CHAPTER 2

# A further look at FINANCIAL STATEMENTS

### Summary of Question TYPEs by STUDY Objective and Level of difficulty

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Item** | **SO** | **LOD** | **Item** | **SO** | **LOD** | **Item** | **SO** | **LOD** | **Item** | **SO** | **LOD** | **Item** | **SO** | **LOD** |
| **True-False Statements** | | | | | | | | | | | | | | |
| 1. | 1 | E | 16. | 2 | E | 31. | 2 | E | 46. | 3 | M | 61. | 3 | E |
| 2. | 1 | E | 17. | 2 | E | 32. | 2 | M | 47. | 3 | M | 62. | 3 | E |
| 3. | 1 | E | 18. | 2 | M | 33. | 2 | M | 48. | 3 | M | 63. | 3 | E |
| 4. | 1 | E | 19. | 2 | E | 34. | 2 | M | 49. | 3 | M | 64. | 3 | M |
| 5. | 1 | E | 20. | 2 | M | 35. | 2 | E | 50. | 3 | M | 65. | 3 | M |
| 6. | 1 | E | 21. | 2 | M | 36. | 2 | E | 51. | 3 | E | 66. | 3 | E |
| 7. | 1 | M | 22. | 2 | E | 37. | 2 | M | 52. | 3 | E | 67. | 3 | E |
| 8. | 1 | M | 23. | 2 | M | 38. | 2 | M | 53. | 3 | E | 68. | 3 | E |
| 9. | 1 | M | 24. | 2 | M | 39. | 2 | M | 54. | 3 | M | 69. | 3 | M |
| 10. | 1 | M | 25. | 2 | E | 40. | 3 | E | 55. | 3 | M | 70. | 3 | M |
| 11. | 1 | M | 26. | 2 | M | 41. | 3 | E | 56. | 3 | E | 71. | 3 | H |
| 12. | 1 | M | 27. | 2 | M | 42. | 3 | M | 57. | 3 | M | 72. | 3 | M |
| 13. | 1 | M | 28. | 2 | M | 43. | 3 | E | 58. | 3 | M | 73. | 3 | E |
| 14. | 1 | M | 29. | 2 | E | 44. | 3 | M | 59. | 3 | E | 74. | 3 | M |
| 15. | 1 | M | 30. | 2 | M | 45. | 3 | M | 60. | 3 | M | 75. | 3 | E |
| **Multiple Choice Questions** | | | | | | | | | | | | | | |
| 76. | 1 | E | 91. | 1 | M | 106. | 2 | E | 121. | 2 | E | 136. | 3 | E |
| 77. | 1 | M | 92. | 1 | M | 107. | 2 | E | 122. | 2 | H | 137. | 3 | E |
| 78. | 1 | E | 93. | 1 | M | 108. | 2 | M | 123. | 2 | H | 138. | 3 | M |
| 79. | 1 | E | 94. | 1 | H | 109. | 2 | E | 124. | 2 | M | 139. | 3 | H |
| 80. | 1 | M | 95. | 1 | M | 110. | 2 | M | 125. | 2 | M | 140. | 3 | E |
| 81. | 1 | E | 96. | 1 | M | 111. | 2 | E | 126. | 2 | M | 141. | 3 | E |
| 82. | 1 | M | 97. | 1 | E | 112. | 2 | M | 127. | 2 | H | 142. | 3 | E |
| 83. | 1 | E | 98. | 1 | H | 113. | 2 | M | 128. | 2 | M | 143. | 3 | E |
| 84. | 1 | E | 99. | 1 | M | 114. | 2 | E | 129. | 2 | M | 144. | 3 | E |
| 85. | 1 | E | 100. | 1 | M | 115. | 2 | E | 130. | 3 | E | 145. | 3 | M |
| 86. | 1 | E | 101. | 2 | E | 116. | 2 | M | 131. | 3 | E | 146. | 3 | E |
| 87. | 1 | E | 102. | 2 | M | 117. | 2 | M | 132. | 3 | M | 147. | 3 | H |
| 88. | 1 | M | 103. | 2 | M | 118. | 2 | M | 133. | 3 | M | 148. | 3 | E |
| 89. | 1 | M | 104. | 2 | E | 119. | 2 | E | 134. | 3 | M | 149. | 3 | E |
| 90. | 1 | M | 105. | 2 | E | 120. | 2 | M | 135. | 3 | E | 150. | 3 | E |
| **Exercises** | | | | | | | | | | | | | | |
| 151. | 1 | M | 155. | 1,2 | M | 159. | 2 | E | 163. | 2 | M | 167. | 3 | M |
| 152. | 1 | E | 156. | 1,2 | M | 160. | 2 | M | 164. | 2 | E | 168. | 3 | E |
| 153. | 1 | E | 157. | 2 | H | 161. | 2 | E | 165. | 2 | E |  |  |  |
| 154. | 1 | E | 158. | 2 | H | 162. | 2 | H | 166. | 3 | E |  |  |  |
| **Matching** | | | | | | | | | | | | | | |
| 169. |  | 1–3 |  |  |  |  |  |  |  |  |  |  |  |  |
| **Short-Answer Essay** | | | | | | | | | | | | | | |
| 170. | 1,2 | E | 172. | 3 | E | 174. | 3 | E |  |  |  |  |  |  |
| 171. | 2 | M | 173. | 3 | E |  |  |  |  |  |  |  |  |  |

Note: E = Easy M = Medium H = Hard

**SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Item** | **Type** | **Item** | **Type** | **Item** | **Type** | **Item** | **Type** | **Item** | **Type** | **Item** | **Type** | **Item** | **Type** |
| **Study Objective 1** | | | | | | | | | | | | | |
| 1. | TF | 8. | TF | 15. | TF | 82. | MC | 89. | MC | 96. | MC | 153. | Ex |
| 2. | TF | 9. | TF | 76. | MC | 83. | MC | 90. | MC | 97. | MC | 154. | Ex |
| 3. | TF | 10. | TF | 77. | MC | 84. | MC | 91. | MC | 98. | MC | 155. | Ex |
| 4. | TF | 11. | TF | 78. | MC | 85. | MC | 92. | MC | 99. | MC | 156. | Ex |
| 5. | TF | 12. | TF | 79. | MC | 86. | MC | 93. | MC | 100. | MC | 169. | Ma |
| 6. | TF | 13. | TF | 80. | MC | 87. | MC | 94. | MC | 151. | Ex | 170. | SAE |
| 7. | TF | 14. | TF | 81. | MC | 88. | MC | 95. | MC | 152. | Ex |  |  |
| **Study Objective 2** | | | | | | | | | | | | | |
| 16. | TF | 26. | TF | 36. | TF | 107. | MC | 117. | MC | 127. | MC | 162. | Ex |
| 17. | TF | 27. | TF | 37. | TF | 108. | MC | 118. | MC | 128. | MC | 163. | Ex |
| 18. | TF | 28. | TF | 38. | TF | 109. | MC | 119. | MC | 129. | MC | 164. | Ex |
| 19. | TF | 29. | TF | 39. | TF | 110. | MC | 120. | MC | 155. | Ex | 165. | Ex |
| 20. | TF | 30. | TF | 101. | MC | 111. | MC | 121. | MC | 156. | Ex | 169. | Ma |
| 21. | TF | 31. | TF | 102. | MC | 112. | MC | 122. | MC | 157. | Ex | 170. | SAE |
| 22. | TF | 32. | TF | 103. | MC | 113. | MC | 123. | MC | 158. | Ex | 171. | SAE |
| 23. | TF | 34. | TF | 104. | MC | 114. | MC | 124. | MC | 159. | Ex |  |  |
| 24. | TF | 34. | TF | 105. | MC | 115. | MC | 125. | MC | 160. | Ex |  |  |
| 25. | TF | 35. | TF | 106. | MC | 116. | MC | 126. | MC | 161. | Ex |  |  |
| **Study Objective 3** | | | | | | | | | | | | | |
| 40. | TF | 51. | TF | 62. | TF | 73. | TF | 138. | MC | 149. | MC |  |  |
| 41. | TF | 52. | TF | 63. | TF | 74. | TF | 139. | MC | 150. | MC |  |  |
| 42. | TF | 53. | TF | 64. | TF | 75. | TF | 140. | MC | 166. | Ex |  |  |
| 43. | TF | 54. | TF | 65. | TF | 130. | MC | 141. | MC | 167. | Ex |  |  |
| 44. | TF | 55. | TF | 66. | TF | 131. | MC | 142. | MC | 168. | Ex |  |  |
| 45. | TF | 56. | TF | 67. | TF | 132. | MC | 143. | MC | 169. | Ma |  |  |
| 46. | TF | 57. | TF | 68. | TF | 133. | MC | 144. | MC | 172. | SAE |  |  |
| 47. | TF | 58. | TF | 69. | TF | 134. | MC | 145. | MC | 173. | SAE |  |  |
| 48. | TF | 59. | TF | 70. | TF | 135. | MC | 146. | MC | 174. | SAE |  |  |
| 49. | TF | 60. | TF | 71. | TF | 136. | MC | 147. | MC |  |  |  |  |
| 50. | TF | 61. | TF | 72. | TF | 137. | MC | 148. | MC |  |  |  |  |

