**LO.a: Describe the elements of the balance sheet: assets, liabilities, and equity.**

1. Which of the following statements is *most* accurate?
   A. A classified balance sheet is one which departs materially from accounting standards as per an auditor's opinion.
   B. A classified balance sheet is grouped into current and non-current assets and liabilities.
   C. The excess of current assets over current liabilities is known as liquidity.

2. An asset or liability is created on the balance sheet when revenue is recognized before cash is received and vice versa. Which of the following combinations is *most* accurate regarding the creation of an asset or liability?

| Revenue recognized. Cash not received. | Cash received. Revenue not recognized. |
|---|---|
| A. Asset | Asset |
| B. Asset. | Liability. |
| C. Liability. | Asset. |

3. Balance sheet provides financial information of a company:
   A. For a particular period such as a quarter, or a year.
   B. At a specific point in time.
   C. In terms of two basic elements: assets and liabilities.

4. Which of the following statements is *most* accurate about balance sheets?
   A. Under US GAAP, intangibles are valued at historical cost.
   B. Under US GAAP, a classified balance sheet presents non-current liabilities after current liabilities.
   C. In a liquidity-based presentation, land use rights is ordered above bank deposits.

5. The balance sheet is based upon which of the following equations?
   A. Assets = Liabilities + Equity.
   B. Assets = Liabilities – Equity.
   C. Assets = Equity – Liabilities.

**LO.b: Describe uses and limitations of the balance sheet in financial analysis.**

6. Which of the following is *least likely* correct about balance sheets?
   A. Different assets and liabilities on the balance sheet have different measurement bases.
   B. Equity in the balance sheet is a measure of the intrinsic value of a company.
   C. Items on the balance sheet are measured at current value at the end of the reporting period that are subject to change.

**LO.c: Describe alternative formats of balance sheet presentation.**

7. A balance sheet format were assets and liabilities are categorized as current and non-current is referred to as the:

A. classified balance sheet format.
B. liquidity-based format.
C. standard format.

8. With of the following is *least likely* correct with respect to the liquidity-based balance sheet format?
   A. The liquidity-based format is more appropriate for a bank relative to a manufacturing company.
   B. With a liquidity-based format assets are presented from most liquid to least liquid.
   C. With a liquidity-based format liabilities are presented from least liquid to most liquid.

**LO.d: Distinguish between current and non-current assets, and current and non-current liabilities.**

9. Which of the following is *least likely* a criterion for classification of a liability as current?
   A. It is expected to be settled in the entity's normal operating cycle.
   B. It is expected to be settled in one year after the balance sheet date.
   C. The entity has an unconditional right to defer settlement of the liability for at least one year after the balance sheet date.

10. The excess of current assets over current liabilities is called:
    A. current ratio.
    B. net assets.
    C. net working capital.

11. Which of the following is *least likely* classified as a current asset?
    A. Prepaid expense.
    B. Marketable securities.
    C. Trades payable.

12. Which of the following is a contra asset account?
    A. Bad debt expense.
    B. Doubtful debt allowance.
    C. Trade receivables.

13. Which of the following is *least likely* a current liability?
    A. Deferred income.
    B. Income tax payable.
    C. Prepaid expense.

14. The following information is available for Melissa March Ltd.

| | |
|---|---|
| Trades receivable | $20,000 |
| Trades payable | $25,000 |
| Notes payable due in 2 years | $12,000 |

| | |
|---|---|
| Accrued expenses | $1,000 |
| Prepaid expenses | $1,500 |
| Deferred revenue | $1,000 |

What is the total value of the company's current liabilities?
A. $27,000.
B. $34,500.
C. $39,000.

15. Deferred income arises when:
A. delivery of goods and services is done but payment is yet to be received.
B. delivery of goods and services and payment are both due.
C. delivery of goods and services is due and payment has been received.

**LO.e: Describe different types of assets and liabilities and the measurement bases of each.**

16. The value of inventory under U.S. GAAP is lower of the cost or the market value. This market value cannot exceed:
A. net realizable value.
B. net realizable value plus a normal profit margin.
C. net realizable value minus a normal profit margin.

17. Which of the following methods is *least likely* to be used to value investment property?
A. Cost model.
B. Fair value model.
C. Retail method.

18. Which of the following statements is correct regarding intangible assets?
A. An intangible asset with an indefinite useful life is amortized rather than tested for impairment.
B. IFRS requires that the costs associated with research phase are capitalized.
C. Start up and training costs are expensed under IFRS and U.S. GAAP.

19. When making adjustments for goodwill an analyst should most likely:
A. exclude goodwill from the balance sheet data but consider goodwill impairment on the income statement.
B. keep goodwill on the balance sheet data but exclude goodwill impairment from the income statement.
C. exclude goodwill from the balance sheet data and also exclude goodwill impairment from the income statement.

