations**
- D. Wholesaler, manufacturer, and retailer

2. Which of the following would be classified as external users of financial statements?

- A. Stockholders and management of the company
- B. The controller of the company and a company's stockholders
- C. The company's marketing managers
- D. The creditors and stockholders of the company**

3. Which of the following statements would be true if you own stock in a company?

- A. You are an owner of the retained earnings and capital stock of the company.
- B. You have a claim to the assets of the business**
- C. You have the right to receive interest on an annual basis.
- D. You have the right to a portion of the company's revenues each accounting period.

4. Which of the following statements best describes the term revenues?

- A. Revenues represent an outflow of assets resulting from the sale of goods or services.
- B. Revenues represent assets received from the sale of products or services.**
- C. Revenues represent assets used or consumed in the sale of products or services.
- D. Revenues represent the dollar amount of bonds sold to the public.

5. Which one of the following events involves a liability for a business?

- A. Loans to be repaid to banks**
- B. Inventories purchased for cash
- C. Amounts invested by the owners
- D. Stock sold to the general public

6. Which of the following best describes the term “expenses”?

- A. The amount of total profits earned by a business since it began operations.
- B. The amount of interest or claim that the owners have in the business.
- C. The future economic resources of a business entity.
- D. The outflow of assets resulting from the sale of goods and services.

7. Which one of the following business decisions will **least** likely require financial information?

- A. The Local Bank is reviewing the loan application from Marla Boutique Corp.
- B. Marla Boutique Corp. is attempting to sell its stock to the public.
- C. The labor union representing Lawn Doctor’s employees is negotiating a pay raise as part of a new labor agreement.
- D. Marla Boutique’s management is deciding whether to wash its vans today or tomorrow.

8. Which one of the following is **not** an external user of financial information?

- A. Company management
- B. Internal Revenue Service
- C. Creditors
- D. Stockholders

9. Bush Company is ready to sell its bonds. Which one of the following financial questions will investors most likely want answered before they make a purchase?

- A. How much did Bush Company earn last year?
- B. What will be Bush Company’s cost to start operations in another city?
- C. How much debt does Bush Company already have?
- D. Will Bush Company pay dividends?

10. What is the name of the branch of accounting concerned with providing managers and administrators with information to facilitate the planning and control of business operations?

- A. Management accounting
- B. Auditing
- C. Financial accounting
- D. Bookkeeping

11. Which of the following invests funds into a business and is considered an owner?

- A. Stockholders
- B. Creditors
- C. Bankers
- D. Lenders

12. Which one of the following is **not** one of the three activities included in the definition of accounting?

- A. Communicating
- B. Identifying
- C. Measuring
- D. Operating

13. Which one of the following is **not** an external user of financial statements?

- A. Suppliers
- B. Creditors
- C. Investors
- D. The company's controller

14. Which one of the following is **least** likely to be a user of financial information of a grocery store?

- A. The manager of the grocery store
- B. The supplier of milk to the grocery store.
- C. A stockbroker looking for a possible investment
- D. A customer at the grocery store

15. Which one of the following groups is considered an internal user of financial statements?

- A. A bank reviewing a loan application from a corporation.
- B. The labor union representing employees of a company that is involved in labor negotiations
- C. The financial analysts for a brokerage firm who are preparing recommendations for the firm's brokers on companies in a certain industry,
- D. Factory managers that supervise production line workers.

16. Which of the following is an organization that lends funds to a business entity and expects repayment of the funds?

- A. A partner
- B. A stockholder
- C. An owner
- D. A creditor

17. You are a potential stockholder and are concerned that a particular company you are ready to invest in might have too much debt. Which financial statement would provide you information needed in order to evaluate your concern?

- A. Balance sheet
- B. Income statement
- C. Statement of retained earnings
- D. Statement of public accounting

18. Which financial statement would you analyze to determine if a company distributed any of its profits to its shareholders?

- A. Balance Sheet
- B. Statement of Retained Earnings**
- C. Income Statement
- D. Statement of Public Accounting

19. Which financial statement would you refer to in order to determine whether a company owed funds to creditors?

- A. Balance Sheet**
- B. Statement of Retained Earnings
- C. Income Statement
- D. Statement of Public Accounting

20. Which one of the following is an economic obligation for a business entity?

- A. Salaries paid to employees for services rendered
- B. Amounts owed to creditors**
- C. Materials used in manufacturing products
- D. Payment of rent for the next year

21. Which one of the following is a correct expression of the accounting equation?

- A. Assets + Liabilities = Owners' Equity
- B. Assets = Liabilities - Owners' Equity
- C. Assets + Owners' Equity = Liabilities
- D. Assets = Liabilities + Owners' Equity**

22. How is the balance sheet linked to the other financial statements?

- A. The amount of retained earnings reported on the balance sheet is equal to net income.
- B. Retained earnings is added to total assets and reported on the balance sheet.
- C. Net income increases retained earnings on the statement of retained earnings, which ultimately increases retained earnings on the balance sheet.**
- D. There is no link between the balance sheet and other statements, as each contains different accounts and provides different information.

23. Which of the following is the correct date format for the financial statement heading?

- A. Balance sheet for the year ended June 30, 2012
- B. Income statement at December 31, 2012
- C. Balance sheet at December 31, 2012**
- D. Statement of retained earnings at December 31, 2012

24. Which of the following best describes the term “retained earnings”?

- A. The amount of total profits earned by a business since it began operations.
- B. The amount of interest or claim that the owners have on the assets of the business.
- C. The future economic resources of a business entity.
- D. The cumulative profits earned by the business less any dividends distributed.

25. Which of the following best describes the term “assets”?

- A. The amount of total profits earned by a business since it began operations.
- B. The amount of interest or claim that the owners have in the business.
- C. The economic resources of a business entity.
- D. The cumulative profits earned by a business less any dividends distributed.

26. Which one of the following items is correct concerning the time element of financial statements?

- A. The balance sheet covers a period of time.
- B. The statement of retained earnings explains changes during a particular period.
- C. An income statement lists amounts at a specific point in time.
- D. Both the income statement and the balance sheet cover a period of time.

27. Which one of the following items appears on a balance sheet?

- A. Accounts payable
- B. Sales revenue
- C. Utilities expense
- D. Cost of goods sold

28. Which one of the following financial statements reports an entity’s financial position at a specific date?

- A. Balance sheet
- B. Statement of retained earnings
- C. Income statement
- D. Both the income statement and the balance sheet

29. Which one of the following correctly represents one of the 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

30. Which of the following statements is true?

- A. Profits distributed to the creditors are called dividends.
- B. The balance sheet 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 revenues and expenses of a company.**

31. Which of the following terms best describes a distribution of the net income of a business to its owners?

- A. Revenue
- B. Dividends**
- C. Earnings
- D. Monetary unit

32. Which statement summarizes the income earned and the dividends paid?

- A. Statement of cash flows
- B. Statement of retained earnings**
- C. Balance sheet
- D. Income statement

33. The costs of doing business through the sale of goods and services are called

- A. Net income
- B. Expenses**
- C. Revenues
- D. Dividends

34. Tempo Corporation's end-of-year balance sheet consisted of the following amounts:

Cash	\$ 15,000	Accounts receivable	\$ 50,000
Property, plant, and equipment	70,000	Long-term debt	40,000
Capital stock	100,000	Accounts payable	20,000
Retained earnings	?	Inventory	35,000

What amount should Tempo report on its balance sheet for *total assets*?

- A. \$110,000
- B. \$155,000
- C. \$170,000**
- D. \$190,000

35. Ronald Corporation's end-of-year balance sheet consisted of the following amounts:

Cash	\$ 25,000	Accounts receivable	\$ 48,000
Property, plant, and equipment	69,000	Long-term debt	40,000
Capital stock	100,000	Accounts payable	20,000
Retained earnings	?	Inventory	33,000

What amount should Ronald report on its balance sheet for *total assets*?

- A. \$175,000**
- B. \$141,000
- C. \$195,000
- D. \$194,000

36. Tempo Corporation's end-of-year balance sheet consisted of the following amounts:

Cash	\$ 15,000	Accounts receivable	\$ 50,000
Property, plant, and equipment	70,000	Long-term debt	40,000
Capital stock	100,000	Accounts payable	20,000
Retained earnings	?	Inventory	35,000

What is Tempo's *retained earnings* balance at the end of the current year?

- A. \$10,000**
- B. \$110,000
- C. \$160,000
- D. \$170,000

37. Ronald Corporation's end-of-year balance sheet consisted of the following amounts:

Cash	\$ 25,000	Accounts receivable	\$ 46,000
Property, plant, and equipment	69,000	Long-term debt	41,000
Capital stock	107,000	Accounts payable	22,000
Retained earnings	?	Inventory	33,000

What is Ronald's *retained earnings* balance at the end of the current year?

- A. \$10,000
- B. \$3,000**
- C. \$66,000
- D. \$110,000

38. Ronald Corporation's end-of-year balance sheet consisted of the following amounts:

Cash	\$ 25,000	Accounts receivable	\$ 46,000
Property, plant & equipment	69,000	Long-term debt	41,000
Capital stock	107,000	Accounts payable	22,000
Retained earnings	?	Inventory	33,000

What is Ronald's *total liabilities* balance at the end of the current year?

- A. \$3,000
- B. \$110,000
- C. \$63,000**
- D. \$173,000

39. Ronald Corporation's end-of-year balance sheet consisted of the following amounts:

Cash	\$ 25,000	Accounts receivable	\$ 46,000
Property, plant & equipment	69,000	Long-term debt	41,000
Capital stock	107,000	Accounts payable	22,000
Retained earnings	?	Inventory	33,000

What is Ronald's *owners' equity* balance at the end of the current year?

