**CHAPTER 1**

**OVERVIEW OF CORPORATE FINANCIAL REPORTING**

### SUMMARY OF QUESTION TYPES BY LEARNING OBJECTIVE AND LEVEL OF DIFFICULTY

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Item** | **LO** | **LOD** | **Item** | **LO** | **LOD** | **Item** | **LO** | **LOD** | **Item** | **LO** | **LOD** | **Item** | **LO** | **LOD** |
| **True-False Statements** |
| 1. | 1 | M | 7. | 4 | E | 13. | 5 | E | 19. | 5 | E | 25. | 5 | E |
| 2. | 1 | E | 8. | 4 | M | 14. | 5 | E | 20. | 5 | E | 26. | 5 | M |
| 3. | 1,5 | M | 9. | 4 | M | 15. | 5 | M | 21. | 5 | M | 27. | 5 | M |
| 4. | 2 | E | 10. | 4 | M | 16. | 5 | E | 22. | 5 | E | 28. | 5 | E |
| 5. | 2 | E | 11. | 4 | E | 17. | 5 | E | 23. | 5 | E | 29. | 5 | E |
| 6. | 2 | E | 12. | 5 | E | 18. | 5 | E | 24. | 5 | M | 30. | 5 | M |
| **Multiple Choice Questions** |
| 31. | 1 | M | 41. | 3 | M | 51. | 4 | M | 61. | 5 | M | 71. | 5 | M |
| 32. | 2 | E | 42. | 4 | M | 52. | 4 | M | 62. | 5 | M | 72. | 5 | E |
| 33. | 2 | E | 43. | 4 | M | 53. | 5 | E | 63. | 5 | M | 73. | 5 | M |
| 34. | 2 | M | 44. | 4 | M | 54. | 5 | E | 64. | 5 | H | 74. | 5 | M |
| 35. | 2 | E | 45. | 4 | M | 55. | 5 | M | 65. | 5 | M | 75. | 5 | E |
| 36. | 3 | E | 46. | 4 | E | 56. | 5 | H | 66. | 5 | M | 76. | 5 | M |
| 37. | 3 | E | 47. | 4 | E | 57. | 5 | E | 67. | 5 | E | 77. | 5 | E |
| 38. | 3 | M | 48. | 4 | E | 58. | 5 | H | 68. | 5 | M |  |  |  |
| 39. | 3 | M | 49. | 4 | M | 59. | 5 | E | 69. | 5 | E |  |  |  |
| 40. | 3 | M | 50. | 4 | M | 60. | 5 | M | 70. | 5 | M |  |  |  |
| **Exercises** |
| 78. | 5 | E | 79. | 5 | M | 80. | 5 | M |  |  |  |  |  |  |
| **Matching** |
| 81. | 4 | M | 82. | 5 | M |  |  |  |  |  |  |  |  |  |
| **Short-Answer Essay** |
| 83. | 2 | M | 84. | 3 | H | 85. | 5 | M | 86. | 5 | H |  |  |  |
| **Essay** |
| 87. | 5 | H | 88. | 5 | H |  |  |  |  |  |  |  |  |  |

