Understanding Financial Accounting (Canadian) 3rd edition Burnley Test Bank

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CHAPTER 2

ANALYZING TRANSACTIONS AND THEIR EFFECTS ON FINANCIAL STATEMENTS

CHAPTER LEARNING OBJECTIVES

1. ***Identify the accounting standards used by Canadian companies.***
Canadian public companies (those whose shares trade on a public stock exchange) are required to prepare their financial statements using International Financial Reporting Standards (IFRS).
Private companies in Canada generally follow Accounting Standards for Private Enterprises (ASPE), but have the option of following IFRS.

2. ***Identify and explain the qualitative characteristics of useful financial information and how the cost constraint affects these.***
Standards setters have developed conceptual frameworks (one for IFRS and another for ASPE) to assist them in determining what "useful information" is.
Useful information has two fundamental qualitative characteristics. It must be relevant (it must matter to users' decision-making) and it must be representationally faithful (it must represent transactions and balances as they took place or are at present).
To be relevant, the information must be material and have a predictive value or a confirmatory value.
To be representationally faithful, the information must be complete, neutral, and free from error.
Four other enhancing qualitative characteristics have been identified that can increase the usefulness of financial information. These are comparability, verifiability, timeliness, and understandability. These characteristics increase usefulness, but they cannot make useless information useful.
Financial statements are prepared using the going concern assumption. This assumes that the company will continue to operate for at least the next 12 months, and if it is a public company that its shares will continue to trade on an exchange during that period.

3. ***Explain the difference between the cash basis of accounting and the accrual basis of accounting.***
Under the cash basis of accounting, revenues are only recorded when cash is received and expenses are recorded when cash is paid out.
Under the accrual basis of accounting, revenues are recorded when they are earned and expenses are recorded when they are incurred.
Revenues are earned when the company has satisfied its performance obligations in the contract by providing the goods or services to its customers.

Accounting standard setters have determined that financial information prepared using the accrual basis of accounting is more useful than that resulting from the use of the cash basis.

4. ***Explain the accounting equation template approach to recording transactions.***
Every transaction must affect at least two accounts when it is recorded.
The accounting equation must remain in balance as transactions are recorded; total assets must equal the sum of total liabilities plus shareholders' equity.
One of the main limitations of the accounting equation template method is that the number of columns that can be used is limited, which means that the number of accounts is also limited. The information resulting from this system may lack the level of detail required by management and other users.
The other main limitation of the accounting equation template method is the lack of specific accounts for recording revenues, expenses, and dividends declared. Instead, these are recorded in the Retained Earnings account. This makes it difficult and time-consuming for management to quantify revenue and expense information, which is critical for managing any business.

5. ***Analyze basic transactions and record their effects on the accounting equation.***
Transactions affecting the Retained Earnings account (revenues, expenses, and the declaration of dividends) should be referenced to indicate the nature of the transaction. Revenues increase Retained Earnings, while expenses and the declaration of dividends decrease Retained Earnings.

6. ***Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.***
The statement of income is normally the first financial statement prepared. This statement, which includes all revenues and expenses, provides the net income figure that is required for all of the other financial statements.
The statement of changes in equity is the next financial statement prepared. It illustrates any changes in the number of shares, changes in the dollar value of share capital, and changes to the Retained Earnings account (due to net income or loss or the declaration of dividends).
The statement of financial position is a vertical presentation of the accounting equation. It includes all assets, liabilities, and shareholders' equity accounts. It is often prepared on a classified basis, meaning that asset and liability accounts are presented in order of liquidity. Current assets are presented separately from non-current assets, while current liabilities are presented separately from non-current liabilities.
All assets expected to be received, realized, or consumed within the next 12 months are considered to be current assets. All liabilities expected to be settled or paid within the next 12 months are considered to be current liabilities.
The final financial statement to be prepared is the statement of cash flows. This statement categorizes all transactions of a business that affect cash into three categories: operating activities, investing activities, and financing activities.

7. ***Calculate and interpret three ratios used to assess the profitability of a company.***
The profit margin ratio is calculated by dividing net income by sales revenue. It indicates the percentage of sales revenue that remains after all expenses, including income taxes, have been recorded.
The return on equity ratio is calculated by dividing net income by average shareholders' equity. It compares profit relative to the amount invested by shareholders. It provides shareholders with a sense of the returns being generated on their equity in the company.
The return on assets ratio is calculated by dividing net income by average total assets. It provides an indication of how effective management has been at generating a return given the assets at their disposal.

TRUE-FALSE STATEMENTS

1. All public companies must follow IFRS.

Answer: True

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Identify the accounting standards used by Canadian companies.
CPA: Financial Reporting
AACSB: Analytic

2. The objective of both IFRS and ASPE is to allow financial reporting that is useful to the financial statement users.

Answer: True

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Identify the accounting standards used by Canadian companies.
CPA: Financial Reporting
AACSB: Analytic

3. Public companies are prohibited from being cross listed.

Answer: False

Bloomcode: Knowledge
Difficulty: Medium
Learning Objective: Identify the accounting standards used by Canadian companies.
CPA: Financial Reporting
AACSB: Analytic

4. Relevance, faithful representation and the cost constraint are examples of the fundamental qualitative characteristics.

Answer: False

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Identify and explain the qualitative characteristics of useful financial information and how the cost constraint affects these.

CPA: Financial Reporting
AACSB: Analytic

5. Information is considered to be material if it impacts the decisions of a financial statement user.

Answer: True

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Identify and explain the qualitative characteristics of useful financial information and how the cost constraint affects these.
CPA: Financial Reporting
AACSB: Analytic

6. Information has predictive value if it provides feedback to users on their previous assessments of the company.

Answer: False

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Identify and explain the qualitative characteristics of useful financial information and how the cost constraint affects these.
CPA: Financial Reporting
AACSB: Analytic

7. Revenue recognition criteria are necessary to determine when to recognize revenue when using both accrual and cash accounting methods.

Answer: False

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Explain the difference between the cash basis of accounting and the accrual basis of accounting.
CPA: Financial Reporting
AACSB: Analytic

8. The sales of merchandise on credit will cause the retained earnings and long-term liabilities

accounts to increase.

Answer: False

Bloomcode: Application
Difficulty: Easy
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

9. The purchase of equipment costing $19,500 with a $1,500 down payment and the balance owing on account will increase both sides of the Statement of Financial Position by $18,000.

Answer: True

Bloomcode: Application
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

10. The issuance of common shares with a value of $9,000 to purchase land will increase the common share account.

Answer: True

Bloomcode: Application
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

11. Dividends are an expense of doing business.

Answer: False

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Explain the accounting equation template approach to recording transactions.

CPA: Financial Reporting
AACSB: Analytic

12. Carrying Value of an asset is the cost of the asset that has already been expensed.

Answer: False

Bloomcode: Knowledge
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

13. Straight-line depreciation = (cost + residual value) ÷ estimated useful life.

Answer: False

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

14. A significant limitation of the template method is the lack of specific retained earnings and dividends declared accounts.

