A primary objective of external financial reporting is

A. Direct measurement of the value of a business enterprise.

B. Provision of information that is useful to present and potential investors, creditors, and others in making rational financial decisions regarding the enterprise.

Answer (B) is **correct**.
According to the FASB's Conceptual Framework, the objectives of external financial reporting are to provide information that (1) is useful to present and potential investors, creditors, and others in making rational financial decisions regarding the enterprise; (2) helps those parties in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from sale, redemption, or maturity of securities or loans; and (3) concerns the economic resources of an enterprise, the claims thereto, and the effects of transactions, events, and circumstances that change its resources and claims thereto.

C. Establishment of rules for accruing liabilities.

D. Direct measurement of the enterprise's stock price.

Question: 2

Notes to financial statements are beneficial in meeting the disclosure requirements of financial reporting. The notes should **not** be used to

A. Describe significant accounting policies.

B. Describe depreciation methods employed by the company.

C. Describe principles and methods peculiar to the industry in which the company operates, when these principles and methods are predominantly followed in that industry.

D. Correct an improper presentation in the financial statements.

Answer (D) is **correct**.
Financial statement notes should not be used to correct improper presentations. The financial statements should be presented correctly on their own. Notes should be used to explain the methods used to prepare the financial statements and the amounts shown. The first footnote typically describes significant accounting policies.

Question: 3

An objective of financial reporting is

A. Providing information useful to investors, creditors, donors, and other users for decision making.

Answer (A) is **correct**.
The objective is to report financial information that is useful in making decisions about providing resources to the reporting entity. Primary users of financial information are current or prospective investors and creditors who cannot obtain it directly. Their decisions depend on expected returns.

B. Assessing the adequacy of internal control.
C. Evaluating management results compared with standards.
D. Providing information on compliance with established procedures.

Question: 4

The management of ABC Corporation is analyzing the financial statements of XYZ Corporation because ABC is strongly considering purchasing a block of XYZ ordinary shares that would give ABC significant influence over XYZ. Which financial statement should ABC primarily use to assess the amounts, timing, and certainty of future cash flows of XYZ Company?

A. Income statement.
B. Statement of changes in equity.
C. Statement of cash flows.

Answer (C) is **correct**.
A statement of cash flows provides information about the cash receipts and cash payments of an entity during a period. This information helps investors, creditors, and other users to assess the entity’s ability to generate cash and cash equivalents and the needs of the entity to use those cash flows. Historical cash flow data indicate the amount, timing, and certainty of future cash flows. It is also a means of verifying past cash flow assessments and of determining the relationship between profits and net cash flows and the effects of changing prices.

D. Statement of financial position.

Question: 5

An entity that sprays chemicals in residences to eliminate or prevent infestation of insects requires that customers prepay for 3 months’ service at the beginning of each new quarter. Select the term that appropriately describes this situation from the viewpoint of the entity.

A. Deferred income.

Answer (A) is **correct**.
The future inflow of economic benefits is not sufficiently certain given that the entity has not done what is required to be entitled to those benefits. Thus, the receipt of cash in anticipation of goods to be delivered or services to be performed must be recognized as a liability, usually called deferred (or unearned) revenue or deferred (or unearned) income.

B. Earned income.
C. Accrued income.
D. Prepaid expense.

Question: 6

Which of the following is **true** regarding the comparison of managerial and financial accounting?

A. Managerial accounting is generally more precise.

B. Managerial accounting has a past focus, and financial accounting has a future focus.

C. The emphasis on managerial accounting is relevance, and the emphasis on financial accounting is timeliness.

D. Managerial accounting need not follow generally accepted accounting principles (GAAP), while financial accounting must follow them.

Answer (D) is **correct**.
Managerial accounting assists management decision making, planning, and control. Financial accounting addresses accounting for an entity's assets, liabilities, revenues, expenses, and other elements of financial statements. Financial statements are the primary method of communicating to external parties information about the entity's results of operations, financial position, and cash flows. For general-purpose financial statements to be useful to external parties, they must be prepared in conformity with accounting principles that are generally accepted in the United States. However, managerial accounting information is primarily directed to specific internal users. Hence, it ordinarily need not follow such guidance.

Question: 7

The financial statements included in the annual report to the shareholders are **least** useful to which one of the following?

A. Stockbrokers.

B. Bankers preparing to lend money.

C. Competing businesses.

D. Managers in charge of operating activities.

Answer (D) is **correct**.
Accrual-basis amounts used in financial reporting are not useful to managers making day-to-day operating decisions. The practice of management accounting fulfills the needs of these users.

Question: 8

The accounting measurement that is **not** consistent with the going concern concept is

A. Historical cost.

B. Realization.

C. The transaction approach.

D. Liquidation value.

Answer (D) is **correct**.
Financial accounting principles assume that a business entity is a going concern in the absence of evidence to the contrary. The concept justifies the use of depreciation and amortization schedules, and the recording of

assets and liabilities using attributes other than liquidation value.

Question: 9 The primary purpose of the statement of financial position is to reflect

A. The fair value of the firm's assets at some moment in time.

B. The status of the firm's assets in case of forced liquidation of the firm.

C. The success of a company's operations for a given amount of time.

D. Items of value, debt, and net worth.

Answer (D) is **correct**.
The balance sheet presents three major financial accounting elements: assets (items of value), liabilities (debts), and equity (net worth). According to the FASB's Conceptual Framework, assets are probable future economic benefits resulting from past transactions or events. Liabilities are probable future sacrifices of economic benefits arising from present obligations as a result of past transactions or events. Equity is the residual interest in the assets after deduction of liabilities.

Question: 10 Prepaid expenses are valued on the statement of financial position at the

A. Cost to acquire the asset.

B. Face amount collectible at maturity.

C. Cost to acquire minus accumulated amortization.

D. Cost less expired or used portion.

Answer (D) is **correct**.
Prepaid expenses, such as supplies, prepaid rent, and prepaid insurance, are reported on the balance sheet at cost minus the expired or used portion. These are typically current assets.

Question: 11 A statement of financial position allows investors to assess all of the following **except** the

A. Efficiency with which enterprise assets are used.

B. Liquidity and financial flexibility of the enterprise.

C. Capital structure of the enterprise.

D. Net realizable value of enterprise assets.

Answer (D) is **correct**.
Assets are usually measured at original historical cost in a statement of financial position, although some exceptions exist. For example, some short-term receivables are reported at their net realizable value. Thus, the statement of financial position cannot be relied upon to assess NRV.

Question: 12 The accounting equation *(assets – liabilities = equity)* reflects the

A. Entity point of view.

B. Fund theory.

C. Proprietary point of view.

> Answer (C) is **correct**.
> The equation is based on the proprietary theory. Equity in an enterprise is what remains after the economic obligations of the enterprise are deducted from its economic resources.

D. Enterprise theory.

Question: 13 Long-term obligations that are or will become callable by the creditor because of the debtor's violation of a provision of the debt agreement at the balance sheet date should be classified as

A. Long-term liabilities.

B. Current liabilities unless the debtor goes bankrupt.

C. Current liabilities unless the creditor has waived the right to demand repayment for more than 1 year from the balance sheet date.

> Answer (C) is **correct**.
> Long-term obligations that are or will become callable by the creditor because of the debtor's violation of a provision of the debt agreement at the balance sheet date normally are classified as current liabilities. However, the debt need not be reclassified if the violation will be cured within a specified grace period or if the creditor formally waives or subsequently loses the right to demand repayment for a period of more than a year from the balance sheet date (also, reclassification is not required if the debtor expects and has the ability to refinance the obligation on a long-term basis).

D. Contingent liabilities until the violation is corrected.

Question: 14 When classifying assets as current and noncurrent for reporting purposes,

A. The amounts at which current assets are carried and reported must reflect realizable cash values.

B. Prepayments for items such as insurance or rent are included in an "other assets" group rather than as current assets as they will ultimately be expensed.

C. The time period by which current assets are distinguished from noncurrent assets is determined by the seasonal nature of the business.

D. Assets are classified as current if they are reasonably expected to be realized in cash or consumed during the normal operating cycle.

> Answer (D) is **correct**.

For financial reporting purposes, current assets consist of cash and other assets or resources expected to be realized in cash, sold, or consumed during the longer of 1 year or the normal operating cycle of the business.

Question: 15

Abernathy Corporation uses a calendar year for financial and tax reporting purposes and has $100 million of mortgage bonds due on January 15, Year 2. By January 10, Year 2, Abernathy intends to refinance this debt with new long-term mortgage bonds and has entered into a financing agreement that clearly demonstrates its ability to consummate the refinancing. This debt is to be

A. Classified as a current liability on the statement of financial position at December 31, Year 1.

B. Classified as a long-term liability on the statement of financial position at December 31, Year 1.

Answer (B) is **correct**.
Short-term obligations expected to be refinanced should be reported as current liabilities unless the firm both plans to refinance and has the ability to refinance the debt on a long-term basis. The ability to refinance on a long-term basis is evidenced by a post-balance-sheet date issuance of long-term debt or a financing arrangement that will clearly permit long-term refinancing.

C. Retired as of December 31, Year 1.

D. Considered off-balance-sheet debt.

Question: 16

Lister Company intends to refinance a portion of its short-term debt in Year 2 and is negotiating a long-term financing agreement with a local bank. This agreement would be noncancelable and would extend for a period of 2 years. The amount of short-term debt that Lister Company can exclude from its statement of financial position at December 31, Year 1,

A. May exceed the amount available for refinancing under the agreement.

B. Depends on the demonstrated ability to consummate the refinancing.

Answer (B) is **correct**.
If an enterprise intends to refinance short-term obligations on a long-term basis and demonstrates an ability to consummate the refinancing, the obligations should be excluded from current liabilities and classified as noncurrent. The ability to consummate the refinancing may be demonstrated by a post-balance-sheet-date issuance of a long-term obligation or equity securities, or by entering into a financing agreement that meets certain criteria. These criteria are that the agreement does not expire within 1 year, it is noncancelable by the lender, no violation of the agreement exists at the balance sheet date, and the lender is financially capable of honoring the agreement.

C. Is reduced by the proportionate change in the working capital ratio.

D. Is zero unless the refinancing has occurred by year end.

Question: 17 A statement of financial position is intended to help investors and creditors

A. Assess the amount, timing, and uncertainty of prospective net cash inflows of a firm.

B. Evaluate economic resources and obligations of a firm.

Answer (B) is **correct**.
The statement of financial position, or balance sheet, provides information about an entity’s resource structure (assets) and financing structure (liabilities and equity) at a moment in time. According to the FASB’s Conceptual Framework, the statement of financial position does not purport to show the value of a business, but it enables investors, creditors, and other users to make their own estimates of value. It helps users to assess liquidity, financial flexibility, profitability, and risk.

C. Evaluate economic performance of a firm.

D. Evaluate changes in the ownership equity of a firm.

Question: 18 A manufacturer receives an advance payment for special-order goods that are to be manufactured and delivered within the next year. The advance payment should be reported in the manufacturer’s current-year statement of financial position as a(n)

A. Current liability.

Answer (A) is **correct**.
The entity has not substantially completed what it must do to be entitled to the benefits of the advance payment, and the receipt of future economic benefits is not sufficiently certain to justify income recognition. Accordingly, the receipt of cash in anticipation of goods to be delivered or services to be performed must be recognized as a liability, usually called deferred (or unearned) revenue or deferred (or unearned) income. Because the manufacturer must deliver the goods within the next year, this liability is current.

B. Noncurrent liability.

C. Contra asset amount.

D. Accrued revenue.

Question: 19 A cable television entity receives deposits from customers that are refunded when service is terminated. The average customer stays with the entity 8 years. How should these deposits be shown on the financial statements?

A. Operating revenue.

B. Other revenue.

C. Paid-in capital.

D. Liability.

Answer (D) is **correct**.
Liabilities are present obligations arising from past events, the settlement of which is expected to result in an outflow of resources embodying economic benefits. Customers’ deposits must be returned or credited to

their accounts. The deposits should therefore be recorded as liabilities.

