CHAPTER 5

BALANCE SHEET AND STATEMENT OF CASH FLOWS

IFRS questions are available at the end of this chapter.

TRUE-FALSE—Conceptual

Answer	No.	Description
F	1.	Liquidity and solvency.
T	2.	Limitations of the balance sheet.
T	3.	Definition of financial flexibility.
T	4.	Long-term liability disclosures.
T	5.	Reporting restricted cash.
F	6.	Land held for speculation.
T	7.	Balance sheet format.
F	8.	Purpose of statement of cash flows.
F	9.	Statement of cash flows reporting.
T	10.	Financial flexibility.
T	11.	Collection of a loan.
T	12.	Determining cash provided by operating activities.
F	13.	Reporting significant financing and investing activities.
T	14.	Current cash debt coverage.
F	15.	Definition of free cash flow.
F	16.	Disclosure of fair values.
F	17.	Disclosure of company operations and estimates.
T	18.	Disclosure of pertinent information.
F	19.	Adjunct account.
F	20.	Definition of activity ratios.

MULTIPLE CHOICE—Conceptual

Answer	No.	Description
d	21.	Limitation of the balance sheet.
c	22.	Uses of the balance sheet.
b	23.	Use of balance sheet information.
d	24.	Use of balance sheet information.
d	25.	Limitation of the balance sheet.
c	[S]26.	Uses of the balance sheet.
b	[S]27.	Criticisms of the balance sheet.
c	[P]28.	Definition of liquidity.
d	29.	Definition of net assets.
b	30.	Current assets presentation.
b	31.	Operating cycle.
d	32.	Operating cycle.
d	33.	Identification of current asset.
d	34.	Identification of current asset.
c	35.	Presentation of current asset.
b	36.	Valuation of receivables.
c	37.	Classification of inventory pledged as security.

MULTIPLE CHOICE—Conceptual (cont.)

Answer	No.	Description
b	38.	Identification of long-term investments.
d	39.	Identification of valuation methods.
b	40.	Identification of current liabilities.
d	41.	Definition of working capital.
b	42.	Identification of working capital items.
d	43.	Identification of long-term liabilities.
d	44.	Identification of long-term liabilities.
d	45.	Classification of treasury stock.
d	46.	Disclosures for common stock.
d	47.	Classification of investment in affiliate.
c	48.	Classification of owners' equity.
d	49.	Classification of assets.
c	50.	Purpose of the statement of cash flows.
c	[S]51.	Statement of cash flows answers.
c	52.	Statement of cash flows reporting.
b	53.	Statement of cash flows objective.
d	54.	Reporting issuance of stock for machine.
d	55.	Identify a financing activity.
b	56.	Classification of cash receipts.
b	57.	Identify a financing activity.
c	58.	Cash flow from operating activities.
a	59.	Identify an investing activity.
d	60.	Preparing the statement of cash flows.
b	61.	Cash debt coverage.
b	62.	Current cash debt coverage.
d	63.	Financial flexibility measure.
c	64.	Calculation of free cash flow.
b	[S]65.	Description of financial flexibility.
b	66.	Cash debt coverage.
d	[S]67.	Balance sheet supplementary disclosure.
a	68.	Fair value hierarchy.
b	69.	Balance sheet supplementary disclosure.
c	70.	Disclosure of contractual situations.
d	71.	Disclosure of accounting policies.
d	72.	Contingency reported in financial statement notes.
d	73.	Methods of disclosure.
d	74.	Disclosure of significant accounting policies.
d	75.	Disclosure of depreciation methods used.
d	76.	Required notes to the financial statements.
d	[P]77.	Identification of contra account.
b	[P]78.	Definition of activity ratios.

[P] Note: these questions also appear in the Problem-Solving Survival Guide.
[S] Note: these questions also appear in the Study Guide.

MULTIPLE CHOICE—Computational

Answer	No.	Description
c	79.	Classifying investments.
a	80.	Identifying intangible assets
b	81.	Calculate total stockholders' equity.
d	82.	Classifying investments.
a	83.	Identifying intangible assets.
b	84.	Calculate total stockholders' equity.
c	85.	Calculate beginning stockholders' equity.
c	86.	Calculate ending stockholders' equity.
d	87.	Calculate net income.
b	88.	Calculate ending cash balance.
b	89.	Calculate ending cash balance.
a	90.	Calculate cash provided by operating activities.
c	91.	Cash provided by operating activities.
c	92.	Cash provided by operating activities.
a	93.	Cash debt coverage.
b	94.	Free cash flow.
c	95.	Asset turnover ratio.
d	96.	Rate of return on assets.

MULTIPLE CHOICE—CPA Adapted

Answer	No.	Description
d	97.	Calculate total current assets.
d	98.	Calculate total current assets.
a	99.	Calculate total current liabilities.
c	100.	Calculate retained earnings balance.
b	101.	Calculate current and long-term liabilities.
c	102.	Classification of investing activity.
a	103.	Classification of operating activity.
d	104.	Classification of financing activity.
b	105.	Classification of investing activity.
c	106.	Summary of significant accounting policies.

BRIEF EXERCISES

Item	Description
BE5-107	Definitions.
BE5-108	Terminology.
BE5-109	Current assets.

EXERCISES

Item	Description
E5-110	Account classification.
E5-111	Valuation of balance sheet items.
E5-112	Balance sheet classifications.
E5-113	Balance sheet classifications.

E5-114	Balance sheet classifications.
E5-115	Statement of cash flows.
E5-116	Statement of cash flows ratios.

PROBLEMS

Item	Description
P5-117	Balance sheet format.
P5-118	Balance sheet preparation.
P5-119	Balance sheet presentation.
P5-120	Statement of cash flows preparation.
P5-121	Statement of cash flows preparation.

CHAPTER LEARNING OBJECTIVES

1. Explain the uses and limitations of a balance sheet.
2. Identify the major classifications of the balance sheet.
3. Prepare a classified balance sheet using the report and account formats.
4. Indicate the purpose of the statement of cash flows.
5. Identify the content of the statement of cash flows.
6. Prepare a basic statement of cash flows.
7. Understand the usefulness of the statement of cash flows.
8. Determine which balance sheet information requires supplemental disclosure.
9. Describe the major disclosure techniques for the balance sheet.

*10.Identify the major types of financial ratios and what they measure.

11. Compare the accounting procedures related to the balance sheet under GAAP and IFRS.

SUMMARY OF LEARNING OBJECTIVES BY QUESTIONS

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Learning Objective 1													
1.	TF	3.	TF	22.	MC	24.	MC	[S]26.	MC	[P]28.	MC		
2.	TF	21.	MC	23.	MC	25.	MC	[S]27.	MC				
Learning Objective 2													
4.	TF	33.	MC	40.	MC	47.	MC	83.	MC	107.	BE-CT	114.	E
5.	TF	34.	MC	41.	MC	48.	MC	84.	MC	108.	BE	117.	P
6.	TF	35.	MC	42.	MC	49.	MC	97.	MC	109.	BE	118.	P
29.	MC	36.	MC	43.	MC	79.	MC	98.	MC	110.	E	119.	P
30.	MC	37.	MC	44.	MC	80.	MC	99.	MC	111.	E		
31.	MC	38.	MC	45.	MC	81.	MC	100.	MC	112.	E		
32.	MC	39.	MC	46.	MC	82.	MC	101.	MC	113.	E		
Learning Objective 3													
7.	TF	[P]50.	MC	85.	MC	86.	MC	87.	MC	118.	P	119.	P
Learning Objective 4													
8.	TF	9.	TF	51.	MC	[S]52.	MC	53.	MC	54.	MC		
Learning Objective 5													
10.	TF	56.	MC	59.	MC	89.	MC	103.	MC	115.	E		
11.	TF	57.	MC	60.	MC	90.	MC	104.	MC				
55.	MC	58.	MC	88.	MC	102.	MC	105.	MC				
Learning Objective 6													
12.	TF	61.	MC	92.	MC	121.	P						
13.	TF	91.	MC	120.	P								
Learning Objective 7													
14.	TF	63.	MC	[S]66.	MC	116.	E-CT						
15.	TF	64.	MC	93.	MC								
62.	MC	65.	MC	94.	MC								
Learning Objective 8													
16.	TF	[S]68.	MC	71.	MC	106.	MC	110.	E	117.	P		
17.	TF	69.	MC	72.	MC	107.	BE	112.	E				
[S]67.	MC	70.	MC	73.	MC	108.	BE	114.	E				
Learning Objective 9													
18.	TF	74.	MC	76.	MC								
19.	TF	75.	MC	77.	MC								
Learning Objective 10													
20.	TF	78.	MC	95.	MC	96.	MC						
Learning Objective 11- IFRS Questions													