Note: TF = True-False Ma = Matching

MC = Multiple Choice Ex = Exercise SAE = Short-Answer Essay

## CHAPTER STUDY OBJECTIVES

1. ***Identify the sections of a classified statement of financial position.*** In a classified statement of financial position, assets are classified as current or non-current assets. In the non-current asset category, they are further classified as investments; property, plant and equipment; intangible assets and goodwill; or other assets. Liabilities are classified as either current or non-current. There is also a shareholders’ equity section, which shows share capital and retained earnings, among other equity items if any exist.

2. ***Identify and calculate ratios for analyzing a company’s liquidity, solvency, and profitability.*** Liquidity ratios, such as working capital and the current ratio, measure a company’s short-term ability to pay its maturing obligations and meet unexpected needs for cash. Solvency ratios, such as debt to total assets, measure a company’s ability to survive over a long period by having enough assets to settle its liabilities as they fall due. Profitability ratios, such as earnings per share and the price-earnings ratio, measure a company’s operating success for a specific period of time.

3. ***Describe the framework for the preparation and presentation of financial statements***. The key components of the conceptual framework are (1) the objective of financial reporting; (2) qualitative characteristics of useful financial information, which include fundamental and enhancing characteristics and the cost constraint; (3) the going concern assumption underlying the accounting process; (4) elements of the financial statements; and (5) measurement of the elements of financial statements.

## TRUE-FALSE STATEMENTS

1. Cash and office supplies are both classified as current assets.

2. Inventories and prepaid expenses are classified as long-term investments.

3. Long-term investments appear in the property, plant, and equipment section of the statement of financial position.

4. Special rights and privileges that provide a future economic benefit to the company are classified as intangible assets.

5. A liability is normally classified as a current liability if it is to be paid within the coming year.

6. Shareholders’ equity is divided into at least two parts: share capital and retained earnings.

7. All long-lived assets including land have estimated useful lives over which they are expected to generate revenue.

8. All long-lived assets are depreciated over their estimated useful lives.

9. Mortgages and pension liabilities are examples of non-current liabilities.

10. The investment classification on the statement of financial position normally includes investments that are intended to be held for a short period of time (less than one year).

11. Shareholders' equity consists of two parts: common and preferred shares.

12. The main difference between intangible assets and property, plant, and equipment is the length of the asset’s life.

13. Listing assets and liabilities in reverse order of liquidity is *not* permitted in Canada.

14. The statement of financial position is normally presented as follows, when ordered in order of liquidity: Current assets, current liabilities, non-current assets, non-current liabilities, and shareholders’ equity.

15. The statement of financial position is normally presented as follows, when ordered in order of *reverse* liquidity: Non-current assets, current assets, shareholders’ equity, non-current liabilities, and current liabilities.

16. Intracompany comparisons are based on comparisons with competitors in the same industry.

17. Calculating financial ratios can give clues to underlying conditions that may *not* be noticed by examining each financial statement item separately.

18. Liquidity ratios are concerned with the frequency and amounts of dividend payments.

19. Analysis of financial statements is enhanced with the use of comparative data.

20. Solvency ratios measure the entity’s ability to survive over a long period.

21. A single ratio by itself is *not* very meaningful.

22. Profitability means having enough funds on hand to pay debts when they fall due.

23. Working capital is the difference between total assets and current liabilities.

24. The excess of current assets over current liabilities is called working capital.

25. The current ratio is calculated by dividing total assets by total liabilities.

26. The current ratio takes into account the composition of current assets.

27. A current ratio of 1.2 to 1 indicates that a company's current assets exceed its current liabilities.

28. All companies, regardless of size, should have a current ratio of at least 2:1.

29. The most liquid resource is inventory.

30. Solvency ratios measure the short-term ability of the company to pay its maturing obligations.

31. The debt to total assets ratio measures the percentage of assets financed by creditors rather than shareholders.

32. From a creditor's point of view, the higher the total debt to total assets ratio, the lower the risk that the company may be unable to pay its obligations.

33. Earnings per share is calculated by dividing profit for the period by the dollar value in the common shares account.

34. The price-earnings ratio is calculated by dividing the market price per share by the earnings per share.

35. The price-earnings ratio is a measure of liquidity.

36. Earnings per share is the only ratio that must be presented in the financial statements for publicly traded companies.

37. Earnings per share is frequently compared across companies in the same industry.

38. The higher the price-earnings ratio, the higher are investors’ expectations of the company’s future profitability.

39. Companies using Accounting Standards for Private Enterprises (ASPE) are *not* required to present earnings per share information in their financial statements.

40. Having a conceptual framework of accounting ensures that standards and practices are clear and consistent.

41. Canada has adopted International Financial Reporting Standards for publicly traded companies.

42. The conceptual framework is fundamentally similar for both Canadian publicly traded companies and Canadian private companies.

43. The objective of financial reporting is to provide financial information about a company that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the company.

44. The objective of financial reporting is to provide financial information that is useful to all types of internal and external users in making decisions.

45. The two fundamental qualitative characteristics are relevance and timeliness.

46. The two fundamental qualitative characteristics are faithful representation and relevance.

47. Information is relevant if it will make a difference in a user’s decision(s).

48. Faithful representation means that accounting information must be complete, neutral, and free from material error.

49. Financial reporting does *not* have to present the economic substance of a transaction in order to provide a faithful representation of what really happened.

50. Information has predictive value if it helps users confirm or correct their previous predictions.

51. Materiality and relevance are both defined in terms of what influences or makes a difference to a decision maker.

52. Enhancing qualitative characteristics include timeliness and comparability.

53. Accounting information does *not* have to be understood by the average user with a general business background in order to be useful.

54. Under the going concern assumption, reporting assets, such as land, at their cost may be more appropriate than reporting land at its fair value.

55. In order for information to be relevant, it must be reported on a timely basis.

56. Consistency aids comparability when a company uses the same accounting principles and methods from year to year or when companies with similar circumstances use the same accounting principles.

57. Comparability in accounting means that a company uses the same generally accepted accounting principles from one accounting period to the next.

58. In order to compare the financial statements of different companies, it would be desirable to have each company develop its own set of accounting rules and practices.