Answer: True

Bloomcode: Comprehension
Difficulty: Easy
Learning Objective: Analyze basic transactions and record their effects on the accounting equation.
CPA: Financial Reporting
AACSB: Analytic

15. The template method can only be used by large companies.

Answer: False

Bloomcode: Knowledge

Difficulty: Easy
Learning Objective: Analyze basic transactions and record their effects on the accounting equation.
CPA: Financial Reporting
AACSB: Analytic

16. The Classified Statement of Financial Position distinguishes between current and non-current assets and liabilities.

Answer: True

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

17. Accumulated depreciation is deducted when calculating net income.

Answer: False

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

18. The purchase of a three-year insurance policy should be reflected on the Statement of Financial Position under current assets.

Answer: True

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

19. A declaration of dividends results in an increase in liabilities and a decrease in

shareholders' equity.

Answer: True

Bloomcode: Knowledge
Difficulty: Medium
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

20. The return on assets = net income ÷ average total assets.

Answer: True

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Calculate and interpret three ratios used to assess the profitability of a company.
CPA: Financial Reporting
AACSB: Analytic

21. The profit margin ratio = sales ÷ net income.

Answer: False

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Calculate and interpret three ratios used to assess the profitability of a company.
CPA: Financial Reporting
AACSB: Analytic

MULTIPLE CHOICE QUESTIONS

22. The accounting standards that publicly traded companies in Canada must adhere to are
a) International Financial Reporting Standards.
b) Accounting Standards for Private Enterprise.
c) Canada Revenue Agency Standards.
d) All of the choices are correct.

Answer: a

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Identify the accounting standards used by Canadian companies.
CPA: Financial Reporting
AACSB: Analytic

23. The main objective of IFRS and ASPE is
a) to ensure compliance with the income tax act.
b) to protect shareholder investment.
c) to produce financial reporting that is useful for financial statement users.
d) to provide specific guidelines for publicly traded companies.

Answer: c

Bloomcode: Knowledge
Difficulty: Medium
Learning Objective: Identify the accounting standards used by Canadian companies.
CPA: Financial Reporting
AACSB: Analytic

24. The enhancing qualitative characteristics that increase the usefulness of financial information includes all of the following, EXCEPT for
a) verifiability.
b) materiality.
c) understandability.
d) comparability.

Answer: b

Bloomcode: Knowledge
Difficulty: Medium
Learning Objective: Identify and explain the qualitative characteristics of useful financial

information and how the cost constraint affects these.
CPA: Financial Reporting
AACSB: Analytic

25. The benefits of reporting financial information must exceed the costs of doing so, according to which characteristic of financial information?
a) the concept of materiality
b) faithful representation
c) cost constraint
d) verifiability

Answer: c

Bloomcode: Knowledge
Difficulty: Medium
Learning Objective: Identify and explain the qualitative characteristics of useful financial information and how the cost constraint affects these.
CPA: Financial Reporting
AACSB: Analytic

26. All of the following are examples of enhancing qualitative characteristics EXCEPT
a) verifiability.
b) understandability.
c) neutrality.
d) timeliness.

Answer: c

Bloomcode: Knowledge
Difficulty: Medium
Learning Objective: Identify and explain the qualitative characteristics of useful financial information and how the cost constraint affects these.
CPA: Financial Reporting
AACSB: Analytic

27. Information that has been determined based on the best information available using the correct process, which also provides an adequate explanation is an example of which fundamental characteristic?
a) neutral
b) faithful representation
c) timeliness
d) verifiability

Answer: b

Bloomcode: Knowledge
Difficulty: Medium
Learning Objective: Identify and explain the qualitative characteristics of useful financial information and how the cost constraint affects these.
CPA: Financial Reporting
AACSB: Analytic

28. Which of the following enhancing characteristics is achieved if a third party, with sufficient understanding, can arrive at a result that is similar to that of the company?
a) comparability
b) understandability
c) timeliness
d) verifiability

Answer: d

Bloomcode: Knowledge
Difficulty: Medium
Learning Objective: Identify and explain the qualitative characteristics of useful financial information and how the cost constraint affects these.
CPA: Financial Reporting
AACSB: Analytic

29. The receipt of cash is a revenue recognition criterion for
a) IFRS.
b) ASPE.
c) cash basis of accounting.
d) accrual basis of accounting.

Answer: c

Bloomcode: Knowledge
Difficulty: Medium
Learning Objective: Explain the difference between the cash basis of accounting and the accrual basis of accounting.
CPA: Financial Reporting
AACSB: Analytic

30. Under the accrual basis of accounting, expenses are
a) always paid in cash.
b) recorded only when paid.

c) recorded when incurred.
d) only relevant for the determination of net income.

Answer: c

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Explain the difference between the cash basis of accounting and the accrual basis of accounting.
CPA: Financial Reporting
AACSB: Analytic

31. Cost of goods sold should be matched up with the revenue generated on each year's Statement of Income because of the
a) revenue recognition criteria.
b) cash basis of accounting.
c) actual basis of accounting.
d) accrual basis of accounting.

Answer: d

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Explain the difference between the cash basis of accounting and the accrual basis of accounting.
CPA: Financial Reporting
AACSB: Analytic

32. A company received a $6,500 deposit from a customer for goods to be delivered in the following month. Under the accrual and cash basis of accounting respectively, the account credited is a

	Accrual basis	Cash basis
a)	liability	liability
b)	liability	revenue
c)	revenue	liability
d)	revenue	revenue

Answer: b

Bloomcode: Application
Difficulty: Easy
Learning Objective: Explain the difference between the cash basis of accounting and the accrual basis of accounting.
Learning Objective: Explain the accounting equation template approach to recording transactions.

CPA: Financial Reporting
AACSB: Analytic

33. During a recent week, McMunn Legal Services received $25,000 cash from clients for services performed with a total value of $75,000. The balance is to be received within 30 days. The effect of this transaction in the accounting records would be
a) + $75,000 revenue = + $25,000 cash + $50,000 accounts receivable.
b) + $50,000 net income = + $50,000 assets.
c) + $25,000 revenue = + $25,000 cash.
d) + $75,000 revenue = + $75,000 accounts receivable.

Answer: a

Bloomcode: Application
Difficulty: Easy
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

34. During a recent week, McMunn Legal Services received $25,000 cash from clients for services performed with a total value of $75,000. The balance is to be received within 30 days. The effect on the Statement of Financial Position equation for this transaction would be
a) + $25,000 cash = – $50,000 accounts payable + $75,000 retained earnings.
b) + $25,000 cash – $50,000 accounts receivable = $75,000 retained earnings.
c) + $25,000 cash + $50,000 accounts receivable = + $75,000 retained earnings.
d) + $25,000 cash = + $25,000 retained earnings.

Answer: c

Bloomcode: Application
Difficulty: Easy
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

35. On March 31, Exacto Company paid $5,200 for a 1-year insurance policy. To record this transaction Exacto Company should
a) decrease Cash and increase Insurance Expense.
b) decrease Cash and increase Prepaid Insurance.
c) increase Accounts Payable and increase Insurance Expense.
d) increase Cash and increase Prepaid Insurance.

