

# Test Bank for Financial Reporting for Managers A Value Creation Perspective 1st Edition by Pratt and Hirst

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## MULTIPLE CHOICE QUESTIONS

1. The balance sheet communicates
- proof to the investor that the company is profitable.
  - assets, liabilities, and shareholders' equity with all transactions reflected through the year.
  - assets, liabilities, and shareholders' equity as of a certain date.
  - operating, investing, and financing activities.

**Ans: C**

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

2. The income statement communicates
- assets, liabilities, and shareholders' equity as of a certain date.
  - how much cash the owner received during the period.
  - information about dividends the company paid to its owners.
  - revenues less expenses during a period of time.

**Ans: D**

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

3. Who prepares financial reports for a particular company?
- The Securities and Exchange Commission
  - The Board of Directors
  - The company's management
  - The company's auditors

**Ans: C**

KP 5 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

4. To run a company effectively, which one of the following might be a source from which management might acquire capital?

- a. Customers
- b. FASB
- c. Debt and equity investors
- d. Auditors

**Ans: C**

5. A Certified Public Accountant
- a. reviews every transaction that a company conducts during any given year.
  - b. performs a company's audit.
  - c. is one of the investors of a company.
  - d. is responsible for the preparation and integrity of a company's financial statements.

**Ans: B**

KP 2 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

6. Where would you find information on the amount of net income for the year?
- a. Factory production reports on units produced
  - b. Auditor's report
  - c. Income statement
  - d. Internal Revenue Service

**Ans: C**

KP 3 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

7. The statement of cash flows communicates
- a. assets, liabilities, and owners' equity at a point of time.
  - b. operating, investing, and financing activities.
  - c. beginning balance plus income less dividends.
  - d. how much cash the company owes its employees.

**Ans: B**

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

8. An investor wants to find the amount of cash and land that a company has. Where will the investor look?
- a. Statement of shareholders' equity
  - b. Income statement
  - c. Balance sheet
  - d. Statement of cash flows

**Ans: C**

KP 3 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

9. Cash received by a company from its regular operations during the year is found in its
- a. balance sheet.
  - b. statement of cash flows.
  - c. statement of shareholders' equity.
  - d. auditor's report.

**Ans: B**

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic

10. A company's profits during its most recent year are found in its
- balance sheet and income statement.
  - statement of cash flows only.
  - statement of shareholders' equity only.
  - income statement and statement of shareholders' equity.

**Ans: D**

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

11. The cash paid during the year to satisfy a company's debt is found in its
- statement of cash flows.
  - income statement.
  - statement of shareholders' equity.
  - auditor's report.

**Ans: A**

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

12. The amount which a company's customers owe the company for products delivered or services rendered is found in the
- footnotes only.
  - income statement.
  - balance sheet.
  - statement of cash flows.

**Ans: C**

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

13. Retained earnings may be described as
- the total past profits retained in the business.
  - a company's future growth.
  - the amount invested in the firm by its owners.
  - amounts retained for payments to vendors.

**Ans: A**

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

14. Liabilities may be described as
- amounts that will be used for future growth.
  - the amounts owed that must be paid in the future.
  - the total measured past growth of a firm less the amount distributed to the owners.
  - amounts the company paid during the past year.

**Ans: B**

KP 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

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15. Public stock exchanges
- are operated by managers of a company.
  - are markets that sell annual reports.
  - provide a forum for buying and selling of equity interests in other companies.
  - are used to evaluate debt and equity investments.

**Ans: C**

KP 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

16. A statement that “the financial statements were prepared in accordance with generally accepted accounting principles” is found in the
- collateral.
  - stock market.
  - footnotes to the balance sheet.
  - auditor’s report.

**Ans: D**

KP 2 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

17. CPA is an abbreviation for
- Certified Public Accountant.
  - Certified Production Accountant.
  - Consumer Protection Agency.
  - Certified Permissible Accounting.

**Ans: A**

KP 2 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

18. An equity investor is
- a person who provides money to a company with the expectation that it will be paid back with interest.
  - a creditor that has a regular trade relationship.
  - a person who provides money to a company as a gift with a stipulation that it will be used as agreed.
  - a person who provides money to a company, though the original money never has to be repaid, and who may be entitled to receive periodic cash payments.