1	TF	3	TF	5	MC	7	MC	9	MC	11	SA		
2	TF	4	TF	6	MC	8	MC	10	MC	12	SA		

Note: TF = True-False E = Exercise CT = Critical Thinking
MC = Multiple Choice BE = Brief Exercise P = Problem SA = Short
Answer

TRUE FALSE—Conceptual

1. Liquidity refers to the ability of an enterprise to pay its debts as they mature.
2. The balance sheet omits many items that are of financial value to the business but cannot be recorded objectively.
3. Financial flexibility measures the ability of an enterprise to take effective actions to alter the amounts and timing of cash flows.
4. Companies frequently describe the terms of all long-term liability agreements in notes to the financial statements.
5. A company excludes from the current assets section, the amount of cash restricted for purposes other than payment of current obligations or for use in current operations.
6. Land held for speculation is reported in the property, plant, and equipment section of the balance sheet.
7. The account form and the report form of the balance sheet are both acceptable under GAAP.
8. The primary purpose of a statement of cash flows is to report the cash effects of operations during a period.
9. The statement of cash flows reports only the cash effects of operations during a period and financing transactions.
10. Financial flexibility is a company's ability to respond and adapt to financial adversity and unexpected needs and opportunities.
11. Collection of a loan is reported as an investing activity in the statement of cash flows.
12. Companies determine cash provided by operating activities by converting net income on an accrual basis to a cash basis.
13. Significant financing and investing activities that do not affect cash are not reported in the statement of cash flows or any other place.
14. Financial statement readers often assess liquidity by using the current cash debt coverage.
15. Free cash flow is net income less capital expenditures and dividends.
16. Because of the historical cost principle, fair values may not be disclosed in the balance sheet.
17. Companies have the option of disclosing information about the nature of their operations and the use of estimates in preparing financial statements.
18. Companies may use parenthetical explanations, notes, cross references, and supporting schedules to disclose pertinent information.

19. On the balance sheet, an adjunct account reduces either an asset, a liability, or an owners' equity account.

20. Activity ratios measure the degree of protection for long-term creditors and investors.

True False Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	F	6.	F	11.	T	16.	F
2.	T	7.	T	12.	T	17.	F
3.	T	8.	F	13.	F	18.	T
4.	T	9.	F	14.	T	19.	F
5.	T	10.	T	15.	F	20.	F

MULTIPLE CHOICE—Conceptual

21. Which of the following is a limitation of the balance sheet?
    a. Many items that are of financial value are omitted.
    b. Judgments and estimates are used.
    c. Current fair value is not reported.
    d. All of these answer choices are correct.

22. The balance sheet is useful for analyzing all of the following **except**
    a. liquidity.
    b. solvency.
    c. profitability.
    d. financial flexibility.

23. Balance sheet information is useful for all of the following **except** to
    a. compute rates of return
    b. analyze cash inflows and outflows for the period
    c. evaluate capital structure
    d. assess future cash flows

24. Balance sheet information is useful for all of the following **except**
    a. assessing a company's risk
    b. evaluating a company's liquidity
    c. evaluating a company's financial flexibility
    d. determining free cash flows.

25. A limitation of the balance sheet that is not also a limitation of the income statement is
    a. the use of judgments and estimates
    b. omitted items
    c. the numbers are affected by the accounting methods employed
    d. valuation of items at historical cost

S26. The balance sheet contributes to financial reporting by providing a basis for all of the following **except**
    a. computing rates of return.
    b. evaluating the capital structure of the enterprise.
    c. determining the increase in cash due to operations.
    d. assessing the liquidity and financial flexibility of the enterprise.

S27. One criticism not normally aimed at a balance sheet prepared using current accounting and reporting standards is
    a. failure to reflect current value information.
    b. the extensive use of separate classifications.
    c. an extensive use of estimates.
    d. failure to include items of financial value that cannot be recorded objectively.

P28. The amount of time that is expected to elapse until an asset is realized or otherwise converted into cash is referred to as
    a. solvency.
    b. financial flexibility.
    c. liquidity.
    d. exchangeability.

29. The net assets of a business are equal to
    a. current assets minus current liabilities.
    b. total assets plus total liabilities.
    c. total assets minus total stockholders' equity.
    d. none of these answer choices are correct.

30. The correct order to present current assets is
    a. cash, accounts receivable, prepaid items, inventories.
    b. cash, accounts receivable, inventories, prepaid items.
    c. cash, inventories, accounts receivable, prepaid items.
    d. cash, inventories, prepaid items, accounts receivable.

31. The basis for classifying assets as current or noncurrent is conversion to cash within
    a. the accounting cycle or one year, whichever is shorter.
    b. the operating cycle or one year, whichever is longer.
    c. the accounting cycle or one year, whichever is longer.
    d. the operating cycle or one year, whichever is shorter.

32. The basis for classifying assets as current or noncurrent is the period of time normally required by the accounting entity to convert cash invested in
    a. inventory back into cash, or 12 months, whichever is shorter.
    b. receivables back into cash, or 12 months, whichever is longer.
    c. tangible fixed assets back into cash, or 12 months, whichever is longer.
    d. inventory back into cash, or 12 months, whichever is longer.

33. The current assets section of the balance sheet should include
    a. machinery.
    b. patents.
    c. goodwill.
    d. inventory.

34. Which of the following is a current asset?
    a. Cash surrender value of a life insurance policy of which the company is the beneficiary.
    b. Investment in equity securities for the purpose of controlling the issuing company.
    c. Cash designated for the purchase of tangible fixed assets.
    d. Trade installment receivables normally collectible in 18 months.

35. Current assets are presented in the balance sheet in
    a. ascending order of their balances.
    b. descending order of their balances.
    c. order of their liquidity.
    d. reverse order of their liquidity.

36. Receivables are valued based on their ________.
    a. fair value
    b. estimated amount collectible
    c. lower-of-cost-or-market value
    d. historical cost

37. When a portion of inventories has been pledged as security on a loan,
    a. the value of the portion pledged should be subtracted from the debt.
    b. an equal amount of retained earnings should be appropriated.
    c. the fact should be disclosed but the amount of current assets should not be affected.
    d. the cost of the pledged inventories should be transferred from current assets to noncurrent assets.

38. Which of the following is **not** a long-term investment?
    a. Cash surrender value of life insurance
    b. Franchise
    c. Land held for speculation
    d. A sinking fund

39. A generally accepted method of valuation is
    1. trading securities at market value.
    2. accounts receivable at net realizable value.
    3. inventories at current cost.

    a. 1
    b. 2
    c. 3
    d. 1 and 2

40. Which item below is **not** a current liability?
    a. Unearned revenue
    b. Stock dividends distributable
    c. The currently maturing portion of long-term debt
    d. Trade accounts payable

41. Working capital is
    a. capital which has been reinvested in the business.
    b. unappropriated retained earnings.
    c. cash and receivables less current liabilities.
    d. none of these answer choices are correct.

42. An example of an item which is not an element of working capital is
    a. accrued interest on notes receivable.
    b. goodwill.
    c. goods in process.
    d. temporary investments.

43. Long-term liabilities include
    a. obligations not expected to be liquidated within the operating cycle.
    b. obligations payable at some date beyond the operating cycle.
    c. deferred income taxes and most lease obligations.
    d. all of these answer choices are correct.

44. Which of the following should be **excluded** from long-term liabilities?
    a. Obligations payable at some date beyond the operating cycle
    b. Most pension obligations
    c. Long-term liabilities that mature within the operating cycle and will be paid from a sinking fund
    d. None of these answer choices are correct.

45. Treasury stock should be reported as a(n)
    a. current asset.
    b. investment.
    c. other asset.
    d. reduction of stockholders' equity.

46. Which of the following should be reported for capital stock?
    a. The shares authorized
    b. The shares issued
    c. The shares outstanding
    d. All of these answer choices are correct.