Answer: b

Bloomcode: Application
Difficulty: Easy
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

36. How is cash invested by shareholders in exchange for shares recorded in a company's accounting records?
a) as an increase in Retained Earnings, and an increase in Cash
b) as an increase in Long-Term Investments, and a decrease in Cash
c) as an increase in Common Shares, and a decrease in Cash
d) as an increase in Common Shares, and an increase in Cash

Answer: d

Bloomcode: Knowledge
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

37. All the following costs are initially expressed as assets but are then reclassified as expenses when they are consumed, EXCEPT for
a) inventory.
b) prepaid insurance.
c) prepaid rent.
d) short-term investments.

Answer: d

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

38. Chamber Enterprises signed a lease for office space during its first month of business. At

that time it paid a total of $12,000 for first and last months' rent. At the end of the first month, the effect on the financial statements would be
a) $12,000 rent expense.
b) $6,000 rent expense and $6,000 prepaid rent on the Statement of Financial Position.
c) $12,000 prepaid rent on the Statement of Financial Position.
d) Nothing recorded because the company has not made any sales yet.

Answer: b

Bloomcode: Application
Difficulty: Easy
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

39. Oxford Company paid $22,000 for goods it had purchased last month on account. What is the effect of the payment?
a) a decrease in inventory
b) a decrease in accounts payable
c) an increase in cost of goods sold
d) an increase in inventory

Answer: b

Bloomcode: Application
Difficulty: Easy
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

40. A company sold merchandise for cash. What is the effect of this sale?
a) increase in revenue, increase in COGS, decrease in inventory
b) increase in revenue, decrease in COGS, increase in inventory
c) increase in revenue, increase in COGS, increase in inventory
d) increase in revenue, decrease in COGS, decrease in inventory

Answer: a

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.

CPA: Financial Reporting
AACSB: Analytic

41. A piece of equipment was recently purchased for $10,600 on April 1. It is estimated that it will last for 10 years and have a residual value of $600. The depreciation expense to be recognized in the year of acquisition, assuming a December year end, would be
a) $1,000.00.
b) $750.00.
c) $662.50.
d) $833.33.

Answer: b

Bloomcode: Application
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

42. If a vehicle was purchased for $6,500 and has a residual value of $500, the annual depreciation expense will be $1,000 if the estimated useful life is
a) 6 years.
b) 6.5 years.
c) 7 years.
d) 13 years.

Answer: a

Bloomcode: Application
Difficulty: Hard
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

43. When $10,000 of inventory is purchased with a three-month note payable bearing 2% interest, the inventory has a total cost of
a) $10,200.
b) $10,000.
c) $10,100.
d) $10,050.

Answer: b

Bloomcode: Application
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

44. The asset that results when a customer buys goods or services on credit is
a) an accounts receivable.
b) an accounts payable.
c) a notes receivable.
d) cash.

Answer: a

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

45. The asset that results from the payment of expenses in advance is
a) an accounts receivable.
b) a short-term investments.
c) inventory.
d) a prepaid expense.

Answer: d

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

46. On Oct. 1, 2024, Howey Inc. signed a 1-year $75,000 note payable from First National Bank. The loan plus 6% interest is to be paid on Sept. 30, 2025. Howey's year-end is December 31. In its 2024 financial statements, Howey will record interest expense of
a) $375.

b) $1,125.
c) $4,500.
d) $75,000.

Answer: b

Bloomcode: Application
Difficulty: Hard
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

47. If dividends are declared and paid in the same accounting period, what is the net effect on the accounting equation?
a) a decrease in Retained Earnings and an increase in Expenses
b) a decrease in Cash and an increase Expenses
c) a decrease in Cash and an increase in Retained Earnings
d) a decrease in Cash and a decrease in Retained Earnings

Answer: d

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

48. The purchase of land for a combination of cash and the issuance of shares would result in which of the following?
a) increase in Land, increase in Common shares, increase in Cash
b) increase in Cash, decrease in Common shares, decrease in Land
c) increase in Land, increase in Common shares
d) increase in Land, increase in Common shares, decrease in Cash

Answer: d

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

49. The sale of merchandise to a customer partly for cash and partly on account would require which of the following?
a) increase in Accounts Receivable, increase in Cash, increase in Sales Revenue
b) increase in Cash, decrease in Accounts Payable, increase in Sales Revenue
c) increase in Cash, increase in Sales Revenue
d) decrease in Accounts Payable, increase in Accounts Receivable, increase in Sales Revenue

Answer: a

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

50. When the board of directors declares a $500 dividend, which of the following would be included in recording the transaction?
a) increase in Retained Earnings, increase in Dividends Declared
b) decrease in Cash, decrease in Dividends Payable
c) increase in Dividends Declared, increase in Dividends Payable
d) decrease in Dividends Payable, increase in Cash

Answer: c

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

51. If the company had a loan outstanding, which of the following would be included in recording the accrued interest at the end of the accounting period?
a) increase Interest Expense, decrease Cash
b) increase Interest Expense, increase Interest Payable
c) decrease Interest Payable, increase Interest Income
d) decrease Interest Payable, decrease Cash

Answer: b

Bloomcode: Comprehension

Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

52. Which of the following reflects the effect of a transaction that records the portion of prepaid rent that has expired within a period?
a) increase Prepaid Rent, decrease Rent Expense
b) increase Rent Expense, decrease Cash
c) increase Prepaid Rent, decrease Cash
d) increase Rent Expense, decrease Prepaid Rent

Answer: d

Bloomcode: Application
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

53. Which of the follow statements regarding the limitations of the accounting template approach is INCORRECT?
a) It creates challenges in Printing out reports.
b) This approach is only suitable for very small businesses.
c) This approach does not allow users to properly quantify revenues and expenses.
d) This is theoretically an incorrect treatment of accounting information.

Answer: c

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Analyze basic transactions and record their effects on the accounting equation.
CPA: Financial Reporting
AACSB: Analytic

54. Which of the following is NOT an example of a financing activity?
a) accepting cash deposits
b) debt repayment
c) share issues
d) borrowing money to buy a building

Answer: a

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

55. How are goods that are purchased for resale at a later date recorded in the financial statements?
a) as inventory
b) as prepaid expenses
c) as cost of goods sold
d) as operating expenses

Answer: a

Bloomcode: Knowledge
Difficulty: Medium
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

56. Which of the following expenses has NO effect on the cash flow of a firm?
a) salaries expense
b) interest expense
c) depreciation expense
d) cost of goods sold

Answer: c

Bloomcode: Knowledge
Difficulty: Medium
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

57. Which of the following assets is NEVER expensed on the Statement of Income?
a) land

b) building
c) inventory
d) equipment

Answer: a

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

58. Which of the following will NOT appear on the Statement of Income?
a) depreciation
b) interest
c) cost of goods sold
d) dividends declared

Answer: d

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

59. Which of the following would be the most useful in determining if a company has sufficient resources to continue operations in the short-term?
a) the profit margin ratio
b) the return on assets ratio
c) the cash from operating activities
d) the cash from financing activities

Answer: c

Bloomcode: Comprehension
Difficulty: Hard
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

60. Which of the following transactions would decrease the cash from operating activities?
a) the payment of dividends
b) the sale of goods on account
c) the purchase of goods on account
d) the payment of wages

Answer: d

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

61. The accounting basis that attempts to measure performance in the period in which it occurred is the
a) approval basis.
b) cash basis.
c) matching basis.
d) accrual basis.