**Ans: D**

KP 4 BT: K Difficulty: Moderate TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

19. An explanation about the assumptions, estimates, and choices of alternative accounting methods used in the financial statements is found in the
- footnotes to the balance sheet.
  - auditor’s report.
  - statement of shareholders’ equity.
  - president’s letter to the shareholders.

**Ans: A**

KP 2 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

20. A debt investor is
- a person who provides money to a company with the expectation that it will be paid back with interest.
  - a person who provides money to a company and expects periodic cash payments in return, though the original money never has to be repaid.
  - a person who provides money to a company as a gift with a stipulation that it will be used as agreed.
  - often referred to as a stockholder.

**Ans: A**

KP 4 BT: K Difficulty: Moderate TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

21. The board of directors
- provides money to a company with the expectation that it will be paid back with interest.
  - makes corporate decisions such as hiring and firing management and setting company policy.
  - is responsible for the future profits of a company.
  - is in charge of accounting and human resources on a daily basis.

**Ans: B**

KP 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

22. As a potential creditor, you are interested in a company's ability to pay loan interest and principal as they come due. Which of the following would be of the greatest interest to you in your analysis?
- statement of shareholders' equity.
  - income statement.
  - statement of cash flows.
  - Statement of Financial Accounting Standards.

**Ans: C**

KP 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

23. A bank that loans money to a company is called
- a supplier.
  - a creditor.
  - an equity investor.
  - a shareholder.

**Ans: B**

KP 1 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

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24. Which one of the following is an equity investor?
- A supplier of inventory waiting for payment
  - A person who purchases common stock of a corporation
  - A bank that loans money to a firm
  - A person who has a savings account in a bank
  - An employee that plans on investing in the company 10 years from now

**Ans: B**

KP 4 BT: K Difficulty: Moderate TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

25. As used in accounting, SEC is an abbreviation for
- Securities and Exchange Commission.
  - South Eccentric Commissioners.
  - Shareholders' Equity Commission.
  - Southeastern Conference.

**Ans: A**

KP 5 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

26. The independence of the auditor is subject to question when the
- auditor is paid by the management of the company being audited.
  - auditor is independent.
  - audit firm is also responsible for preparing the tax return.
  - auditor is paid 1% of the company's profits for the audit services provided.

**Ans: D**

KP 5 BT: K Difficulty: Moderate TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

27. The advantage to the user of financial accounting statements that are audited by independent certified public accountants is assurance that the
- statements are produced in accordance with generally accepted accounting principles.
  - company will be solvent for at least one more year.
  - company cannot remain profitable for more than 2 to 3 years.
  - company pays its fair share of income taxes.

**Ans: A**

KP 5 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

28. GAAP is an acronym for
- General Asset Accounting Procedures.
  - Government Agency Accounting Procedures.
  - Generally Accepted Accounting Principles.
  - Global Accounting Activity Principles.

**Ans: C**

KP 5 BT: K Difficulty: Easy TOT: 1 min.

AACSB: Analytic

29. Debt investments
- require payments to the shareholders for periodic dividends.
  - are found on a company's income statement.
  - may be secured with collateral.
  - return payments at the discretion of the board of directors.

**Ans: C**

KP 4 BT: K Difficulty: Easy TOT: 1 min.

AACSB: Analytic

AICPA BB: Critical Thinking AICPA FN: Reporting

30. Annual reports of public companies
- are published once per year.
  - include financial statements adjusted for inflation.
  - are also known as Form 10-K.
  - are published by companies 4 times per year.

**Ans: A**

KP 4 BT: K Difficulty: Easy TOT: 1 min.

AACSB: Analytic

AICPA BB: Critical Thinking AICPA FN: Reporting

31. Equity investments are bought and sold
- only on the first day of each year.
  - in stock exchanges such as the NASDAQ.
  - by a company's independent auditors.
  - from and to the SEC.

**Ans: B**

KP 4 BT: K Difficulty: Easy TOT: 1 min.