Question: 20

A company has outstanding accounts payable of $30,000 and a short-term construction loan in the amount of $100,000 at year end. The loan was refinanced through issuance of long-term bonds after year end but before issuance of financial statements. How should these liabilities be recorded in the balance sheet?

A. Noncurrent liabilities of $130,000.

B. Current liabilities of $130,000.

C. Current liabilities of $30,000, noncurrent liabilities of $100,000.

Answer (C) is **correct**.
Accounts payable are properly classified as current liabilities because they are for items entering into the operating cycle. Short-term debt that is refinanced by a post-balance-sheet-date issuance of long-term debt should be classified as noncurrent. (The ability to refinance on a long-term basis has been demonstrated.) Thus, the short-term construction loan is classified as noncurrent. Accordingly, the entity records current liabilities of $30,000 and noncurrent liabilities of $100,000.

D. Current liabilities of $130,000, with required footnote disclosure of the refinancing of the loan.

Question: 21

A statement of financial position provides a basis for all of the following **except**

A. Computing rates of return.

B. Evaluating capital structure.

C. Assessing liquidity and financial flexibility.

D. Determining profitability and assessing past performance.

Answer (D) is **correct**.
The statement of financial position, also known as the balance sheet, reports an entity’s financial position at a moment in time. It is therefore not useful for assessing past performance for a period of time. A balance sheet can be used to help users assess liquidity, financial flexibility, and risk.

Question: 22

Noncurrent debt should be included in the current section of the statement of financial position if

A. It is to be converted into common stock before maturity.

B. It matures within the year and will be retired through the use of current assets.

Answer (B) is **correct**.
Current liabilities include those obligations that are expected to be satisfied by the (1) payment of cash, (2) use of current assets other than cash, or (3) creation of new current liabilities within 1 year from the

balance sheet date (or operating cycle, if longer).

C. Management plans to refinance it within the year.

D. A bond retirement fund has been set up for use in its scheduled retirement during the next year.

Question: 23 Dixon Company has the following items recorded on its financial records:

Available-for-sale securities	$200,000
Prepaid expenses	400,000
Treasury stock	100,000

The total amount of the above items to be shown as assets on Dixon's statement of financial position is

A. $400,000

B. $500,000

C. $600,000

Answer (C) is **correct**.
Available-for-sale securities (an investment) and prepaid expenses are assets, but treasury stock is an equity item. The total of the assets reported is therefore $600,000 ($200,000 + $400,000).

D. $700,000

Question: 24 A receivable classified as current on the statement of financial position is expected to be collected within

A. The current operating cycle.

B. 1 year.

C. The current operating cycle or 1 year, whichever is longer.

Answer (C) is **correct**.
Current assets are reasonably expected to be realized in cash, sold, or consumed during the normal operating cycle of the business or within 1 year, whichever is longer. The operating cycle is the time between the acquisition of materials or services and the final cash realization from the earning process.

D. The current operating cycle or 1 year, whichever is shorter.

Question: 25A company pays more than the fair value to acquire treasury stock. The difference between the price paid to acquire the treasury stock and the fair value should be recorded as

A. An asset.

B. A liability.

C. Shareholders' equity.

Answer (C) is **correct**.
Apart from cash paid or received, a firm cannot recognize assets, liabilities, gains, or losses from transactions in its own stock. Treasury stock is reported on the balance sheet as a subtraction from equity.

D. An expense.

Question: 26 The purchase of treasury stock is recorded on the statement of financial position as a(n)

A. Increase in assets.
B. Decrease in liabilities.
C. Increase in shareholders' equity.
D. Decrease in shareholders' equity.

Answer (D) is **correct**.
The purchase of treasury stock is recorded on the statement of financial position as a decrease in shareholders' equity.

Question: 27 Current assets are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business. Current assets **most** likely include

A. Intangible assets.
B. Purchased goodwill.
C. Organizational costs.
D. Trading securities.

Answer (D) is **correct**.
Current assets include, in descending order of liquidity, cash and cash equivalents; certain individual trading, available-for-sale, and held-to-maturity securities; receivables; inventories; and prepaid expenses. Trading securities are expected to be sold in the near term, so they are likely to be classified as current.

Question: 28 Rice Co. was incorporated on January 1, Year 6, with $500,000 from the issuance of stock and borrowed funds of $75,000. During the first year of operations, net income was $25,000. On December 15, Rice paid a $2,000 cash dividend. No additional activities affected equity in Year 6. At December 31, Year 6, Rice's liabilities had increased to $94,000. In Rice's December 31, Year 6 balance sheet, total assets should be reported at

A. $598,000
B. $600,000
C. $617,000

Answer (C) is **correct**.
Total assets equal the sum of total liabilities and equity. Total liabilities were $94,000 at year end, and equity amounted to $523,000 ($500,000 from issuance of stock + $25,000 net income – $2,000 cash dividend). Total assets are therefore $617,000 ($523,000 + $94,000).

D. $692,000

Question: 29 Careful reading of an annual report will reveal that off-balance-sheet debt includes

A. Amounts due in future years under operating leases.

Answer (A) is **correct**.
Off-balance-sheet debt includes any type of liability for which the company is responsible but that does not appear on the balance sheet. The most common example is the amount due in future years on operating leases. Under U.S. GAAP, operating leases are not capitalized; instead, only the periodic payments of rent are reported when actually paid. Capital leases (those similar to a purchase) must be capitalized and reported as liabilities.

B. Transfers of accounts receivable without recourse.

C. Current portion of long-term debt.

D. Amounts due in future years under capital leases.

Question: 30 Which one of the following is **not** a form of off-balance-sheet financing?

A. Sale of receivables.

B. Foreign currency translations.

Answer (B) is **correct**.
Off-balance-sheet financing takes four principal forms: investments in unconsolidated subsidiaries, special purpose entities, operating leases, and factoring receivables with recourse.

C. Operating leases.

D. Special purpose entities.

Question: 31 In a multiple-step income statement for a retail company, all of the following are included in the operating section **except**

A. Sales.

B. Cost of goods sold.

C. Dividend revenue.

Answer (C) is **correct**.
The operating section of a retailer's income statement includes all revenues and costs necessary for the operation of the retail establishment, e.g., sales, cost of goods sold, administrative expenses, and selling expenses. Dividend revenue, however, is classified under other revenues. In a statement of cash flows, cash dividends received are considered an operating cash flow.

D. Administrative and selling expenses.

Question: 32 When reporting extraordinary items,

A. Each item (net of tax) is presented on the face of the income statement separately as a component of net income for the period.

> Answer (A) is **correct**.
> Extraordinary items are reported net of tax after discontinued operations.

B. Each item is presented exclusive of any related income tax.

C. Each item is presented as an unusual item within income from continuing operations.

D. All extraordinary gains or losses that occur in a period are summarized as total gains and total losses, then offset to present the net extraordinary gain or loss.

Question: 33 Which one of the following items is included in the determination of income from continuing operations?

A. Discontinued operations.

B. Extraordinary loss.

C. Cumulative effect of a change in an accounting principle.

D. Unusual loss from a write-down of inventory.

> Answer (D) is **correct**.
> Certain items ordinarily are not to be treated as extraordinary gains and losses. Rather, they are included in the determination of income from continuing operations. These gains and losses include those from write-downs of receivables and inventories, translation of foreign currency amounts, disposal of a business segment, sale of productive assets, strikes, and accruals on long-term contracts. A write-down of inventory is therefore included in the computation of income from continuing operations.

Question: 34 Which one of the following would be shown on a multiple-step income statement but **not** on a single-step income statement?

A. Loss from discontinued operations.

B. Gross profit.

> Answer (B) is **correct**.
> A single-step income statement combines all revenues and gains, combines all expenses and losses, and subtracts the latter from the former in a “single step” to arrive at net income. Gross profit, being the difference between sales revenue and cost of goods sold, does not appear on a single-step income statement.

C. Extraordinary gain.

D. Net income from continuing operations.

Question: 35 The major segments of the statement of retained earnings for a period are

A. Dividends declared, prior period adjustments, and changes due to treasury stock transactions.

B. Before-tax income or loss and dividends paid or declared.

C. Prior-period adjustments, before-tax income or loss, income tax, and dividends paid.

D. Net income or loss, prior-period adjustments, and dividends paid or declared.

Answer (D) is **correct**.
The statement of retained earnings is a basic financial statement. Together with the income statement, the statement of retained earnings is meant to broadly reflect the results of operations. The statement of retained earnings consists of beginning retained earnings adjusted for any prior period adjustment (net of tax), with further adjustments for income (loss), dividends, and in certain other rare adjustments, e.g., quasi-reorganizations. The final figure is ending retained earnings.

Question: 36 Because of inexact estimates of the service life and the residual value of a plant asset, a fully depreciated asset was sold in the current year at a material gain. This gain **most** likely should be reported

A. In the other revenues and gains section of the current income statement.

Answer (A) is **correct**.
Revenues occur in the course of ordinary activities. Gains may or may not occur in the course of ordinary activities. For example, gains may occur from the sale of noncurrent assets. Thus, the gain on the sale of a plant asset is not an operating item and should be classified in an income statement with separate operating and nonoperating sections in the other revenues and gains section.

B. As part of sales revenue on the current income statement.

C. In the extraordinary item section of the current income statement.

D. As an adjustment to prior periods' depreciation on the statement of changes in equity.

Question: 37 In recording transactions, which of the following **best** describes the relation between expenses and losses?

A. Losses are extraordinary charges to income, whereas expenses are ordinary charges to income.

B. Losses are material items, whereas expenses are immaterial items.

C. Losses are expenses that may or may not arise in the course of ordinary activities.

Answer (C) is **correct**.

Expenses are outflow or other usage of assets or incurrences of liability (or both) from activities that qualify as ongoing major or central operations. Losses are similar to expenses but generally do not occur in ordinary activities. For example, losses may result from the sale of noncurrent assets or from natural disasters.

D. Expenses can always be prevented, whereas losses can never be prevented.

Question: 38 An entity has a 50% gross margin, general and administrative expenses of $50, interest expense of $20, and net income of $10 for the year just ended. If the corporate tax rate is 50%, the level of sales revenue for the year just ended was

A. $90

B. $135

C. $150

D. $180

Answer (D) is **correct**.
Net income equals sales minus cost of sales, G&A expenses, interest, and tax. Given a 50% tax rate, income before tax must have been $20 [$10 net income ÷ (1.0 – 0.5 tax rate)]. Accordingly, income before interest and tax must have been $40 ($20 income before tax + $20 interest), and the gross margin (sales – cost of sales) must have been $90 ($40 income before interest and tax + $50 G&A expenses). If the gross margin is 50% of sales, sales equals $180 ($90 gross margin ÷ 0.5).

Question: 39Assume that employees confessed to a $500,000 inventory theft but are not able to make restitution. How should this material fraud be shown in the company's financial statements?

A. Classified as a loss and shown as a separate line item in the income statement.

Answer (A) is **correct**.
Losses may or may not occur in the course of ordinary activities. For example, they may result from nonreciprocal transactions (e.g., theft), reciprocal transactions (e.g., a sale of plant assets), or from holding assets or liabilities. Losses are typically displayed separately.

B. Initially classified as an accounts receivable because the employees are responsible for the goods. Because they cannot pay, the loss would be recognized as a write-off of accounts receivable.

C. Included in cost of goods sold because the goods are not on hand, losses on inventory shrinkage are ordinary, and it would cause the least amount of attention.

D. Recorded directly to retained earnings because it is not an income-producing item.

Question: 40

An entity had the following opening and closing inventory balances during the current year:

	1/1	12/31
Finished goods	$ 90,000	$260,000
Raw materials	105,000	130,000
Work-in-progress	220,000	175,000

The following transactions and events occurred during the current year:

- $300,000 of raw materials were purchased, of which $20,000 were returned because of defects.
- $600,000 of direct labor costs were incurred.
- $750,000 of production overhead costs were incurred.