Answer: d

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Calculate and interpret three ratios used to assess the profitability of a company.
CPA: Financial Reporting
AACSB: Analytic

62. Shareholders of a publicly traded company want to assess the return on their investment. Which ratio should shareholders use to specifically help assess this?
a) Gross profit margin
b) ROE
c) ROA
d) Profit margin

Answer: b

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Calculate and interpret three ratios used to assess the profitability of a

company.
CPA: Financial Reporting
AACSB: Analytic

63. Boro Enterprises ROA has increased year over year. Factors contributing to this increase may include
a) an increase in the average cost of total assets.
b) an increase in revenues.
c) an increase in expenses.
d) an increase in dividend payments.

Answer: b

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Calculate and interpret three ratios used to assess the profitability of a company.
CPA: Financial Reporting
AACSB: Analytic

64. Use the following information to answer the question.

Revenues	$ 50,000
Cost of goods sold...........	35,000
Operating expenses	5,500
Beginning assets	350,000
Beginning liabilities	245,000
Ending assets	450,000
Ending liabilities..............	255,000

The profit margin is closest to
a) 2%.
b) 19%.
c) 30%.
d) 89%.

Answer: b

Bloomcode: Application
Difficulty: Medium
Learning Objective: Calculate and interpret three ratios used to assess the profitability of a company.
CPA: Financial Reporting
AACSB: Analytic

65. Use the following information to answer the question.

Revenues	$ 50,000
Cost of goods sold	35,000
Operating expenses	5,500
Beginning assets	350,000
Beginning liabilities	245,000
Ending assets	450,000
Ending liabilities	255,000

The return on assets is closest to
a) 2.1%.
b) 2.4%.
c) 3.75%.
d) 11.13%.

Answer: b

Bloomcode: Application
Difficulty: Medium
Learning Objective: Calculate and interpret three ratios used to assess the profitability of a company.
CPA: Financial Reporting
AACSB: Analytic

66. Use the following information to answer the question.

Revenues	$ 50,000
Cost of goods sold	35,000
Operating expenses	5,500
Beginning assets	350,000
Beginning liabilities	245,000
Ending assets	450,000
Ending liabilities	255,000

The return on equity is
a) 1.0%.
b) 6.3%.
c) 7.6%.
d) 9.0%.

Answer: b

Bloomcode: Application
Difficulty: Medium
Learning Objective: Calculate and interpret three ratios used to assess the profitability of a company.
CPA: Financial Reporting
AACSB: Analytic

EXERCISES

67. The following transactions have occurred for Madagascar Co. during the month of April:

April 1: Purchased a one-year insurance policy for cash of $5,500.
April 4: Paid utilities bill received last month for $645.
April 10: Performed a service on account of $3,100.
April 16: Paid $9,250 for bi-weekly salaries to employees.
April 19: Received $1,700 from a customer on account.
April 23: Received the amount owing from the April 10 transaction.
April 28: Received a bill for online advertising used in the month of April, $1,310, due in 30 days.
April 30: Received $4,000 cash in advance for a job to be completed in the month of May.

Instructions
Using the template provided below, indicate the amount of revenue and / or expense that should be recognized for each transaction under both the accrual basis and the cash basis of accounting.

	ACCRUAL BASIS		CASH BASIS	
Date	Revenue	Expense	Revenue	Expense

Solution (15 min.)

	ACCRUAL BASIS		CASH BASIS	
Date	Revenue	Expense	Revenue	Expense
April 1				$5,500
April 4				$645
April 10	$3,100			
April 16		$9,250		$9,250
April 19			$1,700	
April 23			$3,100	
April 28		$1,310		
April 30			$4,000	

Bloomcode: Application
Learning Objective: Explain the difference between the cash basis of accounting and the accrual basis of accounting.
Bloom's: Application
Difficulty: Medium
CPA: Financial Reporting
AACSB: Analytic

68. Analyze the effect of the following transactions using the basic accounting equation:

a) Bought land with an estimated fair value of $250,000 by issuing 100,000 shares.
b) Issued 10,000 common shares for $25,000 cash.
c) Purchased a 2-year insurance policy for $4,800.
d) Bought a building for $100,000. Paid one-fourth in cash and the balance on a 10-year, 10% interest note payable.
e) Purchased $9,000 of merchandise inventory on credit.
f) Paid utilities bill for $750.
g) Sold $8,000 of merchandise inventory for $16,000 cash.
h) Paid $2,500 on merchandise inventory previously purchased.
i) Declared a $1,000 dividend.
j) Recognized that 1 month of the insurance coverage had expired.

Solution (12 min.)

ASSETS	=						LIABILITIES +			SHAREHOLDERS' EQUITY	
Trans.	Cash	A/R	Inv.	Prepaid expense	Land	Building	A/P	Dividend Payable	Long-term debt	CS	R/E
a)					+250,000					+250,000	
b)	+25,000									+25,000	
c)	−4,800			+4,800							
d)	−25,000					+100,000			+75,000		
e)			+9,000				+9,000				
f)	−750										−750
g)	+16,000										+16,000
g)			−8,000								−8,000
h)	−2,500						−2,500				
i)								+1,000			−1,000
j)				−200							−200
	+7,950		+1,000	+4,600	+250,000	+100,000	+6,500	+1,000	+75,000	+275,000	+6,050
	=363,550						= 363,550				

Bloomcode: Application
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

69. Consider the following independent transactions:

1. On January 1, paid, in advance, $6,000 for first and last month's rent.
2. On January 1, paid, in advance, $3,000 for 12 months insurance.
3. Bought a truck to use for delivery purposes for $45,000 and paid for it with $10,000 cash and with a loan from the bank of $35,000 at 8%. The company expects to use the truck for 7 years after which they estimate the residual value will be $3,000.
4. Sold goods worth $25,000 on credit, that had an inventory cost $15,000.
5. Bought $5,000 of inventory on account.

Instructions

For each transaction indicate:

a) which accounts are immediately affected and how they are affected,

b) which accounts will be affected in the future as a result of the transaction.

Solution (15 min.)

1. a) Immediate: Increase in Prepaid Rent of $6,000 and decrease in Cash of $6,000.
   b) Future effect: At the end of the month $3,000 in Rent Expense will be recognized; Prepaid Rent Expense will decrease and Rent Expense will increase which decreases Retained Earnings.

2. a) Immediate: Increase in Prepaid Insurance of $3,000 and decrease in Cash of $3,000.
   b) Future effect: Every month a portion of the Prepaid Expense will need to be recognized as Insurance Expense. Prepaid Insurance will decrease $250/month and Insurance Expense will increase, which decreases Retained Earnings.