Note: E = Easy M = Medium H = Hard

### SUMMARY OF LEARNING OBJECTIVES BY QUESTION TYPE

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Item** | **Type** | **Item** | **Type** | **Item** | **Type** | **Item** | **Type** | **Item** | **Type** | **Item** | **Type** | **Item** | **Type** |
| **Learning Objective 1** |
| 1. | TF | 2. | TF | 3. | TF | 31. | MC |  |  |  |  |  |  |
| **Learning Objective 2** |
| 4. | TF | 6. | TF | 33. | MC | 35. | MC |  |  |  |  |  |  |
| 5. | TF | 32. | MC | 34. | MC | 83. | SAE |  |  |  |  |  |  |
| **Learning Objective 3** |
| 36. | MC | 37. | MC | 38. | MC | 39. | MC | 40. | MC | 41. | MC | 84. | SAE |
| **Learning Objective 4** |
| 7. | TF | 10. | TF | 43. | MC | 46. | MC | 49. | MC | 52. | MC |  |  |
| 8. | TF | 11. | TF | 44. | MC | 47. | MC | 50. | MC | 81. | Ma |  |  |
| 9. | TF | 42. | MC | 45. | MC | 48. | MC | 51. | MC |  |  |  |  |
| **Learning Objective 5** |
| 12. | TF | 20. | TF | 28. | TF | 58. | MC | 66. | MC | 74. | MC | 85. | SAE |
| 13. | TF | 21. | TF | 29. | TF | 59. | MC | 67. | MC | 75. | MC | 86. | SAE |
| 14. | TF | 22. | TF | 30. | TF | 60. | MC | 68. | MC | 76. | MC | 87. | Es |
| 15. | TF | 23. | TF | 53. | MC | 61. | MC | 69. | MC | 77. | MC | 88. | Es |
| 16. | TF | 24. | TF | 54. | MC | 62. | MC | 70. | MC | 78. | Ex |  |  |
| 17. | TF | 25. | TF | 55. | MC | 63. | MC | 71. | MC | 79. | Ex |  |  |
| 18. | TF | 26. | TF | 56. | MC | 64. | MC | 72. | MC | 80. | Ex |  |  |
| 19. | TF | 27. | TF | 57. | MC | 65. | MC | 73. | MC | 82. | Ma |  |  |

Note: TF = True-False Ex = Exercise SAE = Short-Answer Essay

 MC = Multiple Choice Ma = Matching Es = Essay

**CHAPTER LEARNING OBJECTIVES**

1. ***Define financial accounting and understand its relationship to economic decision-making.***

• Financial accounting is the process by which information on the transactions of an organization is captured, analyzed, and reported to external decision makers.

• These decision makers are referred to as *financial statement users* and include investors and creditors.

• The primary purpose of financial accounting information is to aid these users in making economic decisions related to the reporting organization, such as whether to invest in it or lend it money.

2. ***Identify the main users of financial accounting information and explain how they use this information.***

• The main users of financial accounting information include shareholders, the board of directors, potential investors, creditors (bankers and suppliers), regulators (stock exchanges), taxing authorities (governments), securities analysts, and others.

• Shareholders, the board of directors, and potential investors will use financial accounting information to enable them to assess how well management has run the company; determine whether they should buy, sell, or continue to hold shares in the company; assess the company’s share price relative to the financial accounting information; and so on.

• Creditors will use financial accounting information to determine whether they should lend funds to the company, establish credit terms for it, assess a company’s ability to meets its obligations, and so on.

• Regulators will use financial accounting information to determine whether a company has met its listing requirements.

• Taxing authorities will use this information in assessing the taxes owed by the organization.

3. ***Describe the major forms of business organization and explain the key distinctions between each form.***

• There are three major forms of business organization: (1) proprietorships, (2) partnerships, and (3) corporations.

• There are public corporations (whose shares trade on a public stock exchange and are widely held) and private corporations (whose shares do not trade on a public exchange and are generally owned by a small number of people).

• Corporations are separate legal entities, whereas proprietorships and partnerships are not. This means the personal assets of owners are protected in the event of legal action against corporations, whereas they are at risk in the case of proprietorships and partnerships. It also means corporations file separate tax returns, whereas the income from proprietorships and partnerships is reported on the personal tax returns of their owners.

4. ***Explain the three categories of business activities and identify examples of transactions related to each category.***

• The three categories of business activities are: (1) operating, (2) investing, and (3) financing activities.

• Operating activities are related to the company’s revenues and expenses, such as sales to customers, collections from customers, purchases of inventory, and payments of wages and other expenses.

• Investing activities include buying and selling property, plant, and equipment and buying and selling the shares of other companies.

• Financing activities include borrowing money, issuing shares, repaying loan principal, and paying dividends.

5. ***Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.***

• There are four basic financial statements: (1) the statement of income, (2) the statement of changes in equity, (3) the statement of financial position, and (4) the statement of cash flows.

• The objective of the statement of income is to measure the company’s operating performance (its profit) for a period of time. This is measured by subtracting the expenses incurred during the period from the income earned (revenues) in the same period.

• The objective of the statement of changes in equity is to provide details on how each component of shareholders’ equity changed during the period. The components of shareholders’ equity include share capital (the shares issued by the company) and retained earnings (the company’s earnings that have been kept and not distributed as dividends).