AACSB: Analytic

AICPA BB: Critical Thinking AICPA FN: Reporting

32. Generally accepted accounting principles are determined by
- annual voting by all certified public accountants.
  - a privately financed body known as the FASB.
  - the SEC.
  - a congressional committee that passes laws governing accounting practice.

**Ans: B**

KP 5 BT: K Difficulty: Moderate TOT: 1 min.

AACSB: Analytic

AICPA BB: Critical Thinking AICPA FN: Reporting

33. Shareholders
- and employees are the owners of a company.
  - receive repayment of the cash they have invested in a business.
  - receive payment from a company regardless if the company is profitable or not.
  - may benefit from increases in the value of their investment of a company.

**Ans: D**

34. Generally accepted accounting principles
- are laws created and enacted by Congress.
  - define the standards for internal management reporting.
  - increase the level of credibility in financial statements.
  - are created by the Securities and Exchange Commission.

**Ans: C**

KP 5 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

35. Financial accounting practices and standards used in other countries
- are the same as practices used by United States companies.
  - have different systems of financial accounting.
  - are more progressive than those used by United States companies.
  - will often have common practices similar to U.S. GAAP.

**Ans: D**

KP 6 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

36. International Financial Reporting Standards (IFRS) are recognized as acceptable by major stock exchanges throughout the world except in
- England.
  - Japan.
  - The United States.
  - France.

**Ans: C**

KP 6 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

37. International Financial Reporting Standards (IFRS) are promulgated by
- the United Nations.
  - the World Bank.
  - the Big Four accounting firms.
  - the IASB.

**Ans: D**

KP 6 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

38. The auditors are charged with responsibility
- to detect financial fraud committed by employees during the course of their audit
  - to conduct a thorough and independent audit
  - to correct all errors in the financial statements
  - for the accuracy and completeness of the financial statements

**Ans: B**

KP 1 BT: K Difficulty: Moderate TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting



39. All of the following might be found in the auditor's report except:
- A statement about conformity with GAAP.
  - A statement about the fair presentation of the financial conditions and operations of the audited company.
  - A statement about the effectiveness of the company's internal control system.
  - A statement about the function of the company's board of directors.

**Ans: D**

KP 3 BT: K Difficulty: Moderate TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

40. Which of the following best describes assets paid to owners of a company as a return for their initial investment?
- payables
  - compensation contracts
  - dividends
  - interest

**Ans: C**

KP 2 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

41. Which of the following statements is true?
- Dividend payments are determined by management.
  - Dividend payments are specified by a contract.
  - Dividend payments are based on company collateral.
  - Dividend payments are paid at the board of director's discretion.

**Ans: D**

KP 4 BT: K Difficulty: Moderate TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

42. All of the following are functions of the board of directors except:
- Attending quarterly meetings.
  - Conducting performance review for management.
  - Declaring dividends.
  - Firing staff personnel.

**Ans: D**

KP 5 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

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43. Which of the following is a measure of past profits that have been retained in a business?
- a. liabilities
  - b. common stock.
  - c. retained earnings.
  - d. assets

Ans: C

KP 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

44. Which of the following factors is least likely to encourage managers and auditors to act professionally?
- a. professional reputation.
  - b. tax structure
  - c. legal liability
  - d. ethics

**Ans: B**

KP 5 BT: C Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

45. Ownership of an equity security entitles the holder to which basic right?
- a. The right to management outstanding loans.
  - b. The right to pay dividends.
  - c. The right to vote for company directors at the annual shareholders' meeting.
  - d. The right to certify financial report reviews.

**Ans: C**

KP 4 BT: K Difficulty: Moderate TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

46. Which of the following is a public exchange for equity and debt securities?
- a. The Federal Trade Commission.
  - b. The New York Stock Exchange.
  - c. The Securities and Exchange Commission.
  - d. The Financial Accounting Standards Board.

**Ans: B**

KP 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

47. Which of the following groups make up a company's audit committee?
- a. Auditors.
  - b. Outside directors from the Board.
  - c. Company officers.
  - d. All of the individuals in (a), (b), and (c) are included in the audit committee.