20. Which of the following financial assets is *least likely* to be measured at cost or amortized cost?
A. Available-for-sale security.
B. Held-to-maturity security.
C. Unquoted equity instruments.

21. Which of the following is *least likely* to be true for long-term financial liabilities?
    A. They are due after one accounting period, usually after a year.
    B. Loans payable and bonds payable are usually reported at amortized cost on the balance sheet.
    C. At maturity, the carrying amount differs from the face value of the bond.

22. Which of the following is *least likely* to be the cause of deferred tax liabilities?
    A. Temporary timing differences between a company's income as reported for tax purposes and income as reported for financial statement purposes.
    B. When items of expense are included in taxable income in later periods than for financial statement net income.
    C. When items of income are included in taxable income for later periods.

23. An analyst included in his presentation below accounting treatment for marketable securities under IAS No. 39.

| **Category** | **Measurement Method** | **Realized Gains & Losses Reported In** |
|---|---|---|
| Trading | Fair Value | Income Statement |
| Held to maturity | Amortized Cost | Income Statement |
| Available for sale | Fair Value | Equity |

The treatment for which category is *least likely* accurate?
A. Trading.
B. Held to maturity.
C. Available for sale.

24. Alpha-Sine Corporation has the following portfolio of marketable securities which was acquired at the end of 2012:

| **Category** | **Original Cost in € as at the Year End, 2012** | **Fair Market Value in € as at the Year End, 2013** |
|---|---|---|
| Held for trading | 10,000,000 | 10,500,000 |
| Available for sale | 5,000,000 | 5,500,000 |

If the company reports under IFRS instead of U.S. GAAP, its net income will *most likely* be:
A. the same.
B. €500,000 lower.
C. €500,000 higher.

25. The following information is from a company's investment portfolio:

**Investment**

| Classification | Held-to-maturity |
|---|---|
| Market value, 31 Dec 2009 | $ 10,000 |
| Cost/Amortized cost 31 Dec 2009 | 12,000 |
| Market value, 31 Dec 2010 | 9,000 |
| Cost/Amortized cost 31 Dec 2010 | 10,000 |

If the investment is reclassified as available-for-sale as of 31 December 2010, the balance sheet carrying value of the company's investment portfolio would *most likely*:
A. remain the same.
B. decrease by $1,000.
C. decrease by $2,000.

26. Which of the following assets are *most likely* tested for impairment annually?
A. A patent with a legal life of 15 years.
B. A copyright with an expected indefinite life.
C. Land.

**LO.f: Describe the components of shareholders' equity.**

27. Which of the following statements is *least accurate*?
A. Treasury stock is non-voting and receives dividends.
B. Minority interest on the balance sheet represents the proportion of ownership of a subsidiary not held by the parent company.
C. A classified balance sheet is one organized to group various assets and liabilities into subcategories.

28. Which of the following components does not comprise of equity attributable to owners of the parent company?
A. Non-controlling interest.
B. Retained earnings.
C. Other comprehensive income.

29. Which of the following shares is non-voting and does not receive any dividends declared by the company?
A. Common stock.
B. Preferred stock.
C. Treasury stock.

30. Perpetual, non-redeemable preferred shares are classified as:
A. Equity.
B. Financial liabilities.
C. Assets.

**LO.g: Convert balance sheets to common-size balance sheets and interpret common-size balance sheets.**

31. In order to analyze what portion of company's assets are liquid, an analyst is *most likely* to use:
A. cash ratio.
B. common-size balance sheet.
C. current ratio.

32. In a vertical common size balance sheet analysis, each balance sheet item is presented as a percentage of:
    A. fixed assets.
    B. total sales.
    C. total assets.

**LO.h: Calculate and interpret liquidity and solvency ratios.**

33. Which of the following is *least likely* to be a solvency ratio?
    A. Acid test.
    B. Financial leverage.
    C. Long term debt-to-equity.

34. The following table is an extract from the balance sheet of Bell Ltd for the years 2011 and 2012.

| | **2012** | **2011** |
|---|---|---|
| **Current Assets** | | |
| Cash and other equivalents | $130,000 | $160,000 |
| Marketable securities | $75,000 | $75,000 |
| Accounts receivable | $80,000 | $60,000 |
| Inventories | $56,000 | $68,000 |
| Deferred tax asset | $15,000 | $14,000 |
| **Current Liabilities** | | |
| Accounts payable | $90,000 | $70,000 |
| Accrued expenses | $50,000 | $39,000 |
| Short term debt | $80,000 | $78,000 |

Which of the following statements is true?
    A. The current ratio has improved over the year.
    B. The quick ratio in 2012 was greater than the quick ratio in 2011.
    C. The cash ratio was 0.93 for 2012 and 1.26 for 2011.

35. Which of the following is *least likely* a limitation of cross-section financial ratio analysis?
    A. Differences in accounting methods.
    B. Companies with a similar line of business.
    C. Judgement in interpreting the specific ratios.