- A. \$3,000
- B. \$110,000**
- C. \$63,000
- D. \$173,000

40. The Ranier Company reported the following items on its financial statements for the year ending December 31, 2012:

Sales	\$ 560,000	Cost of goods sold	\$400,000
Salary expense	40,000	Interest expense	30,000
Dividends	20,000	Income tax expense	25,000

The income statement for Ranier will report *net income* for the current year in the amount of

- A. \$ 45,000
- B. \$ 65,000**
- C. \$ 85,000
- D. \$ 465,000

41. The Ranier Company reported the following items on its financial statements for the year ending December 31, 2012:

Sales	\$ 560,000	Cost of goods sold	\$400,000
Salary expense	40,000	Interest expense	30,000
Dividends	20,000	Income tax expense	25,000

How much will be reported as *retained earnings* on Ranier's balance sheet at December 31, 2012, if this is the first year of operations?

- A. \$ 45,000**
- B. \$ 65,000
- C. \$ 85,000
- D. Not enough information is provided.

42. Raymond Corporation reported the following information for the year ended December 31, 2012:

Net income	\$ 10,000
Dividends	6,000
Retained earnings at December 31, 2012	25,000

What was the balance of Raymond's retained earnings at January 1, 2012?

- A. \$21,000**
- B. \$29,000
- C. \$31,000
- D. \$35,000

43. Raymond Corporation reported the following information for the year ended December 31, 2012:

Net income	\$ 10,000
Dividends	6,000
Retained earnings at December 31, 2012	25,000

What was the economic effect of the payment of Raymond's dividends?

- A. The dividend reduced net income for 2012.**
- B. The dividend should be equal to net income if the company's accounting equation is in balance.
- C. The dividends reduce total retained earnings for the year.**
- D. The dividends must be paid whenever Raymond Corp. reports net income.

44. Clark Corp. reported the following information for the year ended December 31, 2012:

Revenues	\$ 50,000
Expenses	20,000
Retained earnings at December 31, 2011	100,000
Retained earnings at December 31, 2012	105,000

How much was paid out in dividends by Clark in 2012?

- A. \$ 20,000
- B. \$ 25,000**
- C. \$ 30,000
- D. \$ 50,000

45. Tiny Corp. reported the following information for the year ended December 31, 2012.

Revenue	\$ 40,000
Expenses	23,000
Dividends	10,000
Retained earnings at December 31, 2012	175,000

What was the retained earnings balance for Tiny at December 31, 2011?

- A. \$ 165,000
- B. \$ 168,000**
- C. \$ 182,000
- D. \$ 192,000

46. Star Consultants had the following balance sheet amounts at the beginning of the year:

Total assets	\$400,000
Total owner's equity	150,000

During the year, total assets increased by \$100,000 and total liabilities increased by \$40,000. The company also paid \$30,000 in dividends. No other transactions occurred except revenues and expenses. How much is net income for the year?

- A. \$30,000
- B. \$60,000
- C. \$70,000
- D. \$90,000**

47. On January 1, 2012, Zonka Company's balance in retained earnings was \$70,000. At the end of the year, December 31, 2012, the balance in retained earnings was \$94,000. During 2012, the company earned net income of \$40,000. How much were dividends?

- A. \$16,000**
- B. \$24,000
- C. \$40,000
- D. \$64,000

48. On January 1, 2012, America Company's balance in retained earnings was \$70,000. During 2012, the company earned net income of \$43,000 and paid \$15,000 in dividends. Calculate the retained earnings balance at December 31, 2012.

- A. \$42,000
- B. \$90,000
- C. \$98,000**
- D. \$113,000

49. The following information is provided by the Sensible Corporation:

Beginning retained earnings	\$ 50,000
Ending retained earnings	70,000
Dividends paid	10,000
Revenue	50,000

What is the net income for Sensible Corp.?

- A. \$10,000
- B. \$20,000
- C. \$30,000**
- D. Unable to tell from the information provided.

50. The following information is provided by the Sensible Corporation:

Beginning retained earnings	\$ 50,000
Ending retained earnings	70,000
Dividends Paid	10,000
Revenue	50,000

Calculate Sensible Corporation's expenses.

- A. \$20,000**
- B. \$30,000
- C. \$40,000
- D. Cannot tell from the information provided.

51. If a company has \$152,000 of revenues, declares and pays \$55,000 in dividends, and has net income of \$89,000, how much were expenses for the year?

- A. \$ 8,000
- B. \$ 63,000**
- C. \$144,000
- D. Unable to determine the amount due to incomplete information.

52. Gardner Company reports the following information at December 31, 2012:

Revenue	\$150,000
Cash	\$ 30,000
Accounts payable	\$ 40,000
Dividends	\$ 10,000
Expenses	\$ 85,000

What is Gardner Company's net income?

- A. \$ 15,000
- B. \$ 45,000
- C. \$ 55,000
- D. \$ 65,000**

53. T. Price Company has assets of \$350,000, liabilities of \$130,000, and retained earnings of \$180,000. How much is total owners' equity?
- A. \$ 40,000
  - B. \$ 170,000
  - C. \$ 220,000**
  - D. \$ 350,000
54. Gabe's Shop reported a net loss of \$15,000 and total expenses of \$80,000. How much are total revenues?
- A. \$ 15,000
  - B. \$ 65,000**
  - C. \$ 95,000
  - D. The answer cannot be determined from the information given.
55. Which concept is the reason the dollar is used in the preparation of financial statements?
- A. Going concern
  - B. Legal entity
  - C. Monetary unit**
  - D. Time Period
56. Which one of the following is an assumption made in the preparation of financial statements?
- A. Financial statements are prepared for a specific entity that is distinct from the entity owners.**
  - B. Financial statements are prepared assuming that inflation has a distinct effect on the monetary unit
  - C. Preparation of financial statements for a specific time period assumes that the balance sheet covers a period of time.
  - D. Market values are always assumed to be irrelevant when preparing financial statements.
57. Why is the time period assumption required?
- A. Inflation exists
  - B. External users of financial statements want statements that accurately reflect net income or earnings for a specific time period.**
  - C. The dollar is the monetary unit in the United States.
  - D. The federal government requires it.
58. Which one of the following statements is true concerning assets?
- A. They are recorded at market value and then adjusted for inflation.
  - B. They are recorded at market value for financial reporting purposes as historical cost may be arbitrary.
  - C. Accountants use the term historical cost to refer to the original cost of an asset.**
  - D. Assets are measured using the time-period approach.

59. Zach Enterprises purchased land for \$2,000,000 in 1997. In 2012, an independent appraiser assessed the value at \$4,400,000. What amount should appear on the financial statements in 2012 with respect to the land?
- A. \$2,000,000**
  - B. \$2,400,000
  - C. \$4,400,000
  - D. Whatever amount the company believes is the best indicator of the true value of the land.
60. Which of the following organizations is primarily responsible for establishing GAAP today?
- A. Financial Accounting Standards Board (FASB)**
  - B. Securities and Exchange Commission (SEC)
  - C. Internal Revenue Service (IRS)
  - D. Federal Government
61. Which of the following organizations is responsible for setting auditing standards followed by public accounting firms in conducting independent audits of financial statements?
- A. Financial Accounting Standards Board (FASB)
  - B. Securities and Exchange Commission (SEC)
  - C. Public Company Accounting Oversight Board (PCAOB)**
  - D. International Accounting Standards Board (IASB)
62. Which organization, in addition to the Financial Accounting Standards Board (FASB), occasionally issues authoritative rules for financial statements?
- A. The Accounting Profession
  - B. International Accounting Standards Board (IASB)
  - C. Securities and Exchange Commission (SEC)**
  - D. Internal Revenue Service (IRS)
63. The Securities and Exchange Commission (SEC) is concerned with
- A. All companies in the United States regardless of size.
  - B. Companies that issue securities to the general public.**
  - C. Accounting reports issued by government entities.
  - D. All domestic and international companies that issue accounting reports.
64. To which of the following entities must a company report if it sells its stock on the organized stock market?
- A. American Institute of Certified Public Accountants (AICPA)
  - B. American Accounting Association (AAA)
  - C. International Accounting Standards Board (IASB)
  - D. Securities and Exchange Commission (SEC)**

65. The reliability of the information in a company's financial statements is the responsibility of which of the following?

- A. The Securities and Exchange Commission (SEC)
- B. The Certified Public Accountant in charge of the audit of the company's financial statements
- C. The company's management
- D. The stockholders of the company.

66. In order for accounting information to be useful in making informed decisions, it must be

- A. relevant
- B. reliable
- C. both relevant and reliable
- D. nether relevant nor reliable

67. The second step in the ethical decision-making model is to

- A. List alternatives and evaluate the impact of each on those affected
- B. Select the best alternative
- C. Recognize an ethical dilemma
- D. Analyze the key elements in the situation

68. All of the following are important provisions of the Sarbanes-Oxley Act **except**:

- A. The establishment of a new Public Company Accounting Oversight Board.
- B. The requirement to prepare both FASB and IASB financial statements.
- C. A requirement that the external auditors report directly to the company's audit committee.
- D. A clause to prohibit public accounting firms that audit a company from providing any other services that could impair their ability to act independently in the course of their audit.

69. When selecting between the best alternatives regarding an ethical dilemma in accounting all of the following should be considered **except**:

- A. which alternative provides the most relevant information.
- B. which alternative provides the most accurate information.
- C. which alternative provides the most neutral information.
- D. which alternative provides the most profitable information.