**Ans: B**

48. Which of the following groups enacted the Sarbanes Oxley Act?
- a. FASB
  - b. AICPA
  - c. U.S. Congress
  - d. PCAOB

**Ans: C**

KP 5 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

49. All of the following are false regarding international accounting standards (IAS) except which of the following?
- a. The SEC requires all companies to use IAS.
  - b. There are no substantive differences between U.S. GAAP and IFRS.
  - c. The SEC prohibits U.S. stock exchanges from listing non-U.S. companies who follow IFRS.
  - d. All public companies in the European Union are required to report using IFRS and IAS.

**Ans: D**

KP 6 BT: K Difficulty: Moderate TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

## MATCHING QUESTIONS

1. Identify which of the users of financial statement information listed in A through E would most likely desire and/or benefit from the economic aspects listed in items 1 through 5 below. You may use each letter more than once or not at all.

<b>Users</b>
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- A. bankers
- B. potential investors
- C. government agencies
- D. customers
- E. managers

- \_\_\_\_\_ 1. Want to choose a company to earn returns potentially higher than fixed income instruments
- \_\_\_\_\_ 2. Need to predict future cash flows necessary for repayment
- \_\_\_\_\_ 3. Want to determine how much tax a company must pay
- \_\_\_\_\_ 4. Want the best product possible for the money
- \_\_\_\_\_ 5. Want to maintain a level of compensation

Solution:

- 1. B
- 2. A
- 3. C
- 4. D
- 5. E

KP 1,2,4 BT: C Difficulty: Easy TOT: 2 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

2. For each description listed in items 1 through 4 below, select the letter of the accounting term (A through F) it best describes. You may use each letter more than once.

<b>Accounting Terms</b>
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- A. Asset
- B. Liability
- C. Retained earnings
- D. Revenue
- E. Expenses
- F. Equity investment

- \_\_\_\_\_ 1. Total measured past growth less the amount distributed to owners
- \_\_\_\_\_ 2. A measure of assets generated from the products and services sold
- \_\_\_\_\_ 3. Owed and must be paid in the future
- \_\_\_\_\_ 4. Amount invested in the firm by its owners

Solution:

- 1. C
- 2. D
- 3. B
- 4. F

KP 2 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

3. Identify which accounting document(s) listed in A through D would always provide the information indicated in items 1 through 5 below. You may use each letter more than once or not at all. Some items may require more than one answer.

**Accounting Documents**

- A. Auditor's report
- B. Management letter
- C. Financial statements
- D. Footnotes

- \_\_\_\_\_ 1. Represents that the financial statements are stated fairly, in all material respects
- \_\_\_\_\_ 2. Indicates that financial statements were prepared in conformity with GAAP
- \_\_\_\_\_ 3. Contains assets, liabilities, and equity, as well as income from operations
- \_\_\_\_\_ 4. Explains certain items on the balance sheet
- \_\_\_\_\_ 5. An acceptance of responsibility of financial information provided

Solution:

- 1. A
- 2. A, B, D
- 3. C
- 4. D
- 5. B

KP 2,3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

**SHORT ANSWER QUESTIONS**

1. Which financial statement would you review to determine the amount of cash a company received from an issue of capital stock during the year?

Solution: statement of cash flows

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

2. Which financial statement would you review to determine a company's interest expense?

Solution: income statement

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

3. What independent party attests that the balance sheet and income statement present fairly the financial position of the company?

Solution: auditor

KP 2 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

4. Identify the financial statement in which revenues less expenses are reported.

Solution: income statement

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

5. What financial statement communicates profits retained and distributions to shareholders?

Solution: statement of shareholders' equity

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

6. What financial statement communicates cash flows from operating activities?

Solution: statement of cash flows

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

7. What financial statement lists and measures assets, liabilities, and shareholders' equity at a certain date?

Solution: balance sheet

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

8. What financial statement shows where the money came from and where it went?

Solution: statement of cash flows

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

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- 9.** Identify which financial statement you would review to determine the amount of cash a company paid to retire its debt.

Solution: statement of cash flows

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

- 10.** Which source would you review to determine that the financial statements are fairly stated in accordance with GAAP?

Solution: auditor's report

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

- 11.** Which financial statement would you review to determine if a company's operating cash flow is sufficient to pay day-to-day obligations?

Solution: statement of cash flows

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

- 12.** Which financial statement would best help you understand the increases and decreases in cash over a period of time?