The cost of goods sold for the current year ended December 31 would be

A. $1,480,000

Answer (A) is **correct**.
Cost of goods sold equals cost of goods manufactured (COGM) adjusted for the change in finished goods. COGM equals the sum of raw materials used, direct labor costs, and production overhead, adjusted for the change in work-in-progress. Raw materials used equals $255,000 ($105,000 BI + $300,000 purchases – $20,000 returns – $130,000 EI). Thus, COGM equals $1,650,000 ($255,000 RM + $600,000 DL + $750,000 OH + $220,000 BWIP – $175,000 EWIP), and COGS equals $1,480,000 ($1,650,000 COGM + $90,000 BFG – $260,000 EFG).

B. $1,500,000

C. $1,610,000

D. $1,650,000

Question: 41

The profit and loss statement of Madengrad Mining includes the following information for the current fiscal year:

Sales	$160,000
Gross profit	48,000
Year-end finished goods inventory	58,300
Opening finished goods inventory	60,190

The cost of goods manufactured by Madengrad for the current fiscal year is

A. $46,110

B. $49,890

C. $110,110

Answer (C) is **correct**.
Madengrad's cost of goods manufactured can be calculated as follows:

Sales	$160,000
Less: gross profit	(48,000)
Cost of goods sold	$112,000
Add: ending finished goods	58,300
Goods available for sale	$170,300
Less: beginning finished goods	(60,190)
Cost of goods manufactured	$110,110

D. $113,890

Question: 42 If the beginning balance for May of the materials inventory account was $27,500, the ending balance for May is $28,750, and $128,900 of materials were used during the month, the materials purchased during the month cost

A. $101,400

B. $127,650

C. $130,150

Answer (C) is **correct**.
Purchases equals usage adjusted for the inventory change. Hence, purchases equals $130,150 ($128,900 used – $27,500 BI + $28,750 EI).

D. $157,650

Question: 43 Given the following data for Scurry Company, what is the cost of goods sold?

Beginning inventory of finished goods	$100,000
Cost of goods manufactured	700,000
Ending inventory of finished goods	200,000
Beginning work-in-process inventory	300,000
Ending work-in-process inventory	50,000

A. $500,000

B. $600,000

Answer (B) is **correct**.
Scurry's cost of goods sold can be calculated as follows:

Beginning inventory of finished goods $ 100,000

Add: cost of goods manufactured	700,000
Less: ending inventory of finished goods	(200,000)
Cost of goods sold	$ 600,000

C. $800,000
D. $950,000

Question: 44The following information was taken from last year's accounting records of a manufacturing company.

Inventory	January 1	December 31
Raw materials	$38,000	$ 45,000
Work-in-process	21,000	10,000
Finished goods	78,000	107,000

Other information	
Direct labor	$236,000
Shipping costs on outgoing orders	6,500
Factory rent	59,000
Factory depreciation	18,700
Advertising expense	24,900
Net purchases of raw materials	115,000
Corporate administrative salaries	178,000
Material handling costs	35,800

On the basis of this information, the company's cost of goods manufactured and cost of goods sold are

A. $460,500 and $489,500, respectively.
B. $468,500 and $439,500, respectively.

Answer (B) is **correct**.
This solution requires a series of computations.

Beginning raw materials	$ 38,000
Add: net purchases raw materials	$115,000
Materials available	$153,000
Less: ending materials	(45,000)
Materials used in production	$108,000

Direct labor		236,000
Manufacturing overhead		
Factory rent	$59,000	
Factory depreciation	18,700	
Material handling costs	35,800	
Total Manufacturing overhead		113,500
Total manufacturing costs		$457,500
Add: beginning work-in-process		21,000
Less: ending work-in-process		(10,000)
Costs of Goods Manufactured		**$468,500**
Add: beginning finished goods		78,000
Less: ending finished goods		(107,000)
Cost of Goods Sold		**$439,500**

C. $468,500 and $470,900, respectively.
D. $646,500 and $617,500, respectively.

Question: 45 Comprehensive income is **best** defined as

A. Net income excluding extraordinary gains and losses.
B. The change in net assets for the period including contributions by owners and distributions to owners.
C. Total revenues minus total expenses.
D. The change in net assets for the period excluding owner transactions.

Answer (D) is **correct**.
Comprehensive income includes all changes in equity of a business entity except those changes resulting from investments by owners and distributions to owners. Comprehensive income includes two major categories: net income and other comprehensive income (OCI). Net income includes the results of operations classified as income from continuing operations, discontinued operations, and extraordinary items. Components of comprehensive income not included in the determination of net income are included in OCI, for example, unrealized gains and losses on available-for-sale securities (except those that are hedged items

in a fair value hedge).

Question: 46 The financial statement that provides a summary of the firm’s operations for a period of time is the

A. Income statement.

Answer (A) is **correct**.
The results of operations for a period of time are reported in the income statement (statement of earnings) on the accrual basis using an approach oriented to historical transactions.

B. Statement of financial position.

C. Statement of shareholders’ equity.

D. Statement of retained earnings.

Question: 47 The following information pertains to Maynard Corporation’s income statement for the 12 months just ended. The company has an effective income tax rate of 40%.

Discontinued operations	$(70,000)
Extraordinary loss due to earthquake	(90,000)
Income from continuing operations (net of tax)	72,000
Cumulative effect of change in accounting principle	60,000

Maynard’s net income for the year is

A. $36,000

B. $12,000

C. $8,000

D. $(24,000)

Answer (D) is **correct**.
Maynard’s net income for the year is calculated as follows:

	Income Statement Item	Times: Tax Effect	As Reported
ncome from continuing operations (net of tax)			$ 72,000
Discontinued operations	$(70,000)	(1.0 – .40)	(42,000)
Extraordinary loss due to earthquake	(90,000)	(1.0	(54,000)

	.40)
Net income	$(24,000)

Question: 48 Which of the following items is **not** classified as other comprehensive income (OCI)?

A. Extraordinary gains from extinguishment of debt.

Answer (A) is **correct**.
Comprehensive income is divided into net income and other comprehensive income (OCI). Under existing accounting standards, OCI includes (1) unrealized gains and losses on available-for-sale securities (except those that are hedged items in a fair value hedge); (2) gains and losses on derivatives designated, qualifying, and effective as cash flow hedges; (3) certain amounts associated with recognition of the funded status of postretirement defined benefit plans; and (4) certain foreign currency items, including foreign currency translations.

B. Foreign currency translation adjustments.

C. Prior service cost adjustment resulting from amendment of a defined benefit pension plan.

D. Unrealized gains for the year on available-for-sale marketable securities.

Question: 49 Which of the following are acceptable formats for reporting comprehensive income?

I. In one continuous financial statement
II. In a statement of changes in equity
III. In a separate statement of net income
IV. In two separate but consecutive financial statements

A. I and II only.

B. I, II, and III only.

C. III and IV only.

D. I and IV only.

Answer (D) is **correct**.
If an entity that presents a full set of financial statements has items of other comprehensive income (OCI), it must present comprehensive income either (1) in a single continuous statement of comprehensive income or (2) in two separate but consecutive statements (an income statement and a statement of OCI).

Question: 50

A company reports the following information as of December 31:

Sales revenue	$800,000
Cost of goods sold	600,000
Operating expenses	90,000
Unrealized holding gain on available-for-sale securities, net of tax	30,000

What amount should the company report as comprehensive income as of December 31?

A. $30,000

B. $110,000

C. $140,000

Answer (C) is **correct**.
Comprehensive income includes net income and other comprehensive income. Net income equals $110,000 ($800,000 sales revenue – $600,000 COGS – $90,000 operating expenses). Unrealized holding gains on available-for-sale securities ($30,000) are included in other comprehensive income. Thus, comprehensive income is $140,000 ($110,000 + $30,000).

D. $200,000

Question: 51

Crawford Company is researching a future change to IFRS. Which one of the following items reported on Crawford's income statement under U.S. GAAP is required to be changed as a result of adopting IFRS?

A. Crawford values its merchandise inventory using average cost.

B. Crawford uses a multiple-step approach for its income statement.

C. Crawford uses historical cost to value its land, buildings, and intangible assets even though the value of the land and building are greater than book value.

D. Crawford's current-year income statement includes an extraordinary loss.

Answer (D) is **correct**.
Under U.S. GAAP, material transactions that are both unusual in nature and infrequent in occurrence in the environment in which the company operates are classified as extraordinary items. Extraordinary items are reported individually in a separate section in the income statement, net of tax. Under IFRS, no item is classified as extraordinary, and therefore it would be recorded in the normal part of the income statement.

Question: 52

All of the following are defined as elements of an income statement **except**

A. Expenses.

B. Shareholders' equity.

Answer (B) is **correct**.

Equity of a business entity (or the net assets of a nonbusiness organization) is a residual amount that reflects the basic accounting equation: assets minus liabilities equals equity (or net assets). It is reported on the statement of financial position.

C. Gains and losses.

D. Revenues.

Question: 53 Items reported as prior-period adjustments

A. Do not include the effect of a mistake in the application of accounting principles, as this is accounted for as a change in accounting principle rather than as a prior-period adjustment.

B. Do not affect the presentation of prior-period comparative financial statements.

C. Do not require further disclosure in the body of the financial statements.

D. Are reflected as adjustments of the opening balance of the retained earnings of the earliest period presented.

Answer (D) is **correct**.
Prior-period adjustments are made for the correction of errors. According to SFAS 16, *Prior Period Adjustments*, the effects of errors on prior-period financial statements are reported as adjustments to beginning retained earnings for the earliest period presented in the retained earnings statement. Such errors do not affect the income statement for the current period.

Question: 54 An appropriation of retained earnings by the board of directors of a corporation for bonded indebtedness will result in

A. The establishment of a sinking fund to retire bonds when they mature.

B. A decrease in cash on the balance sheet with an equal increase in the investment and funds section of the balance sheet.

C. A decrease in the total amount of retained earnings presented on the balance sheet.

D. The disclosure that management does not intend to distribute assets, in the form of dividends, equal to the amount of the appropriation.

Answer (D) is **correct**.
The appropriation of retained earnings is a transfer from one retained earnings account to another. The only practical effect is to decrease the amount of retained earnings available for dividends. An appropriation of retained earnings is purely for disclosure purposes.

Question: 55 When treasury stock is accounted for at cost, the cost is reported on the balance sheet as a(n)

A. Asset.

B. Reduction of retained earnings.

C. Reduction of additional paid-in-capital.

D. Unallocated reduction of equity.

Answer (D) is **correct**.
Treasury stock is a corporation’s own stock that has been reacquired but not retired. In the balance sheet, treasury stock recorded at cost is subtracted from the total of the capital stock balances, additional paid-in capital, retained earnings, and accumulated other comprehensive income.

Question: 56 The statement of shareholders’ equity shows a

A. Reconciliation of the beginning and ending balances in shareholders’ equity accounts.

Answer (A) is **correct**.
The statement of shareholders’ equity (changes in equity) presents a reconciliation in columnar format of the beginning and ending balances in the various shareholders’ equity accounts. A statement of changes in equity may include, for example, columns for (1) totals, (2) comprehensive income, (3) retained earnings, (4) accumulated OCI (but the components of OCI are presented in another statement), (5) common stock, and (6) additional paid-in capital.

B. Listing of all shareholders’ equity accounts and their corresponding dollar amounts.

C. Computation of the number of shares outstanding used for earnings per share calculations.

D. Reconciliation of net income to net operating cash flow.

Question: 57 Unless the shares are specifically restricted, a holder of common stock with a preemptive right may share proportionately in all of the following **except**

A. The vote for directors.

B. Corporate assets upon liquidation.

C. Cumulative dividends.

Answer (C) is **correct**.
Common stock does not have the right to accumulate unpaid dividends. This right is often attached to preferred stock.

D. New issues of stock of the same class.

Question: 58

Which one of the following statements is **correct** regarding the effect preferred stock has on a company?

A. The firm's after-tax profits are shared equally by common and preferred shareholders.

B. Control of the firm is now shared by the common and preferred shareholders, with preferred shareholders having greater control.