• The objective of the statement of financial position is to present information on a company’s assets, liabilities, and shareholders’ equity at a specific date. Assets must be controlled by the company and embody a future benefit. Examples include cash; accounts receivable; inventory; property, plant, and equipment; land; and so on. Liabilities are obligations of a company that will result in an outflow of resources. Examples include accounts payable, deferred revenue, long-term debt, and so on. Shareholders’ equity represents the shareholders’ interest in the assets of the company and is referred to as *net assets*. Examples include common shares and retained earnings.

• The objective of the statement of cash flows is to enable financial statement users to assess the company’s inflows and outflows of cash related to its operating, investing, and financial activities for a period of time.

• The notes to a company’s financial statements are used to provide additional detail and context for items in the financial statements. They enable the financial statements themselves to remain uncluttered, while increasing their usefulness.

**TRUE-FALSE STATEMENTS**

1. Decision makers are often referred to as users of the financial statements and include investors and creditors.

2. The primary purpose of financial accounting information is to aid users in their economic decision-making relative to the organization.

3. The section of an annual report that contains management’s discussion of the company’s operating results is referred to as the Statement of Management’s Responsibility.

4. The shareholders are an example of an internal user of annual report information.

5. Information contained in the financial statements of a company is of use to both internal and external users.

6. There may be a single shareholder in the case of a public company or many shareholders in the case of a private company.

7. A firm's activities can be divided into borrowing, investing, and operating.

8. If an investor owns 10% of the shares of a company, they normally own 10 shares of the company.

9. Dividends are payments made by the company to distribute future profits.

10. A gain or increase in the value of shares is known as capital appreciation.

11. Creditors are entities that lend money to a company rather than buying shares of a company.

12. The financial statements of a company are prepared by the shareholders.

13. Assets are listed in the order of their liquidity on the classified Statement of Financial Position.

14. Prepaid expenses can be found on the Statement of Income.

15. The statement of financial position measures cash inflows and outflows of a company over a period of time.

16. Profit is determined by subtracting the income earned during the period from the expenses incurred during the same period.

17. Income can also include gains that a company generates from sales that are outside their normal course of operations.

18. Expenses are defined as increases in economic benefits.

19. Gross profit is equal to the sales received from goods and the operating expenses incurred during the period.

20. Net earnings is the amount of the company’s revenue that remains after all of its expenses are accounted for.

21. Retained earnings is the earnings that have been kept and not paid out as dividends.

22. Liquidity refers to how long something will be received, realized, or consumed.

23. Canadian companies use a 12-month period to distinguish between items that are current from those that are non-current.

24. Working capital measures the company’s ability to meet its short-term obligations using its non-current assets.

25. Deferred revenue represents customer deposits.

26. Shareholders’ equity is often referred to as the net assets of the company.

27. Share capital records the amount that investors have received in the form of dividends.

28. Companies that are growing normally have negative cash flows from investing activities.

29. IFRS are the financial reporting standards that must be followed by Canadian public companies.

30. The MD&A provides a discussion of the risks facing the company and information about future plans.

#### ANSWERS TO TRUE-FALSE STATEMENTS

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** |
| 1. | T | 9. | F | 17. | T | 25. | T |
| 2. | T | 10. | T | 18. | F | 26. | T |
| 3. | F | 11. | T | 19. | F | 27. | F |
| 4. | F | 12. | F | 20. | T | 28. | T |
| 5. | T | 13. | T | 21. | T | 29. | T |
| 6. | F | 14. | F | 22. | F | 30. | T |
| 7. | F | 15. | F | 23. | T |  |  |
| 8. | F | 16. | F | 24. | F |  |  |

**MULTIPLE CHOICE QUESTIONS**

31. In which section of the annual report does management comment on the company and its operating results?

a) report to the shareholders

b) management's discussion and analysis

c) corporate profile

d) selected financial data

32. Which of the following is an internal user of annual report information?

a) creditors

b) board of directors

c) regulators

d) shareholders

33. The shareholders typically elect which of the following to represent their interests?

a) senior management

b) independent auditors

c) board of directors

d) chief operating officer

34. All of the following are external users EXCEPT

a) labour unions.

b) management.

c) regulators.

d) journalists.