47. Which of the following would be classified in a different major section of a balance sheet from the others?
    a. Capital stock
    b. Common stock subscribed
    c. Stock dividend distributable
    d. Stock investment in affiliate

48. The stockholders' equity section is usually divided into what three parts?
    a. Preferred stock, common stock, treasury stock
    b. Preferred stock, common stock, retained earnings
    c. Capital stock, additional paid-in capital, retained earnings
    d. Capital stock, appropriated retained earnings, unappropriated retained earnings

49. Which of the following is **not** an acceptable major asset classification?
    a. Current assets
    b. Long-term investments
    c. Property, plant, and equipment
    d. Deferred charges

50. The financial statement which summarizes operating, investing, and financing activities of an entity for a period of time is the
    a. retained earnings statement.
    b. income statement.
    c. statement of cash flows.
    d. statement of financial position.

[S]51. The statement of cash flows provides answers to all of the following questions **except**
    a. where did the cash come from during the period?
    b. what was the cash used for during the period?
    c. what is the impact of inflation on the cash balance at the end of the year?
    d. what was the change in the cash balance during the period?

52. The statement of cash flows reports all of the following **except**
    a. the net change in cash for the period.
    b. the cash effects of operations during the period.
    c. the free cash flows generated during the period.
    d. investing transactions.

53. The statement of cash flows helps meet the objective of financial reporting, which is to assess all of the following **except** the
    a. amount of future cash flows.
    b. source of future cash flows.
    c. timing of future cash flows.
    d. uncertainty of future cash flows.

54. If common stock was issued to acquire an $8,000 machine, how would the transaction appear on the statement of cash flows?
    a. It would depend on whether you are using the direct or the indirect method.
    b. It would be a positive $8,000 in the financing section and a negative $8,000 in the investing section.
    c. It would be a negative $8,000 in the financing section and a positive $8,000 in the investing section.
    d. It would not appear on the statement of cash flows but rather on a schedule of noncash investing and financing activities.

55. Which of the following events will appear in the cash flows from financing activities section of the statement of cash flows?
    a. Cash purchases of equipment.
    b. Cash purchases of bonds issued by another company.

c. Cash received as repayment for funds loaned.
d. Cash purchase of treasury stock.

56. Making and collecting loans and disposing of property, plant, and equipment are
    a. operating activities.
    b. investing activities.
    c. financing activities.
    d. liquidity activities.

57. In preparing a statement of cash flows, sale of treasury stock at an amount greater than cost would be classified as a(n)
    a. operating activity.
    b. financing activity.
    c. extraordinary activity.
    d. investing activity.

58. In preparing a statement of cash flows, cash flows from operating activities
    a. are always equal to accrual accounting income.
    b. are calculated as the difference between revenues and expenses.
    c. can be calculated by appropriately adding to or deducting from net income those items in the income statement that do not affect cash.
    d. can be calculated by appropriately adding to or deducting from net income those items in the income statement that do affect cash.

59. In preparing a statement of cash flows, which of the following transactions would be considered an investing activity?
    a. Sale of equipment at book value
    b. Sale of merchandise on credit
    c. Declaration of a cash dividend
    d. Issuance of bonds payable at a discount

60. Preparing the statement of cash flows involves all of the following except determining the
    a. cash provided by operations.
    b. cash provided by or used in investing and financing activities.
    c. change in cash during the period.
    d. cash collections from customers during the period.

61. The cash debt coverage is computed by dividing net cash provided by operating activities by
    a. average long-term liabilities.
    b. average total liabilities.
    c. ending long-term liabilities.
    d. ending total liabilities.

62. The current cash debt coverage is often used to assess
    a. financial flexibility.
    b. liquidity.
    c. profitability.
    d. solvency.

63. A measure of a company's financial flexibility is the
    a. cash debt coverage.

b. current cash debt coverage.
c. free cash flow.
d. cash debt coverage and free cash flow.

64. Free cash flow is calculated as net cash provided by operating activities less
a. capital expenditures.
b. dividends.
c. capital expenditures and dividends.
d. capital expenditures and depreciation.

S65. One of the benefits of the statement of cash flows is that it helps users evaluate financial flexibility. Which of the following explanations is a description of financial flexibility?
a. The nearness to cash of assets and liabilities.
b. The firm's ability to respond and adapt to financial adversity and unexpected needs and opportunities.
c. The firm's ability to pay its debts as they mature.
d. The firm's ability to invest in a number of projects with different objectives and costs.

P66. Net cash provided by operating activities divided by average total liabilities equals the
a. current cash debt coverage.
b. cash debt coverage.
c. free cash flow.
d. current ratio.

S67. Which of the following balance sheet classifications would normally require the greatest amount of supplementary disclosure?
a. Current assets
b. Current liabilities
c. Plant assets
d. Long-term liabilities

68. Level 1 of fair value hierarchy measures are based on:
a. market prices for identical assets.
b. market prices for similar assets.
c. unobservable inputs.
d. historical cost of similar assets.

69. Which of the following is not a required supplemental disclosure for the balance sheet?
a. Contingencies
b. Financial forecasts
c. Accounting policies
d. Contractual situations

70. Typical contractual situations that are disclosed in the notes to the balance sheet include all of the following **except**
a. debt covenants
b. lease obligations
c. advertising contracts
d. pension obligations

71. Accounting policies disclosed in the notes to the financial statements typically include all of the following **except**

a. the cost flow assumption used
b. the depreciation methods used
c. significant estimates made
d. significant inventory purchasing policies

72. Which of the following best exemplifies a contingency that is reported in the notes to the financial statements?
a. Losses from potential future lawsuits
b. Loss from a lawsuit settled out of court prior to the end of the fiscal year
c. Warranty claims on future sales
d. Estimated loss from an ongoing lawsuit

73. Which of the following is **not** a method of disclosing pertinent information?
a. Supporting schedules
b. Parenthetical explanations
c. Cross reference and contra items
d. All of these are methods of disclosing pertinent information.

74. Significant accounting policies may **not** be
a. selected on the basis of judgment.
b. selected from existing acceptable alternatives.
c. unusual or innovative in application.
d. omitted from financial-statement disclosure.

75. A general description of the depreciation methods applicable to major classes of depreciable assets
a. is not a current practice in financial reporting.
b. is not essential to a fair presentation of financial position.
c. is needed in financial reporting when company policy differs from income tax policy.
d. should be included in corporate financial statements or notes thereto.

76. It is mandatory that the essential provisions of which of the following be clearly stated in the notes to the financial statements?
a. Stock option plans
b. Pension obligations
c. Lease contracts
d. All of these answer choices are correct

P77. Which of the following is a contra account?
a. Premium on bonds payable
b. Unearned revenue
c. Patents
d. Accumulated depreciation

78. __________ ratios measure how effectively a company uses its assets.
a. Liquidity
b. Activity
c Profitability
d. Coverage

Multiple Choice Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
21.	d	30.	b	39.	d	48.	c	57.	b	66.	b	75.	D
22.	c	31.	b	40.	b	49.	d	58.	c	67.	d	76.	D
23.	b	32.	d	41.	d	50.	c	59.	a	68.	a	77.	D
24.	d	33.	d	42.	b	51.	c	60.	D	69.	b	78.	b
25.	d	34.	d	43.	d	52.	c	61.	B	70.	c		
26.	c	35.	c	44.	d	53.	b	62.	B	71.	D		
27.	b	36.	b	45.	d	54.	d	63.	D	72.	D		
28.	c	37.	c	46.	d	55.	D	64.	C	73.	d		
29.	d	38.	b	47.	d	56.	b	65.	b	74.	d		

Solutions to those Multiple Choice questions for which the answer is "none of these."

29. Total assets minus total liabilities.
41. Current assets less current liabilities.
44. Many answers are possible.

MULTIPLE CHOICE—Computational

79. Fulton Company owns the following investments:

Trading securities (fair value)	$140,000
Available-for-sale securities (fair value)	70,000
Held-to-maturity securities (amortized cost)	94,000

Fulton will report investments in its current assets section of
a. $0.
b. exactly $140,000.
c. $140,000 or an amount greater than $140,000, depending on the circumstances.
d. exactly $210,000.

80. For Grimmett Company, the following information is available:

Capitalized leases	$600,000
Trademarks	245,000
Long-term receivables	225,000

In Grimmett's balance sheet, intangible assets should be reported at
a. $245,000.
b. $275,000.
c. $845,000.
d. $875,000.

81. Houghton Company has the following items: common stock, $800,000; treasury stock, $105,000; deferred income taxes, $125,000 and retained earnings, $390,000. What total amount should Houghton Company report as stockholders' equity?
a. $960,000.
b. $1,085,000.
c. $1,210,000.
d. $1,295,000.