C. Preferred shareholders' claims take precedence over the claims of common shareholders in the event of liquidation.

Answer (C) is **correct**.
Preferred stockholders have preference over common stockholders with respect to dividend and liquidation rights, but payment of preferred dividends, unlike bond interest is not mandatory. In exchange for these preferences, the preferred stockholders give up the right to vote. Consequently, preferred stock is a hybrid of debt and equity.

D. Nonpayment of preferred dividends places the firm in default, as does nonpayment of interest on debt

Question: 59

Zinc Co.'s adjusted trial balance at December 31, Year 6, includes the following account balances:

Common stock, $3 par	$600,000
Additional paid-in capital	800,000
Treasury stock, at cost	50,000
Net unrealized holding loss on	
available-for-sale securities	20,000
Retained earnings: appropriated for	
uninsured earthquake losses	150,000
Retained earnings: unappropriated	200,000

What amount should Zinc report as total equity in its December 31, Year 6, balance sheet?

A. $1,680,000

Answer (A) is **correct**.
Total credits to equity equal $1,750,000 ($600,000 common stock at par + $800,000 additional paid-in capital + $350,000 retained earnings). The treasury stock recorded at cost is subtracted from (debited to) total equity, and the unrealized holding loss on available-for-sale securities is debited to other comprehensive income, a component of equity. Because total debits equal $70,000 ($50,000 cost of treasury stock + $20,000 unrealized loss on available-for-sale securities), total equity equals

$1,680,000 ($1,750,000 – $70,000).

B. $1,720,000

C. $1,780,000

D. $1,820,000

Question: 60 A retained earnings appropriation can be used to

A. Absorb a fire loss when a company is self-insured.

B. Provide for a contingent loss that is probable and reasonable.

C. Smooth periodic income.

D. Restrict earnings available for dividends.

Answer (D) is **correct**.
Transfers to and from accounts properly designated as appropriated retained earnings (such as general purpose contingency reserves or provisions for replacement costs of fixed assets) are always excluded from the determination of net income. However, appropriation of retained earnings is permitted if it is displayed within the equity section and is clearly identified. The effect of the appropriation is to restrict the amount of retained earnings available for dividends, not to set aside assets.

Question: 61 Which one of the following statements regarding treasury stock is **correct**?

A. It is unretired but no longer outstanding, yet it has all the rights of outstanding shares.

B. It is an asset representing shares that can be sold in the future or otherwise issued in stock option plans or in effectuating business combinations.

C. It is unable to participate in the liquidation proceeds of the firm but able to participate in regular cash dividend distributions as well as stock dividends and stock splits.

D. It is reflected in shareholders' equity as a contra account.

Answer (D) is **correct**.
Treasury stock recorded at cost is a reduction of total equity. Treasury stock recorded at par is a direct reduction of the pertinent contributed capital balance, e.g., common stock or preferred stock.

Question: 62 Tyler Corporation purchased 10,000 shares of its own $5 par-value common stock for $25 per share. This stock originally sold for $28 per share. Tyler used the cost method to record this transaction. If the par-value method had been used rather than the cost method, which of the following accounts would show a different dollar amount?

A. Treasury stock and total shareholders' equity.

B. Additional paid-in capital and retained earnings.

C. Paid-in capital from treasury stock and retained earnings.

D. Additional paid-in capital and treasury stock.

Answer (D) is **correct**.
Under the cost method, the treasury stock account was debited for the full market price of the shares; had the par-value method been used, treasury stock would only have been debited for the par value of the shares. Under the cost method, the additional paid-in capital account was not affected; had the par-value method been used, additional paid-in capital would have been debited for the excess of the market price of the shares over par.

Question: 63

On December 1, Noble Inc.'s Board of Directors declared a property dividend, payable in stock held in the Multon Company. The dividend was payable on January 5. The investment in Multon stock had an original cost of $100,000 when acquired 2 years ago. The market value of this investment was $150,000 on December 1, $175,000 on December 31, and $160,000 on January 5. The amount to be shown on Noble's statement of financial position at December 31 as property dividends payable would be

A. $100,000

B. $150,000

Answer (B) is **correct**.
When a property dividend is declared, the property is remeasured at its fair value as of the declaration date. This amount is then reclassified from retained earnings to property dividends payable.

C. $160,000

D. $175,000

Question: 64

Garland Corporation, a public company, has declared a property dividend of one share of its investment in Marlowe, Inc., for every 10 shares of its common stock outstanding. The Marlowe shares were originally purchased by Garland for $50 per share; on the date the dividend was declared, the market value was $75 per share. As a result of this declaration, Garland should recognize

A. A loss of $25 per share to be distributed.

B. A gain of $25 per share to be distributed.

Answer (B) is **correct**.
When a property dividend is declared, the property is remeasured at its fair value as of the declaration date ($75 – $50 = $25).

C. No gain or loss.

D. An appropriate gain or loss based on the market value on the date of distribution.

Question: 65

Grand Corporation has 10,000,000 shares of $10 par-value stock authorized, of which 2,000,000 shares are issued and outstanding. The Board of Directors of Grand declared a 2-for-1 stock split on November 30 to be issued on December 30. The stock was selling for $30 per share on the date of declaration. In addition, the Board has amended the articles of incorporation to allow for a proportional increase in the number of authorized shares. The par-value information appearing in the shareholder's equity section of Grand's statement of financial position at December 31 will be

A. $5

Answer (A) is **correct**.
As a result of the 2-for-1 stock split, the par value of Grand's shares is halved to $5.

B. $10

C. $15

D. $30

Question: 66

Fox Company has 1,000,000 shares of common stock authorized, of which 100,000 shares are held as treasury shares; the remainder are held by the company shareholders. On November 1, the Board of Directors declared a cash dividend of $.10 per share to be paid on January 2. At the same time, the Board declared a 5% stock dividend to be issued on December 31. On the date of the declaration, the stock was selling for $10 a share, and no fractional shares were to be issued. The total amount of these declarations to be shown as current liabilities on Fox's statement of financial position as of December 31 is

A. $90,000

Answer (A) is **correct**.
Cash dividends are only paid on outstanding shares. Thus, the dividend payable at December 31 is $90,000 (900,000 × $.10). Stock dividends distributable are reported in equity, not current liabilities.

B. $100,000

C. $540,000

D. $600,000

Question: 67

Bertram Company had a balance of $100,000 in retained earnings at the beginning of the year and of $125,000 at the end of the year. Net income for this time period was $40,000. Bertram's statement of financial position indicated that the dividends payable account had decreased by $5,000 throughout the year, despite the fact that both cash dividends and a stock dividend were declared. The amount of the stock dividend was $8,000. When preparing its statement of cash flows for the year, Bertram should show cash paid for dividends as

A. $20,000

B. $15,000

C. $12,000

Answer (C) is **correct**.
The amount of total dividends declared during the year can be calculated as follows:

Beginning retained earnings	$100,000
Net income for the year	40,000
Ending retained earnings	(125,000)
Dividends declared during the year	$ 15,000

Since $8,000 is the amount of stock dividends declared, the amount of cash dividends declared this year is $7,000 ($15,000 – $8,000). The amount of cash dividends paid during the year can be calculated as follows:

Decrease in the cash dividends payable account during the period	$ 5,000
Cash dividends declared during the year	7,000
Cash paid for dividends during the year	$12,000

NOTE: Stock dividends declared does not affect the dividends payable account.

D. $5,000

Question: 68

How would a stock split affect the par value of the stock and the company's shareholders' equity?

Par Value	Shareholders' Equity
A. Decrease	Increase
B. Decrease	No change

Answer (B) is **correct**.
A stock split reduces the par value of the stock and increases the number of shares outstanding, making it more attractive to investors. As with a stock dividend, each shareholder's proportionate interest in the company and total book value remain unchanged.

C. Increase	Decrease
D. Increase	No change

Question: 69

An undistributed stock dividend declared by the Board of Directors should be reported as a(n)

A. Current liability.
B. Long-term liability.
C. Footnote to the financial statements.
D. Item in the shareholders' equity section.

Answer (D) is **correct**.
In accounting for a stock dividend, the fair value of the additional shares issued is reclassified from retained earnings to capital stock and the difference to additional paid in capital. Stock dividend distributable is an item of shareholders' equity and not a liability.

Question: 70 Which one of the following statements regarding dividends is **correct**?

A. A stock dividend of 15% of the outstanding common shares results in a debit to retained earnings at the par value of the stock distributed.

B. At the declaration date of a 30% stock dividend, the carrying value of retained earnings will be reduced by the fair market value of the stock distributed.

C. The declaration of a cash dividend will have no effect on book value per share.

D. The declaration and payment of a 10% stock dividend will result in a reduction of retained earnings at the fair market value of the stock.

Answer (D) is **correct**.
When a small stock dividend is declared (less than 20% to 25% of the previously outstanding common shares), retained earnings is debited for the fair value of the stock.

Question: 71 Which one of the following transactions does **not** affect the balance of retained earnings?

A. Declaration of a stock dividend.

B. A quasi-reorganization.

C. Declaration of a stock split.

Answer (C) is **correct**.
In a stock split, no journal entry is recorded and no retained earnings are reclassified.

D. Declaration of a property dividend.

Question: 72 Underhall, Inc.'s common stock is currently selling for $108 per share. Underhall is planning a new stock issue in the near future and would like to stimulate interest in the company. The Board, however, does not want to distribute capital at this time. Therefore, Underhall is considering whether to offer a 2-for-1 common stock split or a 100% stock dividend on its common stock. The **best** reason for opting for the stock split is that

A. It will not decrease shareholders' equity.

B. It will not impair the company's ability to pay dividends in the future.

Answer (B) is **correct**.
A 2-for-1 stock split doubles the number of shares outstanding; retained earnings is not affected. Under a stock dividend, however, a portion of retained earnings is reclassified as common stock. Since dividends are

restricted by the amount of available retained earnings, a stock dividend, but not a stock split, will impair the firm's ability to pay dividends in the future.

C. The impact on earnings per share will not be as great.

D. The par value per share will remain unchanged.

Question: 73 When preparing the statement of cash flows, companies are required to report separately as operating cash flows all of the following **except**

A. Interest received on investments in bonds.

B. Interest paid on the company's bonds.

C. Cash collected from customers.

D. Cash dividends paid on the company's stock.

Answer (D) is **correct**.
In general, the cash flows from transactions and other events that enter into the determination of income are to be classified as operating. Cash receipts from sales of goods and services, from interest on loans, and from dividends on equity securities are from operating activities. Cash payments to suppliers for inventory; to employees for wages; to other suppliers and employees for other goods and services; to governments for taxes, duties, fines, and fees; and to lenders for interest are also from operating activities. However, distributions to owners (cash dividends on a company's own stock) are cash flows from financing, not operating, activities.

Question: 74 A statement of cash flows is intended to help users of financial statements

A. Evaluate a firm's liquidity, solvency, and financial flexibility.

Answer (A) is **correct**.
The primary purpose of a statement of cash flows is to provide information about the cash receipts and payments of an entity during a period. If used with information in the other financial statements, the statement of cash flows should help users to assess the entity's ability to generate positive future net cash flows (liquidity), its ability to meet obligations (solvency) and pay dividends, the need for external financing, the reasons for differences between income and cash receipts and payments, and the cash and noncash aspects of the investing and financing activities.

B. Evaluate a firm's economic resources and obligations.

C. Determine a firm's components of income from operations.

D. Determine whether insiders have sold or purchased the firm's stock.

Question: 75 Which of the following items is specifically included in the body of a statement of cash flows?

A. Operating and nonoperating cash flow information.

Answer (A) is **correct**.
All noncash transactions are excluded from the body of the statement of cash flows to avoid undue complexity and detraction from the objective of providing information about cash flows. Information about all noncash financing and investing activities affecting recognized assets and liabilities shall be reported in related disclosures.

B. Conversion of debt to equity.

C. Acquiring an asset through a capital lease.

D. Purchasing a building by giving a mortgage to the seller.

Question: 76 With respect to the content and form of the statement of cash flows, the

A. Pronouncements covering the cash flow statement encourage the use of the indirect method.

B. Indirect method adjusts ending retained earnings to reconcile it to net cash flows from operations.

C. Direct method of reporting cash flows from operating activities includes disclosing the major classes of gross cash receipts and gross cash payments.