35. Those who lend money or otherwise extend credit rather than invest it directly are known as

a) investors.

b) regulators.

c) creditors.

d) unions.

36. A corporation whose shares are held by a small number of individuals is referred to as a

a) proprietorship.

b) publicly traded corporation.

c) small business corporation.

d) privately held corporation.

37. Businesses can be operated in a number of different forms, such as a

a) corporation.

b) partnership.

c) proprietorship.

d) all of the above.

38. Which statement is INCORRECT in regards to the characteristics of a corporation?

a) It is a separate legal entity.

b) It can be sued.

c) Shareholders liability is limited to their investment.

d) It cannot be publicly accountable.

39. Which of the following statements best describes a proprietorship?

a) can be single or multiple owners

b) taxed separately

c) most expensive to establish

d) owner is responsible for debt of the company

40. Which of the following statements best describes a partnership?

a) separate legal entity

b) single owner

c) most expensive to establish

d) owners are responsible for debt of the company

41. Which of the following statements best describes a corporation?

a) can be single or multiple owners

b) taxed separately

c) most expensive to establish

d) all of the above

42. What is the initial investment by the shareholders in a company called?

a) owners’ capital

b) shareholders’ capital

c) retained earnings

d) shareholders’ equity

43. The fundamental types of business activities that a firm typically engages in include all of the following EXCEPT

a) operating.

b) borrowing.

c) investing.

d) financing.

44. Which of the following is an example of an operating activity?

a) paying dividends

b) sale of investment in other companies' shares

c) purchase of property, plant, and equipment

d) payment of interest expense

45. Which of the following is a typical financing activity?

a) purchasing property, plant or equipment

b) purchasing another company’s shares

c) paying interest expense

d) paying dividends

46. All of the following are investing activities EXCEPT

a) earning interest income.

b) purchasing property, plant, and equipment.

c) purchasing other companies' shares.

d) selling property, plant, and equipment.

47. Which of the following is a typical financing activity?

a) payment of dividends

b) payment of interest expense

c) payment of wages

d) purchases of inventory

48. Operating activities include all of the following EXCEPT

a) collections of accounts receivable.

b) payment of tax expense.

c) payment of dividends.

d) payment of interest expense.

49. Which of the following is NOT a typical operating activity?

a) payment of accounts payable

b) payment of long term notes payable

c) payment of wages

d) collection of accounts receivable

50. An example of a financing activity is

a) purchase of property.

b) issuing shares.

c) sales to customers.

d) payment of taxes.

51. An example of an investing activity is

a) purchase of inventory.

b) collections of amounts owed by customers.

c) purchase of shares of other companies.

d) payment of taxes.

52. An example of an operating activity is

a) repaying loan principal.

b) paying dividends.

c) purchase of shares of other companies.

d) payments of taxes owed to the government.

53. Which of the following statements best describes financial accounting?

a) An information system in which the underlying transactions of organization are captured, analyzed, and reported.

b) The reports that management prepares for the owners of the company summarizing how the company performed during the period.

c) An information system in which all transactions with the company are accurately reported.

d) The reports that management prepares for use in making decisions related to the financing, investing, and operating activities of a company.

54. Where would the information about company operations be found?

a) on the Statement of Income

b) on the Statement of Financial Position

c) in the notes of the financial statements

d) in the statement of management responsibility

55. In 2014 Farrow Ltd. earned gross revenues of $2,500,000 and had net income of $480,000. During 2014 the company had 200,000 common shares outstanding and its average shareholders’ equity was $1,000,000. Farrow’s basic earnings per share for 2014 is

a) $2.50.

b) $2.40.

c) $12.50.

d) $0.48.

56. All of the following can be found on an Statement of Income EXCEPT

a) Interest expense.

b) Depreciation Salaries expense.

c) Prepaid rent expense.

d) Other income.