70. Which of the following is a five-member body that has the authority from Congress to set standards for conducting audits?

- A. FASB
- B. SEC
- C. PCAOB
- D. AICPA

71. The inflow of assets resulting from the sale of products and services is called a(n)

- A. asset
- B. liability
- C. revenue**
- D. expense

72. Top Choice Inc. had net income for 2012 of \$40,000. It declared and paid a \$3,500 cash dividend in 2012. If the company's retained earnings for the end of the year was \$38,200, what was the company's retained earnings balance at the beginning of 2012?

- A. \$81,700
- B. \$74,700
- C. \$5,300
- D. \$1,700**

73. Kingston Inc. had net income for 2012 of \$24,000. It declared and paid a \$13,000 cash dividend in 2012. If the company's retained earnings for the end of the year was \$39,600, what was the company's retained earnings balance at the beginning of 2012?

- A. \$28,600**
- B. \$50,600
- C. \$76,600
- D. \$2,600

74. At December 31, 2012, the accounting records of Green Corporation contain the following:

Accounts payable	\$16,000	Accounts receivable	\$40,000
Land	\$240,000	Cash	?
Capital stock	?	Equipment	\$120,000
Building	\$180,000	Notes payable	\$190,000
Retained earnings	\$160,000		

If capital stock is \$260,000, what is the December 31, 2012 cash balance?

- A. \$46,000**
- B. \$506,000
- C. \$94,000
- D. \$86,000

75. At December 31, 2012, the accounting records of Green Corporation contain the following:

Accounts payable	\$16,000	Accounts receivable	\$40,000
Land	\$240,000	Cash	?
Capital stock	?	Equipment	\$120,000
Building	\$180,000	Notes payable	\$190,000
Retained earnings	\$160,000		

If Cash is \$26,000, what is the December 31, 2012 capital stock balance?

- A. \$272,000
- B. \$240,000**
- C. \$220,000
- D. \$400,000

76. Easton Enterprises began the year with total assets of \$450,000 and total liabilities of \$230,000. If Easton's total assets increased by \$80,000 and its total liabilities increased by \$57,000 during the year, what is the amount of Easton's owners' equity at the end of the year?

- A. \$197,000
- B. \$543,000
- C. \$243,000**
- D. \$220,000

77. Easton Enterprises began the year with total assets of \$450,000 and total liabilities of \$230,000. If Easton total liabilities increased by \$31,000 and its owners' equity decreased by \$53,000 during the year, what was the amount of its total assets at the end of the year?

- A. \$472,000
- B. \$242,000
- C. \$198,000
- D. \$428,000**

78. The natural progression in items from one statement to another and preparation of financial statements is best represented by the following order:

- A. Balance sheet and statement of cash flows > statement of retained earnings > income statement
- B. Balance sheet and statement of cash flows > income statement > statement of retained earnings.
- C. Statement of retained earnings > income statement > balance sheet and statement of cash flows
- D. Income statement > statement of retained earnings > balance sheet and statement of cash flows**

79. All of the following are different expressions for net income **except**:

- A. Profits
- B. Excess of revenues over expenses
- C. Capital**
- D. Earnings

80. Easton Enterprises began the year with total assets of \$450,000 and total liabilities of \$230,000. If Easton's total assets doubled to \$900,000 and its owners' equity remained the same during the year, what was the amount of its total liabilities at the end of the year?

A. \$670,000

**B. \$680,000**

C. \$440,000

D. \$900,000

81. Which of the following would be internal users of accounting information?

A. Customers and vendors

**B. Employees and managers**

C. Government and banks

D. Employees and customers

82. The statement of retained earnings accomplishes which of the following?

**A. It summarizes income earned and dividends paid over a single period of the business.**

B. It accumulates all revenues for the year.

C. It summarizes the balance sheet accounts.

D. It summarizes the capital stock accounts over the life of the business.

83. Business entities and non-business entities are both organized to earn a profit.

**FALSE**

84. Financial accounting is the branch of accounting concerned with communication with internal management.

**FALSE**

85. External users of accounting information include present and potential stockholders, bankers and other creditors, and management.

**FALSE**

86. The balance sheet is a statement that summarizes revenues and expenses for a period.

**FALSE**

87. Assets may be used to satisfy business obligations and to carry on business operations.

**TRUE**

88. The amount of earnings distributed to stockholders can be found in the income statement.

**FALSE**

89. Profits from operating activities distributed to business owners are called dividends.

**TRUE**

90. An entity's assets come from three primary sources: creditors, investors, and profits retained in the business.

**TRUE**

91. The balance sheet is linked to the retained earnings statement by the ending retained earnings balance.

**TRUE**

92. A balance sheet provides information at one specific point in time, while the other basic financial statements provide information on activities that occur over a period of time.

**TRUE**

93. When an entity's revenues exceed its expenses for a period of time, the entity will report a net loss.

**FALSE**

94. Owners' equity is the residual interest that remains after deducting liabilities from stockholders' equity.

**FALSE**

95. If a company prepares a statement of stockholders' equity, net income is added to retained earnings on this statement.

**TRUE**

96. Stockholders' equity is owners' equity in a corporation.

**TRUE**

97. The time period assumption assumes a company prepares financial statements every month.

**FALSE**

99. Because market values are subjective, many assets are carried on the balance sheet at their acquisition cost.

**TRUE**

100. The term used to refer to an asset's original cost is "historical cost."

**TRUE**

101. The going concern assumption infers that a company will continue to operate indefinitely.

**TRUE**

102. A company in the process of liquidation meets the requirements under the going concern assumption.

**FALSE**

103. The International Accounting Standards Board (IASB) was created in order to develop worldwide accounting standards that must be used for all financial statements prepared regardless of country.

**FALSE**

104. The primary objective of external auditors is to provide assurance to stockholders and other users that the statements are fairly presented.

**TRUE**

105. The independent auditor's report conveys whether or not the business is a good investment.

**FALSE**

106. The IASB is a branch of the FASB.

**FALSE**

107. Bondholders are internal users of company's accounting information.

**FALSE**

109. Someone to whom a company has a debt is known as an investor.

**FALSE**

110. All assets are tangible in nature.

**FALSE**

111. The Internal Revenue Service (IRS) is an external user that has the authority of the law to obtain certain accounting information.

**TRUE**

112. A partnership is a business owned by two individuals; if three or more individuals organize a business, it must be established as a corporation.

**FALSE**

113. Owners of corporations are called\_\_\_\_\_.

**stockholders**

114. The three types of business activities in which all corporations engage are\_\_\_\_\_, \_\_\_\_\_, and\_\_\_\_\_.

**financing, investing, operating**

115. The process of identifying, measuring, and communicating economic information to various users is called\_\_\_\_\_.

**accounting**

116. The names of the four financial statements are\_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, and\_\_\_\_\_.

**income statement, balance sheet, statement of retained earnings, statement of cash flows**

117. Another name for profits or earnings of a business is \_\_\_\_\_.

**net income**

118. The various methods, rules, practices, and other procedures that have evolved over time in response to the need to regulate the preparation of financial statements are called

\_\_\_\_\_.

**generally accepted accounting principles**

119. The concept that assumes that assets are recorded at the amount to acquire them is called the

\_\_\_\_\_.

**cost principle**

120. The concept that assumes that an entity is **not** in the process of liquidation is

\_\_\_\_\_.

**going concern**

121. The federal government agency with the ultimate authority to determine the rules in preparing statements for companies whose stock is sold to the public is the

\_\_\_\_\_.

**Securities and Exchange Commission**

122. The private sector group with authority to set accounting standards is the

\_\_\_\_\_.

**Financial Accounting Standards Board**

123. For each statement provided, choose the letter of the appropriate term from the list that each statement best describes. Some terms may be used more than once, while others are not used at all.

- |   |                            |
|---|----------------------------|
| 1. The cost of doing business that results from the process of generating revenues.                                   | Retained earnings <b>8</b> |
| 2. A future benefit.  | Owners' equity <b>6</b>    |
| 3. The sale of goods or the performance of services.  | Dividends <b>4</b>         |
| 4. A distribution of the net income of a business to its owners.  | Revenue <b>3</b>           |
| 5. The principle or rule that specifies the amount recorded for an asset upon acquisition.                            | Capital stock <b>9</b>     |
| 6. The owners' claims on the assets of an entity.   | Expense <b>1</b>           |
| 7. Claims of the creditors against the assets of a company.   | Asset <b>2</b>             |
| 8. The portion of owner's equity that represents the net income less any dividends paid over the life of the entity.  | Time period <b>12</b>      |
| 9. A category on the balance sheet to indicate the owners' direct investment in a corporation.                        | Going concern <b>11</b>    |
| 10. An entity that lends a company money with the expectation of repayment.   | Cost principle <b>5</b>    |
| 11. The assumption that an entity is <b>not</b> in the process of liquidation and that it will continue indefinitely. | Creditor <b>10</b>         |
| 12. An artificial segment on the calendar used as a basis for preparing financial statements.                         | Liability <b>7</b>         |

124. Travis Corporation

The accountant for Travis Corporation prepared the following list of account balances from the company's records for the year ended December 31, 2012:

Sales revenue	\$165,000	Cash	\$ 30,000
Accounts receivable	14,000	Selling expenses	44,000
Equipment	42,000	Common stock	41,000
Accounts payable	12,000	Interest income	3,000
Salaries and wages expense	40,000	Cost of sales	51,000
Inventories	22,000	Prepaid expenses	2,000
Income taxes payable	5,000	Income taxes expense	18,000
Notes payable	20,000	Retained earnings	?