Answer (C) is **correct**.
The FASB encourages use of the direct method of reporting major classes of operating cash receipts and payments, but the indirect method may be used. The minimum disclosures of operating cash flows under the direct method are cash collected from customers, interest and dividends received, other operating cash receipts, cash paid to employees and other suppliers of goods or services, interest paid, income taxes paid, and other operating cash payments.

D. Reconciliation of the net income to net operating cash flow need not be presented when using the direct method.

Question: 77 Depreciation expense is added to net income under the indirect method of preparing a statement of cash flows in order to

A. Report all assets at gross carrying amount.

B. Ensure depreciation has been properly reported.

C. Reverse noncash charges deducted from net income.

Answer (C) is **correct**.
The indirect method begins with net income and then removes the effects of past deferrals of operating cash receipts and payments, accruals of expected future operating cash receipts and payments, and net income items not affecting operating cash flows (e.g., depreciation).

D. Calculate net carrying amount.

Question: 78

All of the following should be classified under the operating section in a statement of cash flows **except** a

A. Decrease in inventory.

B. Depreciation expense.

C. Decrease in prepaid insurance.

D. Purchase of land and building in exchange for a long-term note.

Answer (D) is **correct**.
Operating activities include all transactions and other events not classified as investing and financing activities. Operating activities include producing and delivering goods and providing services. Cash flows from such activities are usually included in the determination of net income. However, the purchase of land and a building in exchange for a long-term note is an investing activity. Because this transaction does not affect cash, it is reported in related disclosures of noncash investing and financing activities.

Question: 79

Which one of the following transactions should be classified as a financing activity in a statement of cash flows?

A. Purchase of equipment.

B. Purchase of treasury stock.

Answer (B) is **correct**.
Financing activities are defined to include the issuance of stock, the payment of dividends, the receipt of donor-restricted resources to be used for long-term purposes, treasury stock transactions (purchases or sales), the issuance of debt, the repayment of amounts borrowed, obtaining and paying for other resources obtained from creditors on long-term credit.

C. Sale of trademarks.

D. Payment of interest on a mortgage note.

Question: 80

Kelli Company acquired land by assuming a mortgage for the full acquisition cost. This transaction should be disclosed on Kelli’s statement of cash flows as a(n)

A. Financing activity.

B. Investing activity.

C. Operating activity.

D. Noncash financing and investing activity.

Answer (D) is **correct**.
The exchange of debt for a long-lived asset does not involve a cash flow. It is therefore classified as a noncash financing and investing activity.

Question: 81

Which one of the following transactions should **not** be classified as a financing activity in the statement of cash flows?

A. Issuance of common stock.

B. Purchase of treasury stock.

C. Payment of dividends.

D. Income tax refund.

Answer (D) is **correct**.
Financing activities include obtaining resources from owners and providing them with a return on, and a return of, their investment. Cash inflows from financing activities include proceeds from issuing equity instruments. Cash outflows include outlays to reacquire the enterprise's equity instruments, and outlays to pay dividends. However, an income tax refund is an operating activity.

Question: 82

All of the following should be classified as investing activities in the statement of cash flows **except**

A. Cash outflows to purchase manufacturing equipment.

B. Cash inflows from the sale of bonds of other entities.

C. Cash outflows to lenders for interest.

Answer (C) is **correct**.
Investing activities include the lending of money and the collecting of those loans; the acquisition, sale, or other disposal of debt or equity instruments; and the acquisition, sale, or other disposition of assets (excluding inventory) that are held for or used in the production of goods or services. Investing activities do not include acquiring and disposing of certain loans or other debt or equity instruments that are acquired specifically for resale. Cash outflows to lenders for interest are cash from an operating, not an investing, activity.

D. Cash inflows from the sale of a manufacturing plant.

Question: 83

All of the following should be included in the reconciliation of net income to net operating cash flow in the statement of cash flows **except** a(n)

A. Decrease in inventory.

B. Decrease in prepaid insurance.

C. Purchase of land and building in exchange for a long-term note.

Answer (C) is **correct**.
The purchase of land and a building in exchange for a long-term note is a noncash investing activity that does not affect net income. Thus, it is reported in the related disclosures section of the cash flow statement but is not a reconciling item.

D. Increase in income tax payable.

Question: 84

In preparing a statement of cash flows, an item included in determining net cash flow from operating activities is the

A. Amortization of a bond premium.

Answer (A) is **correct**.
The debtor (issuer) on a bond sold at a premium debits or reduces the bond premium for the excess of cash interest paid over interest expense recognized under the effective interest method. The lender (buyer) likewise reduces the bond premium (by a credit) for the excess of cash interest received over interest income recognized. Interest paid (received) is a cash outflow (inflow) from an operating activity. In a reconciliation of net income to net cash flow from operating activities, both the issuer of the bond and the purchaser must make an adjustment for the difference between the cash flow and the effect on net income. Because the issuer's cash outflow exceeded interest expense, it must deduct the difference (premium amortization) from net income in performing the reconciliation. The purchaser's cash inflow is greater than interest income, so it must add the difference (premium amortization) to net income to arrive at net cash flow from operating activities.

B. Proceeds from the sale of equipment for cash.

C. Cash dividends paid.

D. Purchase of treasury stock.

Question: 85

The information reported in the statement of cash flows should help investors, creditors, and others to assess all of the following **except** the

A. Amount, timing, and uncertainty of prospective net cash inflows of a firm.

B. Company's ability to pay dividends and meet obligations.

C. Company's ability to generate future cash flows.

D. Management of the firm with respect to the efficient and profitable use of its resources.

Answer (D) is **correct**.
The statement of cash flows is not designed to provide information with respect to the efficient and profitable use of the firm's resources. Financial reporting provides information about an enterprise's performance during a period when it was under the direction of a particular management but does not directly provide information about that management's performance. Financial reporting does not try to separate the impact of a particular management's performance from the effects of prior management actions, general economic conditions, the supply and demand for an enterprise's inputs and outputs, price changes, and other events.

Question: 86

To calculate cash flows using the indirect method, which one of the following items must be added back to net income?

A. Revenue.

B. Marketing expense.

C. Depreciation expense.

Answer (C) is **correct**.
The indirect method begins with accrual-basis net income or the change in net assets and removes items that did not affect operating cash flow. Depreciation is a non-cash item and thus does not affect the cash flows. This amount must be added back to net income because it decreased net income even though it had no cash effect.

D. Interest income.

Question: 87

The net income for Cypress, Inc., was $3,000,000 for the year ended December 31. Additional information is as follows:

Depreciation on fixed assets	$1,500,000
Gain from cash sale of land	200,000
Increase in accounts payable	300,000
Dividends paid on preferred stock	400,000

The net cash provided by operating activities in the statement of cash flows for the year ended December 31 should be

A. $4,200,000

B. $4,500,000

C. $4,600,000

Answer (C) is **correct**.
Net operating cash flow may be determined by adjusting net income. Depreciation is an expense not directly affecting cash flows that should be added back to net income. The increase in accounts payable is added to net income because it indicates that an expense has been recorded but not paid. The gain on the sale of land is an accrual-basis item affecting net income and thus should be subtracted. The dividends paid on preferred stock are cash outflows from financing, not operating, activities and do not require an adjustment. Thus, net cash flow from operations is $4,600,000 ($3,000,000 + $1,500,000 – $200,000 + $300,000).

D. $4,800,000

Fact Pattern: Royce Company had the following transactions during the fiscal year ended December 31, Year 2:

- Accounts receivable decreased from $115,000 on December 31, Year 1, to $100,000 on December 31, Year 2.
- Royce's board of directors declared dividends on December 31, Year 2, of $.05 per share on the 2.8 million shares outstanding, payable to shareholders of record on January 31, Year 3. The company did not declare or pay dividends for fiscal Year 1.
- Sold a truck with a net carrying amount of $7,000 for $5,000 cash, reporting a loss of $2,000.
- Paid interest to bondholders of $780,000.
- The cash balance was $106,000 on December 31, Year 1, and $284,000 on December 31,

Question: 88 Royce Company uses the direct method to prepare its statement of cash flows at December 31, Year 2. The interest paid to bondholders is reported in the

A. Financing section, as a use or outflow of cash.

B. Operating section, as a use or outflow of cash.

Answer (B) is **correct**.
Payment of interest on debt is considered a cash outflow from an operating activity, although repayment of debt principal is a financing activity.

C. Investing section, as a use or outflow of cash.

D. Debt section, as a use or outflow of cash.

Fact Pattern: Royce Company had the following transactions during the fiscal year ended December 31, Year 2:

- Accounts receivable decreased from $115,000 on December 31, Year 1, to $100,000 on December 31, Year 2.
- Royce's board of directors declared dividends on December 31, Year 2, of $.05 per share on the 2.8 million shares outstanding, payable to shareholders of record on January 31, Year 3. The company did not declare or pay dividends for fiscal Year 1.
- Sold a truck with a net carrying amount of $7,000 for $5,000 cash, reporting a loss of $2,000.
- Paid interest to bondholders of $780,000.
- The cash balance was $106,000 on December 31, Year 1, and $284,000 on December 31, Year 2.

Question: 89 Royce Company uses the indirect method to prepare its Year 2 statement of cash flows. It reports a(n)

A. Source or inflow of funds of $5,000 from the sale of the truck in the financing section.

B. Use or outflow of funds of $140,000 in the financing section, representing dividends.

C. Deduction of $15,000 in the operating section, representing the decrease in year-end accounts receivable.

D. Addition of $2,000 in the operating section for the $2,000 loss on the sale of the truck.

Answer (D) is **correct**.
The indirect method determines net operating cash flow by adjusting net income. Under the indirect method, the $5,000 cash inflow from the sale of the truck is shown in the investing section. A $2,000 loss was recognized and properly deducted to determine net income. This loss, however, did not require the use of cash and should be added to net income in the operating section.

Fact Pattern: Royce Company had the following transactions during the fiscal year ended December 31, Year 2:

- Accounts receivable decreased from $115,000 on December 31, Year 1, to $100,000 on December 31, Year 2.
- Royce's board of directors declared dividends on December 31, Year 2, of $.05 per share on the 2.8 million shares outstanding, payable to shareholders of record on January 31, Year 3. The company did not declare or pay dividends for fiscal Year 1.
- Sold a truck with a net carrying amount of $7,000 for $5,000 cash, reporting a loss of $2,000.
- Paid interest to bondholders of $780,000.
- The cash balance was $106,000 on December 31, Year 1, and $284,000 on December 31, Year 2.

Question: 90 The total of cash provided (used) by operating activities plus cash provided (used) by investing activities plus cash provided (used) by financing activities is

A. Cash provided of $284,000.

B. Cash provided of $178,000.

Answer (B) is **correct**.
The total of cash provided (used) by the three activities (operating, investing, and financing) should equal the increase or decrease in cash for the year. During Year 2, the cash balance increased from $106,000 to $284,000. Thus, the sources of cash must have exceeded the uses by $178,000.