3. a) Immediate: Increase in capital assets: truck for $45,000 and decrease in cash of $10,000 and increase in loan payable by $35,000.
   b) Future: The truck will need to be depreciated at a rate of ($45,000 – $3,000)/7 = $6,000 per year. The truck account will decrease (or Accumulated Depreciation will increase) and Depreciation Expense will increase which decreases Retained Earnings. Also, the loan interest will become payable which will be recorded as an increase in Interest Expense and decrease in Cash. Interest Expense is ($35,000 *.08) = $2,800 annually. (Answers may vary if students make assumptions about when the interest is paid). The increase in Interest Expense will decrease Retained Earnings.

4. a) Immediate: Accounts Receivable increases $25,000 and Sales Revenue increases $25,000 which increases retained earnings. Increase in Cost of Goods Sold expense of $15,000 and decrease in Inventory of $15,000. The increase in Cost of Goods Sold decreases Retained Earnings $15,000.
   b) Future: When the payments are received on account, the Accounts Receivable will decrease and Cash will increase.

5. a) Immediate: Inventory increases by $5,000 and Accounts Payable increases by $5,000.

b) Future: When the inventory is sold the Inventory account will decrease and the Cost of Goods Sold account will increase which will decrease retained earnings, all by $5,000. When payments are made on account, Accounts Payable will decrease and Cash will decrease.

Bloomcode: Analysis
Difficulty: Hard
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

70. Consider the following independent transactions:

1. On June 30, paid in advance, $8,500 for first and last month's rent.
2. On July 1, paid in advance, $3,000 for 6 months insurance.
3. Issued $5,000 in common shares for legal services.
4. Bought a used delivery van for $25,000 and paid for it with $10,000 cash and with a $15,000 loan from the bank at 5%. The company expects to use the truck for 5 years. At the end of 5 years the company expects that the vehicle will be worthless.
5. Sold goods worth $32,000, 80% of the sales were on credit and the remainder was in cash. The goods had an inventory cost $15,000.
6. Bought $7,500 of inventory on account.

Instructions
For each transaction indicate:

a) which accounts are immediately affected and how they are affected,
b) which accounts, if any, will be affected in the future as a result of the transaction.

Solution (20 min.)

1. a) Immediate: Increase in Prepaid Rent of $8,500 and decrease in Cash of $8,500.
   b) Future effect: At the end of July, $4,250 in Rent Expense will be recognized; Prepaid Rent Expense will decrease and Rent Expense will increase which decreases Retained Earnings.

2. a) Immediate: Increase in Prepaid Insurance of $3,000 and decrease in Cash of $3,000.
   b) Future effect: Every month a portion of the Prepaid Expense will need to be recognized as Insurance Expense. Prepaid Insurance will decrease $500/month and Insurance Expense will increase, which decreases Retained Earnings.

3. a) Immediate: Increase in Common Shares of $5,000 and an increase in expenses, which decreases retained earnings
   b) No additional future effect.

4. a) Immediate: Increase in capital assets: van for $25,000 and decrease in cash of

$10,000 and increase in loan payable by $15,000.

b) Future: The truck will need to be depreciated at a rate of ($25,000 – $0)/5 = $5,000 per year. The truck account will decrease (or Accumulated Depreciation will increase) and Depreciation Expense will increase which decreases Retained Earnings. Also, the loan interest will become payable which will be recorded as an increase in Interest Expense and decrease in Cash. Interest Expense is ($15,000 *.05) = $750 annually. (Answers may vary if students make assumptions about when the interest is paid). The increase in Interest Expense will decrease Retained Earnings.

5. a) Immediate: Accounts Receivable increases $25,600, cash increases by $6,400 and Sales Revenue increases $32,000 which increases retained earnings. Increase in Cost of Goods Sold expense of $15,000 and decrease in Inventory of $15,000. The increase in Cost of Goods Sold decreases Retained Earnings $15,000.

   b) Future: When the payments are received on account, the Accounts Receivable will decrease and Cash will increase.

6. a) Immediate: Inventory increases by $7,500 and Accounts Payable increases by $7,500.

   b) Future: When the inventory is sold the Inventory account will decrease and the Cost of Goods Sold account will increase which will decrease retained earnings, all by $7,500. When payments are made on account, Accounts Payable will decrease and Cash will decrease.

Bloomcode: Analysis
Difficulty: Hard
Learning Objective: Explain the accounting equation template approach to recording transaction.
CPA: Financial Reporting
AACSB: Analytic

71. Golladay Inc. began operations in April of the current year with the following transactions occurring during the month:

Apr	1	Sold 15,000 common shares for $13 per share.
	2	Paid $6,300 for three months' rent in advance.
	5	Purchased $25,000 of equipment paying 25% down and agreeing to pay the balance in two years.
	6	Purchased inventory for $19,000 on credit.
	10	Sold on account $16,000 of inventory for $23,000.
	15	Paid wages of $1,200.
	20	Collected $8,000 from customers on account.
	25	Paid suppliers $3,000 on account.
	31	Paid wages of $1,100.
	31	Recognized one month's rent expense.
	31	Recognized one month's equipment depreciation expense. The estimated salvage value is $4,000 and the estimated useful life is 5 years.

Instructions
Indicate the effects of these transactions on the balance sheet equation.

Solution (20 min.)

Assets =							Liabilities +		Shareholders' Equity	
Date	Cash	+A/R	+Inv	+Prepaid Rent	+Equip-ment	=	A/P	+N/P	+CS	+R/E
1	+195,000								+195,000	
2	−6,300			+6,300						
5	−6,250				+25,000			+18,750		
6			+19,000				+19,000			
10		+23,000								+23,000
10			−16,000							−16,000
15	−1,200									−1,200
20	+8,000	−8,000								
25	−3,000						−3,000			
31	−1,100									−1,100
31				−2,100						−2,100
31					−350					−350
Total	+185,150	+15,000	+3,000	+4,200	+24,650	=	+16,000	+18,750	+195,000	+2,250
	= 232,000						= 232,000			

Bloomcode: Application
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transaction.
CPA: Financial Reporting
AACSB: Analytic

72. Apply the template approach by using the template provided. Identify the accounts affected in the following transactions and the impact on each account by indicating an "increase" or "decrease". Assess the impact on any revenue, expense or dividend transactions based on the impact on retained earnings. The first transaction has been provided as an example.

Transactions:

1. The company borrowed $200,000 by taking out a bank loan.
2. Purchased equipment for $100,000, paying half with cash and issuing a note payable for the remainder.
3. Purchase $46,000 of inventory on account.
4. Sale of merchandise for cash of $5,600. The cost of the goods sold amount to $1,450.
5. Paid a supplier $46,000 in settlement of its accounts payable.

6. Declared and paid cash dividends totalling $50,000.

Response template:

Transaction	Accounts	Increase	Decrease
1.	Cash	X	
	Bank Loan	X	

Solution (15 min.)