59. Comparability and understandability are examples of enhancing qualitative characteristics.

60. Information has verifiability if the information is comparable.

61. The cost constraint ensures that the value of information provided is greater than the cost of providing it.

62. The cost constraint ensures that information costs less than budget.

63. The going concern assumption states that the business will continue in operation for the foreseeable future.

64. If a company is *not* a going concern, the classification of its assets and liabilities does *not* matter.

65. Using a simplified version of Canadian GAAP for small companies in order to reduce the cost of providing financial information is an example of the application of materiality.

66. Elements of financial statements include assets, equity, and expenses, but *not* liabilities.

67. Two measurement principles are historical cost and fair value.

68. Two recognition principles are the fair value basis of accounting and the going concern assumption.

69. In general, standard setters require that most assets be recorded using historical cost because cost is representationally faithful.

70. The fair value basis of accounting states that all assets and liabilities can be reported at fair value.

71. Fair values may *not* always be representationally faithful.

72. The cost basis of accounting states that assets and liabilities should be recorded at their cost *not* only when originally acquired, but also during the time the entity holds them.

73. Qualitative characteristics help ensure that the information provided in financial statements is useful.

74. The going concern assumption underlies the preparation of financial statements.

75. A conceptual framework is still under development for companies using International Financial Reporting Standards (IFRS).

#### Answers to True-False Statements

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** |
| 1. | T | 14. | F | 27. | T | 40. | T | 53. | F | 66. | F |
| 2. | F | 15. | T | 28. | F | 41. | T | 54. | T | 67. | T |
| 3. | F | 16. | F | 29. | F | 42. | T | 55. | T | 68. | F |
| 4. | T | 17. | T | 30. | F | 43. | T | 56. | T | 69. | T |
| 5. | T | 18. | F | 31. | T | 44. | F | 57. | F | 70. | F |
| 6. | T | 19. | T | 32. | F | 45. | F | 58. | F | 71. | T |
| 7. | F | 20. | T | 33. | F | 46. | T | 59. | T | 72. | T |
| 8. | F | 21. | T | 34. | T | 47. | T | 60. | F | 73. | T |
| 9. | T | 22. | F | 35. | F | 48. | T | 61. | T | 74. | T |
| 10. | F | 23. | F | 36. | T | 49. | F | 62. | F | 75. | T |
| 11. | F | 24. | T | 37. | F | 50. | F | 63. | T |  |  |
| 12. | F | 25. | F | 38. | T | 51. | T | 64. | T |  |  |
| 13. | F | 26. | F | 39. | T | 52. | T | 65. | F |  |  |

## MULTIPLE CHOICE QUESTIONS

76. On a classified statement of financial position, prepaid expenses are classified as

(a) a current liability.

(b) property, plant, and equipment.

(c) a current asset.

(d) a long-term investment.

77. A current asset is

(a) the last asset purchased by a business.

(b) an asset which is not currently being used to produce a product or service.

(c) usually found as a separate classification in the income statement.

(d) expected to be converted to cash or used in the business within a relatively short period of time.

78. Which of the following is *not* classified as a current asset?

(a) supplies

(b) short-term (trading) investments

(c) a fund to be used to purchase a building within the next year

(d) equipment with an estimated useful life of five years

79. An intangible asset

(a) derives its value from the rights and privileges it provides the company.

(b) is worthless because it has no physical substance.

(c) is converted into a tangible asset during the year.

(d) cannot be classified on the statement of financial position because it lacks physical substance.

80. Which of the following is *not* considered to be an asset?

(a) equipment

(b) dividends

(c) accounts receivable

(d) inventory

81. The difference between cost and accumulated depreciation is referred to as

(a) net depreciation.

(b) carrying amount.

(c) fair value.

(d) cost value.

82. Trademarks would appear in which section of the statement of financial position?

(a) Shareholders’ equity

(b) Investments

(c) Intangible assets

(d) Current assets

83. Liabilities are generally classified on a statement of financial position as

(a) small liabilities and large liabilities.

(b) present liabilities and future liabilities.

(c) tangible liabilities and intangible liabilities.

(d) current liabilities and non-current liabilities.

84. Which of the following would *not* normally be classified as a non-current liability?

(a) current maturities of non-current debt

(b) bonds payable

(c) mortgage payable

(d) lease liabilities

85. Which of the following is *not* normally a current liability?

(a) salaries payable

(b) accounts payable

(c) income tax payable

(d) bonds payable

86. Office equipment is classified on the statement of financial position as

(a) a current asset.

(b) property, plant, and equipment.

(c) shareholders’ equity.

(d) a long-term investment.

87. Current liabilities are expected to be

(a) converted to cash within one year.

(b) paid within one year.

(c) used in the business within one year.

(d) acquired within one year.

88. On a classified statement of financial position, current assets are often listed

(a) in alphabetical order.

(b) with the largest dollar amounts first.

(c) in the order in which they are expected to be converted into cash.

(d) in the order of acquisition.

89. Long-lived assets without physical substance are

(a) listed directly under current assets on the statement of financial position.

(b) not listed on the statement of financial position because they do not have physical substance.

(c) intangible assets.

(d) listed as a long-term investment on the statement of financial position.

Use the following information to answer questions 90–94.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| HONEST RON'S FURNITURE OUTLET LTD. | | | | | |
| Statement of Financial Position | | | | | |
| December 31, 2015 | | | | | |
| –––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––––– | | | | | |
| Cash |  | $ 5,000 | Accounts payable | $ 30,000 |  |
| Accounts receivable |  | 20,000 | Salaries payable | 10,000 |  |
| Supplies |  | 1,000 | Mortgage payable | 130,000 |  |
| Inventory |  | 170,000 | Total liabilities |  | $170,000 |
| Land |  | 100,000 | Shareholders’ equity |  |  |
| Building | $100,000 |  | Common shares | $140,000 |  |
| Less: Accum. depreciation | 20,000 | 80,000 | Retained earnings | 96,000 |  |
| Trademark | $ 40,000 |  | Total shareholders' equity |  | 236,000 |
| Less:Accum. amortization | 10,000 | 30,000 |  |  |  |
| Total assets |  | $406,000 | Total liabilities and shareholders' equity |  | $406,000 |

90. The dollar amount of current liabilities is

(a) $196,000.

(b) $170,000.

(c) $ 40,000.

(d) $ 30,000.

91. The dollar amount of net property, plant and equipment is

(a) $ 80,000.

(b) $180,000.

(c) $210,000.

(d) $350,000.

92. The dollar amount of current assets is

(a) $ 26,000.

(b) $ 40,000.

(c) $ 25,000.

(d) $196,000.

93. The dollar amount of share capital is

(a) $406,000.

(b) $236,000.

(c) $140,000.

(d) $ 96,000.

94. The total obligations that have resulted from past transactions are

(a) $ 20,000.

(b) $ 40,000.

(c) $ 96,000.

(d) $170,000.

Use the following information to answer questions 95–100.

MARCOTTE MASONARY LTD.

Statement of Financial Position

December 31, 2015

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Cash $ 50,000 Accounts payable $ 40,000

Prepaid insurance 5,000 Salaries payable 5,000

Accounts receivable 75,000 Bonds payable 190,000

Inventory 110,000 Total liabilities 235,000

Land 90,000

Building $220,000 Common shares 200,000

Less: Accumulated Retained earnings 105,000

depreciation 60,000 160,000 Total shareholders’ equity 305,000

Trademark $ 75,000

Less: Accum. amort. 25,000 50,000 Total liabilities and

Total assets $540,000 shareholders’ equity $540,000

95. The total dollar amount of assets to be classified as current assets is

(a) $240,000.

(b) $220,000.

(c) $170,000.

(d) $130,000.

96. The total dollar amount of assets to be classified as net property, plant, and equipment is

(a) $300,000.

(b) $250,000.

(c) $240,000.

(d) $160,000.

97. The total dollar amount of assets to be classified as investments is

(a) $ 0.

(b) $ 50,000.

(c) $ 90,000.