Solution: statement of cash flows

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

- 13.** What financial statement would you review to determine if a company's payroll exceeds \$1,000,000?

Solution: income statement

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

- 14.** What financial statement would you review to determine profitability?

Solution: income statement

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting



- 15.** What financial statement would you review to determine whether or not dividends were distributed during the year?

Solution: statement of shareholders' equity

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

- 16.** On which financial statement would you find the amount invested by a company's owners? What is the name of this amount?

Solution: balance sheet; equity investment (stock), also statement of shareholders' equity

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

- 17.** On which financial statement(s) would you find the accumulation of total profits and losses less distributions to owners since the company began operations? What is the name of this amount?

Solution: balance sheet and statement of shareholders' equity; retained earnings

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

- 18.** What accounting name is given to one who provides money to a company with the expectation that it will be paid back with interest?

Solution: debt investor or creditor

KP 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

- 19.** What is the name of a person who provides money to a company who never has to be paid back but expects periodic cash payments?

Solution: equity investor or owner

KP 4 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

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**20.** Identify the responsibilities of the board of directors.

Solution: Sets company policies; declares dividends; sets management compensation; hires and fires management; appoints the audit committee

KP 4 BT: K Difficulty: Easy TOT: 2 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

**21.** Who assesses whether the financial statements fairly represent the financial position and results of operations?

Solution: independent auditor

KP 2 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

**22.** List the names of the financial statements that appear in an annual report.

Solution: balance sheet, income statement, statement of cash flows, statement of shareholders' equity

KP 3 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

<b>SHORT PROBLEMS</b>
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1. Sampson Company has \$500 in its checking account. A customer owes Sampson \$1,000. The company has store equipment that cost \$1,500 and a truck that cost \$5,000. Sampson Company owes the bank \$3,500 on the truck loan of which one payment of \$700 is due in one week, and owes \$4,000 to creditors for its monthly operating expenses, including rent, all of which is due in the next 30 days.
- A. List Sampson Company's assets and the dollar amount of each.
- B. List Sampson Company's liabilities and the dollar amount of each.

Solution:

A.

ASSETS

Cash	\$ 500
Accounts receivable	1,000
Truck	5,000
Store equipment	1,500
Total	<u>\$8,000</u>

B.

LIABILITIES

Note payable (truck loan)	\$3,500
Accounts payable	4,000
Total	<u>\$7,500</u>

KP 3 BT: AN Difficulty: Moderate TOT: 7 min. AACSB: Analytic  
 AICPA BB: Critical Thinking AICPA FN: Reporting

2. Connan, Inc. reported the following activities for the year:  
Borrowed \$300,000 from the bank to be repaid in 5 years  
Issued stock to investors for \$35,000 cash  
Paid dividends to shareholders totaling \$10,000  
Purchased equipment by promising to pay \$145,000 to a creditor over the next 3 years

- A. Identify which activities are debt investments.  
B. Identify which activities are equity investments.

Solution:

A. Debt investments: Borrowed \$300,000 from the bank to be repaid in 5 years  
Promising to pay \$145,000 to a creditor over the next 3 years

B. Equity investments: Issued stock to investors for \$35,000 cash

KP 4 BT: AN Difficulty: Moderate TOT: 3 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

3. Sonnan Company showed profits for the last two years totaling \$115,000 and \$250,000, respectively. Sonnan Company paid a total of \$94,000 to its owners over the two-year period.

How much remains in Sonnan Company as retained earnings at the end of the second year of business?

Solution:

Total profits (\$115,000 + \$250,000)	\$365,000
Distributions to owners	( 94,000)
	<u>\$271,000</u>

KP 3 BT: AN Difficulty: Moderate TOT: 3 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

**SHORT ESSAY QUESTIONS**

1. What is the role of the Securities and Exchange Commission?

Solution:

The Securities and Exchange Commission is an agency of the federal government that was commissioned to implement and enforce the Securities Act of 1933 and the Securities Exchange Act of 1934.