Read the information for Travis Corporation. Determine the following amounts for Travis Corp.

A)	Total assets at the end of 2012	
B)	Total liabilities at the end of 2012	
C)	What parties have a claim on Travis Corporation's assets? Explain you answer in the terms of the accounting equation.	

- A) \$110,000  
(\$30,000 Cash + \$14,000 Accounts Receivable + \$42,000 Equipment + \$22,000 Inventories + 2,000 Prepaid Expenses = \$110,000)
- B) \$37,000  
(\$12,000 Accounts Payable + \$5,000 Income Taxes Payable + \$20,000 Notes Payable = \$37,000)
- C) Both the creditors and the owners have a claim on the assets of the corporation. The creditors have their claim arising from the liabilities of the corporation, while the owners have a claim through the owners' (or stockholders') equity.

125. Travis Corporation

The accountant for Travis Corporation prepared the following list of account balances from the company's records for the year ended December 31, 2012:

Sales revenue	\$165,000	Cash	\$ 30,000
Accounts receivable	14,000	Selling expenses	44,000
Equipment	42,000	Common stock	41,000
Accounts payable	12,000	Interest income	3,000
Salaries and wages expense	40,000	Cost of sales	51,000
Inventories	22,000	Prepaid expenses	2,000
Income taxes payable	5,000	Income taxes expense	18,000
Notes payable	20,000	Retained earnings	?

Read the information for Travis Corporation. Determine the following amounts for Travis Corporation.

A)	The balance of retained earnings at the end of 2012.	
B)	The total stockholders' equity at the end of 2012.	
C)	Name the two events that might cause stockholders' equity to increase.	

- A) \$32,000  
(\$110,000 Total Assets - \$37,000 Total Liabilities - \$41,000 Common Stock = \$32,000)
- B) \$73,000  
(\$110,000 Total Assets - \$37,000 Total Liabilities = \$73,000; OR \$41,000 Common Stock + \$32,000 Retained Earnings = \$73,000)
- C) Stockholders equity can increase when common (or capital) stock is issued to investors. It also can increase through increases to retained earnings when the net income of the business is greater than any dividends paid to the shareholders.

Sales revenue	\$165,000	Cash	\$ 30,000
Accounts receivable	14,000	Selling expenses	44,000
Equipment	42,000	Common stock	41,000
Accounts payable	12,000	Interest income	3,000
Salaries and wages expense	40,000	Cost of sales	51,000
Inventories	22,000	Prepaid expenses	2,000
Income taxes payable	5,000	Income taxes expense	18,000
Notes payable	20,000	Retained earnings	?

Read the information for Travis Corporation. Determine the following amounts for Travis Corporation:

A)	Total revenues for 2012.	
B)	Total expenses for 2012.	
C)	What is the purpose of the income statement?	
D)	Is Travis Corp. profitable? Explain your answer.	
E)	Is this the first year of operations for Travis Corp.? Explain your answer.	

- A) \$168,000  
(\$165,000 Sales Revenue + \$3,000 Interest Income = \$168,000)
- B) \$153,000  
(\$51,000 Cost of Sales + \$40,000 Salaries & Wages Expense + \$44,000 Selling Expenses + \$18,000 Income Taxes Expense = \$153,000)
- C) The purpose of the income statement is to provide information regarding the revenues and expenses of the entity. The difference shows the profitability of the company for a particular period of time.
- D) Travis Corporation had net income for the period of \$15,000. Since revenues exceeded expenses for the period, the company would be considered profitable.
- E) This would not be the first year of operations for Travis Corporation. The reasons for this are that the ending Retained Earnings balance is greater than the net income of \$15,000. Since the ending balance of Retained Earnings is \$32,000, and Net Income for the period was \$15,000 as well as apparently no dividends being paid to the stockholders during the year, Travis Corporation began the year with a balance of \$17,000 (\$32,000 - \$15,000) in Retained Earnings.

### 127. Travis Corporation

The accountant for Travis Corporation prepared the following list of account balances from the company's records for the year ended December 31, 2012:

Sales revenue	\$165,000	Cash	\$ 30,000
Accounts receivable	14,000	Selling expenses	44,000
Equipment	42,000	Common stock	41,000
Accounts payable	12,000	Interest income	3,000
Salaries and wages expense	40,000	Cost of sales	51,000
Inventories	22,000	Prepaid expenses	2,000
Income taxes payable	5,000	Income taxes expense	18,000
Notes payable	20,000	Retained earnings	?

Read the information for Travis Corporation. Prepare an income statement for Travis Corporation in good form.

Travis  
Corporation  
Income  
Statement  
For the  
Year  
Ended  
December 31,  
2012  
Revenues:

Sales revenue	\$165,000	
Interest income	<u>3,000</u>	\$168,000

Expenses:

Cost of sales	\$ 51,000	
Salaries and wages expense	40,000	
Selling expenses	44,000	
Income taxes expense	<u>18,000</u>	<u>153,000</u>

Net income \$ 15,000

### 128. Travis Corporation

The accountant for Travis Corporation prepared the following list of account balances from the company's records for the year ended December 31, 2012:

Sales revenue	\$165,000	Cash	\$ 30,000
Accounts receivable	14,000	Selling expenses	44,000
Equipment	42,000	Common stock	41,000
Accounts payable	12,000	Interest income	3,000
Salaries and wages expense	40,000	Cost of sales	51,000
Inventories	22,000	Prepaid expenses	2,000
Income taxes payable	5,000	Income taxes expense	18,000
Notes payable	20,000	Retained earnings	?

Read the information for Travis Corporation. Prepare a balance sheet for Travis Corporation in good form.

Travis Corporation  
Balance Sheet  
December 31, 2012

<u>Assets</u>	<u>Liabilities &amp; Owners' Equity</u>	
Cash	\$ 30,000	Accounts payable \$ 12,000
Accounts receivable	14,000	Income taxes payable 5,000
Inventories	22,000	Notes payable 20,000
Prepaid expenses	2,000	Common stock 41,000
Equipment	<u>42,000</u>	Retained Earnings <u>32,000 0</u>
		Total liabilities and
Total assets	<u>\$ 110,000</u>	owners' equity <u>\$ 110,000</u>

### 129. Canyon Corporation

The accountant for the Canyon Corporation prepared the following list from the company's accounting records for the year ended December 31, 2012:

Retained earnings	?	Prepaid expenses	\$ 3,000
Cash	\$ 7,000	Common stock	40,000
Accounts payable	15,000	Accounts receivable	17,000
Sales revenue	125,000	Interest income	500
Cost of sales	70,000	Salary expense	4,000
Land	75,000	Income tax expense	200
Notes payable	15,000	Selling expense	45,000
Inventory	20,000	Salaries payable	5,000

Read the information for Canyon Corporation. Determine the following amounts for Canyon Corporation.

A)	Total assets at the end of 2012.	
B)	Total liabilities at the end of 2012.	
C)	Total equity at the end of 2012.	

- A) \$122,000  
(\$3,000 Prepaid Expenses + \$7,000 Cash + \$17,000 Accounts Receivable + \$75,000 Land + \$20,000 Inventory = \$122,000)
- B) \$35,000  
(\$15,000 Accounts Payable + \$15,000 Notes Payable + \$5,000 Salaries Payable = \$35,000)
- C) \$87,000  
(\$122,000 Total Assets - \$35,000 Total Liabilities = \$87,000)

### 130. Canyon Corporation

The accountant for the Canyon Corporation prepared the following list from the company's accounting records for the year ended December 31, 2012:

Retained earnings	?	Prepaid expenses	\$ 3,000
Cash	\$ 7,000	Common stock	40,000
Accounts payable	15,000	Accounts receivable	17,000
Sales revenue	125,000	Interest income	500
Cost of sales	70,000	Salary expense	4,000
Land	75,000	Income tax expense	200
Notes payable	15,000	Selling expense	45,000
Inventory	20,000	Salaries payable	5,000

Read the information for Canyon Corporation. Determine the following amounts for Canyon Corporation:

A)	Total revenues for 2012.	
B)	Total expenses for 2012.	
C)	Net income for 2012.	

- A) \$125,500  
(\$125,000 Sales Revenue + \$500 Interest Income = \$125,500)
- B) \$119,200  
(\$70,000 Cost of Sales + \$4,000 Salary Expense + \$200 Income Tax Expense + \$45,000 Selling Expense = \$119,200)
- C) \$6,300  
(\$125,500 Total Revenue - \$119,200 Total Expenses = \$6,300)

### 131. Canyon Corporation

The accountant for the Canyon Corporation prepared the following list from the company's accounting records for the year ended December 31, 2012:

Retained earnings	?	Prepaid expenses	\$ 3,000
Cash	\$ 7,000	Common stock	40,000
Accounts payable	15,000	Accounts receivable	17,000
Sales revenue	125,000	Interest income	500
Cost of sales	70,000	Salary expense	4,000
Land	75,000	Income tax expense	200
Notes payable	15,000	Selling expense	45,000
Inventory	20,000	Salaries payable	5,000

Read the information for Canyon Corporation. Determine the following amounts for Canyon Corporation:

A)	Stockholders' equity at the end of 2012.	
B)	Retained earnings at the end of 2012.	
C)	Name two events that might cause stockholders' equity to decrease.	