(d) $190,000.

98. The total amount in the contra asset accounts is

(a) $ 60,000.

(b) $ 85,000.

(c) $210,000.

(d) $235,000.

99. Non-current liabilities total

(a) $540,000.

(b) $235,000.

(c) $190,000.

(d) $ 45,000.

100. Profit retained for use in the business is

(a) $540,000.

(b) $305,000.

(c) $200,000.

(d) $105,000.

101. A measure of profitability is the

(a) current ratio.

(b) debt to total assets ratio.

(c) earnings per share.

(d) working capital.

102. Earnings per share is calculated by dividing

(a) revenue by weighted average shareholders’ equity.

(b) revenue by the weighted average number of common shares.

(c) profit by weighted average shareholders’ equity.

(d) profit by the weighted average number of common shares.

103. The price-earnings ratio is calculated by dividing

(a) the market price per share by earnings per share.

(b) earnings per share by the average number of shares.

(c) profit by the market price per share.

(d) earnings per share by the market price per share.

104. The relationship between current assets and current liabilities is important in evaluating a company's

(a) profitability.

(b) liquidity.

(c) fair value.

(d) solvency.

105. The most important information needed to determine if companies can pay their current obligations is the

(a) profit for this year.

(b) projected profit for next year.

(c) relationship between current assets and current liabilities.

(d) relationship between current and non-current liabilities.

106. A short-term creditor is primarily interested in the \_\_\_ of the borrower.

(a) liquidity

(b) profitability

(c) comparability

(d) solvency

107. The current ratio is calculated as

(a) current assets plus current liabilities.

(b) current assets minus current liabilities.

(c) current assets divided by current liabilities.

(d) current assets times current liabilities.

108. Working capital is calculated as

(a) current assets plus current liabilities.

(b) current assets minus current liabilities.

(c) current assets divided by current liabilities.

(d) current assets times current liabilities.

109. Working capital is a measure of

(a) comparability.

(b) liquidity.

(c) profitability.

(d) solvency.

110. Long-term creditors are usually most interested in evaluating

(a) liquidity and profitability.

(b) comparability and profitability.

(c) profitability and solvency.

(d) consistency and solvency.

111. A liquidity ratio measures the

(a) profit or operating success of a company over a period of time.

(b) ability of a company to survive over a long period of time.

(c) short-term ability of a company to pay its maturing obligations and to meet unexpected needs for cash.

(d) percentage of total financing provided by creditors.

112. Working capital is

(a) calculated by dividing current assets by current liabilities.

(b) used to evaluate a company’s liquidity and short-term debt paying ability.

(c) used to evaluate a company’s solvency and long-term debt paying ability.

(d) calculated by subtracting current liabilities from total assets.

113. The ability of a business to pay obligations that are expected to become due within the next year is called

(a) leverage.

(b) liquidity.

(c) profitability.

(d) solvency.

Use the following information to answer questions 114–118.

Current assets $18,000 Net sales $40,000

Current liabilities 8,000 Total liabilities 10,000

Average assets 80,000 Shareholders’ equity 50,000

Total assets 60,000 Market price of shares $4

Profit 18,000 Weighted average number

of common shares 26,000

114. What is the total amount of working capital?

(a) $4,000

(b) $8,000

(c) $10,000

(d) $14,000

115. What is the current ratio?

(a) 2.3:1

(b) 2.0:1

(c) 0.6:1

(d) 0.4:1

116. What is the earnings per share?

(a) $0.44

(b) $0.70

(c) $1.92

(d) $1.54

117. What is the price-earnings ratio?

(a) 9.1 times

(b) 5.7 times

(c) 2.1 times

(d) 1.7 times

118. What is the debt to total assets?

(a) 12.5%

(b) 20.0%

(c) 75.0%

(d) 16.7%

119. The debt to total assets ratio is calculated by dividing

(a) non-current liabilities by total assets.

(b) non-current liabilities by average assets.

(c) total liabilities by total assets.

(d) total liabilities by average assets.

120. A useful measure of solvency is the

(a) current ratio.

(b) price-earnings ratio.

(c) earnings per share.

(d) debt to total assets.

121. Which of the following is *not* considered a measure of liquidity?

(a) current ratio

(b) working capital

(c) both current ratio and working capital

(d) debt to total assets

122. Investors are usually most interested in evaluating

(a) liquidity and solvency.

(b) solvency and marketability.

(c) liquidity and profitability.

(d) profitability and solvency.

123. Shareholders are most interested in evaluating

(a) liquidity and solvency.

(b) profitability and solvency.

(c) liquidity and profitability.

(d) marketability and solvency.

124. The current assets of Mario Corporation are $420,000. The current liabilities are $300,000. The current ratio expressed as a ratio is

(a) 140%

(b) 1.4:1

(c) 0.7:1

(d) $420,000 ÷ $300,000

125. A weakness of the current ratio is

(a) the difficulty of the calculation.

(b) that it doesn't take into account the composition of the current assets.

(c) that it is rarely used by sophisticated analysts.

(d) that it can be expressed as a percentage, as a rate, or as a proportion.

126. A supplier to a company would probably be most interested in the

(a) debt to total assets.

(b) price-earnings ratio.

(c) current ratio.

(d) earnings per share.

Use the following information for questions 127–128.

Cooney Corporation had $275,000 in current assets and $105,000 in current liabilities before borrowing $75,000 from the bank for a 6-month period.

127. What effect did the borrowing transaction have on the amount of Cooney's working capital?

(a) No effect

(b) $75,000 increase

(c) $105,000 increase

(d) $75,000 decrease

128. What effect did the borrowing transaction have on Cooney's current ratio?

(a) The ratio remained unchanged.

(b) The change in the current ratio cannot be determined.

(c) The ratio decreased.

(d) The ratio increased.

129. City Recycling Inc. has $120,000 in current assets and $100,000 in current liabilities. When the company pays $20,000 owed to employees (salaries payable), what effect does this have on their current ratio?

(a) The ratio increases.

(b) The ratio decreases.

(c) The ratio stays the same.

(d) Cannot be determined.

130. The conceptual framework of accounting helps to ensure that

(a) users with no accounting or business knowledge will understand financial statements.

(b) a rule will be in place for every possible situation.

(c) there are consistent standards prescribing the nature, functions and limits of financial statements.

(d) all countries have their own unique accounting standards.

131. The objective of financial reporting is to

(a) provide information to the Canada Revenue Agency.

(b) provide financial information that is useful to existing and potential investors, lenders and other creditors.

(c) comply with Accounting Standards for Private Enterprises.

(d) comply with International Financial Reporting Standards.

132. The conceptual framework of accounting begins with

(a) qualitative characteristics.

(b) the going concern assumption.

(c) the objective of financing reporting.

(d) elements of financial statements.

133. Which one of the following is *not* a qualitative characteristic of useful accounting information?

(a) relevance

(b) verifiability

(c) going concern

(d) comparability

134. Which one of the following is a fundamental qualitative characteristic?

(a) relevance

(b) timeliness

(c) understandability

(d) comparability

135. In order for accounting information to be relevant, it must

(a) have very little cost.

(b) help predict future events or confirm prior expectations.

(c) be verifiable.

(d) be used by a lot of different organizations.

136. If accounting information has relevance, it

(a) is not required to be complete.

(b) will not have predictive value.

(c) will only make a difference for internal stakeholders.

(d) will make a difference in users’ decisions.

137. The two qualitative characteristics that are defined in terms of what influences or makes a difference to a decision maker are

(a) faithful representation and materiality.

(b) comparability and timeliness

(c) materiality and relevance.

(d) relevance and understandability

138. Which of the following is *not* an enhancing qualitative characteristic?

(a) verifiability

(b) faithful representation

(c) comparability

(d) timeliness

139. Accounting information should be neutral in order to enhance

(a) faithful representation.