KP 5 BT: K Difficulty: Easy TOT: 1 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

2. Veronica Ingram is the CEO of a small corporation whose stock is traded on public stock exchange. She has been concerned with the high cost of producing and distributing annual financial statements. She has proposed that the corporation stop producing these financial reports which would save the company \$240,000 annually. Briefly explain to Ms. Ingram why her proposal cannot be adopted.

Solution:

Although the \$240,000 savings is significant, failure to comply with the Securities Exchange Act of 1934 is a violation of regulatory practices for publicly held companies. This Act requires companies with equity securities that are listed on public security markets to (1) annually file a Form 10-K (audited financial reports), (2) quarterly 10-Qs (unaudited quarterly financial statements) and (3) annually provide audited financial reports to the shareholders. Violations lead to being barred from public trading.

KP 1 BT: AP Difficulty: Moderate TOT: 3 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

3. Describe the three components of the statement of cash flows.

Solution:

The three components of the statement of cash flows are operating, investing, and financing activities. Operating activities are associated with the actual products and services provided by a company. Investing activities include the purchase and sale of assets, such as equipment and land. Financing activities refer to the collections and payments related to a company's capital resources, such as cash borrowings, loan payments, cash from owners, and payment of dividends to owners.

KP 3 BT: K Difficulty: Easy TOT: 4 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

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4. The Sarbanes-Oxley Act was passed by Congress in 2002 in response to a series of financial and accounting scandals. The purpose of the Act was to bolster corporate governance and restore confidence in the financial reporting system. Describe one of the new things that the management of a US public corporation is required to do under this act.

Solution:

certification of that the financial statements have been reviewed by the CEO and CFO, or  
file an annual report on internal controls over financial reporting, or  
additional responsibilities to ensure that adequate internal controls and in place, or  
provide reasonable assurance that financial records are complete and accurate.

KP 5 BT: K Difficulty: Moderate TOT: 4 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

5. Frank Fontana, chief operating officer for Star Master Corporation, has discovered that two separate and distinct sets of financial statements are being provided—one to the Internal Revenue Service and the other to its shareholders. He objected to this policy and is insisting that one set of financial statements be provided to all interested parties. Provide examples of the needs of the two parties.

Solution:

Although one might initially react favorably to Frank's proposal of one set of financial statements for all users, it would be impossible. Various rules for determining income and financial position are specified by each user. These rules reflect different uses of accounting information. The IRS raises money to support government operations and has codified rules designed to accomplish this task. The public information provided to shareholders and other outside parties is governed by generally accepted accounting principles that are designed to provide the general users with information required for investment decisions.

KP 5 BT: AP Difficulty: Moderate TOT: 4 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

6. Describe the two components of the income statement.

Solution:

The two components of the income statement are revenues and expenses, the difference of which represents net income or loss for a period of time. Revenues are a measure of the assets generated from the products sold and services provided. Expenses are a measure of the asset outflows or costs associated with selling the products and providing the services.

KP 3 BT: K Difficulty: Easy TOT: 2 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

**7.** Why must managers understand financial reporting?

Solution:

Managers often use financial statements to assess the financial condition and performance of their own company, its competitors, and other companies of which investments in stocks and bonds of other companies might be undertaken. Managers must understand how business decisions affect the financial statements and how capital providers and other outsiders use financial statements to evaluate and control their actions.

KP 1 BT: C Difficulty: Moderate TOT: 2 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

**8.** What powers does the Securities and Exchange Commission have?

Solution:

The Securities and Exchange Commission has the power to prescribe the accounting practices and standards to be employed by companies within its jurisdiction—public companies. However, the SEC has chosen to delegate the responsibility for establishing accounting practices and standards to the Financial Accounting Standards Board (FASB). The SEC also is responsible for ensuring that listed companies prepare and file registration statements before they issue new securities, and file periodic quarterly and annual reports.

KP 5 BT: K Difficulty: Moderate TOT: 3 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting

**9.** What are the two fundamental economic reasons why investors and creditors demand financial accounting information?

Solution:

Creditors need financial information to monitor and enforce the debt and compensation contracts written with management, and investors need financial information to help decide where to invest their funds.

KP 1 BT: K Difficulty: Moderate TOT: 2 min. AACSB: Analytic  
AICPA BB: Critical Thinking AICPA FN: Reporting