82. Kohler Company owns the following investments:

Trading securities (fair value)	$120,000
Available-for-sale securities (fair value)	80,000
Held-to-maturity securities (amortized cost)	94,000

Kohler will report securities in its long-term investments section of
a. exactly $200,000.
b. exactly $214,000.
c. exactly $294,000.
d. $174,000 or an amount less than $174,000, depending on the circumstances.

83. For Randolph Company, the following information is available:

Capitalized leases	$560,000
Copyrights	190,000
Long-term receivables	210,000

In Randolph's balance sheet, intangible assets should be reported at
a. $190,000.
b. $220,000.
c. $750,000.
d. $780,000.

84. Olmsted Company has the following items: common stock, $750,000; treasury stock, $105,000; deferred income taxes, $125,000 and retained earnings, $454,000. What total amount should Olmsted Company report as stockholders' equity?
a. $974,000.
b. $1,099,000.
c. $1,224,000.
d. $1,349,000.

85. Presented below are data for Antwerp Corp.

	2014	2015
Assets, January 1	$2,800	$3,360
Liabilities, January 1	1,680	?
Stockholders' Equity, Jan. 1	?	?
Dividends	560	420
Common Stock	504	448
Stockholders' Equity, Dec. 31	?	?
Net Income	560	448

Stockholders' Equity at January 1, 2014 is
a. $ 704.
b. $ 760.
c. $1,120.
d. $1,624.

86. Presented below are data for Bandkok Corp.

	2014	2015
Assets, January 1	$5,900	$6,480
Liabilities, January 1	3,240	?
Stockholders' Equity, Jan. 1	?	?
Dividends	1,080	810
Common Stock	972	864
Stockholders' Equity, Dec. 31	?	?
Net Income	1,280	864

Stockholders' Equity at January 1, 2015 is
a. $3,832.
b. $2,660.
c. $2,860.
d. $3,940.

87. Presented below are data for Caracas Corp.

	2014	2015
Assets, January 1	$4,560	?
Liabilities, January 1	?	$2,736
Stockholders' Equity, Jan. 1	?	2,750
Dividends	570	646
Common Stock	608	650
Stockholders' Equity, Dec. 31	?	2,266
Net Income	684	?

Net income for 2015 is
a. $484 income.
b. $484 loss.
c. $162 loss.
d. $162 income.

88. Lohmeyer Corporation reports:

Cash provided by operating activities	$320,000
Cash used by investing activities	110,000
Cash provided by financing activities	140,000
Beginning cash balance	70,000

What is Lohmeyer's ending cash balance?
a. $350,000.
b. $420,000.
c. $570,000.
d. $640,000.

89. Keisler Corporation reports:

Cash provided by operating activities	$280,000
Cash used by investing activities	110,000
Cash provided by financing activities	140,000
Beginning cash balance	70,000

What is Keisler's ending cash balance?
a. $310,000.
b. $380,000.
c. $530,000.
d. $600,000.

90. During 2014 the DLD Company had a net income of $75,000. In addition, selected accounts showed the following changes:

Accounts Receivable	$3,000 increase
Accounts Payable	1,000 increase
Buildings	4,000 decrease
Depreciation Expense	1,500 increase
Bonds Payable	8,000 increase

What was the amount of cash provided by operating activities?
a. $74,500
b. $75,000
c. $76,500
d. $84,500

91. Harding Corporation reports the following information:

Net income	$480,000
Depreciation expense	140,000
Increase in accounts receivable	60,000

Harding should report cash provided by operating activities of
a. $280,000.
b. $400,000.
c. $560,000.
d. $680,000.

92. Sauder Corporation reports the following information:

Net income	$320,000
Depreciation expense	70,000
Increase in accounts receivable	30,000

Sauder should report cash provided by operating activities of
a. $220,000.
b. $280,000.
c. $360,000.
d. $420,000.

93. Packard Corporation reports the following information:

Net cash provided by operating activities	$285,000
Average current liabilities	150,000
Average long-term liabilities	100,000
Dividends declared	60,000
Capital expenditures	110,000
Payments of debt	35,000

Packard's cash debt coverage is
a. 1.14.
b. 1.90.
c. 2.85.
d. 4.75.

94. Packard Corporation reports the following information:

Net cash provided by operating activities	$285,000
Average current liabilities	150,000
Average long-term liabilities	100,000
Dividends paid	60,000
Capital expenditures	110,000
Payments of debt	35,000

Packard's free cash flow is
a. $100,000.
b. $115,000.
c. $175,000.
d. $225,000.

95. Huge Cart Inc. gives you the following information pertaining to the year 2014.

Net sales	$800,000
Cost of goods sold	500,000
Current assets	500,000
Current liabilities	250,000
Average total assets	900,000
Total liabilities	550,000
Net income	150,000

The asset turnover ratio of Huge Cart Inc. is
a. 0.56
b. 0.17
c. 0.89
d. 1.13

96. Huge Cart Inc. gives you the following information pertaining to the year 2014.

Net sales	$850,000
Cost of goods sold	500,000
Current assets	500,000
Current liabilities	250,000
Average total assets	900,000
Total liabilities	550,000
Net income	150,000

The rate of return on assets Huge Cart Inc. is:
a. 55.5%.
b. 30.0%.
c. 18.7%.
d. 16.6%.

Multiple Choice Answers—Computational

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
79.	c	83.	a	87.	d	91.	c	95.	c
80.	a	84.	b	88.	b	92.	c	96.	d
81.	b	85.	c	89.	b	93.	a		
82.	d	86.	c	90.	a	94.	b		

MULTIPLE CHOICE—CPA Adapted

97. Stine Corp.'s trial balance reflected the following account balances at December 31, 2014:

Accounts receivable (net)	$19,000
Trading securities	6,000
Accumulated depreciation on equipment and furniture	15,000
Cash	16,000
Inventory	30,000
Equipment	25,000
Patent	4,000
Prepaid expenses	2,000
Land held for future business site	18,000

In Stine's December 31, 2014 balance sheet, the current assets total is
a. $90,000.
b. $82,000.
c. $77,000.
d. $73,000.

Use the following information for questions 98 through 100.

The following trial balance of Reese Corp. at December 31, 2014 has been properly adjusted except for the income tax expense adjustment.

Reese Corp.
Trial Balance
December 31, 2014

	Dr.	Cr.
Cash	$ 775,000	
Accounts receivable (net)	2,695,000	
Inventory	2,085,000	
Property, plant, and equipment (net)	7,566,000	
Accounts payable and accrued liabilities		$ 1,701,000
Income taxes payable		654,000
Deferred income tax liability		85,000
Common stock		2,350,000
Additional paid-in capital		3,680,000
Retained earnings, 1/1/14		3,450,000
Net sales and other revenues		13,560,000
Costs and expenses	11,180,000	
Income tax expenses	1,179,000	
	$25,480,000	$25,480,000

Other financial data for the year ended December 31, 2014:

- Included in accounts receivable is $1,200,000 due from a customer and payable in quarterly installments of $150,000. The last payment is due December 29, 2016.
- The balance in the Deferred Income Tax Liability account pertains to a temporary difference that arose in a prior year, of which $20,000 is classified as a current liability.
- During the year, estimated tax payments of $525,000 were charged to income tax expense. The current and future tax rate on all types of income is 30%.

In Reese's December 31, 2014 balance sheet,

98. The current assets total is
    a. $6,080,000.
    b. $5,555,000.
    c. $5,405,000.
    d. $4,955,000.

99. The current liabilities total is
    a. $1,850,000.
    b. $1,915,000.
    c. $2,375,000.
    d. $2,440,000.

100. The final retained earnings balance is
    a. $4,651,000.
    b. $4,736,000.
    c. $5,176,000.
    d. $5,105,000.

101. On January 4, 2014, Kiley Co. leased a building to Dodd Corp. for a ten-year term at an annual rental of $150,000. At inception of the lease, Kiley received $600,000 covering the first two years' rent of $300,000 and a security deposit of $300,000. This deposit will not be returned to Dodd upon expiration of the lease but will be applied to payment of rent for the last two years of the lease. What portion of the $600,000 should be shown as a current and long-term liability in Kiley's December 31, 2014 balance sheet?