(b) materiality.

(c) comparability.

(d) understandability.

140. Which of the following is *not* a main section of the conceptual framework of accounting?

(a) the objective of financial reporting

(b) the going concern assumption

(c) financial analysis

(d) the elements of financial statements

141. Which of the following statements is *not* true?

(a) Comparability means using different accounting principles from year to year within a company.

(b) Faithful representation means information must be neutral, complete, and free from material error.

(c) Relevant accounting information must be capable of making a difference in a user’s decision.

(d) For accounting information to be relevant, it must have timeliness.

142. A company can change to a new accounting principle if management can justify that the change will result in

(a) less likelihood of clerical errors.

(b) higher profit.

(c) lower profit for tax purposes.

(d) more relevant information for decision-making.

143. If accounting information has predictive value, it will help users

(a) prepare for future Canada Revenue Agency audits.

(b) make predictions about future events.

(c) make predictions about foreign currency exchange rates.

(d) confirm or correct previous predictions or expectations.

144. The going concern assumption assumes that the business

(a) will be liquidated in the near future.

(b) will be purchased by another business.

(c) is in a growth industry.

(d) will remain in operation for the foreseeable future.

145. The going concern assumption is inappropriate when

(a) the business is just starting up.

(b) liquidation appears likely.

(c) fair values are higher than costs.

(d) the business is organized as a proprietorship.

146. Which of the following is a constraint in accounting?

(a) comparability

(b) cost

(c) faithful representation

(d) timeliness

147. In general, standard setters require that most assets be recorded using historical cost because

(a) fair values may overstate assets and equity.

(b) fair values may not always be representationally faithful.

(c) cost often cannot be verified.

(d) cost values may or may not be relevant.

148. Which of the following is *not* a financial statement element?

(a) Liabilities

(b) Equity

(c) Expenses

(d) Fair value

149. The qualitative characteristic that says the value of information should exceed the cost of preparing it is called

(a) relevance.

(b) understandability.

(c) cost constraint.

(d) verifiability.

150. The measurement principle that says assets are reported at the price that would be received if the item were sold is called

(a) fair value.

(b) historical cost.

(c) materiality.

(d) going concern.

#### Answers to Multiple Choice Questions

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** | **Item** | **Ans.** |
| 76. | c | 89. | c | 102. | d | 115. | a | 128. | c | 141. | a |
| 77. | d | 90. | c | 103. | a | 116. | b | 129. | a | 142. | d |
| 78. | d | 91. | b | 104. | b | 117. | b | 130. | c | 143. | b |
| 79. | a | 92. | d | 105. | c | 118. | d | 131. | b | 144. | d |
| 80. | b | 93. | c | 106. | a | 119. | c | 132. | c | 145. | b |
| 81. | b | 94. | d | 107. | c | 120. | d | 133. | c | 146. | b |
| 82. | c | 95. | a | 108. | b | 121. | d | 134. | a | 147. | b |
| 83. | d | 96. | b | 109. | b | 122. | d | 135. | b | 148. | d |
| 84. | a | 97. | a | 110. | c | 123. | b | 136. | d | 149. | c |
| 85. | d | 98. | b | 111. | c | 124. | b | 137. | c | 150. | a |
| 86. | b | 99. | c | 112. | b | 125. | b | 138. | b |  |  |
| 87. | b | 100. | d | 113. | b | 126. | c | 139. | a |  |  |
| 88. | c | 101. | c | 114. | c | 127. | d | 140. | c |  |  |

## Exercises

##### Ex. 151

Identify the errors, corrections required, and corrected subtotals required in the following classified statement of financial position. Then prepare a corrected statement of financial position.

RUMPBELL INC.

Statement of Financial Position

Year Ended December 31, 2015

———————————————————————————————————–––––––——

Assets

Current assets

Accounts receivable (net of accounts payable of $2,000) $12,000

Prepaid expenses 1,500

Goodwill 1,200

14,700

Property, plant and equipment $4,300

Less: Accounted depreciation 1,100

Other assets (non-current) 1,720 4,920

Total assets $19,620

Liabilities

Bank loan payable (due in 6 months) $9,500

Long term debt 6,700

Total liabilities 16,200

Shareholders' equity

Retained earnings $2,460

Less: Dividends 150

Common shares 1,110 3,420

Total $19,620

##### Solution 151 (15 min.)

1. The date is not properly identified in the heading—it should be December 31, 2015, not year ended.

2. The accounts payable should not be netted against the receivables—accounts receivable should be $14,000 and accounts payable shown as a current liability of $2,000.

3. Goodwill should not be a current asset. Goodwill is a type of intangible asset, shown separately. Current assets should be $15,500.

4. Other (non-current) assets should not be included with property, plant and equipment subtotal. The subtotal should be $3,200.

5. Accounted depreciation should be accumulated depreciation.

6. A heading “Liabilities and Shareholders' Equity” should replace the “Liabilities” heading.

7. Liabilities should be classified as current and non-current.

8. Current liabilities should include accounts payable of $2,000 and note payable (due in 6 months) of $9,500—for total current liabilities of $11,500.

9. Common shares should be listed first under the shareholders' equity heading.

10. Dividends should not be shown on the statement of financial position—only the ending amount of retained earnings of $2,310 ($2,460 – $150) should be shown.

Corrected statement of financial position:

RUMPBELL INC.

Statement of Financial Position

December 31, 2015

———————————————————————————————————–––––––——

Assets

Current assets

Accounts receivable $14,000

Prepaid expenses 1,500

Total current assets 15,500

Property, plant and equipment $4,300

Less: Accumulated depreciation 1,100 3,200

Goodwill 1,200

Other assets (non-current) 1,720

Total assets $21,620

Liabilities and Shareholders’ Equity

Liabilities

Current liabilities

Accounts payable $2,000

Bank loan payable (due in 6 months) 9,500

Total current liabilities $11,500

Non-current liabilities

Long term debt 6,700

Total liabilities 18,200

Shareholders' equity

Common shares $1,110

Retained earnings 2,310

Total shareholders’ equity 3,420

Total liabilities and shareholders’ equity $21,620

##### Ex. 152

##### The following information is available for Jordi Ltd. at December 31, 2015:

Accounts payable $14,500

Accounts receivable 2,500

Accumulated amortization, patents 3,500

Accumulated depreciation, equipment 3,000

Retained earnings 6,400

Cash 41,900

Common shares 40,000

Equipment 3,500

Land 15,000

Long-term investments 500

Bank loan payable (due in 5 years) 4,200

Patents 5,500

Short-term (trading) investments 2,700

**Instructions**

Use the above information to prepare a classified statement of financial position at December 31, 2015.

##### Solution 152 (20 min.)

JORDI LTD.

Statement of Financial Position

December 31, 2015

———————————————————————————————————–––––––——

Assets

Current assets

Cash $41,900

Short-term (trading) investments 2,700

Accounts receivable 2,500

Total current assets $47,100

Long-term Investments 500

Property, plant, and equipment

Land 15,000

Equipment $3,500

Less Accumulated depreciation, equipment 3,000 500

Intangible assets

Patents $5,500

Less: Accumulated amortization, patents 3,500 2,000

Total assets $65,100

###### Liabilities and Shareholders’ Equity

Current liabilities

Accounts payable $14,500

Total current liabilities 14,500

Non-current liabilities

Bank loan payable 4,200

Total liabilities 18,700

Shareholders’ equity

Common shares $40,000

Retained earnings 6,400

Total shareholders’ equity 46,400

Total liabilities and shareholders’ equity $65,100

##### Ex. 153

The following accounts were taken from a company’s statement of financial position:

Account Classification

|  |  |
| --- | --- |
| Cash |  |
| Inventory |  |
| Trading Investments |  |
| Building |  |
| Accounts payable |  |
| Trademarks |  |
| Equipment |  |
| Prepaid Insurance |  |
| Long term debt |  |
| Unearned Revenue |  |
| Mortgage Payable |  |
| Accounts Receivable |  |
| Accumulated Depreciation- Building |  |
| Land |  |
| Notes Receivable (due in 24 months) |  |
|  |  |

**Instructions**

Classify each of the above accounts as current assets (CA), non-current assets (NCA), current liabilities (CL), non- current liabilities (NCL), or shareholders’ equity (SE).