57. Which of the financial statements provides information about the company’s financial position?

a) Statement of Income

b) Statement of Financial Position

c) Statement of Cash Flows

d) Statement of Changes in Equity

58. Which of the following is the proper order to list current assets on the Statement of Financial Position?

a) Cash, Short-Term Investments, Inventory, Prepaid Expenses

b) Cash, Short-Term Investments, Prepaid Expenses, Accounts Receivable

c) Cash, Inventory, Accounts Receivable, Short-Term Investments

d) Cash, Accounts Receivable, Short-Term Investments, Inventory

59. Which of the following is the basic accounting equation?

a) Assets = liabilities – shareholders' equity

b) Assets = liabilities × shareholders' equity

c) Assets = liabilities ÷ shareholders' equity

d) Assets = liabilities + shareholders' equity

60. Which of the following are the two components of Shareholders’ equity?

a) Dividends and Retained Earnings

b) Share Capital and Retained Earnings

c) Share Capital and Net Income

d) Net Income and Dividends

61. The change in retained earnings can be calculated as follows:

a) Net Income – Dividends

b) Net Income + Dividends

c) Net Income – Interest

d) Net Income + Interest

62. Dividends are paid when approved by the

a) board of directors.

b) management.

c) shareholders.

d) creditors.

63. The following information is NOT found on the Statement of Income:

a) EPS.

b) Depreciation Expense.

c) Future Income Taxes.

d) Cost of Goods Sold.

64. Which of the following statements is true?

a) The market value and the book value of a company’s shareholders’ equity are usually the same.

b) The market value is usually less than the book value of a company’s shareholders’ equity.

c) The market value is usually more than the book value of a company’s shareholders’ equity.

d) The value of the shareholders’ equity on the Statement of Financial Position is based on the value of the company’s shares in the market.

65. Which of the following is a section found in the Statement of Cash Flows?

a) cash from lending activities

b) cash from shareholder activities

c) cash from financing activities

d) cash from borrowing activities

66. On the Statement of Cash Flows, the repayment of long-term obligations would be considered

a) a financing activity.

b) an investing activity.

c) an operating activity.

d) a reduction in a liability.

67. The starting point in the operating activities section of the cash flow statement is

a) Sales Revenue.

b) Retained Earnings.

c) Beginning Cash Balance.

d) Net Income.

68. Where in the financial statements would a user find out which accounting policies management has selected to use?

a) Statement of Management Responsibility

b) Notes to the Financial Statements

c) Auditors’ Report

d) Management Discussion and Analysis

69. The Statement of Income is also known as

a) Statement of Operations.

b) Statement of Earnings.

c) Statement of Profit or Loss.

d) all of the above.

70. Who determines how much of earnings will be paid as dividends?

a) management

b) board of directors

c) shareholders

d) regulators

71. The working capital equation is

a) Working Capital = Current Assets – Current Liabilities.

b) Working Capital = Current Assets + Current Liabilities.

c) Working Capital = Current Assets – Non-Current Liabilities.

d) Working Capital = Non-current Assets + Current Liabilities.

72. The accounting equation is

a) Assets = Liabilities – Shareholders’ Equity.

b) Assets + Liabilities = Shareholders’ Equity.

c) Assets = Liabilities + Shareholders’ Equity.

d) Assets – Liabilities = Shareholders’ Equity.

73. A characteristic of an asset is

a) a resource controlled by an entity.

b) a future economic outflow.

c) an event that will happen in the future.

d) none of the above.

74. Licences, patents, trademarks, and copyrights are all examples of

a) current assets.

b) goodwill.

c) intangible assets.

d) short term investments.

75. Goods held for resale to customers are called

a) Inventory.

b) Prepaid Deposits.

c) Property, Plant, and Equipment.

d) Intangible Assets.

76. Amounts owed to customers for advance payments until the related goods or services have been provided are called

a) Accounts Payable.

b) Deferred Revenue.

c) Accrued Liabilities.

d) Deferred Income Taxes.