- A) \$87,000  
 (\$122,000 Total Assets - \$35,000 Total Liabilities = \$87,000)
- B) \$47,000  
 (\$87,000 Total Stockholders' Equity - \$40,000 Common Stock = \$47,000)
- C) Stockholders' equity is decreased when dividends are declared and paid. Expenses or net losses also reduce stockholders' equity.

### 132. Canyon Corporation

The accountant for the Canyon Corporation prepared the following list from the company's accounting records for the year ended December 31, 2012:

Retained earnings	?	Prepaid expenses	\$ 3,000
Cash	\$ 7,000	Common stock	40,000
Accounts payable	15,000	Accounts receivable	17,000
Sales revenue	125,000	Interest income	500
Cost of sales	70,000	Salary expense	4,000
Land	75,000	Income tax expense	200
Notes payable	15,000	Selling expense	45,000
Inventory	20,000	Salaries payable	5,000

Read the information for Canyon Corporation. Using good form, prepare an income statement for Canyon Corporation.

Canyon Corporation  
Income Statement  
For the Year Ended  
December 31, 2012  
Revenues:

Sales Revenue	\$125,000	
Interest Income	<u>500</u>	\$125,500

Expenses:

Cost of Sales	\$ 70,000	
Selling Expense	45,000	
Salary Expense	4,000	
Income tax Expense	<u>200</u>	<u>119,200</u>
Net Income		<u>\$ 6,300</u>

### 133. Canyon Corporation

The accountant for the Canyon Corporation prepared the following list from the company's accounting records for the year ended December 31, 2012:

Retained earnings	?	Prepaid expenses	\$ 3,000
Cash	\$ 7,000	Common stock	40,000
Accounts payable	15,000	Accounts receivable	17,000
Sales revenue	125,000	Interest income	500
Cost of sales	70,000	Salary expense	4,000
Land	75,000	Income tax expense	200
Notes payable	15,000	Selling expense	45,000
Inventory	20,000	Salaries payable	5,000

Read the information for Canyon Corporation. Using good form, prepare a Balance Sheet for the Canyon Corporation.

Canyon Corporation  
Balance Sheet  
December 31, 2012

<u>Assets</u>		<u>Liabilities and Owners' Equity</u>	
Cash	\$ 7,000	Accounts payable	\$ 15,000
Accounts receivable	17,000	Salaries payable	5,000
Inventory	20,000	Notes payable	15,000
Prepaid expenses	3,000	Common stock	40,000
Land	<u>75,000</u>	Retained earnings	<u>47,000</u>
Total assets	<u>\$122,000</u>	Total liabilities and owners' equity	<u>\$122,000</u>

134. Assume that you have received copies of the financial statements for PepsiCo for the years ending December 31, 2012 and 2011. Answer the following questions:

- A) If you were a banker, why would you need information from PepsiCo's financial statements?
- B) If you were a potential investor in PepsiCo stock, what information would you want from their financial statements?
- C) If you were a labor negotiator for a union that represents a group of PepsiCo's employees, which financial statement would provide you with the most useful information?
- 
- A) A banker wants to be assured that the company will make its interest payments and repay the principle of the loan in a timely manner.
- B) Investors want to know whether they should make an investment in the company's stock, or continue to hold their investment. They will be looking at the company's recent performance, whether the company has been profitable, how their profits compare with other companies, and how much the company has paid in dividends.
- C) A labor negotiator needs to know how much profit the company has made. This information is found on the Income Statement.

135. Target, Inc., started the year with total assets of \$400,000 and total liabilities of \$240,000. Net income for the year is \$120,000 and dividends declared and paid during the year are \$90,000.

A) What is the amount of Target's total stockholders' equity at the end of the year?

B) Could Target have paid additional dividends during the year? Explain your answer.

A) \$190,000  
 (\$400,000 Total Assets at the beginning of the year - \$240,000 Total Liabilities at the beginning of the year = \$160,000 Total Equity at the beginning of the year)  
 (\$160,000 Total Equity at the beginning of the year + \$120,000 Net Income for the year - \$90,000 Dividends declared and paid during the year = \$190,000)

B) Yes. Assuming the company has enough cash to do so, dividends can be paid. Net income exceeded the amount of dividends paid by \$30,000 (\$120,000 - \$90,000), so the amount paid could have been increased. Also the company has total positive retained earnings.

136. Ramos Corp. started business at the beginning of the year, with assets of \$600,000 and stockholders' equity of \$240,000. By the end of the year, assets increased by \$80,000 and liabilities increased by \$60,000. Other than net income or loss, the only change in stockholders' equity was dividends of \$55,000.

A) What was the amount of Ramos Corp. stockholders' equity at the end of the year?

B) What was the amount of Ramos Corp. net income or net loss for the year?

A)

	Assets		Liabilities	Stockholders' Equity
Beginning of year	\$600,000		\$360,000	\$240,000
Change during year	+80,000		+60,000	+20,000
End of year	\$680,000	=	\$420,000	\$260,000

B)

Change in equity	\$20,000
Add: Dividends	<u>55,000</u>
Net Income	<u>\$75,000</u>

137. Presented below are selected data from the balance sheet of Farmer Company for 2012. The figures are expressed in millions.

Total Current assets	\$ 5,572
Property, plant, and equipment	16,325
Other assets	???
Total Current liabilities	3,274
Total Long-term debt	5,632
Total Stockholders' equity	19,639

- A) Determine the amount of “Other assets” for Farmer’s 2012 balance sheet. (HINT: you must use the accounting equation concept to determine your answer.)
- B) How much of Farmer Company is financed by creditors? How much is financed by the owners?

A) \$6,648  
 (\$3,274 Current liabilities + \$5,632 Long-term debt + \$19,639 Stockholders’ equity = \$28,545 Total Assets)  
 (\$28,545 Total Assets - \$5,572 Current assets - 16,325 Property, plant & equipment = \$6,648)

B) Amount of financing by creditors: \$8,906  
 (\$3,274 Current liabilities + \$5,632 Long-term debt = \$8,906)  
 Amount of financing by owners: \$19,639  
 (\$19,639 Stockholders’ equity)

138. Presented below are selected data from the accounting records for Micco’s Gift Store for 2012.

Net sales	\$ 190,000
Income taxes	30,000
Cost of sales	80,000
Operating expenses	45,000
Dividends	12,000

- A) Calculate the net income or loss for 2012.
- B) Explain how the amount from part “A” will affect the financial position of Micco’s Gift Store.
- C) Is the company profitable? Explain your answer.

- A) \$35,000  
 (\$190,000 Net sales - \$30,000 Income taxes - \$80,000 Cost of sales - \$45,000 Operating expenses = \$35,000)
- B) Net income will improve the company’s financial position.
- C) Yes. The amount of revenues exceeds the amount of expenses by \$35,000.

139. The following information comes from the records of Morton Corporation. Assume no additional investment by owners when answering the following questions:

	<u>Assets</u>	<u>Liabilities</u>	<u>Owners' Equity</u>
January 1, 2012	\$ 98,000	\$ 54,000	\$ _____
December 31, 2012	131,000	_____	84,000

- A) What is the amount of owners' equity at January 1, 2012? \_\_\_\_\_
- B) What is the amount of liabilities at December 31, 2012? \_\_\_\_\_
- C) Assume that the company paid dividends of \$22,000 during the year. How much net income did it earn during the year?
- D) Assume that the company paid no dividends during the year. Without looking at the income statement, how can you tell if the company is profitable or not?

- A) \$44,000  
(\$98,000 Assets - \$54,000 Liabilities = \$44,000)
- B) \$47,000  
(\$131,000 Assets - \$84,000 Owners' Equity = \$47,000)
- C) \$62,000  
(\$44,000 Beginning Owners' Equity + X - \$22,000 Dividend = \$84,000 Ending Owners' Equity)  
(X = \$106,000 - 44,000 = \$62,000)
- D) Assuming that the increase in owners' equity would come from net income, the company would have to be considered profitable. Net income will increase retained earnings which is a part of owners' equity

140. Avery Corporation began the year with total assets of \$800,000 and total liabilities of \$620,000. Use the accounting equation to answer the following questions. Assume no additional investment by owners when answering these questions.

- A) What was the amount of Avery's total assets at the end of the year if liabilities decreased by \$60,000 and owners' equity increased by \$90,000?
- B) Was the company profitable? Explain your answer.

A)	\$830,000	Assets	Liabilities	Owners' Equity
	Beginning of the year	\$800,000	\$620,000	\$180,000
	Change during the year	<u>30,000</u>	<u>(60,000)</u>	<u>90,000</u>
	End of the year	\$830,000	\$560,000	\$270,000

B) The company was profitable because the owners' equity increased from the beginning of the year to the end of the year.

141. The beginning balance of retained earnings was \$630,000, and the ending balance was \$650,000. The company declared and paid dividends of \$60,000.

A) Determine the amount of net income for the year.

B) What information would one find on the income statement in addition to net income?

- A) \$80,000  
 (\$650,000 Ending Retained Earnings - \$630,000 Beginning Retained Earnings = \$20,000)  
 (\$20,000 + \$60,000 Dividends = \$80,000)
- B) The Income Statement will show the sources of amounts earned (Revenues) as well as the amount and type of costs incurred by the company (Expenses) during the period.

142. The Trenton Corporation began 2012 with \$390,000 in assets, \$140,000 in liabilities, and \$170,000 of retained earnings. Net income for the year was \$120,000, and dividends of \$110,000 were paid.

- A) Prepare a statement of retained earnings for 2012.
- B) What is the nature or purpose of the statement of retained earnings?
- C) What was the amount of capital stock for Trenton Corporation at the beginning of 2012?
- D) Identify what business events might occur in Trenton Corp.'s business operations that would cause the two stockholders' equity items to increase.
- E) How do you identify whether Trenton was profitable during 2012 by examining the statement of retained earnings?