**Solution 153**

Account Classification

|  |  |
| --- | --- |
| Cash | CA |
| Inventory | CA |
| Trading Investments | CA |
| Building | NCA |
| Accounts payable | CL |
| Trademarks | NCA |
| Equipment | NCA |
| Prepaid Insurance | CA |
| Long term debt | NCL |
| Unearned Revenue | CL |
| Mortgage Payable | NCL |
| Accounts Receivable | CA |
| Accumulated Depreciation- Building | NCA |
| Land | NCA |
| Notes Receivable (due in 24 months) | NCA |

##### Ex. 154

Accounting standards do not prescribe the order in which items are presented in the statement of financial position. Below are various categories to the statement of financial position:

Non-current assets

Shareholders’ equity

Current liabilities

Current assets

Non-current liabilities

**Instructions**

(a) Present each category in “Order of Liquidity”.

(b) Present each category in “Order of Reverse Liquidity”.

**Solution 154**

(a) Order of Liquidity

Current assets

Non-current assets

Current liabilities

Non-current liabilities

Shareholders’ equity

(b) Order of Reverse Liquidity

Non-current assets

Current assets

Shareholders’ equity

Non-current liabilities

Current liabilities

##### Ex. 155

The following items are taken from the financial statements of La Brea Ltd. for the fiscal year ended December 31, 2015. Note they are in alphabetical order.

Accounts payable $ 15,500

Accounts receivable 18,000

Accumulated depreciation—video equipment 30,500

Advertising expense 21,000

Cash 15,000

Common shares (10,000 shares) 90,000

Depreciation expense 12,000

Dividends 5,000

Income tax expense 10,000

Insurance expense 3,000

Bank loan payable 70,000

Prepaid insurance 6,000

Rent expense 22,000

Retained earnings, January 1, 2015 12,000

Salaries expense 32,000

Salaries payable 3,000

Service revenue 143,000

Supplies 4,000

Supplies expense 6,000

Video equipment 210,000

**Instructions**

(a) Calculate the profit for the year.

(b) Calculate the balance of Retained Earnings that would appear on the statement of financial position at December 31, 2015.

(c) Prepare a classified statement of financial position for La Brea Ltd. at December 31, 2015, assuming the bank loan payable is a non-current liability.

(d) Calculate the current ratio, debt to total assets, and earnings per share. Assets at the beginning of 2015 totalled $183,000. No additional shares were issued or redeemed during the year.

##### Solution 155 (20 min.)

(a) Profit is $143,000 – $21,000 – $12,000 – $3,000 – $22,000 – 32,000 – $6,000 – $10,000 = $37,000

(b) Retained earnings, January 1 $12,000

Add: Profit 37,000

49,000

Less: Dividends 5,000

Retained earnings, December 31 $44,000

(c)

LA BREA LTD.

Statement of Financial Position

December 31, 2015

———————————————————————————————————–––––––——

Assets

Current assets

Cash $ 15,000

Accounts receivable 18,000

Supplies 4,000

Prepaid insurance 6,000

Total current assets 43,000

Property, plant and equipment

Video equipment $210,000

Less: Accumulated depreciation—video equipment 30,500 179,500

Total assets $222,500

Liabilities and Shareholders’ Equity

Current liabilities

Accounts payable $ 15,500

Salaries payable 3,000

Total current liabilities 18,500

Non-current liabilities

Bank loan payable 70,000

Total liabilities 88,500

Shareholders’ equity

Common shares $90,000

Retained earnings 44,000 134,000

Total liabilities and shareholders’ equity $222,500

(d) Current ratio: $43,000 ÷ $18,500 = 2.3:1

Debt to total assets: $88,500 ÷ $222,500 = 39.8%

Earnings per share: $37,000 ÷ 10,000 = $3.70

##### Ex. 156

The following items are taken from the financial statements of Columbia Ltd. for the year ended December 31, 2015:

Accounts payable $19,500

Accounts receivable 4,000

Accumulated depreciation – equipment 4,800

Bonds payable 18,000

Cash 22,000

Common shares (1,500 shares issued) 25,000

Cost of goods sold 12,000

Depreciation expense 4,800

Dividends 300

Equipment 48,000

Goodwill 7,500

Income tax expense 1,000

Interest expense 3,500

Market price per common share $4.50

Retained earnings, beginning 16,000

Salaries expense 8,200

Sales revenue 32,500

Supplies 4,500

**Instructions**

(a) Prepare an income statement and a classified statement of financial position for Columbia for 2015.

(b) Calculate the following ratios:

1. Current ratio

2. Debt to total assets

3. Earnings per share

4. Price-earnings ratio

##### Solution 156 (25 min.)

(a)

COLUMBIA LTD.

Income Statement

Year Ended December 31, 2015

———————————————————————————————————–––––––——

Sales revenue $32,500

Operating expenses

Cost of goods sold $12,000

Salaries expense 8,200

Depreciation expense 4,800

Interest expense 3,500 28,500

Profit before income tax 4,000

Income tax expense 1,000

Profit $ 3,000

COLUMBIA LTD.

Statement of Financial Position

December 31, 2015

———————————————————————————————————–––––––——

Assets

Current assets

Cash $22,000

Accounts receivable 4,000

Supplies 4,500

Total current assets 30,500

Property, plant, and equipment

Equipment $48,000

Less: Accumulated depreciation—equipment 4,800 43,200

Goodwill 7,500

Total assets $81,200

Liabilities and Shareholders’ Equity

Current liabilities

Accounts payable $19,500

Non-current liabilities

Bonds payable 18,000

Total liabilities 37,500

Shareholders’ equity

Common shares $25,000

Retained earnings 18,700\* 43,700

Total liabilities and shareholders’ equity $81,200

\*Retained earnings = $18,700 ($16,000 + $3,000 – $300)

(b) 1. Current ratio: $30,500 ÷ $19,500 = 1.6:1

2. Debt to total assets: $37,500 ÷ $81,200 = 46.2%

3. Earnings per share: $3,000 ÷ 1,500 = $2.00

4. Price-earnings ratio: $4.50 ÷ $2.00 = 2.3 times

##### Ex. 157

Presented below is information on XBRL Ltd.:

2015 2014

Cash $ 15,000 $ 12,000

Cash provided by financing activities 20,000 0

Cash used in investing activities 18,000 7,000

Common shares 30,000 30,000

Current assets 85,000 75,000

Current liabilities 60,000 45,000

Dividends paid on common shares 11,000 15,000

Long term assets 125,000 110,000

Price-earnings ratio 12 14

Retained earnings 60,000 40,000

Total liabilities 110,000 95,000

Weighted average number of shares issued 1,000 1,000

**Instructions**

Calculate the following for 2015:

(a) Earnings per share

(b) Market price per common share

(c) Working capital

(d) Current ratio

(e) Debt to total assets

##### Solution 157 (15–20 min.)

(a) Earnings per share

Calculate profit

Retained earnings 2014 $40,000

Less: Dividends paid on common shares 11,000

Subtotal 29,000

Profit X

Retained earnings 2015 $60,000

Solving for X, profit = $31,000

Earnings per share = profit ÷ weighted average number of common shares

= $31,000 ÷ 1,000 = $31

(b) Market price per common share

Price-earnings ratio = Market price per share ÷ EPS

Therefore Market price per share = Price-earnings ratio × EPS = 12 × $31 = $372

(c) Working capital = current assets – current liabilities

= $85,000 – $60,000 = $25,000

(d) Current ratio = current assets ÷ current liabilities

= $85,000 ÷ $60,000 = 1.4:1

(e) Debt to total assets = Total liabilities ÷ Total assets

= $110,000 ÷ ($85,000 + $125,000) = 52%

##### Ex. 158

The following data are taken from the financial statements of Kamloops Inc.:

Accounts payable $28,000

Accounts receivable 56,000

Cash 54,000

Dividends 10,000

Market price per share 12.75

Other current liabilities 17,000

Profit 44,000

Wages payable 5,000

Weighted average number of common shares 10,000

##### Instructions

Calculate the following ratios:

(a) Current ratio

(b) Working capital

(c) Earnings per share

(d) Price-earnings ratio

##### Solution 158 (10 min.)

Current assets = $56,000 + $54,000 = $110,000

Current liabilities = $28,000 + $17,000 + $5,000 = $50,000

(a) Current ratio = Current assets ÷ Current liabilities = $110,000 ÷ $50,000 = 2.2:1

(b) Working capital = Current assets – Current liabilities = $110,000 – $50,000 = $60,000

(c) Earnings per share = Profit ÷ Weighted average number of common shares

= $44,000 ÷ 10,000 = $4.40

(d) Price-earnings ratio = Market price ÷ Earnings per share = $12.75 ÷ $4.40 = 2.9

##### Ex. 159

The following data are taken from the financial statements of Estevan Inc.:

Current assets $150,000

Current liabilities 100,000

Dividends 5,000

Market price per share 5

Net sales 150,000

Profit 21,000

Total liabilities 105,000

Total assets 175,000

Weighted average number of common shares 5,000

**Instructions**

Calculate the following ratios:

(a) Current ratio

(b) Working capital

(c) Earnings per share

(d) Price-earnings ratio

(e) Debt to total assets

##### Solution 159 (15 min.)

(a) Current ratio = Current assets ÷ Current liabilities = $150,000 ÷ $100,000 = 1.5:1

1. Working capital = Current assets – Current liabilities = $150,000 – $100,000 = $50,000

(c) Earnings per share = Profit ÷ Weighted average number of common shares

= $21,000 ÷ 5,000 = $4.20

(d) Price-earnings ratio = Market price per share ÷ Earnings per share

= $5 ÷ $4.20 = 1.2

(e) Debt to total assets = Total debt ÷ Total assets = $105,000 ÷ $175,000 = 60%

##### Ex. 160

The following selected data are taken from the financial statements of Wolsco Inc. The data are in alphabetical order.

Accounts payable $ 40,000

Accounts receivable 65,000

Average assets 460,000

Cash 92,000

Market price/share 52.00

Net sales 500,000

Other current liabilities 15,000

Profit 160,000

Salaries payable 14,000

Shareholders’ equity 269,000

Total assets 472,000

Weighted average number of common shares 3,500

**Instructions**

Calculate the following ratios:

(a) Current ratio

(b) Working capital

(c) Earnings per share

(d) Price-earnings ratio

(e) Debt to total assets

##### Solution 160 (10 min.)

(a) Current ratio = Current assets ÷ Current liabilities

= $157,000 ÷ $69,000 = 2.3:1

(b) Working capital = Current assets – Current liabilities

= $157,000 – $69,000 = $88,000

(c) Earnings per share = Profit ÷ Weighted avg. number of common shares

= $160,000 ÷ 3,500 = $45.71

(d) Price-earnings ratio = Market price per share ÷ Earnings per share

= $52.00 ÷ $45.71= 1.1

(e) Debt to total assets = Total liabilities ÷ Total assets

= $203,000 ÷ $472,000 = 43%

(Total liabilities = Total assets – Shareholders’ equity = $472,000 – $269,000 = $203,000)

##### Ex. 161

For each of the ratios listed below, indicate by the appropriate code letter, whether it is a liquidity ratio, a profitability ratio, or a solvency ratio.

Code:

L = Liquidity ratio

P = Profitability ratio

S = Solvency ratio

1. Earnings per share

2. Debt to total assets

3. Price-earnings ratio

4. Current ratio

##### Solution 161 (5 min.)

P 1. Earnings per share

S 2. Debt to total assets

P 3. Price-earnings ratio

L 4. Current ratio

##### Ex. 162

The following information is available from the 2015 financial statements of Hubble Corp. and Bubble Inc.

(amounts in millions, except share price)

Hubble Bubble

Beginning total assets $17,102 $33,130

Current assets 11,712 28,447

Current liabilities 7,966 14,950

Ending total assets 22,088 36,167

Profit 565 1,271

Sales 26,510 34,512

Share price $79 $112

Total liabilities 16,136 31,222

Weighted average number of common shares 22 39

**Instructions**

(a) For each company, calculate the following ratios:

1. Current ratio

2. Debt to total assets

3. Earnings per share

4. Price-earnings ratio

(b) Based on your calculations, discuss the relative liquidity, solvency, and profitability of the two companies.

##### Solution 162 (15 min.)

(a) Hubble Bubble .

1. Current ratio 1.5:1 ($11,712 ÷ $7,966) 1.9:1 ($28,447 ÷ $14,950)

2. Debt to total assets 73.1% ($16,136 ÷ $22,088) 86.3% ($31,222 ÷ $36,167)

3. Earnings per share $25.68 ($565 ÷ 22) $32.59 ($1,271 ÷ 39)

4. Price-earnings ratio 3.1 ($79 ÷ $25.68) 3.4 ($112 ÷ $32.59)

(b) Based on the current ratio, Bubble is more liquid than Hubble since its current ratio (1.9:1) is 27% higher than Hubble’s ratio (1.5:1). However, Hubble would be considered more solvent than Bubble since its debt to total assets (73.1%) is lower than Bubble’s debt to total assets ratio (86.3%). A lower debt to total assets ratio indicates a company is more solvent and better able to survive over a long period of time.

Bubble has a higher earnings per share and price-earnings ratio than Hubble. Bubble’s earnings per share ($32.59) is 26.9% higher than Hubble’s earnings per share ($25.68); as well, Bubble’s price-earnings ratio (3.4) is 9.7% higher than Hubble’s ratio (3:1).

##### Ex. 163

Selected information from the comparative financial statements of National Falls Inc. for the year ended December 31 appears below:

2015 2014

Accounts receivable $ 142,000 $ 182,000

Bonds payable 490,000 390,000

Cash 27,000 17,000

Cost of goods sold 970,000 900,000

Current liabilities 125,000 95,000

Income tax expense 80,000 60,000

Interest expense 40,000 15,000

Inventory 136,000 154,000

Profit 220,000 155,000

Total assets 1,350,000 950,000

Total revenues 2,100,000 1,100,000

Weighted average number of common shares 15,000 7,000

**Instructions**

Calculate the following ratios for 2015:

(a). Current ratio.

(b) Working capital.

(c) Debt to total assets.

(d) Earnings per share.

##### Solution 163 (12 min.)

(a) Current ratio is 2.4:1.

$27,000 + $142,000 + $136,000

—————————–—————– = 2.4:1

$125,000

(b) Working capital is $180,000.

($27,000 + $142,000 + $136,000) – $125,000 = $180,000

(c) Debt to total assets is 46%.

$125,000 + $490,000

———————–——– = 46%

$1,350,000

(d). Earnings per share is $15.