	Current Liability	Long-term Liability
a.	$0	$600,000
b.	$150,000	$300,000
c.	$300,000	$300,000
d.	$300,000	$150,000

102. In a statement of cash flows, receipts from sales of property, plant, and equipment and other productive assets should generally be classified as cash inflows from
a. operating activities.
b. financing activities.
c. investing activities.
d. selling activities.

103. In a statement of cash flows, interest payments to lenders and other creditors should be classified as cash outflows for
a. operating activities.
b. borrowing activities.
c. lending activities.
d. financing activities.

104. In a statement of cash flows, proceeds from issuing equity instruments should be classified as cash inflows from
a. lending activities.
b. operating activities.
c. investing activities.
d. financing activities.

105. In a statement of cash flows, payments to acquire debt instruments of other entities (other than cash equivalents) should be classified as cash outflows for
a. operating activities.
b. investing activities.
c. financing activities.
d. lending activities.

106. Which of the following facts concerning fixed assets should be included in the summary of significant accounting policies?

	Depreciation Method	Composition
a.	No	Yes
b.	Yes	Yes
c.	Yes	No
d.	No	No

Multiple Choice Answers—CPA Adapted

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
97.	d	99.	a	101.	b	103.	a	105.	b
98.	d	100.	c	102.	c	104.	d	106.	c

DERIVATIONS — Computational

No.	Answer	Derivation
79.	c	
80.	a	
81.	b	$800,000 – $105,000 + $390,000 = $1,085,000.
82.	d	
83.	a	
84.	b	$750,000 – $105,000 + $454,000 = $1,099,000.
85.	c	$2,800 – $1,680 = $1,120.
86.	c	($5,900 – $3,240) + $1,280 – $1,080 = $2,860.
87.	d	$2,266 + $646 – $2,750 = $162.
88.	b	$70,000 + $320,000 – $110,000 + $140,000 = $420,000.
89.	b	$70,000 + $280,000 – $110,000 + $140,000 = $380,000.
90.	a	$75,000 – $3,000 + $1,000 + $1,500 = $74,500.
91.	c	$480,000 + $140,000 – $60,000 = $560,000.
92.	c	$320,000 + $70,000 – $30,000 = $360,000.
93.	a	$285,000 ÷ ($150,000 + $100,000) = 1.14.
94.	b	$285,000 – $60,000 – $110,000 = $115,000.
95.	c	$800,000 ÷ $900,000 = 0.89.
96.	d	$150,000 ÷ $900,000 = 16.6%.

DERIVATIONS — CPA Adapted

No.	Answer	Derivation
97.	d	$19,000 + $6,000 + $16,000 + $30,000 + $2,000 = $73,000.
98.	d	$775,000 + [$2,695,000 – ($150,000 × 4)] + $2,085,000 = $4,955,000.
99.	a	$1,701,000 + ($654,000 – $525,000) + $20,000 = $1,850,000.
100.	c	$3,450,000 + $13,560,000 – $11,180,000 – ($1,179,000 – $525,000) = $5,176,000.
101.	b	Conceptual.
102.	c	Conceptual.

No.	**Answer**	**Derivation**
103.	a	Conceptual.
104.	d	Conceptual.
105.	b	Conceptual.
106.	c	Conceptual.

BRIEF EXERCISES

BE. 5-107—Definitions.

Provide clear, concise answers for the following.

1. What are assets?

2. What are liabilities?

3. What is equity?

4. What are current liabilities?

5. Explain what working capital is and how it is computed.

6. What are intangible assets?

7. What are current assets?

Solution 5-107

1. Assets are probable future economic benefits obtained or controlled by an entity as a result of past transactions or events.

2. Liabilities are probable future sacrifices of economic benefits arising from present obligations of an entity as a result of past transactions or events.

3. Equity is the residual interest in the net assets of an entity.

4. Current liabilities are obligations that are expected to be liquidated through the use of current assets or the creation of other current liabilities.

5. Working capital is the net amount of a company’s relatively liquid resources. It is the excess of total current assets over total current liabilities.

6. Intangible assets are economic resources or competitive advantages. They lack physical substance and have a high degree of uncertainty about the future benefits to be received.

7. Current assets are resources (future economic benefits) expected to be converted to cash, sold, or consumed in one year or the operating cycle, whichever is longer.

BE. 5-108—Terminology.

In the space provided at right, write the word or phrase that is defined or indicated.

1. Obligations expected to be liquidated through use of current assets.	1. ____________________
2. Statement showing financial condition at a point in time.	2. ____________________
3. Events that depend upon future outcomes.	3. ____________________
4. Probable future sacrifices of economic benefits.	4. ____________________
5. Resources expected to be converted to cash in one year or the operating cycle, whichever is longer.	5. ____________________
6. Resources of a durable nature used in operations.	6. ____________________
7. Economic rights or competitive advantages which lack physical substance.	7. ____________________
8. Probable future economic benefits.	8. ____________________
9. Residual interest in the net assets of an entity.	9. ____________________

Solution 5-108

1. Current liabilities.
2. Balance sheet.
3. Contingencies.
4. Liabilities.
5. Current assets.
6. Property, plant, and equipment.
7. Intangible assets.
8. Assets.
9. Equity.

BE. 5-109—Current assets.

Define current assets without using the word "asset."

Solution 5-109

Current assets are resources (future economic benefits) expected to be converted to cash, sold, or consumed in one year or the operating cycle, whichever is longer.

EXERCISES

Ex. 5-110—Account classification.

ASSETS	LIABILITIES AND CAPITAL
a. Current assets	f. Current liabilities
b. Investments	g. Long-term liabilities
c. Plant and equipment	h. Preferred stock
d. Intangibles	i. Common stock
e. Other assets	j. Additional paid-in capital
	k. Retained earnings
	l. Items excluded from balance sheet

Using the letters above, classify the following accounts according to the preferred and ordinary balance sheet presentation.

____ 1. Bond sinking fund

____ 2. Common stock dividend distributable

____ 3. Appropriation for plant expansion

____ 4. Bank overdraft

____ 5. Bonds payable (due 2017)

____ 6. Premium on common stock

____ 7. Securities owned by another company which are collateral for that company's note

____ 8. Equity investments (trading)

____ 9. Inventory

____ 10. Discount on bonds payable

____ 11. Patents

____ 12. Unearned rent revenue

Solution 5-110

1. b	5. g	9. a
2. i	6. j	10. g
3. k	7. l	11. d
4. f	8. a	12. f

Ex. 5-111—Valuation of Balance Sheet Items.

Use the code letters listed below (a – l) to indicate, for each balance sheet item (1 – 13) listed below the usual valuation reported on the balance sheet.

____ 1. Common stock

____ 2. Prepaid insurance

____ 3. Natural resources

____ 4. Property, plant, and equipment

____ 5. Accounts receivable

____ 6. Copyrights

____ 7. Inventory

____ 8. Long-term bonds payable

____ 9. Land (in use)

____ 10. Land (future plant site)

____ 11. Patents

____ 12. Equity investments (trading)

____ 13. Accounts payable

a. Par value
b. Current cost of replacement
c. Amount payable when due, less unamortized discount or plus unamortized premium
d. Amount payable when due
e. Market value at balance sheet date
f. Net realizable value
g. Lower of cost or market
h. Original cost less accumulated amortization
i. Original cost less accumulated depletion
j. Original cost less accumulated depreciation
k. Historical cost
l. Unexpired or unconsumed cost

Solution 5-111

1. a
2. l
3. i
4. j
5. f
6. h
7. g
8. c
9. k
10. k
11. h
12. e
13. d

Ex. 5-112—Balance sheet classifications.

Typical balance sheet classifications are as follows.

a. Current Assets
b. Investments
c. Plant Assets
d. Intangible Assets
e. Other Assets
f. Current Liabilities
g. Long-Term Liabilities
h. Capital Stock
i. Additional Paid-In Capital
j. Retained Earnings
k. Notes to Financial Statements
l. Not Reported on Balance Sheet

Indicate by use of the above letters how each of the following items would be classified on a balance sheet prepared at December 31, 2014. If a contra account, or any amount that is negative or opposite the normal balance, put parentheses around the letter selected. A letter may be used more than once or not at all.