A)

Trenton Corporation  
 Statement of Retained Earnings  
 For the Year Ended December 31, 2012

Beginning balance	\$170,000
Add: Net income for the year	120,000
Deduct: Dividends for the year	<u>(110,000)</u>
Ending balance	<u>\$180,000</u>

- B) The statement of retained earnings explains the change in retained earnings during a period.
- C) \$80,000  
(\$390,000 Total Assets - \$140,000 Total Liabilities - \$170,000 Beginning Retained Earnings = \$80,000)
- D) One way that the company can increase stockholders' equity is to sell additional shares of stock. Retained earnings will increase when the company reports net income for the period greater than the dividends paid.
- E) The statement of retained earnings shows that the company was profitable for the year by reporting net income for the period. If the company were to experience an operating loss, then this would be shown as a deduction from the beginning balance of retained earnings.

143. Below are several accounts from Costello Company's accounting records. Answer the questions that follow.

Total liabilities, end of the year	\$92,000	Total assets, end of the year	\$143,000
Capital stock, end of the year	16,000	Retained earnings, beginning of the year	15,000
Dividends for the period	20,000	Net income	40,000

- A) How much is the balance of retained earnings at the end of the year?
  - B) Show the accounting equation for Costello Company at the end of the year with the respective dollar amounts.
  - C) If stockholders' equity increases during the year, does that mean that the company is profitable? Explain your answer.
- 
- A) \$35,000  
(\$15,000 Retained earnings, beginning of the year + \$40,000 Net income - \$20,000 Dividends for the period = \$35,000) OR  
(\$143,000 Total assets, end of the year - \$92,000 Total liabilities, end of the year - \$16,000 Capital stock, end of the year = \$35,000)
  - B) \$143,000 Total assets, end of the year = \$92,000 Total liabilities, end of the year + \$51,000 Owners' Equity, end of the year (\$16,000 Capital stock, end of the year + \$35,000 Retained earnings, end of the year)
  - C) This would depend upon what causes the stockholders' equity to increase. If the increase were due to an increase in retained earnings, then the company would have been profitable for the period. But if the increase were due to an increase in the amount of capital stock issued, this would not be a measure of profitability.

144. Classify the following items according to the financial statement on which each belongs, either the income statement (IS) or the balance sheet (BS). Also indicate whether each is a revenue (R), expense (E), asset (A), liability (L), or owners' equity (OE) item.

	Appears on Which Statement?	Type of Account
1. Retained earnings	_____	_____
2. Buildings	_____	_____
3. Common stock	_____	_____
4. Accounts payable	_____	_____
5. Football ticket sales	_____	_____
6. Salaries expense	_____	_____
7. Accounts receivable	_____	_____

1.	BS	OE
2.	BS	A
3.	BS	OE
4.	BS	L
5.	IS	R
6.	IS	E
7.	BS	A

145. Several amounts from Duggard Company at December 31, 2012 are listed below. Answer the questions.

Service revenue	\$245,000	Salaries expense	\$109,000
Dividends paid	15,000	Rent expense	36,000
Buildings	110,000	Land	100,000
Accounts payable	40,000	Accounts receivable	28,000
Capital stock	60,000	Retained earnings, Jan. 1, 2012	40,000
Utilities expense	19,000	Notes payable	30,000
Income tax payable	4,000	Income tax expense	11,000

- A) Calculate net income for 2012.
- B) How much is Duggard Company's retained earnings at the end of 2012?
- C) What primary asset account is missing?

- A) \$70,000  
 (\$245,000 Service Revenue - \$109,000 Salaries Expense - \$36,000 Rent Expense - \$19,000 Utilities Expense - \$11,000 Income Tax Expense = \$70,000)
- B) \$95,000  
 (\$40,000 Retained Earnings, Jan 1, 2012 + \$70,000 Net Income - \$15,000 Dividends Paid = \$95,000)
- C) The Cash account is missing.

146. Gym Corporation reported the following information at December 31, 2012:

Accounts payable	\$40,000	Dividends paid	\$10,000
Cash	75,000	Expenses	60,000
Inventories	18,000	Revenue	75,000

- A) Calculate Gym Corporation's total assets.
- B) Calculate Gym Corporations' net income for 2012.
- C) Calculate Gym Corporation's total stockholders' equity at the end of 2012.

- A) \$93,000  
 (\$75,000 Cash + \$18,000 Inventories = \$93,000)
- B) \$15,000  
 (\$75,000 Revenue - \$60,000 Expenses = \$15,000)
- C) \$53,000  
 (\$93,000 Total Assets - \$40,000 Accounts Payable = \$53,000)

147. Macon Corporation has been in the business of delivering small packages for local companies within the city of Atlanta, Georgia, since 1960. The following information concerning financial activities during 2012 is available at December 31, 2012:

Delivery revenue	\$280,000	Salary and wage expense	\$82,000
Dividends paid	85,000	Rent expense	43,000
Buildings	140,000	Land	60,000
Accounts payable	30,000	Accounts payable	30,000
Capital stock	105,000	Retained earnings, January 1, 2012	42,000
Water, gas, and electricity	28,000	Notes payable	34,000
Cash	56,000	Income tax expense	18,000

- A. Prepare an income statement for the year ended December 31, 2012.
- B. If you were a bank loan officer and Macon Corporation wanted to borrow \$100,000 from your bank, would you lend the money? Explain.
- C. Calculate retained earnings at December 31, 2012.

A. Macon Corporation  
Income Statement  
Year Ended December 31, 2012

Revenues:			
Delivery revenue			\$280,000
Expenses:			
Salary and wage expense	\$82,000		
Rent expense	43,000		
Water, gas, and electricity	28,000		
Income tax expense	<u>18,000</u>		<u>171,000</u>
Net income			<u>\$109,000</u>

- B. The company appears profitable. Basing the decision solely on profitability, it appears the company can generate operating income to enable it to repay the loan. But the company also had accounts payable and notes payable of \$30,000 and \$34,000, respectively, for which cash may not be available to pay when these amounts become due.
- C.  $\$42,000 + \$109,000 - \$85,000 = \$66,000$

148. Meredith Corporation is in the business of providing dog and cat grooming services to customers within the city of New York. The following information concerning financial activities during 2012 is available at December 31, 2012:

Grooming revenue	\$130,000	Salary and wage expense	\$44,000
Dividends paid	13,000	Rent expense	24,000
Equipment	40,000	Furniture	60,000
Accounts payable	30,000	Accounts receivable	23,000
Capital stock	22,000	Retained earnings, Jan. 1, 2012	21,000
Utilities expense	10,000	Notes payable	88,000
Cash	33,000	Income tax expense	7,000

- A. Calculate net income for 2012.
- B. Prepare a statement of retained earnings for the year ended December 31, 2012.
- C. What information can you derive from the statement of retained earnings concerning this company? Explain.

A.  $\$130,000 - \$10,000 - \$44,000 - \$24,000 - \$7,000 = \$45,000$

B.  
 Meredith  
 Corporati  
 on  
 Statemen  
 t of  
 Retained  
 Earnings  
 For the  
 Year  
 Ended  
 Decembe  
 r 31,  
 2012  
 Beginnin \$21,000  
 g balance  
 Add: Net 45,000  
 income  
 for the  
 year  
 Less: (13,000)  
 Dividend  
 s for the  
 year  
 Ending \$53,000  
 balance

- C. The statement of retained earnings provides information on the changes in retained earnings during 2012. Net income causes retained earnings to increase, and dividends cause it to decrease. Since net income exceeded dividends paid, the ending balance is larger than the beginning balance.

149. Joseph is the president of Sunshine Enterprises. Sunshine Enterprises began business on January 1, 2012. The company's controller is out of the country on business. Joseph needs a copy of the company's balance sheet for a meeting tomorrow and asks his assistant to obtain the required information from the company's records. She presents Joseph with the following balance sheet. He asks you to review it for accuracy.

Sunshine Enterprises Balance Sheet December 31, 2012		
ASSETS	LIABILITIES & STOCKHOLDERS' EQUITY	
Accounts payable	\$ 30,600	\$ 24,200
Building and equipment	177,300	\$12,200
Cash	14,700	100,000

Cash dividends paid	16,000	113,800
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**Required**

1. Prepare a corrected balance sheet.
2. Draft a memo explaining the major differences between the balance sheet Joseph's assistant prepared and the one you prepared.

1.

Sunshine Enterprises Balance Sheet December 31, 2012		
ASSETS	LIABILITIES & STOCKHOLDERS' EQUITY	
Cash	\$ 14,700	\$ 30,600
Accounts receivable	24,200	100,000
Supplies	12,200	<u>97,800*</u>
Building and equipment	177,300	

Total assets	<u>\$228,400</u>	<u>d\$228,400</u>
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\* \$113,800 - \$16,000

2.

Memorandum to the company president:

TO: Company president

FROM: Your name

DATE: January 1, 2013

SUBJECT: Corrected balance sheet

Attached please find the original balance sheet your assistant prepared, along with a corrected version of that same statement. The differences can be explained as follows:

1. The balance sheet is always as of a certain date, in this case, December 31, 2012, rather than a period of time, such as a year.
2. Accounts payable should be classified as a liability.
3. Cash dividends paid do not belong on the balance sheet; this amount should appear instead on the statement of retained earnings for the year.
4. Accounts receivable should be classified as an asset.
5. Net income for 2012 does not belong on the balance sheet; this amount should appear instead on the statement of retained earnings for the year.
6. Supplies should be classified as an asset.
7. Retained earnings should appear with capital stock as a component of stock-holders' equity on the balance sheet. Since this is the first year of operations, the retained earnings balance comprises the net income for the year less the cash dividends paid.
8. Totals were added as necessary to provide summary information.