$220,000

——–—— = $15

15,000

##### Ex. 164

Channing Corporation reported the following current assets and current liabilities:

Dec. 31, 2015 Dec. 31, 2014

Current assets

Cash $ 40,000 $ 30,000

Short-term investments 40,000 10,000

Accounts receivable 55,000 95,000

Inventory 110,000 90,000

Prepaid expenses 35,000 20,000

Total current assets $280,000 $245,000

Current liabilities

Accounts payable $120,000 $110,000

Salaries payable 40,000 30,000

Income tax payable 20,000 15,000

Total current liabilities $180,000 $155,000

**Instructions**

(a) Calculate the following ratios for 2015:

1. Current ratio.

2. Working capital.

(b) Explain the purpose of each ratio.

##### Solution 164 (10–15 min.)

(a)

1. Current ratio = Current assets ÷ Current liabilities

= $280,000 ÷ $180,000

= 1.56:1

2. Working capital = $280,000 – $180,000

= $100,000

(b) The purpose of each ratio:

1. The current ratio is a measure of liquidity. For example, for every dollar of current liabilities, the corporation has $1.56 of current assets.

2. Working capital is a measure of liquidity. When working capital is positive, there is a greater likelihood that the company can pay its liabilities.

##### Ex. 165

Selected data from Doghouse Ltd. are presented below:

Net sales $1,250,000

Profit 195,000

Share price 12.25

Weighted average number of common shares 163,000

**Instructions**

(a) Based on the above information, calculate two profitability ratios.

(b) Explain the purpose of each ratio.

##### Solution 165 (10–15 min.)

(a) With the information provided, the profitability ratios that can be calculated are as follows:

1. Earnings per share = Profit ÷ Weighted average number of shares

= $195,000 ÷ 163,000 = $1.20

2. Price-earnings = Market price per share ÷ Earnings per share

= $12.25 ÷ $1.20 = 10.21

(b) The purpose of each ratio:

1. Earnings per share measures the profit for each common share.

2. The price-earnings ratio measures the ratio of the market price of each common share to its earnings per share. It reflects the investors’ assessment of the company’s future profit expectations.

##### Ex. 166

Insert the characteristics listed below that are associated with relevance and faithful representation:

Confirmatory value Materiality

Completeness Free from material errors

Neutral Predictive value

RELEVANCE FAITHFUL REPRESENTATION

1. 1.

2. 2.

3. 3.

##### Solution 166 (5 min.)

RELEVANCE FAITHFUL REPRESENTATION

1. Confirmatory value 1. Free from material errors

2. Predictive value 2. Completeness

3. Materiality 3. Neutral

##### Ex. 167

The following terms relate to the characteristics of useful information. Match the key letter of the correct term with the descriptive statement below.

(a) Confirmatory value (e) Faithful representation

(b) Neutral (f) Timeliness

(c) Predictive value (g) Verifiability

(d) Relevance

\_\_\_\_\_ 1. Accounting information cannot be selected, prepared, or presented to favour one set of interested users over another.

\_\_\_\_\_ 2. Providing information in time to make decisions

\_\_\_\_\_ 3. Providing information that can be confirmed or duplicated by independent parties

\_\_\_\_\_ 4. Providing information that would make a difference in a business decision

\_\_\_\_\_ 5. Providing information that represents economic reality

\_\_\_\_\_ 6. Helping evaluate prior decisions

##### Solution 167 (5 min.)

1. (b)

2. (f)

3. (g)

4. (d)

5. (e)

6. (a)

##### Ex. 168

For each of the independent situations described below, list the fundamental or enhancing qualitative characteristic that has been violated, if any. List only one term for each case.

(a) Brunswick Corporation is in its third year of operations and has yet to issue financial statements.

(b) Ontario Corporation has used different methods for recording the cost of inventory. In the current year, the cost of goods sold is calculated based on the average cost of inventory. Last year, the cost of inventory was calculated based on the actual cost of each item sold. Next year, the company plans to change back to average cost.

(c) Manitoba Inc. is carrying inventory at its current cost of $110,000. The inventory has a fair value of $135,000.

(d) Saskatchewan Corporation expenses some inexpensive office equipment even though it has a useful life of more than one year.

##### Solution 168 (5 min.)

(a) Timeliness

(b) Comparability (consistency)

(c) No violation

(d) No violation (materiality)

## MATCHING

169. Match the items below by entering the appropriate code letter in the space provided.

A. Relevance G. Working capital

B. Liquidity ratios H. Current ratio

C. Comparability I. Earnings per share

D. Liabilities J. Solvency ratios

E. Intangible assets K. Price-earnings ratio

F. Timeliness L. Materiality

1. Measures of the ability of an entity to survive over a long period of time

2. Current assets divided by current liabilities

3. Knowledge that will influence a user’s decision.

4. Market price per share divided by earnings per share

5. An omission or statement that could influence the decisions of users.

6. Obligations that result from past transactions.

7. Noncurrent assets that do not have physical substance.

8. Profit divided by the weighted average number of common shares

9. Different companies using the same accounting principles

10. Measures of the short-term ability of the company to pay its maturing obligations.

11. The excess of current assets over current liabilities

12. Information is available to stakeholders before it loses its ability to influence decisions.

#### Answers to Matching

1. J

2. H

3. A

4. K

5. L

6. D

7. E

8. I

9. C

10. B

11. G

12. F

## SHORT-ANSWER ESSAY QUESTIONS

##### S-A E 170

Give the definition of current assets, current liabilities and the current ratio.

##### Solution 170

Current assets are cash or other resources that are reasonably expected to be realized in cash or sold or consumed in the business within one year or the operating cycle, if longer. Current liabilities are obligations reasonably expected to be paid from the existing current assets or through the creation of other current liabilities within the next year, or the operating cycle. The current ratio is a measure used to evaluate a company’s liquidity and short-term debt paying ability, calculated by dividing current assets by current liabilities.

##### S-A E 171

Fast Express specializes in overnight transportation of medical equipment and laboratory specimens. The company has selected the following information from its most recent annual report to be the subject of an immediate press release.

* The financial statements are being released.
* Profit this year was $2.1 million. Last year's, profit was $1.8 million.
* The current ratio has changed to 2:1 from last year's 1.5:1.
* The debt to total assets ratio has changed to 4:5 from last year's 3:5.
* The company expanded its truck fleet substantially by purchasing ten new delivery vans.
* The company already had twelve delivery vans. The company is now the largest medical courier in the Northern Ontario region.

**Instructions**

Prepare a brief press release incorporating the information above. Include all information. Think carefully which information (if any) is good news for the company, and which (if any) is bad news.

##### Solution 171

Fast Express released its financial statements today, disclosing a 17% increase in profit, to $2.1 million from $1.8 million last year. The company also improved its short-term liquidity. Its current ratio improved to 2:1 from last year's 1.5:1. Part of the improved performance is no doubt due to the addition of ten new delivery vans to its fleet, allowing it to become the largest medical courier in the Northern Ontario region. The purchase of the vans, however, caused the debt to total assets ratio to increase. There are now $4 of debt for every $5 in assets, while last year, there were only $3 of debt to $5 in assets.

##### SA-E 172

Comparability is an enhancing qualitative characteristic that makes accounting information useful for decision-making purposes. Briefly explain how comparability affects financial reporting.

##### Solution 172

Comparability results when a specific company, and similar companies, use the same accounting principles and methods, so that users can identify and understand similarities and differences among items on the financial reports.

##### S-A E 173

List four enhancing characteristics of useful decision-making information.

##### Solution 173

To be useful for decision-making, information should have verifiability, timeliness, comparability, and understandability.

##### S-A E 174

Identify *and describe* the three characteristics information must have in order to provide a faithful representation of economic reality.

##### Solution 174

In order to achieve faithful representation, information must be complete, neutral and free from material error. Neutral information is free of bias and does not intentionally favour one set of stakeholders over another. Completeness means that all the information that is needed to faithfully represent economic reality must be included, and nothing important is omitted. The statements should be, as far as possible, free from material error. However, this does not mean that there is necessarily 100% accuracy at all times. This is basically impossible given the fact that accounting estimates are frequently necessary.

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