C. Cash used of $582,000.

D. Equal to net income reported for fiscal year ended December 31, Year 2.

Question: 91 The following information was taken from the accounting records of Oak Corporation for the year ended December 31:

Proceeds from issuance of preferred stock F	$4,000,000
Dividends paid on preferred stock F	400,000
Bonds payable converted to common stock	2,000,000
Payment for purchase of machinery	500,000
Proceeds from sale of plant building	1,200,000
2% stock dividend on common stock	300,000
Gain on sale of plant building	200,000

The net cash flows from investing and financing activities that should be presented on Oak's statement of cash flows for the year ended December 31 are, respectively,

A. $700,000 and $3,600,000.

Answer (A) is **correct**.
The relevant calculations are as follows:

Proceeds from sale of plant building	$1,200,000
Payment for purchase of machinery	(500,000)
Net cash provided by investing activities	$ 700,000
Proceeds from issuance of preferred stock	$4,000,000
Dividends paid on preferred stock	(400,000)
Net cash provided by financing activities	$3,600,000

B. $700,000 and $3,900,000.

C. $900,000 and $3,900,000.

D. $900,000 and $3,600,000.

Question: 92 Zip Company entered into the following transactions during the year:

- Purchased stock for $200,000
- Purchased electronic equipment for use on the manufacturing floor for $300,000
- Paid dividends to shareholders of Zip Company in the amount of $800,000

The amount to be reported in the investing activities section of Zip's statement of cash flows would be

A. $200,000

B. $500,000

Answer (B) is **correct**.
The statement of cash flows classifies an enterprise's cash flows into three categories. Investing activities typically include the purchase and sale of securities of other entities and the purchase and sale of property, plant, and equipment. Thus, the amount to be reported in the investing activities section of Zip's statement of cash flows is $500,000 ($200,000 + $300,000).

C. $800,000

D. $1,300,000

Question: 93 When using the statement of cash flows to evaluate a company's continuing solvency, the **most** important factor to consider is the cash

A. Balance at the end of the period.

B. Flows from (used for) operating activities.

Answer (B) is **correct**.
Solvency is the ability of an entity to pay its noncurrent debts as they

become due. A statement of cash flows provides information about, among other things, an entity's activities in generating cash through operations (operating activities) to (1) repay debt, (2) distribute dividends, or (3) reinvest to maintain or expand operating capacity. Thus, cash flows from operating activities (net operating cash inflows), which are generated by an entity's ongoing major or central activities, are the best indicator of its ability to remain solvent over the long term.

C. Flows from (used for) investing activities.

D. Flows from (used for) financing activities.

Question: 94 Dividends paid to shareholders are shown on the statement of cash flows as

A. Operating cash inflows.

B. Operating cash outflows.

C. Cash flows from investing activities.

D. Cash flows from financing activities.

Answer (D) is **correct**.
The payment of dividends is a cash outflow from a financing activity. The receipt of dividends, however, is generally considered a cash inflow from an operating activity.

Question: 95 All of the following are classifications on the statement of cash flows **except**

A. Operating activities.

B. Equity activities.

Answer (B) is **correct**.
The three classifications used on the statement of cash flows are operating activities, investing activities, and financing activities.

C. Investing activities.

D. Financing activities.

Question: 96The sale of available-for-sale securities should be accounted for on the statement of cash flows as a(n)

A. Operating activity.

B. Investing activity.

Answer (B) is **correct**.
Investing activities include acquiring and disposing of debt or equity instruments.

C. Financing activity.

D. Noncash investing and financing activity.

Question: 97 Metro, Inc., reported net income of $150,000 for the current year. Changes occurred in several balance sheet accounts during the current year as follows:

nvestment in Videogold, Inc., stock, all of which was acquired in the previous year, carried on the equity basis	$5,500 increase
ccumulated depreciation, caused by major repair to projection equipment	2,100 decrease
Premium on bonds payable	1,400 decrease
eferred income tax liability (long-term)	1,800 increase

In Metro’s current year cash flow statement, the reported net cash provided by operating activities should be

A. $150,400

B. $148,300

C. $144,900

Answer (C) is **correct**.
The increase in the equity-based investment reflects the investor’s share of the investee’s net income after adjustment for dividends received. Hence, it is a noncash revenue and should be subtracted in the reconciliation of net income to net operating cash inflow. A major repair provides benefits to more than one period and therefore should not be expensed. One method of accounting for a major repair is to charge accumulated depreciation if the useful life of the asset has been extended, with the offsetting credit to cash, a payable, etc. However, the cash outflow, if any, is from an investing activity. The item has no effect on net income and no adjustment is necessary. Amortization of bond premium is a noncash income statement item that reduces accrual-basis expenses and therefore must be subtracted from net income to arrive at net cash flow from operating activities. The increase in the deferred tax liability is a noncash item that reduces net income and should be added in the reconciliation. Accordingly, net cash provided by operations is $144,900 ($150,000 – $5,500 – $1,400 + $1,800).

D. $142,800

Question: 98

Hauschka Company reported net income for the year of $1,050,000. During the year, accounts receivable decreased $300,000, prepaid expenses increased $150,000, accounts payable for merchandise decreased $150,000, and liabilities for other expenses increased $100,000. Administrative expenses include depreciation expense of $50,000, and the company reported a loss on the sale of obsolete equipment of $10,000. Calculate Hauschka’s net cash flows from operating activities during the year.

A. $1,790,000

B. $1,690,000

C. $1,210,000

Answer (C) is **correct**.
Net operating cash flow may be determined by adjusting net income. The depreciation expense, decrease in accounts receivable, increase in liabilities, and loss on the sale of obsolete equipment must be added back. The increase in prepaid expense and decrease in accounts payable must be subtracted from net income. Thus, net cash flow from operations

is $1,210,000 ($1,050,000 net income + $50,000 depreciation + $300,000 accounts receivable + $100,000 liabilities + $10,000 loss – $150,000 prepaid expenses – $150,000 accounts payable).

D. $1,110,000

Question: 99

Garnett Company's year-end income statement shows the following:

Revenues	$5,000,000
Selling and general expenses (including depreciation expense of $200,000)	3,800,000
Interest expense	50,000
Gain on sale of equipment	40,000
Income tax expense (including deferred tax expense of $30,000)	320,000
Net income	$ 870,000

During the year, Garnett's noncash current assets rose by $100,000, and current liabilities increased by $150,000. On its statement of cash flows, Garnett would report cash provided by operating activities of

A. $1,080,000

B. $1,110,000

Answer (B) is **correct**.
Net operating cash flow may be determined by adjusting net income. Net income of $870,000 is decreased by the increase in current assets of $100,000, increased by the increase in current liabilities of $150,000, increased by depreciation expense of $200,000, decreased by the gain on sale of equipment of $40,000, and increased by the deferred tax liability. Thus, cash provided by operating activities would be $1,110,000.

C. $1,160,000

D. $1,190,000

Question: 100

An accountant with Nasbo Enterprises, Inc., has gathered the following information to prepare the statement of cash flows for the current year. Net income of $456,900 includes a deduction of $45,600 for depreciation expense. The company issued $300,000 of dividends this year and purchased one new building for $275,000. The balance sheets from the current period and prior period included the following balances:

	Prior Year	Current Year
Accounts receivable, net	$ 56,860	$ 45,300
Accounts payable	12,900	10,745
Inventory	186,700	194,320

Using the indirect method, what is the amount of cash provided by operating activities?

A. $202,500

B. $405,205

C. $504,285

Answer (C) is **correct**.
Net operating cash flow may be determined by adjusting net income. Depreciation is an expense not directly affecting cash flows that should be added back to net income. The decrease in accounts payable is subtracted from net income because it indicates that an expense has been paid, while the decrease in accounts receivable should be added to net income. The increase in inventory should be subtracted from net income because cash was used to purchase the inventory. The dividends paid on preferred stock are cash outflows from financing, not operating, activities and do not require an adjustment. Thus, net cash flow from operations is $504,285 ($456,900 + $45,600 + $11,560 – $2,155 – $7,620).

D. $521,405

Question: 100 An accountant with Nasbo Enterprises, Inc., has gathered the following information to prepare the statement of cash flows for the current year. Net income of $456,900 includes a deduction of $45,600 for depreciation expense. The company issued $300,000 of dividends this year and purchased one new building for $275,000. The balance sheets from the current period and prior period included the following balances:

	Prior Year	Current Year
Accounts receivable, net	$ 56,860	$ 45,300
Accounts payable	12,900	10,745
Inventory	186,700	194,320

Using the indirect method, what is the amount of cash provided by operating activities?

A. $202,500

B. $405,205

C. $504,285

Answer (C) is **correct**.
Net operating cash flow may be determined by adjusting net income. Depreciation is an expense not directly affecting cash flows that should be added back to net income. The decrease in accounts payable is subtracted from net income because it indicates that an expense has been paid, while the decrease in accounts receivable should be added to net income. The increase in inventory should be subtracted from net income because cash was used to purchase the inventory. The dividends paid on preferred stock are cash outflows from financing, not operating, activities and do not require an adjustment. Thus, net cash flow from operations is $504,285 ($456,900 + $45,600 + $11,560 – $2,155 – $7,620).

D. $521,405

Question: 101 Which one of the following would result in a decrease in cash flow measured under the indirect method of preparing a statement of cash flows?

A. Amortization expense.

B. Decrease in income taxes payable.

Answer (B) is **correct**.
The indirect method reconciles accrual-basis net income to net operating cash flow. A decrease in income taxes payable implies an operating cash outflow not reflected in net income. Thus, the reconciling adjustment is a subtraction from net income. The result is a lower measure of net operating cash flow.

C. Proceeds from the issuance of common stock.

D. Decrease in inventories.

Question: 102 A statement of cash flows prepared using the indirect method would have cash activities listed in which one of the following orders?

A. Financing, investing, operating.

B. Investing, financing, operating.

C. Operating, financing, investing.

D. Operating, investing, financing.

Answer (D) is **correct**.
A statement of cash flows prepared using either the direct or the indirect method lists the categories of cash flows in the following order: operating, investing, and financing.

Question: 103 Which one of the following should be classified as a cash flow from an operating activity on the statement of cash flows?

A. A decrease in accounts payable during the year.

Answer (A) is **correct**.
Operating activities are all transactions and other events that are not financing or investing activities. In general, operating activities involve the production and delivery of goods and the provision of services. Their effects normally are reported in earnings. A decrease in accounts payable indicates a cash outflow to the entity’s suppliers in payment for goods or services.

B. An increase in cash resulting from the issuance of previously authorized common stock.

C. The payment of cash for the purchase of additional equipment needed for current production.

D. The payment of a cash dividend from money arising from current operations.

Question: 104

The most commonly used method for calculating and reporting a company's net cash flow from operating activities on its statement of cash flows is the

A. Direct method.

B. Indirect method.

> Answer (B) is **correct**.
> The FASB has expressed a preference for the direct method. However, if the direct method is used, a separate reconciliation based on the indirect method must be provided in a separate schedule. For this reason, most entities use the indirect method. The same net operating cash flow is reported under both methods.

C. Single-step method.

D. Multiple-step method.

Question: 105

The presentation of the major classes of operating cash receipts (such as receipts from customers) minus the major classes of operating cash disbursements (such as cash paid for merchandise) is best described as the

A. Direct method of calculating net cash provided or used by operating activities.

> Answer (A) is **correct**.
> The direct method converts the accrual-basis amounts in the income statement to the cash basis. It then reports the separate categories of gross cash receipts and disbursements. Net cash flow from operating activities is the difference between total cash receipts and total cash disbursements.

B. Cash method of determining income in conformity with generally accepted accounting principles.

C. Format of the statement of cash flows.

D. Indirect method of calculating net cash provided or used by operating activities.

Question: 106

Larry Mitchell, Bailey Company's controller, is gathering data for the statement of cash flows for the most recent year end. Mitchell is planning to use the direct method to prepare this statement and has made the following list of cash inflows for the period:

- Collections of $100,000 for goods sold to customers
- Securities purchased for investment purposes with an original cost of $100,000 sold for $125,000
- Proceeds from the issuance of additional company stock totaling $10,000

The correct amount to be shown as cash inflows from operating activities is

A. $100,000

> Answer (A) is **correct**.
> Cash flows from operating activities are those generated by the firm's major and ongoing activities. They include cash flows from all activities not classified as investing or financing. Only the $100,000 of collections

on sales to customers qualifies.

B. $135,000

C. $225,000

D. $235,000

Question: 107

During the year, Deltech, Inc., acquired a long-term productive asset for $5,000 and also borrowed $10,000 from a local bank. These transactions should be reported on Deltech's statement of cash flows as

A. Outflows for investing activities, $5,000; inflows from financing activities, $10,000.

Answer (A) is **correct**.
The acquisition and disposal of property, plant, equipment, and other productive assets are investing activities. Borrowing money is a financing activity. Deltech's transactions should therefore be reported on its statement of cash flows as a $5,000 outflow for investing activities and a $10,000 inflow from financing activities.