77. Measures the resources controlled by a company and the claims on resources at a given point in time.

a) Statement of Financial Position

b) Statement of Income

c) Statement of Cash Flows

d) Statement of Changes in Equity

**ANSWERS TO MULTIPLE CHOICE QUESTIONS**

| **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 31. | b | 39. | d | 47. | a | 55. | b | 63. | c | 71. | a |
| 32. | b | 40. | d | 48. | c | 56. | c | 64. | c | 72. | c |
| 33. | c | 41. | d | 49. | b | 57. | b | 65. | c | 73. | a |
| 34. | b | 42. | d | 50. | b | 58. | a | 66. | a | 74. | c |
| 35. | c | 43. | b | 51. | c | 59. | d | 67. | d | 75. | a |
| 36. | d | 44. | d | 52. | d | 60. | b | 68. | b | 76. | b |
| 37. | d | 45. | d | 53. | a | 61. | a | 69. | d | 77. | a |
| 38. | d | 46. | a | 54. | a | 62. | a | 70. | b |  |  |

**EXERCISES**

78. The following data was taken from the books of Kahluha, Inc. as of December 31, 2015:

 Cost of goods sold $ 15,300 Selling & administrative expense $3,500

 Income tax expense 6,120 Accounts payable 12,000

 Cash 3,500 Common shares, (6,500 shares) 20,000

 Retained earnings 8,000 Dividends 6,000

 Other income 1,500 Interest expense 900

 Sales revenue 35,000 Depreciation expense 1,500

**Instructions**

a) Calculate total assets.

b) Calculate total revenue and expenses.

c) Calculate total liabilities.

**Solution** (10 min.)

a) Total Assets

 Cash $3,500

b) Total revenue

 Sales $35,000

 Other income 1,500

 Total Revenue $36,500

 Total expenses

 Cost of goods sold $15,300

 Selling & administrative expense 3,500

 Interest expense 900

 Depreciation expense 1,500

 Total expenses $21,200

c) Total Liabilities

 Accounts payable $12,000

79. The following data was taken from the books of Somerset Corporation as of December 31, 2015:

 Accounts payable $ 9,000 Income tax payable $ 36,800

 Cost of goods sold 214,000 Selling expense 80,000

 Cash 12,000 General expense 50,000

 Long-term notes payable 19,000 Accounts receivable 10,000

 Sales revenue 480,000 Prepaid rent 2,000

 Short term investment 5,000 Dividends payable 5,000

 Inventory 66,000 Income tax expense 40,800

 Common shares 60,000 Equipment 100,000

 Retained earnings 65,200 Number of common shares 20,000

**Instructions**

From the list above determine which items should not be reported on the Statement of Financial Position.

**Solution** (10 min.)

Cost of goods sold 214,000

Selling expense 80,000

General expense 50,000

Sales revenue 480,000

Income tax expense 40,800

Number of common shares 20,000

80 The following data was taken from the books as at December 31, 2015 of Marco Inc.:

 Cash $15,000 Common shares $15,000

 Income tax expense 2,300 Cost of goods sold 39,000

 Sales revenue 85,000 Retained earnings (as of January 1) 8,500

 Inventory 21,500 Notes payable 50,750

 Accounts payable 32,000 Equipment 125,000

 Operating expenses 28,900 Dividends paid 4,000

 Interest expense 5,600 Accounts Receivable 10,000

 Prepaid expenses 750

**Instructions**

a) Determine the gross profit.

b) List the current assets in order of liquidity.

**Solution** (10 min.)

a) Gross profit = $85,000 – 39,000 = $546,000

b) Cash 15,000

 Accounts receivable 10,000

 Inventory 21,500

 Prepaid expenses 750

**MATCHING**

81. Match each of the following activities to the transactions listed below by placing the appropriate letter in the space provided.

ACTIVITIES

a) Operating

b) Investing

c) Financing

\_\_\_\_ 1. Borrowing money

\_\_\_\_ 2. Payment of salaries and wages

\_\_\_\_ 3. Payment of dividends

\_\_\_\_ 4. Sale of long term assets

\_\_\_\_ 5. Purchase of another company's shares

\_\_\_\_ 6. Receipt of dividends

\_\_\_\_ 7. Collections of amounts owed by customers

\_\_\_\_ 8. Issuing shares

\_\_\_ 9. Purchase of another company’s bonds

\_\_\_ 10. Purchase of inventory

\_\_\_ 11. Sales to customers

\_\_\_ 12. Share repurchase

**Solution** (5 min.)

1. c

2. a

3. c

4. b

5. b

6. a

7. a

8. c

9. b

10. a

11. a

12. c

82. Match each of the following financial statement lines to the correct financial statement by placing the appropriate letter in the space provided.