____ 1. Accrued salaries and wages

____ 2. Rent revenues for 3 months collected in advance

____ 3. Land used as plant site

____ 4. Equity securities classified as trading

____ 5. Cash

____ 6. Accrued interest payable due in 30 days

____ 7. Premium on preferred stock issued

____ 8. Dividends in arrears on preferred stock

____ 9. Petty cash fund

____ 10. Unamortized discount on bonds payable due 2017

____ 11. Common stock at par value

____ 12. Bond indenture covenants

____ 13. Unamortized premium on bonds payable due in 2018

____ 14. Allowance for doubtful accounts

____ 15. Accumulated depreciation—equipment

____ 16. Natural resource—timberlands

____ 17. Deficit (no net income earned since beginning of company)

____ 18. Goodwill

____ 19. 90 day notes payable

____ 20. Investment in bonds of another company; will be held to 2017 maturity

____ 21. Land held for speculation

____ 22. Death of company president

____ 23. Current maturity of bonds payable

____ 24. Investment in subsidiary; no plans to sell in near future

____ 25. Accounts payable

____ 26. Preferred stock ($10 par)

____ 27. Prepaid rent

____ 28. Copyright

____ 29. Accumulated amortization, patents

____ 30. Earnings not distributed to stockholders

Solution 5-112

1.	f	6.	f	11.	h	16.	c	21.	b	26.	h
2.	f	7.	i	12.	k	17.	(j)	22.	l	27.	a
3.	c	8.	k	13.	g	18.	d	23.	f	28.	d
4.	a	9.	a	14.	(a)	19.	f	24.	b	29.	(d)
5.	a	10.	(g)	15.	(c)	20.	b	25.	f	30.	j

Ex. 5-113—Balance sheet classifications.

The various classifications listed below have been used in the past by Maris Company on its balance sheet. It asks your professional opinion concerning the appropriate classification of each of the items 1-14 below.

a. Current Assets
b. Investments
c. Plant and Equipment
d. Intangible Assets
e. Other Assets
f. Current Liabilities
g. Long-Term Liabilities
h. Common Stock and Paid-in Capital in Excess of Par
i. Retained Earnings

Indicate by letter how each of the following items should be classified. If an item need not be reported on the balance sheet, use the letter "X." A letter may be used more than once or not at all. If an item can be classified in more than one category, choose the category most favored by the authors of your textbook.

____ 1. Employees' payroll deductions.

____ 2. Cash in sinking fund.

____ 3. Rent revenue collected in advance.

____ 4. Equipment retired from use and held for sale.

____ 5. Patents.

____ 6. Payroll cash fund.

____ 7. Goods held on consignment.

____ 8. Accrued revenue on short-term investments.

____ 9. Advances to salespersons.

____10. Premium on bonds payable due two years from date.

____11. Bank overdraft.

____12. Salaries which company budget shows will be paid to employees within the next year.

____13. Work in process.

____14. Appropriation for bonded indebtedness.

Solution 5-113

1. f	5. d	9. a	13. a
2. b	6. a	10. g	14. i
3. f	7. x	11. f	
4. a or e	8. a	12. x	

Ex. 5-114—Balance sheet classifications.

The various classifications listed below have been used in the past by Hale Company on its balance sheet.

a. Current Assets
b. Investments
c. Plant and Equipment
d. Intangible Assets
e. Current Liabilities
f. Long-term Liabilities
g. Common Stock and Paid-in Capital in Excess of Par
h. Retained Earnings

Instructions
Indicate by letter how each of the items below should be classified at December 31, 2014. If an item is not reported on the December 31, 2014 balance sheet, use the letter "X" for your answer. If the item is a contra account within the particular classification, place parentheses around the letter. A letter may be used more than once or not at all.

Sample question and answer:

__(a)__ Allowance for doubtful accounts.

____ 1. Customers' accounts with credit balances.

____ 2. Bond sinking fund.

____ 3. Salaries which the company's cash budget shows will be paid to employees in 2015.

____ 4. Accumulated depreciation—equipment.

____ 5. Appropriation for plant expansion.

____ 6. Amortization of patents for 2014.

____ 7. On December 31, 2014, Hale signed a purchase commitment to buy all of its raw materials from Delta Company for the next 2 years.

____ 8. Discount on bonds payable due March 31, 2017.

____ 9. Launching of Hale's Internet retailing division in February, 2015.

____ 10. Cash dividends declared on December 15, 2014 payable to stockholders on January 15, 2015.

Solution 5-114

1.	e	4.	(c)	7.	x	10.	e
2.	b	5.	h	8.	(f)		
3.	x	6.	x	9.	x		

Ex. 5-115—Statement of cash flows.

For each event listed below, select the appropriate category which describes the effect of the event on a statement of cash flows:

a. Cash provided/used by operating activities.
b. Cash provided/used by investing activities.
c. Cash provided/used by financing activities.
d. Not a cash flow.

____ 1. Payment on long-term debt

____ 2. Issuance of bonds at a premium

____ 3. Collection of accounts receivable

____ 4. Cash dividends declared

____ 5. Issuance of stock to acquire land

____ 6. Sale of available-for-sale securities (long-term)

____ 7. Payment of employees' wages

____ 8. Issuance of common stock for cash

____ 9. Payment of income taxes payable

____10. Purchase of equipment

____11. Purchase of treasury stock (common)

____12. Sale of real estate held as a long-term investment

Solution 5-115

1.	c	4.	d	7.	a	10.	b
2.	c	5.	d	8.	c	11.	c
3.	a	6.	b	9.	a	12.	b

Ex. 5-116—Statement of cash flows ratios.

Financial statements for Hilton Company are presented below:

Hilton Company
Balance Sheet
December 31, 2014

Assets		Liabilities & Stockholders' Equity	
Cash	$ 40,000	Accounts payable	$ 20,000
Accounts receivable	35,000	Bonds payable	50,000
Buildings and equipment	150,000	Common stock	65,000
Accumulated depreciation—		Retained earnings	60,000
buildings and equipment	(50,000)		$195,000
Patents	20,000		
	$195,000		

Hilton Company
Statement of Cash Flows
For the Year Ended December 31, 2014

Cash flows from operating activities		
Net income		$55,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accounts receivable	$(16,000)	
Increase in accounts payable	8,000	
Depreciation—buildings and equipment	15,000	
Gain on sale of equipment	(6,000)	
Amortization of patents	2,000	3,000
Net cash provided by operating activities		58,000
Cash flows from investing activities		
Sale of equipment	12,000	
Purchase of land	(25,000)	
Purchase of buildings and equipment	(48,000)	
Net cash used by investing activities		(61,000)
Cash flows from financing activities		
Payment of cash dividend	(15,000)	
Sale of bonds	30,000	
Net cash provided by financing activities		15,000
Net increase in cash		12,000
Cash, January 1, 2014		28,000
Cash, December 31, 2014		$40,000

At the beginning of 2014, Accounts Payable amounted to $12,000 and Bonds Payable was $20,000.

Instructions
Calculate the following for Hilton Company:

a. Current cash debt coverage
b. Cash debt coverage
c. Free cash flow

d. Explain the purpose of free cash flow analysis.

Solution 5-116

a. Current cash debt coverage $= \dfrac{\text{Net cash provided by operating activities}}{\text{Average current liabilities}}$

$$= \frac{\$58,000}{(\$12,000 + \$20,000) \div 2} = \frac{\$58,000}{\$16,000} = \underline{\underline{3.6 : 1}}$$

b. Cash debt coverage $= \dfrac{\text{Net cash provided by operating activities}}{\text{Average total liabilities}}$

$$= \frac{\$58,000}{(\$32,000 + \$70,000) \div 2} = \frac{\$58,000}{\$51,000} = \underline{\underline{1.1 : 1}}$$

c. Free cash flow = Net cash provided by operating activities – capital expenditures and dividends

= \$58,000 – *\$73,000 – \$15,000 = $\underline{\underline{\$(30,000)}}$

*\$25,000 + \$48,000

d. Free cash flow is net cash provided by operating activities less capital expenditures and dividends. The purpose of free cash flow analysis is to determine the amount of discretionary cash flow a company has for purchasing additional investments, retiring its debt, purchasing treasury stock, or simply adding to its liquidity and financial flexibility.

PROBLEMS

Pr. 5-117—Balance sheet format.

The following balance sheet has been submitted to you by an inexperienced bookkeeper. List your suggestions for improvements in the format of the balance sheet. Consider both terminology deficiencies as well as classification inaccuracies.