B. Inflows from investing activities, $10,000; outflows for financing activities, $5,000.

C. Outflows for operating activities, $5,000; inflows from financing activities, $10,000.

D. Outflows for financing activities, $5,000; inflows from investing activities, $10,000.

Question: 108

Atwater Company has recorded the following payments for the current period:

Purchase Trillium stock	$300,000
Dividends paid to Atwater shareholders	200,000
Repurchase of Atwater Company stock	400,000

The amount to be shown in the investing activities section of Atwater's statement of cash flows should be

A. $300,000

Answer (A) is **correct**.
Financing activities include paying dividends and treasury stock transactions. Investing activities include acquiring and disposing of debt and equity instruments. Thus, the amount to be shown in the investing activities section of Atwater's statement of cash flows is $300,000.

B. $500,000

C. $700,000

D. $900,000

Question: 109

Carlson Company has the following payments recorded for the current period:

Dividends paid to Carlson shareholders	$150,000
Interest paid on bank loan	250,000
Purchase of equipment	350,000

The total amount of the above items to be shown in the operating activities section of Carlson's statement of cash flows should be

A. $150,000

B. $250,000

Answer (B) is **correct**.
Cash flows from operating activities include cash flows from all activities not classified as investing or financing. Their effects normally are reported in earnings. Operating cash flows include the payment and collection of interest, dividends paid are a financing cash outflow, and the purchase of equipment is an investing activity. Thus, the total amount to be reported in the operating activities section of the statement of cash flows is $250,000.

C. $350,000

D. $750,000

Question: 110

Barber Company has recorded the following payments for the current period:

Interest paid on bank loan	$300,000
Dividends paid to Barber shareholders	200,000
Repurchase of Barber stock	400,000

The amount to be shown in the financing activities section of Barber's statement of cash flows should be

A. $300,000

B. $500,000

C. $600,000

Answer (C) is **correct**.
The payment and collection of interest are treated as cash flows from operating activities. Financing activities include paying dividends and treasury stock transactions. Thus, the amount to be reported in the financing activities section of the statement of cash flows is $600,000 ($200,000 + $400,000).

D. $900,000

Fact Pattern: Selected financial information for Kristina Company for the year just ended is shown below.

Net income	$2,000,000
Increase in net accounts receivable	300,000
Decrease in inventory	100,000
Increase in accounts payable	200,000
Depreciation expense	400,000
Gain on the sale of available-for-sale securities	700,000
Cash receivable from the issue of common stock	800,000
Cash paid for dividends	80,000
Cash paid for the acquisition of land	1,500,000
Cash received from the sale of available-for-sale securities	2,800,000

Question: 111 Kristina's cash flow from financing activities for the year is

A. $(80,000)

Answer (A) is **correct**.
Cash flows from financing activities for the year consist of the $80,000 outflow for dividends paid. The issue of common stock is a financing activity, but the $800,000 of proceeds have not yet been received.

B. $720,000

C. $800,000

D. $3,520,000

Fact Pattern: Selected financial information for Kristina Company for the year just ended is shown below.

Net income	$2,000,000
Increase in net accounts receivable	300,000
Decrease in inventory	100,000
Increase in accounts payable	200,000
Depreciation expense	400,000
Gain on the sale of available-for-sale securities	700,000
Cash receivable from the issue of common stock	800,000
Cash paid for dividends	80,000
Cash paid for the acquisition of land	1,500,000

Cash received from the sale of available-for-sale securities	2,800,000

Question: 112 Kristina's cash flow from investing activities for the year is

A. $(1,500,000)

B. $1,220,000

C. $1,300,000

Answer (C) is **correct**.
Cash flows from investing activities for the year include the $2,800,000 inflow from the sale of available-for-sale securities and the $1,500,000 cash outflow for the purchase of land ($2,800,000 − $1,500,000 = $1,300,000 net cash inflow).

D. $2,800,000

Question: 113 For the fiscal year just ended, Doran Electronics had the following results:

Net income	$920,000
Depreciation expense	110,000
Increase in accounts payable	45,000
Increase in net accounts receivable	73,000
Increase in deferred income tax liability	16,000

Doran's net cash flow from operating activities is

A. $928,000

B. $986,000

C. $1,018,000

Answer (C) is **correct**.
The following is the net cash flow from operating activities calculated using the indirect method:

Net income	$ 920,000
Add: increase in accounts payable	45,000
Add: increase in deferred tax liability	16,000
Add: depreciation expense	110,000
Minus: increase in net accounts receivable	(73,000)
Net cash provided by operating activities	$1,018,000

The adjustment from cost of goods sold (an accrual accounting amount used to calculate net income) to cash paid to suppliers requires two steps: (1) from cost of goods sold to purchases and (2) from purchases to cash paid to suppliers. An increase in inventory is subtracted from net income. It indicates that purchases were greater than cost of goods sold. A decrease in inventory is added to net income. It indicates that purchases were less than cost of goods sold. However, the change in inventory is not given, so it is assumed to be zero. The increase in accounts payable is added to net income. It indicates that cash paid to suppliers was $45,000 less than purchases. Thus, the net effect of the changes in inventory and accounts payable is that cash paid to suppliers was $45,000 ($0 + $45,000) less than the accrual basis cost of goods sold. The increase in a deferred income tax liability (debit income tax expense, credit deferred liability) is a noncash item. The adjustment is a $16,000 addition to net income. Depreciation ($110,000) also is a noncash item that is added to net income. The net accounts receivable balance increased by $73,000, implying that cash collections were less than sales. If sales, collections, write-offs, and recognition of bad debt expense were the only relevant transactions, $73,000 should be subtracted from net income. Use of the change in net accounts receivable as a reconciliation adjustment is a short-cut method. It yields the same net adjustment to net income as separately including the effects of the change in gross accounts receivable, bad debt expense (a noncash item resulting in an addition), and bad debt write-offs (reflecting that write-offs did not result in collections).

D. $1,074,000

Question: 114 Three years ago, Jameson Company purchased stock in Zebra, Inc., at a cost of $100,000. This stock was sold for $150,000 during the current fiscal year. The result of this transaction should be shown in the investing activities section of Jameson's statement of cash flows as

A. Zero.

B. $50,000

C. $100,000

D. $150,000

Answer (D) is **correct**.
The statement of cash flows reports the cash effects of transactions. The accrual-basis gain on the stock is not relevant.

Question: 115 Madden Corporation's controller has gathered the following information as a basis for preparing the statement of cash flows. Net income for the current year was $82,000. During the year, old equipment with a cost of $60,000 and a net carrying amount of $53,000 was sold for cash at a gain of $10,000. New equipment was purchased for $100,000. Shown below are selected closing balances for last year and the current year.

	Last Year	Current Year
Cash	$ 39,000	$ 85,000
Accounts receivable net	43,000	37,000
Inventories	93,000	105,000
Equipment	360,000	400,000
Accumulated depreciation -- equipment	70,000	83,000
Accounts payable	22,000	19,000
Notes payable	100,000	100,000
Common stock	250,000	250,000
Retained earnings	93,000	175,000

Madden's net cash flow from operating activities for the current year is

A. $63,000

B. $73,000

C. $83,000

Answer (C) is **correct**.
The net operating cash flow may be determined by reconciling it with net income.

Net income	$ 82,000
Add: decrease in receivables	6,000
Add: depreciation expense	20,000
Minus: increase in inventories	(12,000)
Minus: decrease in payables	(3,000)
Minus: gain on sale of equipment	(10,000)
Net cash provided by operating activities	$ 83,000

The net accounts receivable balance declined by $6,000 ($43,000 – $37,000), implying that cash collections exceeded sales. Assuming that sales, collections, write-offs, and recognition of bad debt expense were the only relevant transactions, $6,000 should be added to net income. Use of the change in net accounts receivable as a reconciliation adjustment is a short-cut method. It yields the same net adjustment to net income as separately including the effects of the change in gross accounts receivable, bad debt expense (a noncash item), and bad debt write-offs.

Equipment costing $60,000 and having a carrying amount of $53,000 was sold on January 1, Year 6, for $63,000 in cash. Thus, the debit to accumulated depreciation must have been $7,000 ($60,000 – $53,000). During the year, Madden must have recognized $20,000 of depreciation [$83,000 acc. dep. year end – ($70,000 acc. dep. begin. of yr. – $7,000 acc. dep. on sold equip.)]. The depreciation should be added to net income because it is included in net income but had no cash effect.

The adjustment from cost of goods sold (an accrual accounting amount used to calculate net income) to cash paid to suppliers requires two steps: (1) from cost of goods sold to purchases and (2) from purchases to cash paid to suppliers. The $12,000 ($105,000 – $93,000) increase in inventory is subtracted from net income. It indicates that purchases were $12,000 greater than cost of goods sold. The decrease in accounts payable is subtracted from net income. It indicates that cash paid to suppliers was $3,000 greater than purchases. Thus, the net effect of the changes in inventory and accounts payable is that cash paid to suppliers was $15,000 ($12,000 + $3,000) less than the accrual basis cost of goods sold. The $10,000 gain on the sale of equipment is subtracted from net income because it is a cash inflow from an investing, not an operating, activity.

D. $93,000

Fact Pattern: Selected financial information for Kristina Company for the year just ended is shown below.

Net income	$2,000,000
Increase in net accounts receivable	300,000
Decrease in inventory	100,000
Increase in accounts payable	200,000
Depreciation expense	400,000
Gain on the sale of available-for-sale securities	700,000
Cash receivable from the issue of common stock	800,000
Cash paid for dividends	80,000
Cash paid for the acquisition of land	1,500,000
Cash received from the sale of available-for-sale securities	2,800,000

Question: 116 Assuming the indirect method is used, Kristina's cash flow from operating activities for the year is

A. $1,700,000

Answer (A) is **correct**.
The following is the net cash flow from operating activities calculated using the indirect method:

Net income	$2,000,000
Add: decrease in inventory	100,000
Add: increase in accounts payable	200,000
Add: depreciation expense	400,000
Minus: increase in net accounts receivable	(300,000)
Minus: gain on sale of securities	(700,000)
Net cash provided by operating activities	$1,700,000

The adjustment from cost of goods sold (an accrual accounting amount used to calculate net income) to cash paid to suppliers requires two steps: (1) from cost of goods sold to purchases and (2) from purchases to cash paid to suppliers. The $100,000 decrease in inventory is added to net income. It indicates that purchases were $100,000 less than cost of goods sold. The $200,000 increase in accounts payable is added to net income. It indicates that cash paid to suppliers was $200,000 less than purchases. Thus, the net effect of the changes in inventory and accounts payable is that cash paid to suppliers was $300,000 ($100,000 + $200,000) less than the accrual basis cost of goods sold. Depreciation expense ($300,000) is a noncash item included in net income. Hence, it is subtracted from net income. The net accounts receivable balance increased by $300,000, implying that cash collections were less than sales. If sales, collections, write-offs, and recognition of bad debt expense were the only relevant transactions, $300,000 should be subtracted from net income. Use of the change in net accounts receivable as a reconciliation adjustment is a short-cut method. It yields the same net adjustment to net income as separately including the effects of the change in gross accounts receivable, bad debt expense (a noncash item resulting in an addition), and bad debt write-offs (a subtraction to reflect that write-offs did not result in collections). The sale of securities is an investing activity. It also is subtracted from net income.

B. $2,000,000

C. $2,400,000

D. $3,100,000

Question: 117

ABC operates a catering service that specializes in business luncheons for large corporations. ABC requires customers to place their orders 2 weeks in advance of the scheduled events. ABC bills its customers on the 10th day of the month following the date of service and requires that payment be made within 30 days of the billing date. Conceptually, ABC should recognize revenue from its catering services at the date when a

A. Customer places an order.

B. Luncheon is served.

Answer (B) is **correct**.
Revenues should be recognized when (1) realized or realizable and (2) earned. The most common time at which these two conditions are met is when goods are delivered or services are rendered.