Transaction	Accounts	Increase	Decrease
1.	Cash	X	
	Bank Loan	X	
2.	Cash		X
	Equipment	X	
	Note Payable	X	
3.	Inventory	X	
	Accounts Payable	X	
4.	Cash	X	
	Inventory		X
	Retained Earnings (net)	X	
5.	Cash		X
	Accounts Payable		X
6.	Cash		X
	Retained Earnings		X

Bloomcode: Application
Difficulty: Medium
Learning Objective: Analyze basic transactions and record their effects on the accounting equation.
CPA: Financial Reporting
AACSB: Analytic

73. Shown below are the account balances for Daisy Corporation for their year-end September 30:

Cash .... $ 10,475
Accounts receivable 16,640

Inventory	98,220
Building	188,600
Accumulated depreciation—building	72,600
Accounts payable	14,850
Common shares	$154,525
Retained earnings, beginning	40,720
Dividends declared	7,500
Sales revenue	265,000
Cost of goods sold	143,600
Salaries and wages expense	64,540
Depreciation expense	12,850
Utilities expense	3,300
Supplies expense	1,970

Instructions

Given the above information, prepare the

a) Statement of Income,

b) Statement of Changes in Equity, and

c) Classified Statement of Financial Position.

Solution (20 min.)

a)

DAISY CORPORATION
Statement of Income
For the Year Ended September 30

Sales revenue		$265,000
Cost of goods sold		143,600
Gross Profit		121,400
Expenses		
Salaries and wage expense	$64,540	
Depreciation expense	12,850	
Utilities expense	3,300	
Supplies expense	1,970	
Total operating expense		82,660
Net income		$ 38,740

b)

DAISY CORPORATION
Statement of Changes in Equity
Year Ended September 30

Retained earnings, October 1	$ 40,720
Add: Net income	38,740

Deduct: Dividends declared	(7,500)
Retained earnings, September 30	$71,960

c)

DAISY CORPORATION
Statement of Financial Position
As at September 30

Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	$ 10,475	Accounts payable	$ 14,850
Accounts receivable	16,640		
Inventory	98,220		
	$125,335		
Non-current Assets		Shareholders' Equity	
Building	188,600	Common shares	154,525
Accumulated depreciation	(72,600)	Retained earnings	71,960
	116,000	Total shareholders' equity	$226,485
Total Assets	$241,335	Total Liabilities and Shareholders' Equity	$241,335

Bloomcode: Application
Difficulty: Medium
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

74. Maple Grove Hardware Ltd. has the following balances in the company ledgers for the year ending December 31:

Mortgage Payable	$80,000	Interest Expense	$10,000
Prepaid Insurance	$ 2,000	Land	$25,000
Short-term investments.	$ 5,000	Office salaries	$70,000
Common Shares	$15,000	Sales Salaries	$100,000
Cash	$ 5,000	Supplies expense	$20,000
Advertising	$50,000	Insurance expense	$10,000
Accounts Receivable	$15,000	Depreciation expense	$20,000
Sales revenue	$600,000	Income tax expense	$10,000
Accounts Payable	$12,000	Dividend Payments	$10,000
Buildings (Net)	$100,000	Interest Income	$15,000
Cost of Goods Sold	$300,000	Inventory	$20,000

Note Payable (due in 9 months).........	$10,000
Retained Earnings (Beg Bal-Jan 1).....	$40,000

Instructions
Using the above information prepare the following:
a) Statement of Income
b) Statement of Changes in Equity
c) Classified Statement of Financial Position

Solution (20 min.)
a)

MAPLE GROVE HARDWARE LTD.
Statement of Income
For the Year Ended December 31

Sales revenue..................................		$600,000
Cost of goods sold		300,000
Gross Profit		300,000
Expenses		
Advertising	50,000	
Office salaries..................................	70,000	
Sales salaries..................................	100,000	
Insurance expense	10,000	
Depreciation expense	20,000	
Supplies expense	20,000	
Interest expense..................................	10,000	
Total operating expense..................................		280,000
Net operating income..................................		20,000
Other Income—Interest..................................		15,000
Earnings before taxes		35,000
Income tax expense		10,000
Net income..................................		$ 25,000

b)

MAPLE GROVE HARDWARE LTD.
Statement of Changes in Equity
Year Ended December 31

Retained earnings, January 1..................................	$ 40,000
Add: Net income	25,000
Deduct: Dividends declared	(10,000)
Retained earnings, December 31	$ 55,000

c)

MAPLE GROVE HARDWARE LTD.
Statement of Financial Position

December 31

Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	$ 5,000	Accounts payable	$ 12,000
Short-term investments	5,000	Note payable	10,000
Accounts receivable	15,000		
Prepaid insurance	2,000		
Inventory	20,000		
Total Current Assets	$47,000	Total Current Liabilities	22,000
Non-current Assets		Non-current Liabilities	
Land	25,000	Mortgage Payable	80,000
Buildings (net)	100,000		
Total Long-term Assets	$125,000	Total Liabilities	$102,000
		Shareholders' Equity	
		Common shares	15,000
		Retained earnings	55,000
		Total shareholders' equity	$70,000
Total Assets	$172,000	Total Liabilities and Shareholders' Equity	$172,000

Bloomcode: Application
Difficulty: Medium
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

75. Cormorant Corporation had the following transactions during the fiscal year ended August 31:

a) Purchased inventory costing $325,000 on account.
b) Sold inventory to customers for $725,000; of these sales, $125,000 were cash sales.
c) Borrowed $90,000 from the bank on March 1 at 6% interest payable annually at year-end.
d) Paid employees $110,000 in cash.
e) Purchased equipment costing $225,000 in cash.
f) Collected $520,000 from customers on account.
g) Purchased $55,000 of another company's shares as a long-term investment.
h) Issued 50,000 common shares for $3.75 per share.
i) Paid suppliers $340,000.
j) Collected a $7,500 cash dividend on the share investment.
k) Declared and paid a $13,500 dividend during the year.
l) Sold a piece of land for proceeds of $150,000.

m) Paid the interest due on the loan from the bank in part c.

Instructions
Prepare a statement of cash flow for the August 31 year end.

Solution (20 min.)