Jasper Industries, Inc.
Balance Sheet
For the Period Ended 12/31/14

Assets			
Fixed Assets—Tangible			
Equipment	$110,000		
Less: reserve for depreciation	(40,000)	$ 70,000	
Factory supplies		22,000	
Land and buildings	400,000		
Less: reserve for depreciation	(150,000)	250,000	
Plant site held for future use		90,000	$ 432,000
Current Assets			
Accounts receivable		175,000	
Cash		80,000	
Inventory		220,000	
Treasury stock (at cost)		20,000	495,000
Fixed Assets--Intangible			
Goodwill		80,000	
Notes receivable		40,000	
Patents		26,000	146,000
Deferred Charges			
Advances to salespersons		60,000	
Prepaid rent		27,000	
Returnable containers		75,000	162,000
TOTAL ASSETS			$1,235,000
Liabilities			
Current Liabilities			
Accounts payable		$140,000	
Allowance for doubtful accounts		8,000	
Common stock dividend distributable		35,000	
Income tax payable		42,000	
Sales tax payable		17,000	$ 242,000
Long-Term Liabilities, 5% debenture bonds, due 2017		500,000	
Reserve for contingencies		150,000	650,000
TOTAL LIABILITIES			892,000
Equity			
Capital stock, $10 par value, issued 12,000 shares with 60 shares held as treasury stock		$150,000	
Capital surplus		90,000	
Dividends paid		(20,000)	
Earned surplus		123,000	
TOTAL EQUITY			343,000
TOTAL LIABILITIES AND EQUITY			$1,235,000

Note 1. The reserve for contingencies has been created by charges to earned surplus and has been established to provide a cushion for future uncertainties.

Note 2. The inventory account includes only items physically present at the main plant and warehouse. Items located at the company's branch sales office amounting to $40,000 are excluded since the company has consistently followed this procedure for many years.

Solution 5-117

1. The heading should be as of a specific date rather than for a period of time.
2. Reserve for Depreciation is poor terminology; the title Accumulated Depreciation is more appropriate.
3. Land and buildings should be segregated into two accounts. The Accumulated Depreciation account should only be reported for the buildings.
4. Plant site held for future use should be shown in the Investments section.
5. Current assets should be shown on the balance sheet first in most situations; current assets are listed usually in order of liquidity; factory supplies should be shown as a current asset.
6. Treasury stock is not an asset, but a contra account to stockholders' equity in most situations.
7. Notes receivable should be reported as a current asset or an investment.
8. The deferred charge items should be reclassified as follows in most situations:

   Advances to salespersons—current asset
   Prepaid rent—current asset
   Returnable containers—current asset

9. Allowance for doubtful accounts should be shown as a contra account to accounts receivable.
10. Common stock dividend distributable should be shown in stockholders' equity.
11. 5% debenture bonds should be shown on a separate line.
12. Reserve for Contingencies should be shown as an appropriation of retained earnings. The authors prefer the term "appropriation" to the term "reserve."
13. Capital stock should be shown at the par value of the shares issued, $120,000. Any excess should be included in a paid-in capital account.
14. Capital surplus and earned surplus are poor terminology. The terms "additional paid-in capital" and "retained earnings" are more appropriate.
15. The dividends paid title is a misnomer. It probably is a dividends declared item that should be closed to retained earnings.
16. No reference in the body of the statement is made to the notes. The order of the notes is wrong.
17. Note 2 indicates that the inventory account is understated by $40,000.
18. Specific identification and description of all significant accounting principles and methods that involve selection from among alternatives and/or those that are peculiar to a given industry should be disclosed in the annual report.

Pr. 5-118—Balance sheet presentation.

The following balance sheet was prepared by the bookkeeper for Kraus Company as of December 31, 2014.

Kraus Company
Balance Sheet
as of December 31, 2014

Cash	$ 95,000	Accounts payable	$ 85,000
Accounts receivable (net)	52,200	Bonds payable	100,000
Inventory	62,000	Stockholders' equity	238,500
Investments	76,300		
Equipment (net)	106,000		
Patents	32,000		
	$423,500		$423,500

The following additional information is provided:

1. Cash includes the cash surrender value of a life insurance policy $9,400, and a bank overdraft of $2,500 has been deducted.
2. The net accounts receivable balance includes:
   (a) accounts receivable—debit balances $60,000;
   (b) accounts receivable—credit balances $4,000;
   (c) allowance for doubtful accounts $3,800.
3. Inventory does not include goods costing $3,000 shipped out on consignment. Receivables of $3,000 were recorded on these goods.
4. Investments include investments in common stock, trading $19,000 and available-for-sale $48,300, and franchises $9,000.
5. Equipment costing $5,000 with accumulated depreciation $4,000 is no longer used and is held for sale. Accumulated depreciation on the other equipment is $40,000.

Instructions

Prepare a balance sheet in good form (stockholders' equity details can be omitted.)

Solution 5-118

Kraus Company
Balance Sheet
As of December 31, 2014

Assets				
Current assets				
Cash			$ 88,100	(1)
Trading securities			19,000	
Accounts receivable	$ 57,000	(2)		
Less: Allowance for doubtful accounts	3,800		53,200	
Inventories			65,000	(3)
*Equipment held for sale			1,000	(4)
Total current assets			226,300	
Investments				
Available-for-sale securities	48,300			
Cash surrender value	9,400		57,700	
Property, plant, and equipment				
Equipment	145,000	(5)		
Less: accumulated depreciation	40,000		105,000	
Intangible assets				
Patents	32,000			
Franchises	9,000		41,000	
Total assets			$430,000	
Liabilities and Stockholders' Equity				
Current liabilities				
Accounts payable			$ 85,000	
Bank overdraft			2,500	
Unearned revenue			4,000	(6)
Total current liabilities			91,500	
Long-term liabilities				
Bonds payable			100,000	
Total liabilities			191,500	
Stockholders' equity			238,500	
Total liabilities and stockholders' equity			$430,000	

(1) ($95,000 – $9,400 + $2,500)
(2) ($60,000 – $3,000)
(3) ($62,000 + $3,000)
(4) ($5,000 – $4,000)
(5) ($106,000 + $40,000 – $5,000 + $4,000)
(6) Credit balances in accounts receivable

*An alternative is to show it as an other asset.

Pr. 5-119—Balance sheet presentation.

Given the following account information for Leong Corporation, prepare a balance sheet in report form for the company as of December 31, 2014. All accounts have normal balances.

Equipment	60,000
Interest Expense	2,400
Interest Payable	600
Retained Earnings	?
Dividends	50,400
Land	137,320
Accounts Receivable	102,000
Bonds Payable	78,000
Notes Payable (due in 6 months)	29,400
Common Stock	70,000
Accumulated Depreciation - Equip.	10,000
Prepaid Advertising	5,000
Service Revenue	341,400
Buildings	80,400
Supplies	1,860
Income Taxes Payable	3,000
Utilities Expense	1,320
Advertising Expense	1,560
Salaries and Wages Expense	53,040
Salaries and Wages Payable	900
Accumulated Depr. - Bld.	15,000
Cash	45,000
Depreciation Expense	8,000

Solution 5-119

Leong Corporation			
Balance Sheet			
December 31, 2014			
Assets			
Cash		$ 45,000	
Accounts Receivable		102,000	
Supplies		1,860	
Prepaid advertising		5,000	
Total current assets			$ 153,860
Land		137,320	
Building	$ 80,400		
Accumulated depreciation - bld	(15,000)	65,400	
Equipment	60,000		
Accumulated depreciation -eq	(10,000)	50,000	252,720
Total assets			$ 406,580
Liabilities & Stockholders' Equity			
Notes payable		$ 29,400	
Taxes payable		3,000	
Salaries and wages payable		900	
Interest payable		600	
Total current liabilities			$ 33,900
Long-term liabilities			
Bonds payable			78,000
Total liabilities			111,900
Common stock		70,000	
Retained earnings ($275,080*- $50,400)		224,680	
Total stockholders' equity			294,680
Total liabilities & stockholders' equity			$ 406,580

*$341,400 - $53,040 - $8,000 - $2,400 - $1,560 - $1,320

Pr. 5-120—Statement of cash flows preparation.

Selected financial statement information and additional data for Stanislaus Co. is presented below. Prepare a statement of cash flows for the year ending December 31, 2014

	December 31	
	2013	2014
Cash	$42,000	$65,000
Accounts receivable (net)	84,000	144,200
Inventory	168,000	206,600
Land	58,800	21,000
Equipment	504,000	789,600
TOTAL	$856,800	$1,226,400
Accumulated depreciation	$84,000	$115,600
Accounts payable	50,400	86,000
Notes payable - short-term	67,200	29,400
Notes payable - long-term	168,000	302,400
Common stock	420,000	487,200
Retained earnings	67,200	205,800
TOTAL	$856,800	$1,226,400

Additional data for 2014:
1. Net income was $220,200.
2. Depreciation was $31,600.
3. Land was sold at its original cost.
4. Dividends of $81,600 were paid.
5. Equipment was purchased for $84,000 cash.
6. A long-term note for $201,600 was used to pay for an equipment purchase.
7. Common stock was issued to pay a $67,200 long-term note payable.