C. Billing is mailed.

D. Customer's payment is received.

Question: 118

A company provides fertilization, insect control, and disease control services for a variety of trees, plants, and shrubs on a contract basis. For $50 per month, the company will visit the subscriber's premises and apply appropriate mixtures. If the subscriber has any problems between the regularly scheduled application dates, the company's personnel will promptly make additional service calls to correct the situation. Some subscribers elect to pay for an entire year because the company offers an annual price of $540 if paid in advance. For a subscriber who pays the annual fee in advance, the company should recognize the related revenue

A. When the cash is collected.

B. Evenly over the year as the services are performed.

Answer (B) is **correct**.
Revenues should be recognized when (1) realized or realizable and (2) earned. The most common time at which these two conditions are met is when goods are delivered or services are rendered. In the situation presented, the performance of the service (monthly spraying) is so significant to creating a sufficient probability of a flow of future economic benefits that it should be the triggering event for revenue recognition.

C. At the end of the contract year after all of the services have been performed.

D. At the end of the fiscal year.

Question: 119

On February 1, Year 1, a computer software firm agrees to program a software package. Twelve payments of $10,000 on the first of each month are to be made, with the first payment March 1, Year 1. The software is accepted by the client June 1, Year 2. How much Year 1 revenue should be recognized?

A. $0

Answer (A) is **correct**.
Revenues should be recognized when (1) realized or realizable and (2) earned. Because the software firm has not substantially fulfilled its obligation, the earning process has not been substantially completed in

Year 1. Accordingly, a liability should be recognized because the entity has a current obligation arising from a past event that will require an outflow of economic benefits, that is, to deliver the software or to refund the customer's money. Thus, a liability for $100,000 and revenue of $0 should be recognized for Year 1.

B. $100,000

C. $110,000

D. $120,000

Question: 120 An airline should recognize revenue from airline tickets in the period when

A. Passenger reservations are booked.

B. Passenger reservations are confirmed.

C. Tickets are issued.

D. Related flights occur.

Answer (D) is **correct**.
Revenues should be recognized when (1) realized or realizable and (2) earned. Although the benefits of the service rendered are reliably measurable on the date the reservations are booked, the earning process is not substantially completed until the airline has fulfilled its obligation, that is, when the related flights occur.

Question: 121 A department store sells gift certificates that may be redeemed for merchandise. Each certificate expires 3 years after issuance. The revenue from the gift certificates should be recognized

A. Evenly over 3 years from the date of issuance.

B. In the period the certificates are sold.

C. In the period the certificates expire.

D. In the period the certificates are redeemed or in the period they expire if they are allowed to lapse.

Answer (D) is **correct**.
Revenues should be recognized when (1) realized or realizable and (2) earned. These criteria are met when the certificates are redeemed or expire.

Question: 122 To comply with the matching principle, the cost of labor services of an employee who participates in the manufacturing of a product normally should be charged to the income statement in the period in which the

A. Work is performed.

B. Employee is paid.

C. Product is completed.

D. Product is sold.

Answer (D) is **correct**.
The matching principle states that expenses should be recognized in the same period as the revenues that those expenses helped produce. Revenues related to the employee's labor are not recognized until the goods are sold.

Question: 123 Revenues of an entity are usually measured by the exchange values of the assets or liabilities involved. Recognition of revenue does **not** occur until

A. The revenue is realizable.

B. The revenue is realized and earned.

Answer (B) is **correct**.
According to the FASB's conceptual framework, revenues should be recognized when they are realized or realizable and earned. Revenues are realized when products, merchandise, or other assets are exchanged for cash or claims to cash. Revenues are realizable when related assets received or held are readily convertible to known amounts of cash or claims to cash. Revenues are earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues.

C. Products or services are exchanged for cash or claims to cash.

D. The entity has substantially accomplished what it agreed to do.

Question: 124 Robin Gavaskar, who recently founded a company that produces baseball bats and balls, wants to determine her company's policy for revenue recognition. According to the revenue recognition principle, the **most**appropriate time to recognize revenue would be when

A. The sale occurs.

Answer (A) is **correct**.
Revenues are normally recognized when they are realized or realizable and earned. Revenues are realized (or realizable) when goods or services have been exchanged for cash or claims to cash (assets readily convertible to cash). Revenues are earned when the earning process is substantially complete, and the entity is entitled to the resulting benefits or revenues. The revenue recognition criteria are ordinarily met at the point of sale (time of delivery of goods or services).

B. Cash is received.

C. Production is completed.

D. Quarterly financial statements are prepared.

Question: 125 For financial statement purposes, the installment method of accounting may be used if the

A. Collection period extends over more than 12 months.

B. Installments are due in different years.

C. Ultimate amount collectible is indeterminate.

Answer (C) is **correct**.
Profits from sales in the ordinary course of business usually should be recognized at the time of sale unless collection of the sales price is not reasonably assured. When receivables are collected over an extended period and, because of the terms of the transaction or other conditions, no reasonable basis exists for estimating the degree of collectibility, the installment method or the cost-recovery method of accounting may be used.

D. Percentage-of-completion method is inappropriate.

Question: 126 It is proper to recognize revenue prior to the sale of merchandise when

I. The revenue will be reported as an installment sale.

II. The revenue will be reported under the cost-recovery method.

A. I only.
B. II only.
C. Both I and II.
D. Neither I nor II.

Answer (D) is **correct**.
The installment method recognizes income on a sale as the related receivable is collected. Under the cost-recovery method, profit is recognized only after collections exceed the cost of the item sold.

Question: 127 Several of Fox, Inc.'s customers are having cash flow problems. Information pertaining to these customers for the years ended March 31, Year 7 and Year 8 follows:

	3/31/Yr 7	3/31/Yr 8
Sales	$10,000	$15,000
Cost of sales	8,000	9,000
Cash collections		
on Year 7 sales	7,000	3,000
on Year 8 sales	--	12,000

If the cost-recovery method is used, what amount would Fox report as gross profit from sales to these customers for the year ended March 31, Year 8?

A. $2,000
B. $3,000
C. $5,000

Answer (C) is **correct**.
The cost-recovery method recognizes profit only after collections exceed

the cost of the item sold, that is, when the full cost has been recovered. Subsequent amounts collected are treated entirely as revenue (debit cash and deferred gross profit, credit the receivable and realized gross profit). The sum of collections in excess of costs to be recognized as gross profit is $5,000 {[$3,000 Year 8 collections on Year 7 sales – ($8,000 cost – $7,000 Year 7 collections on Year 7 sales)] + ($12,000 collections on Year 8 sales – $9,000 cost)}.

D. $15,000

Question: 128

Paulson Company uses the percentage-of-completion method to account for long-term construction contracts. The following information relates to a contract that was awarded at a price of $700,000. The estimated costs were $500,000, and the contract duration was 3 years.

	Year 1	Year 2	Year 3
Cumulative cost to date	$300,000	$390,000	$530,000
Costs to complete at year end	250,000	130,000	--
Progress billings	325,000	220,000	155,000
Collections on account	300,000	200,000	200,000

Assuming that $65,000 was recognized as gross profit in Year 1, the amount of gross profit Paulson recognized in Year 2 was

A. $35,000

B. $70,000

Answer (B) is **correct**.
Determining the annual recognized gross profit requires calculation of the estimated total gross profit.

	Year 1	Year 2
Contract price	$700,000	$700,000
Minus: estimated total costs		
Costs to date	$300,000	$390,000
Estimated costs to complete	250,000	130,000
Estimated total costs	$550,000	$520,000
Estimated total gross profit	$150,000	$180,000

The completion percentage for Year 2 is the ratio of costs incurred to date to estimated total costs ($390,000 ÷ $520,000 = 75%). The cumulative gross profit recognized at the end of Year 2 is therefore $135,000 ($180,000 × 75%). Because $65,000 was recognized in Year 1, the amount recognized in Year 2 is $70,000 ($135,000 – $65,000).

C. $135,000
D. $170,000

Question: 129

The calculation of the income recognized in the third year of a 5-year construction contract accounted for using the percentage-of-completion method includes the ratio of

A. Costs incurred in Year 3 to total billings.
B. Costs incurred in Year 3 to total estimated costs.
C. Total costs incurred to date to total billings.
D. Total costs incurred to date to total estimated costs.

Answer (D) is **correct**.
The percentage-of-completion method recognizes gross profit or revenue based on the ratio of costs to date to estimated total costs. (This relationship is the recommended but not the only basis for determining progress.)

Question: 130

A company appropriately uses the completed-contract method to account for a long-term construction contract. Revenue is recognized when progress billings are

	Recorded	Collected
A.	No	Yes
B.	Yes	Yes
C.	Yes	No
D.	No	No

Answer (D) is **correct**.
GAAP require that revenue be recognized when it is realized or realizable and earned. Under the completed-contract method, revenue recognition is appropriate only at the completion of the contract. Neither the recording nor the collection of progress billings affects this recognition.

Question: 131

A building contractor has a fixed-price contract to construct a large building. It is estimated that the building will take 2 years to complete. Progress billings will be sent to the customer at quarterly intervals. Which of the following describes the preferable point for revenue recognition for this contract if the outcome of the contract can be estimated reliably?

A. After the contract is signed.
B. As progress is made toward completion of the contract.

Answer (B) is **correct**.
Under the percentage-of-completion method, revenues and expenses are recognized based on the stage of completion at the balance sheet date if the outcome of the contract can be estimated reliably. For a fixed-price contract, the outcome can be estimated reliably if (1) total revenue can be measured reliably, (2) it is probable that the economic benefits of the

contract will flow to the enterprise, (3) contract costs to complete and stage of completion can be measured reliably, and (4) contract costs can be clearly identified and measured reliably so that actual and estimated costs can be compared.

C. As cash is received.

D. When the contract is completed.

Question: 132 How should the balances of progress billings and construction in progress be shown at reporting dates prior to the completion of a long-term contract?

A. Progress billings as deferred income, construction in progress as a deferred expense.

B. Progress billings as income, construction in progress as inventory.

C. Net, as a current asset if debit balance and current liability if credit balance.

Answer (C) is **correct**.
The difference between construction in progress (costs and recognized gross profit) and progress billings to date must be reported as a current asset if construction in progress exceeds total billings, and as a current liability if billings exceed construction in progress. Separate recognition is required for each project.

D. Net, as gross profit from construction if credit balance, and loss from construction if debit balance.

Question: 133 During Year 1, Tidal Co. began construction on a project scheduled for completion in Year 3. At December 31, Year 1, an overall loss was anticipated at contract completion. What would be the effect of the project on Year 1 operating income under the percentage-of-completion method and the completed-contract method?

	Percentage-of-Completion	Completed-Contract
A.	No effect	No effect
B.	No effect	Decrease
C.	Decrease	No effect
D.	Decrease	Decrease

Answer (D) is **correct**.
When the current estimate of total contract costs indicates a loss, an immediate provision for the entire loss should be made regardless of method. Thus, under either method, Year 1 operating income is decreased by the projected loss.

Question: 134

A company began work on a long-term construction contract in Year 1. The contract price was $3,000,000. Year-end information related to the contract is as follows:

	Year 1	Year 2	Year 3
Estimated total cost	$2,000,000	$2,000,000	$2,000,000
Cost incurred	700,000	900,000	400,000
Billings	800,000	1,200,000	1,000,000
Collections	600,000	1,200,000	1,200,000

Under the percentage-of-completion method, the gross profit to be recognized in Year 1 is

A. $(100,000)

B. $100,000

C. $200,000

D. $350,000

Answer (D) is **correct**.

The percentage-of-completion method recognizes revenue based on the stage of completion of the contract. One typical method for estimating the stage of completion is the calculation of ratio of the contract costs incurred to date to the estimated total costs. The percentage-of-completion at year-end on the cost-to-cost basis is 35% ($700,000 ÷ $2,000,000). The gross profit for Year 1 is the anticipated gross profit on the contract times the completion percentage. Thus, profit for Year 1 is $350,000 [($3,000,000 – $2,000,000) × 35%].