CORMORANT CORPORATION
Statement of Cash Flow
For the Year Ended August 31

Cash flows from operating activities:		
Receipts from customers ($125,000 + $520,000)	$645,000	
Dividend from investment	7,500	
Payments to suppliers	(340,000)	
Payments to employees	(110,000)	
Payments for interest (.06 x $90,000 x 6/12)	(2,700)	
Total cash flows from operating activities		$199,800
Cash flows from investing activities:		
Purchase of equipment	(225,000)	
Proceeds on sale of land	150,000	
Purchase of long-term investment	(55,000)	
Total cash flows from investing activities		(130,000)
Cash flows from financing activities:		
Borrowed from bank	90,000	
Issued common shares	187,500	
Dividends paid	(13,500)	
Total cash flows from financing activities		264,000
Net change in cash during the period		$333,800

Bloomcode: Application
Difficulty: Medium
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

76. Due to the sudden resignation of the accountant at Floyd Flower Shop, the sales manager has prepared the annual financial statements, shown below:

FLOYD FLOWER SHOP
Statement of Income
December 31

Sales Revenue		$326,000
Cost of goods sold		182,000
Gross Profit		$144,000
Operating expenses:		
Salaries & Wages expense	$24,600	
Rent expense	24,000	
Prepaid rent	3,600	
Dividends	5,000	
Accumulated Depreciation	28,400	
Supplies expense	2,100	87,700
Earnings before taxes		$56,300
Income tax expense		26,000
Net income		$30,300

FLOYD FLOWER SHOP
Statement of Changes in Equity
For the Year Ended December 31

Retained earnings, January 1	$138,200
Add: Net income	30,300
Retained earnings, December 31	$168,500

FLOYD FLOWER SHOP
Statement of Financial Position
For Year Ended December 31

Assets		Liabilities	
Cash	$ 22,450	Accounts payable	$ 9,600
Accounts receivable	11,250		
		Long-term debt	32,000
Inventory	92,000	Total Liabilities	41,600
		Shareholders' Equity	
Building	172,000	Common shares	$45,000
		Retained earnings	168,500
Less depreciation expense	(14,200)		
	$157,800	Total shareholders' equity	213,500
		Total liabilities and	
Total assets	$283,500	Shareholders' Equity	$255,100

Instructions

a) Identify the errors in the financial statements.

b) Prepare corrected financial statements for Floyd Flower Shop.

Solution (25 min.)

a) The errors are:

- The Statement of Financial Position is not classified and the title is incorrect. This statement measures a point in time, not a year ended.
- The Statement of Financial Position is not balanced (Total Assets do not equal Liabilities + Shareholders' Equity).
- Prepaid rent is recorded on the Statement of Income; it should be a current asset.
- Dividends are recorded on the Statement of Income; they should be deducted and shown in the Statement of Changes in Equity. (This is just a presentation error and would not affect the Statement of Financial Position from balancing).
- Depreciation expense should be recorded on the Statement of Income and not deducted from the asset. The accumulated depreciation should be reflected on the Statement of Financial Position and deducted from the related asset.
- The income statement measures a period ending not a snapshot in time, the statement title is incorrect.

b)

FLOYD FLOWER SHOP
Statement of Income
For the Year Ended December 31

Sales Revenue		$326,000
Cost of goods sold		182,000
Gross Profit	$144,000	
Operating expenses:		
Salaries & Wages expense	$24,600	
Depreciation expense	14,200	
Rent expense	24,000	
Supplies expense	2,100	64,900
Earnings before taxes		$79,100
Income tax expense		26,000
Net income	$53,100	

FLOYD FLOWER SHOP
Statement of Changes in Equity
For the Year Ended December 31

Retained earnings, January 1	$138,200
Add: Net income	53,100
	191,300
Deduct: Dividends declared	(5,000)

Retained earnings, December 31 .... $186,300

FLOYD FLOWER SHOP
Statement of Financial Position
December 31

Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	$ 22,450	Accounts payable	$ 9,600
		Non-current Liabilities	
Accounts receivable..........................	11,250	Long-term debt	32,000
Inventory	92,000	Total Liabilities	41,600
Prepaid rent	3,600		
Total Current Assets	129,300	Shareholders' Equity	
Non-current Assets			
Building	172,000	Common shares	$45,000
Less: Accumulated depreciation........	(28,400)	Retained earnings	186,300
....	143,600	Total shareholders' equity	231,300
Total assets	$272,900	Total liabilities and shareholders' equity	$272,900

Bloomcode: Analysis
Difficulty: Hard
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

77. Jones Pharmaceuticals accounting system provided the following data for the last two years:

	2024	2023
Revenues	$ 40,000	$ 25,000
Cost of goods sold	22,500	6,000
Operating expenses	10,000	5,000
Interest expense	1,500	750
Income tax	2,500	1,500
Total assets	150,000	120,000
Total liabilities	80,000	60,000
Total equity	70,000	60,000

Instructions
Calculate the profit margin, return on assets, and return on equity for 2024. Explain what each ratio measures in general, and what each specifically indicates for Jones Pharmaceuticals.

Solution (15 min.)

a) Profit margin = Net income ÷ Sales Revenue = $3,500 ÷ $40,000 = 8.75%
Net income = $40,000 – $22,500 – $10,000 – $1,500 – $2,500 = $3,500

This ratio measures how much profit is made on each sales dollar. For Jones Pharmaceuticals, this means 8.75 cents of every sales dollar is profit.

b) Return on assets = Net income ÷ Average total assets
= $3,500 ÷ [($120,000 + $150,000)/2]
= 2.6%

This ratio measures the profit earned on the average amount invested in the company's assets. For Jones Pharmaceuticals, each dollar invested in assets earns 2.6 cents.

c) Return on equity = Net income ÷ Average total shareholders' equity
= $3,500 ÷ [($60,000 + $70,000) ÷ 2]
= 5.4%

This ratio measures the profit earned on the average shareholders' investment. For Jones Pharmaceuticals each dollar invested by the shareholders earns 5.4 cents.

Bloomcode: Analysis
Difficulty: Medium
Learning Objective: Calculate and interpret three ratios used to assess the profitability of a company.
CPA: Financial Reporting
AACSB: Analytic

78. Jetty's Landscaping accounting system provided the following data for the last two years:

	2024	2023
Revenues............................	$ 42,250	$ 31,500
Gross Profit	21,000	17,000
Operating expenses...........	11,500	7,750
Interest expense	3,500	3,000
Income tax	1,500	950
Total assets	175,000	160,000
Total liabilities	80,000	75,000
Total equity........................	95,000	85,000

Instructions

Calculate the profit margin, return on assets, and return on equity for 2024. Explain what each ratio measures in general, and what each specifically indicates for Jetty's Landscaping.

Solution (15 min.)

a) Profit margin = Net income ÷ Sales Revenue = $4,750 ÷ $42,250 = 11.2%
Net income = $21,000 – $11,500 – $3,500 – $1,250 = $4,750

This ratio measures how much profit is made on each sales dollar. For Jetty's, this means 11.2 cents of every sales dollar is profit.

b) Return on assets = Net income ÷ Average total assets
= $4,750 ÷ [($175,000 + $160,000)/2]
= 2.8%

This ratio measures the profit earned on the average amount invested in the company's assets. For Jetty's, each dollar invested in assets earns 2.8 cents.

c) Return on equity = Net income ÷ Average total shareholders' equity
= $4,750 ÷ [($95,000 + $85,000) ÷ 2]
= 5.3%

This ratio measures the profit earned on the average shareholders' investment. For Jetty's each dollar invested by the shareholders earns 5.3 cents.