150. The following items are available from the records of Ramos Corporation at the end of its fiscal year, June 30, 2012:

Accounts payable	\$17,000
Advertising expense	4,600
Accounts receivable	5,700
Notes payable	50,000
Buildings	35,000
Office equipment	12,000
Inventory	12,100
Retained earnings (end of year)	26,300
Capital stock	25,000
Salary and wage expense	8,230
Cash	21,900
Sales revenue	14,220
Computerized grinders	25,800
Hand Tools	5,800

**Required**

- (1) Prepare a balance sheet.
- (2) For each non-balance-sheet item, indicate where it should appear.

**(1)**

**RAMOS CORPORATION  
BALANCE SHEET  
JUNE 30, 2012**

<b>Assets</b>		<b>Liabilities and Stockholders' Equity</b>	
Cash	\$ 21,900	Accounts payable	\$ 17,000
Accounts receivable	5,700	Notes payable	50,000
Inventory	12,100	Capital stock	25,000
Computerized grinders	25,800	Retained earnings	<u>26,300</u>
Office equipment	12,000		
Buildings	35,000		
Hand tools	<u>5,800</u>		
Total assets	<u>\$118,300</u>	Total liabilities and stockholders' equity	<u>\$118,300</u>

(2) Items not shown on a balance sheet and where they would appear:

- Advertising expense—income statement
- Salary and wage expense—income statement
- Sales revenue—income statement

151. **Tentco** reported the following amounts in various statements included in its 2012 annual report. (All amounts are stated in millions of dollars.)

Net income for 2010	\$142
Cash dividends declared in 2012	15
Retained earnings, December 31, 2011	\$ 95

REQUIRED:

- (1) Prepare a Statement of retained earnings for the year ended December 31, 2012.
- (2) Assume that Tentco presents a statement of stockholders' equity rather than a statement of retained earnings in its annual report. Explain how the information differs between the two statements.

(1)

Tentco

Statement of Retained Earnings  
For the Year Ended December 31, 2012  
(amounts in millions)

Retained earnings, beginning of year	\$ 95
Add: Net income for the year	142
Deduct: Dividends for the year	<u>(15)</u>
Retained earnings, end of year	<u>\$222</u>

- (2) The statement of stockholders' equity would include all changes in stockholders' equity such as issuances and retirements of stock in addition to the information normally provided in a retained earnings statement.

152. The following information is available from the records of Focus Seascapes, Inc. at the end of the 2012 calendar year:

Accounts payable	\$ 4,700
Service revenues	28,000
Accounts receivable	3,600
Office equipment	9,200
Capital stock	?
Rent expense	2,500
Cash	13,200
Retained earnings, beginning of year	10,500
Dividends paid during the year	3,800
Salary and wage expense	14,000

Required:

- (1) What is Focus' net income for the year ended December 31, 2012?
- (2) What is Focus' retained earnings balance for the year ended December 31, 2012?

1. Revenue – Expenses = Net Income

$$\$28,000 - (\$2,500 + \$14,000) = \$11,500$$

2. Retained Earnings + Net Income - Dividends = Retained Earnings

(Beginning) (Ending)

$$\$10,500 + \$11,500 - \$3,800 = \$18,200$$

153. The following information is available from the records of Focus Seascapes, Inc. at the end of the 2012 calendar year:

Accounts payable	\$ 4,700	
Service revenues	28,000	
Accounts receivable	3,600	
Office equipment	9,200	
Capital stock	?	
Rent expense	2,500	
Cash	13,200	
Retained earnings, beginning of year	10,500	
Dividends paid during the year	3,800	
Salary and wage expense	14,000	

Required:

1. What is the total amount of Focus' assets at December 31, 2012?
2. What is the total amount of Owners' Equity at December 31, 2012?
3. What is the capital stock balance at December 31, 2012?

### 1. Total Assets:

Cash	\$13,000
Accounts receivable	3,600
Office equipment	<u>9,200</u>
Total assets	<u>\$26,000</u>

2.  $\$26,000 - \$4,700 = \$21,300$

3.  $\$21,300 - \$18,200 = \$3,100$

154. Here is a list of accounts and their balances that appear on the Thomas Company's income statement and balance sheet.

Accounts payable	\$ 800
Accounts receivable	500
Building	2,000
Cash	3,300
Gas, utilities, and other expenses	300
Land	4,000
Lawn-care revenue	1,500
Notes payable	6,000
Salaries and wages expense	900
Tools	800
Tree-trimming revenue	500
Truck	2,000

REQUIRED:

Identify which of these are:

- (a) Assets
- (b) Liabilities
- (c) Expenses
- (d) Revenues

- (a) Assets: Accounts receivable, Building, Cash, Land, Tools, Truck
- (b) Liabilities: Accounts payable, Notes payable
- (c) Expenses: Gas, utilities, and other expenses, Salaries and wages expense
- (d) Revenues: Lawn-care revenue, Tree-trimming revenue

155. List three different groups of users of accounting information. Indicate the type of decisions each group typically makes from accounting information.

The groups and their decisions are:

Stockholders:	Is the company profitable enough to pay dividends? Did the company make a profit for the period?
Management:	How should an item be priced? Should we continue operations? Can we give employees raises?
Bankers:	Can the company pay interest and principal when it comes due?
Creditors:	Can the company pay bills when they are due?
Government:	How much did the company earn? (i.e., how much taxes should be paid?)

156. What is the purpose of an income statement?

An income statement reports the company's revenues and expenses for a period of time and shows the company's profitability (or lack of). The income statement is sometimes called the "statement of income."

157. List the four financial statements. Explain the connection between these four statements.

1. Balance sheet
2. Income statement
3. Statement of retained earnings
4. Statement of cash flows

Net income on the income statement increases retained earnings on the statement of retained earnings. The ending balance in the statement of retained earnings goes to the balance sheet. Finally, the net increase in cash at the bottom of the statement of cash flows equals the amount shown in cash on the balance sheet.

<b>Statement A</b>	<b>2012</b>	<b>2011</b>
Total current assets	\$ 82,309	\$ 80,080
Property, plant & equipment (net of accumulated depreciation)	63,451	62,724
Investments	303	1,061
Other assets	<u>3,438</u>	<u>2,606</u>
Total assets	<u>\$149,501</u>	<u>\$146,471</u>
Total current liabilities	\$ 33,928	\$ 28,668
Long-term debt	20,491	25,676
Deferred income taxes and contingencies	<u>4,174</u>	<u>5,208</u>
Total liabilities	\$ 58,593	\$ 59,552
Total stockholders' equity	<u>90,908</u>	<u>86,919</u>
Total liabilities & stockholders' equity	<u>\$149,501</u>	<u>\$146,471</u>
<b>Statement B</b>	<b>2012</b>	<b>2011</b>
Net sales	\$209,203	\$174,206
Cost of sales	<u>136,225</u>	<u>114,284</u>
Gross profit	72,978	59,922
Selling, general and administrative expenses	63,895	53,520
Other income (expense)	<u>693</u>	<u>(118)</u>
Income (loss) before income taxes	9,776	6,284
Income tax expense	<u>3,534</u>	<u>2,388</u>
Net income (loss)	<u>\$ 6,242</u>	<u>\$ 3,896</u>

**REQUIRED:**

1.	What is the name of Statement A?	
2.	What is the name of Statement B?	

1. Statement A is the Balance Sheet

2. Statement B is the Income Statement

<b>Statement A</b>	<u>2012</u>	<u>2011</u>
Total current assets	\$ 82,309	\$ 80,080
Property, plant & equipment (net of accumulated depreciation)	63,451	62,724
Investments	303	1,061
Other assets	<u>3,438</u>	<u>2,606</u>
Total assets	<u>\$149,501</u>	<u>\$146,471</u>
Total current liabilities	\$ 33,928	\$ 28,668
Long-term debt	20,491	25,676
Deferred income taxes and contingencies	<u>4,174</u>	<u>5,208</u>
Total liabilities	<u>\$ 58,593</u>	<u>\$ 59,552</u>
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Total liabilities & stockholders' equity	<u>\$149,501</u>	<u>\$146,471</u>
 <b>Statement B</b>	 <u>2012</u>	 <u>2011</u>
Net sales	\$209,203	\$174,206
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Other income (expense)	<u>693</u>	<u>(118)</u>
Income (loss) before income taxes	9,776	6,284
Income tax expense	<u>3,534</u>	<u>2,388</u>
Net income (loss)	<u>\$ 6,242</u>	<u>\$ 3,896</u>

**Required:** Which statement indicates the financial position of the company? What information is provided on that statement that indicates the "financial position" of the company? Explain.

The balance sheet, Statement A, provides information on the financial position of the company. It is expressed in terms of the accounting equation. When total liabilities are subtracted from total assets, the difference is owners' or stockholders' equity. This amount represents net worth or the financial position of a company at the balance sheet date.