 Financial Statement

a) Statement of Financial Position

b) Statement of Income

c) Statement of changes in equity

d) Statement of Cash Flows

\_\_\_ 1. Income Taxes Payable

\_\_\_ 2. Cost of Goods Sold

\_\_\_ 3. Property, plant and equipment

\_\_\_ 4. Cash from Operating activities

\_\_\_ 5. Dividends Declared

\_\_\_ 6. Inventory

\_\_\_ 7. Operating expenses

\_\_\_ 8. Gain on machinery

\_\_\_ 9. Prepaid Expenses

\_\_\_ 10. Accounts Receivable

\_\_\_ 11. Net Income

\_\_\_ 12. Goodwill

**Solution** (5 min.)

1. a

2. b

3. a

4. d

5. c

6. a

7. b

8. b

9. a

10. a

11. b

12. a

**SHORT-ANSWER ESSAY QUESTIONS**

83. How do internal users differ from external users of financial statements? Identify two internal and two external users of annual reports.

**Solution** (5 min.)

Internal users are using the information to make decisions regarding product/service pricing, operational expenses, buy versus lease decisions, and cost control measures.

External users use the information in a variety of ways

* Shareholders – to make buy/sell decisions
* Creditors – to see if the company can fulfill its debt obligations in both the short- and long-term
* Regulators – are looking for corporate compliance
* Tax authorities – tax assessment and compliance

Internal—management and board of directors

External—shareholders, creditors, regulators, taxing authorities, other corporations, security analysts, credit-rating agencies, unions

84. Briefly explain the relationship between the management, the board of directors, and the shareholders in a public company.

**Solution** (5 min.)

The shareholders are the owners of the company. In a large public company they are generally not involved in the day-to-day operations of the company. The shareholders elect the members of the board of directors to represent them. The board then hires (and fires) senior management to manage the operations of the company.

85. Identify and describe the three primary financial statements prepared by accountants. How do these statements differ?

**Solution** (10 min.)

Statement of Income

* Measures the operating activities and performance of a company over a period of time, normally a year. Calculates the net income for a period of time by deducting expenses from sales revenues. Revenues – Expenses = Net Income

Statement of Financial Position

* Can be represented by the equation: Assets = Liabilities + Shareholders’ equity.
* Measures the resources controlled by a company (assets) and the claims on those resources (liability and equity holders) at a given point in time.

Statement of Cash Flow

* Measures the cash inflows and outflows or change in cash flow over a period of time, normally a year, and groups the cash flows into operating, investing, and financing activities.

86. List the three types of business activities that are measured and reflected on the cash flow statement and provide three examples of transactions found within each activity.

**Solution** (5 min.)

 Financing

 These activities involve raising long-term capital to finance the purchase of long-term assets. Typically this includes borrowing money, repaying loans, issuing shares, repurchasing shares, and paying dividends.

 Investing

 These activities involve the sale or purchase of long-term assets. This includes purchasing property, plant, and equipment; selling property, plant, and equipment; investing in other companies' shares; selling the investment in other companies' shares.

 Operating

 These are day-to-day activities the firm engages in, including sales to customers, collections on accounts receivable, purchase of inventory, payments on accounts payable, operating expenses, and taxes.

**ESSAY QUESTIONS**

87. What are consolidated statements? Do they provide useful information to their users?

**Solution** (12 min.)

Consolidated statements are the combination of all the elements of the subsidiary’s financial statements with that of the parent company. When businesses , they will often establish other companies or buy shares in other companies. This enables them to expand operations and diversify their risk.

When subsidiary companies are similar to the parent company’s business, the consolidated financial statements provide much more useful information because they cover the entire group of companies that are under common ownership.

When the business subsidiary is very different from the parent company, it may be difficult to interpret the financial statements due to the complexity.

88. What are the “notes to the financial statements”? Why are they used?

**Solution** (15 min).

The notes to the financial statements are a critical part of the financial statements. In them management gives more detail about specific items such as the various types of inventory held by the company and details on their long-term assets. By including additional explanations in notes rather than in the financial statements, management keeps the company’s statements simple and uncluttered. Note disclosures help to increase the usefulness of the financial statements and enhance the user’s understanding of the various components of the statements.

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