Bloomcode: Analysis
Difficulty: Medium
Learning Objective: Calculate and interpret three ratios used to assess the profitability of a company.
CPA: Financial Reporting
AACSB: Analytic

MATCHING

79. For each of the following transactions, indicate if total assets would I increase, D decrease, or NE for no effect.

____ a) Sale of common shares for cash

____ b) Purchase of inventory for cash

____ c) Collection of accounts receivable

____ d) Payment of dividends

____ e) Sale of merchandise to customers on account

____ f) Recording of depreciation expense

____ g) Payment of accounts payable

____ h) Recording the cost of goods sold

____ i) Receipt of cash and signed long-term note payable

____ j) Purchase of machinery for cash

Solution (7 min.)

a) I

b) NE

c) NE

d) D

e) I

f) D

g) D

h) D

i) I

j) NE

Bloomcode: Application
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

80. For each of the following transactions, indicate the effect on shareholders' equity. Use I to indicate an increase, D to indicate a decrease, or NE for no effect.

____ a) Sale of goods for cash

____ b) Payment of operating expenses

____ c) Sale of goods on credit

____ d) Payment of dividends previously declared

____ e) Payment of accounts payable

____ f) Payment of income taxes.

____ g) Prepayment of expenses.

____ h) Recognizing depreciation expense.

____ i) Exchange of Common Shares for Land

____ j) Dividend declaration

Solution (5 min.)
a) I

b) D

c) I

d) NE

e) NE

f) D

g) NE

h) D

i) I

j) D

Bloomcode: Application
Difficulty: Medium
Learning Objective: Explain the accounting equation template approach to recording transactions.
CPA: Financial Reporting
AACSB: Analytic

SHORT-ANSWER ESSAY QUESTIONS

81. Identify and describe the accounting standards used in Canada. What is the general objective of these standards?

Solution (7 min.)
The two accounting standards used in Canada are IFRS and ASPE. All publicly traded corporation must use IFRS, while privately held corporation may choose to use IFRS, but generally follow ASPE.

The general objective of both sets of standards is to produce financial reporting that is useful to the financial statement users. Both IFRS and ASPE focus on the needs of the shareholders (current and potential) and creditors in determining what financial information that would be useful. Specifically the aim of the standards is to provide financial information that assists these two user groups in making decisions about providing resources to the reporting company, such as whether they should buy or sell the reporting company's shares and whether or not they should extend credit to the reporting company.

Bloomcode: Knowledge
Difficulty: Easy
Learning Objective: Identify the accounting standards used by Canadian companies.
CPA: Financial Reporting
AACSB: Analytic

82. Identify and briefly describe all of the characteristics and constraints of accounting information according to the IFRS conceptual framework.

Solution (12 min.)
Fundamental Qualitative Characteristics:

- Relevance – matters to the decision makers
- Predictive Value – can be used to predict future performance
- Confirmatory Value – provides feedback on previous assessments
- Materiality – consider material if in the absence of this information a different decision might be made
- Faithful Representation – represents what actually took place
- Completeness – provides all the information users need to understand the financial information
- Neutrality – information is unbiased and exhibits prudence
- Freedom from Error – if information is determined based on the best information available

Enhancing qualitative characteristics – on their own cannot make useless information useful

- Comparability
- Verifiability

- Timeliness
- Understandability

Constraints

- Cost – if the cost of obtaining the information is outweighed by the benefit, then this information should not be captured

Bloomcode: Knowledge
Difficulty: Medium
Learning Objective: Identify and explain the qualitative characteristics of useful financial information and how the cost constraint affects these.
CPA: Financial Reporting
AACSB: Analytic

83. What are the limitations of the template method for recording financial information? Provide examples of these limitations. When might it be appropriate for a company to use this method?

Solution (8 min)
The limitations of the template method include:

1. Number of columns used in the template. This can be unlimited in an excel spreadsheet; however, this makes it very difficult to print out reports. For example, a company may have different types of assets or inventory that it would like to account for separately, but would not be able to do this under this method.
2. Lack of specific revenue, expense and dividend accounts. These transactions would be recorded directly to R/E. This makes it very difficult for business owners to quantify revenue and expense information. For example, if management was wondering about sale for a given period, they would need to go through the R/E account and pull out all revenue transactions.

This method would normally only be used by very small companies.

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Analyze basic transactions and record their effects on the accounting equation.
CPA: Financial Reporting
AACSB: Analytic

84. Identify which statement(s) dividends declared and paid affects and explain why.

Solution (5 min.)
Dividends paid are a distribution of a portion of the company's earnings to the shareholders of the company. As a result this is not an expense and is deducted from Retained Earnings when

declared. When declared, a liability for Dividends Payable (on the Statement of Financial Position) is created and it is reduced when the dividends are paid, a short time later. The payment of the dividends reduces Cash on the Statement of Financial Position. Dividends Paid appear in the financing activities section of the statement of cash flow as a cash outflow representing a return on the amount invested by shareholders.

Bloomcode: Comprehension
Difficulty: Hard
Learning Objective: Summarize the effects of transactions on the accounting equation and prepare and interpret a simple set of financial statements.
CPA: Financial Reporting
AACSB: Analytic

85. What are three profitability ratios? How are these ratios calculated and interpreted and when would be these ratios be used?

Solution (12 min.)
1. Profit Margin Ratio = Net Income / Revenues, expressed as a percentage and measures the amount of net income after all expenses / dollar of sales. For example, a profit margin of 8.5% indicates 8.5 cents of profit after all expenses for each dollar in revenues. The higher the profit margin the better. Theses profits can be retained in the company or distributed to shareholders as dividends.
2. Return on Equity = Net Income / Average Total SHE, expressed as a percentage and measures the net income / dollar of shareholder investment. For example, a ROE of 3.8% indicates that the company earned a net income of 3.8 cents for each dollar invested by owners. The higher the ROE the better, shareholders can compare this return with other investment alternatives.
3. Return of Assets= Net Income / average total assets, expressed as a percentage and measures the net income / dollar invested in company assets. For example, a ROA of 2.1% indicates that the company earned 2.1 cents in net income for every dollar that was invested in company assets. The higher the ROA the better, it indicates that the company is using its assets effectively.

Bloomcode: Comprehension
Difficulty: Medium
Learning Objective: Calculate and interpret three ratios used to assess the profitability of a company.
CPA: Financial Reporting
AACSB: Analytic

ESSAY QUESTIONS

86. Explain both the accrual basis and the cash basis of accounting and indicate why most companies use the accrual basis.

Solution (8–10 min.)
The accrual basis of accounting recognizes revenues in the period in which the revenues are earned and expenses in the period in which the expenses are incurred. Under this basis, the financial statements would be much more reflective of actual events because the revenues and related expenses would be shown in periods in which they were earned or incurred. It is meaningful because all of the profit generating activity incurred during a period is captured on the Statement of Income.

The cash basis of accounting only recognizes revenues when the related cash is received. Expenses are only recognized when the related cash is paid out. With this basis, if a revenue or expense transaction is incurred in one period, but the relating revenue or expense transaction is not recognized until a later period, then each period's performance is distorted.

Bloomcode: Knowledge
Difficulty: Medium
Learning Objective: Explain the difference between the cash basis of accounting and the accrual basis of accounting.
CPA: Financial Reporting
AACSB: Analytic

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