<b>Statement A</b>	<u>2012</u>	<u>2011</u>
Total current assets	\$ 82,309	\$ 80,080
Property, plant & equipment (net of accumulated depreciation)	63,451	62,724
Investments	303	1,061
Other assets	<u>3,438</u>	<u>2,606</u>
Total assets	<u>\$149,501</u>	<u>\$146,471</u>
Total current liabilities	\$ 33,928	\$ 28,668
Long-term debt	20,491	25,676
Deferred income taxes and contingencies	<u>4,174</u>	<u>5,208</u>
Total liabilities	<u>\$ 58,593</u>	<u>\$ 59,552</u>
Total stockholders' equity	<u>90,908</u>	<u>86,919</u>
Total liabilities & stockholders' equity	<u>\$149,501</u>	<u>\$146,471</u>
 <b>Statement B</b>	 <u>2012</u>	 <u>2011</u>
Net sales	\$209,203	\$174,206
Cost of sales	<u>136,225</u>	<u>114,284</u>
Gross profit	72,978	59,922
Selling, general and administrative expenses	63,895	53,520
Other income (expense)	<u>693</u>	<u>(118)</u>
Income (loss) before income taxes	9,776	6,284
Income tax expense	<u>3,534</u>	<u>2,388</u>
Net income (loss)	<u>\$ 6,242</u>	<u>\$ 3,896</u>

**Required:** Was Erwin Factory profitable both years? What are the amounts of the total revenues and total expenses, respectively, for 2012? Which financial statement provides this information to you?

The company was profitable in both 2012 and 2011. For 2012, total revenues include net sales of \$209,203, and other income, \$693, for a total of \$209,896. Total expenses are cost of sales of \$136,225, selling, general and administrative expenses of \$63,895, and income tax expense of \$3,534, or a total of \$203,654. This information is reported on the income statement, Statement B.

<b>Statement A</b>	<u>2012</u>	<u>2011</u>
Total current assets	\$ 82,309	\$ 80,080
Property, plant & equipment (net of accumulated depreciation)	63,451	62,724
Investments	303	1,061
Other assets	<u>3,438</u>	<u>2,606</u>
Total assets	<u>\$149,501</u>	<u>\$146,471</u>
Total current liabilities	\$ 33,928	\$ 28,668
Long-term debt	20,491	25,676
Deferred income taxes and contingencies	<u>4,174</u>	<u>5,208</u>
Total liabilities	<u>\$ 58,593</u>	<u>\$ 59,552</u>
Total stockholders' equity	<u>90,908</u>	<u>86,919</u>
Total liabilities & stockholders' equity	<u>\$149,501</u>	<u>\$146,471</u>
<b>Statement B</b>	<u>2012</u>	<u>2011</u>
Net sales	\$209,203	\$174,206
Cost of sales	<u>136,225</u>	<u>114,284</u>
Gross profit	72,978	59,922
Selling, general and administrative expenses	63,895	53,520
Other income (expense)	<u>693</u>	<u>(118)</u>
Income (loss) before income taxes	9,776	6,284
Income tax expense	<u>3,534</u>	<u>2,388</u>
Net income (loss)	<u>\$ 6,242</u>	<u>\$ 3,896</u>

**Required:** How much of Erwin Factory is financed by owners at the end of December of 2012?

The financing by owners for 2012 is the amount of stockholders' equity, \$90,908. Over time, sales of stock and earnings of the company cause this amount to increase.

<b>Statement A</b>	<u>2012</u>	<u>2011</u>
Total current assets	\$ 82,309	\$ 80,080
Property, plant & equipment (net of accumulated depreciation)	63,451	62,724
Investments	303	1,061
Other assets	<u>3,438</u>	<u>2,606</u>
Total assets	<u>\$149,501</u>	<u>\$146,471</u>
Total current liabilities	\$ 33,928	\$ 28,668
Long-term debt	20,491	25,676
Deferred income taxes and contingencies	<u>4,174</u>	<u>5,208</u>
Total liabilities	<u>\$ 58,593</u>	<u>\$ 59,552</u>
Total stockholders' equity	<u>90,908</u>	<u>86,919</u>
Total liabilities & stockholders' equity	<u>\$149,501</u>	<u>\$146,471</u>
 <b>Statement B</b>	 <u>2012</u>	 <u>2011</u>
Net sales	\$209,203	\$174,206
Cost of sales	<u>136,225</u>	<u>114,284</u>
Gross profit	72,978	59,922
Selling, general and administrative expenses	63,895	53,520
Other income (expense)	<u>693</u>	<u>(118)</u>
Income (loss) before income taxes	9,776	6,284
Income tax expense	<u>3,534</u>	<u>2,388</u>
Net income (loss)	<u>\$ 6,242</u>	<u>\$ 3,896</u>

**Required:** How much of Erwin Factory is financed by creditors at the end of December of 2012? Evaluate the change from 2011 to 2012.

The amount of financing by creditors for 2012 is the amount of liabilities reported on the balance sheet, \$58,593. For 2011, the amount was \$59,552. Total liabilities decreased by \$959, or about 1.6%. The company must be keeping its debt at a steady position as stockholders' equity and assets have increased. The change must be examined relative to the entire financial position.

163. Presented below are condensed data from the financial statements of Erwin Factory for 2012 and 2011. The figures are expressed in thousands. Use this information to answer the questions that follow.

<b>Statement A</b>	<u>2012</u>	<u>2011</u>
Total current assets	\$ 82,309	\$ 80,080
Property, plant & equipment (net of accumulated depreciation)	63,451	62,724
Investments	303	1,061
Other assets	<u>3,438</u>	<u>2,606</u>
Total assets	<u>\$149,501</u>	<u>\$146,471</u>
Total current liabilities	\$ 33,928	\$ 28,668
Long-term debt	20,491	25,676
Deferred income taxes and contingencies	<u>4,174</u>	<u>5,208</u>
Total liabilities	<u>\$ 58,593</u>	<u>\$ 59,552</u>
Total stockholders' equity	<u>90,908</u>	<u>86,919</u>
Total liabilities & stockholders' equity	<u>\$149,501</u>	<u>\$146,471</u>
<b>Statement B</b>	<u>2012</u>	<u>2011</u>
Net sales	\$209,203	\$174,206
Cost of sales	<u>136,225</u>	<u>114,284</u>
Gross profit	72,978	59,922
Selling, general and administrative expenses	63,895	53,520
Other income (expense)	<u>693</u>	<u>(118)</u>
Income (loss) before income taxes	9,776	6,284
Income tax expense	<u>3,534</u>	<u>2,388</u>
Net income (loss)	<u>\$ 6,242</u>	<u>\$ 3,896</u>

**Required:** Based on the information provided, is Erwin Factory considered a business or non-business entity? How do you know by examining the financial statements?

Erwin Factory is a business entity, because its purpose is to make a profit, not simply provide a service. Non-business entities have no owners, and Erwin Factory has owners, as evidenced by examining the stockholders' equity section of the balance sheet.

164. What is meant by generally accepted accounting principles?

Generally accepted accounting principles (GAAP) are a set of guidelines that are based on a conceptual framework. They represent the various rules, practices, and other procedures used as a basis for accounting principles. GAAP was created in response to the need for some form of regulation over the preparation of financial statements.

165. The following accounting principles and assumptions are included in the conceptual framework of accounting:

Economic entity	Going concern	Cost principle
Monetary unit	Time period	

For each situation in A through C below, identify which assumption or principle applies by selecting from the list provided above, and explain why that assumption or principle applies.

- A) Multinational Corp. has divisions in several countries around the world. Each of these countries has a currency different from the U.S. dollar. Multinational Corp. is a U.S. company and must include the financial data of its worldwide divisions in its financial statements.
- B) Cheater and Sly operate a security business as a partnership. They are considering the advantages of changing over to the corporate form of business.
- C) Food N' Fun is a locally owned and operated fast-food business. The owners have decided to expand into nearby cities. Expansion will require more capital, but management doesn't expect it will stay in business for more than a year or so regardless if it expands or not.

- A) Monetary unit. Financial statements must be denominated in one currency--the standard monetary unit. In the United States, this unit is the dollar.
- B) Economic entity. A business can take three forms. Regardless of form, however, the unit itself is distinct from other units.
- C) Going concern. A business is assumed to continue indefinitely to more accurately reflect the valuation of assets and appropriately allocate costs to accounting periods.

166. In 2012, you invested \$12,000 along with 5 other investors in a new theatre, Viva, that offers Broadway play productions. Because you live out of state, you have not been actively involved in the daily affairs of the theatre. On January 10, 2013, you are excited because you received \$12,000 as a dividend after the end of the 1st year of the theatre's existence. Included with your \$12,000 check are financial statements and some supplemental information regarding the accounting. The supplemental information explains:

(1) During the last three months of 2012, an aggressive advertising campaign resulted in the sale of 600 season tickets for the 2013 productions. Each season ticket cost \$120 and the resulting \$72,000 was included in 2012 income.

(2) Along with the advertising campaign, the general manager was able to secure pledges of \$7,500 for advertising by local merchants in the playbills for the first two productions for 2013. This amount is included as advertising revenue in the 2012 financial statements.

**REQUIRED:**

Are there any problems related to the supplementary disclosures? If so, explain and indicate what effects (over- or understatements) these items will have on the financial statements.

The recognition of the 2013 season ticket sales as revenue in 2012 should not be recognized as revenue in the current year, because Viva has not provided these ticketholders with any service yet.

The recognition of \$7,500 in advertising revenue is currently just a pledge for 2013 playbills. It is not clear whether a contract has been signed with the advertisers and it sounds as if no money has changed hands. In any event, this revenue will need to be matched with the period in which the playbills are used (or 2013) rather than the current year of 2012.

As a result, the 2012 net income will be overstated by \$79,500 and the 2013 net income will be understated by \$79,500.