Solution 5-120

Stanislaus Co.
Statement of Cash Flows
For the year ended December 31, 2014

Net Income		$220,200
Cash flow from operating activities		
Depreciation expense	31,600	
Increase in accounts receivable	(60,200)	
Increase in inventory	(38,600)	
Increase in accounts payable	35,600	
Decrease in short-term notes payable	(37,800)	(69,400)
Net cash provided by operating activities		150,800
Cash flow from investing activities		
Purchase equipment	(84,000)	
Sale of land	37,800	
Net cash used by investing activities		(46,200)
Cash flow from financing activities		
Payment of cash dividend	(81,600)	
Net cash used by financing activities		(81,600)
Net increase in cash		23,000
Cash at beginning of year		42,000
Cash at end of the year		65,000

Noncash investing and financing activities

Payment of long-term note payable with issuance of $67,200 of common stock

Payment for equipment with issuance of $201,600 long-term note

Pr. 5-121—Statement of cash flows preparation.

Selected financial statement information and additional data for Johnston Enterprises is presented below. Prepare a statement of cash flows for the year ending December 31, 2014

Johnston Enterprises
Balance Sheet and Income Statement Data

	December 31, 2014	December 31, 2013
Current Assets:		
Cash	$143,000	$119,000
Accounts Receivable	228,000	306,000
Inventory	391,000	340,000
Total Current Assets	762,000	765,000
Property, Plant, and Equipment	1,261,000	1,122,000
Less: Accumulated Depreciation	(476,000)	(442,000)
Total Assets	$1,547,000	$1,445,000
Current Liabilities:		
Accounts Payable	$187,000	$102,000
Notes Payable	51,000	68,000
Income Taxes Payable	85,000	76,500
Total Current Liabilities	323,000	246,500
Bonds Payable	350,000	391,000
Total Liabilities	673,000	637,500
Stockholders' Equity:		
Common Stock	510,000	467,500
Retained Earnings	364,000	340,000
Total Stockholders' Equity	874,000	807,500
Total Liabilities & Stockholders' Equity	$1,547,000	$1,445,000
Sales Revenue	1,615,000	$1,513,000
Less Cost of Goods Sold	781,000	731,000
Gross Profit	834,000	782,000
Expenses:		
Depreciation Expense	153,000	136,000
Salaries and Wages Expense	391,000	357,000
Interest Expense	34,000	34,000
Loss on Sale of Equipment	12,000	0
Income Before Taxes	244,000	255,000
Less Income Tax Expense	98,000	102,000
Net Income	$146,000	$153,000

Additional Information:
During the year, Johnston sold equipment with an original cost of $133,000 and accumulated depreciation of $119,000 and purchased new equipment for $272,000.

Solution 5-121

Johnston Enterprises
Statement of Cash Flows
For the Year Ended December 31, 2014

Net Income		$ 146,000
Cash flow from operating activities		
Depreciation expense	153,000	
Loss on sale of equipment	12,000	
Decrease in accounts receivable	78,000	
Increase in inventory	(51,000)	
Increase in accounts payable	85,000	
Decrease in notes payable	(17,000)	
Increase in tax payable	8,500	268,500
Net cash provided by operating activities		414,500
Cash flow from investing activities		
Sale of equipment	2,000	
Purchase of equipment	(272,000)	
Net cash used by investing activities		(270,000)
Cash flow from financing activities		
Retirement of bonds payable	(41,000)	
Issuance of common stock	42,500	
Payment of dividends	(122,000)**	
Net cash used by financing activities		(120,500)
Net increase in cash		24,000
Beginning cash		119,000
Cash at end of year		$143,000

**Beginning R/E + Net income – Dividends = Ending R/E
$340,000 + $146,000 – Dividends = $364,000
Dividends = $122,000

IFRS QUESTIONS

True/False:

1. Although the presentation formats for the balance sheet and statement of cash flows are similar under IFRS and U.S. GAAP, IFRS requires far more extensive disclosure.
2. One significant difference between a balance sheet prepared using IFRS rather than U.S. GAAP is that long-term tangible assets may be reported at fair value rather than historical cost.
3. Both IFRS and U.S. GAAP require that specific items be reported on the balance sheet.
4. Both IFRS and U.S. GAAP require current assets to be listed first on the balance sheet.

Answers to True/False:

1. False
2. True
3. False
4. False

Multiple Choice Questions:

5. Which of the following statements about IFRS and U.S. GAAP accounting and reporting requirements for the balance sheet is not correct?
   a. The presentation formats required by IFRS and U.S. GAAP for the balance sheet are similar.
   b. One difference between the reporting requirements under IFRS and those of U.S. GAAP balance sheet is that an IFRS balance sheet may list long-term assets first.
   c. Both IFRS and U.S. GAAP require that property, plant and equipment be reported at historical cost on the balance sheet.
   d. Both IFRS and U.S. GAAP require that comparative information be reported.

Use the following information to answer the next two questions.

Franco Company uses IFRS and owns property, plant and equipment with a historical cost of 5,000,000 euros. At December 31, 2013, the company reported a valuation reserve of 8,565,000 euros. At December 31, 2014, the property, plant and equipment was appraised at 5,525,000 euros.

6. The property, plant and equipment will be reported on the December 31, 2014 statement of financial position at
   a. 5,000,000 euros.
   b. 5,525,000 euros.
   c. 8,565,000 euros.
   d. 9,090,000 euros.

7. The valuation reserve at December 31, 2014 will be reported at
   a. 8,040,000 euros on the Statement of Stockholders’ Equity.
   b. 8,565,000 euros in the Assets section of the Statement of Financial Position
   c. 9,090,000 euros in the equity section of the Statement of Financial Position.
   d. 525,000 euros on the Income Statement.

8. Similarities between IFRS and U.S. GAAP requirements for balance sheet presentation include all of the following except:
   a. Both require that changes to the valuation reserve be disclosed in the notes to the financial statements.
   b. Both require disclosure of significant accounting policies.
   c. Both require the preparation of financial statements annually.
   d. Both generally require the use of the current/ non-current classification for both assets and liabilities.

9. Under IFRS, current assets are listed in:
   a. the order of liquidity.
   b. the reverse order of liquidity.
   c. the ascending order of their balances.
   d. the descending order of their balances.

10. Under IFRS, which of the following current assets will be listed last in a statement of financial position?
    a. Inventory
    b. Accounts Receivable
    c. Short-term Investments Cash
    d. Cash

Answers to Multiple Choice:

5. c
6. b
7. c
8. a
9. b
10. d

IFRS Short Answer:

11. Briefly describe some of the similarities and differences between U.S. GAAP and IFRS with respect to balance sheet reporting.

    1. Among the similarities between U.S. and IFRS related to balance sheet presentation are as follows:

        - IAS 1 specifies minimum note disclosures. These must include information about (1) accounting policies followed, (2) judgments that management has made in the process of applying the entity's accounting policies, and (3) the key assumptions and estimation uncertainty that could result in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.
        - Comparative prior-period information must be presented and financial statements must be prepared annually.
        - Current/non-current classification for assets and liabilities is normally required. In general, post-balance sheet events are not considered in classifying items as current or non-current.

Differences include (1) IFRS statements may report property, plant, and equipment first in the balance sheet. Some companies report the sub-total “net assets”, which equals total assets minus total liabilities. (2) While the use of the term “reserve” is discouraged in U.S. GAAP, there is no such prohibition in IFRS.

12. Briefly describe the convergence efforts related to financial statement presentation.

2. The IASB and the FASB are working on a project to converge their standards related to financial statement presentation. This joint project will establish a common, high-quality standard for presentation of information in the financial statements, including the classification and display of line items. A key feature of the proposed framework for financial statement presentation is that each of the statements will be organized in the same format to separate an entity’s financing activities from its operating and other activities (investing) and further separates financing activities into transactions with owners and creditors. Thus, the same classifications used in the balance sheet would also be used in the income statement and the statement of cash flows.