36. The following data is available for a company:

| | |
|---|---|
| Cash | 7,000 |
| Marketable securities | 31,000 |
| Accounts receivable | 274,000 |
| Inventory | 301,000 |

| | |
|---|---|
| Total current assets | 549,000 |
| Current liabilities | 307,000 |

The company's quick ratio is *closest* to:
A. 0.12.
B. 0.90.
C. 1.02.

37. Which of the following ratios *best* represent a company's liquidity?
A. Quick ratio.
B. Cash ratio.
C. Current ratio.

38. Which of the following ratios is a good measure of financial risk and financial leverage?
A. Acid test ratio.
B. Quick ratio.
C. Debt-to-equity ratio.

39. Cash ratio is *best* described as:
A. $\frac{\text{Cash+Marketable securities}}{\text{Current liabilities}}$
B. $\frac{\text{Cash+Marketable securities+Receivables}}{\text{Current liabilities}}$
C. $\frac{\text{Current assets}}{\text{Current liabilities}}$

 

**Solutions**

1. B is correct. Excess of current assets over current liabilities is known as working capital.

2. B is correct. Recognizing revenue before receiving cash creates an account receivable, an asset. Receiving cash before recognizing revenue creates a liability.

3. B is correct. Balance sheet provides information about a company at a specific point in time. C is incorrect because there are three elements: assets, liabilities, and equity.

4. B is correct. C is incorrect because in a liquidity-based presentation, assets are ordered in decreasing order of liquidity. Less liquid items appear near the bottom of the listing.

5. A is correct. The accounting equations is Assets = Liabilities + Equity.

6. B is correct. Equity is a not a measure of the company's intrinsic value because different items are measured differently, such as historical cost, fair value.

7. A is correct. A balance sheet where assets and liabilities are classified as current and non-current is called a classified balance sheet.

8. C is correct. With a liquidity-based format assets and liabilities are presented from most liquid to least liquid. Such a presentation is appropriate for banks.

9. C is correct. With a liquidity-based presentation assets and liabilities are presented from most liquid to least liquid. Such a presentation is appropriate for banks but not for manufacturing companies.

10. C is correct. The excess of current assets over current liabilities is called net working capital.

11. C is correct. Trade payable is a current liability.

12. B is correct. Allowance for doubtful debt is a contra asset account because it is netted against the balance of trade receivables.

13. C is correct. Prepaid expense is a current asset and not a current liability.

14. A is correct. Current liabilities will comprise of accounts payable, accrued expenses, and deferred revenue. Therefore $25,000 + $1,000 + $1,000 = $27,000.

15. C is correct. Deferred income arises when the delivery of goods and services is due and the payment has been received.

16. A is correct. The market value cannot exceed the net realizable value and cannot be lower than the net realizable value minus a normal profit margin.

17. C is correct. The retail method is used to value inventories and not an investment property.

18. C is correct. Statement A is incorrect because an intangible asset with an indefinite useful life is not amortized and rather tested for impairment. Statement B is incorrect because IFRS requires that the costs associated with research phase are expensed. Statement C is correct.

19. C is correct. When making adjustments for goodwill, an analyst should exclude goodwill from the balance sheet and also exclude goodwill impairment from the income statement.

20. A is correct. Available-for-sale security is measured at fair value.

21. C is correct. At maturity, the carrying amount is equal to the face value of the bond.

22. B is correct. Deferred tax liability arises when items of expense are included in taxable income in earlier periods than for financial statement net income. *Note: This topic will be covered in the reading on income taxes.*

23. C is correct. All categories treat realized gains or losses in the same way - they are reported on the income statement. It is the unrealized gains and losses that are included in other comprehensive income (in owner's equity) for available for sale securities carried at market value.

24. A is correct. Whether securities are classified as held for trading or available for sale, they are measured at their fair value on the balance sheet, but all gains/losses on held for trading securities are reported on the income statements. The unrealized gains/losses on available for sale securities are reported as part of equity. However, this treatment is the same under both IFRS and U.S. GAAP.

25. B is correct. Held-for-trading and available-for-sale securities are carried at market value, whereas held-to-maturity securities are carried at amortized cost. If the investment is reclassified as available-for-sale in 2010, the carrying amount should be adjusted to its market value, which is $9,000. Compared with the amortized cost of $10,000, it is a decrease of $1,000.

26. B is correct. Intangible assets with indefinite lives are tested for impairment annually.

27. A is correct. Treasury stock is non-voting and does not receive dividends.

28. A is correct. Non-controlling interests are equity interests of minority shareholders in the subsidiary companies that have been consolidated by the parent company, but that are not wholly owned by the parent company.

29. C is correct. Common stockholders get dividends once preferred stockholders have been paid. They enjoy voting rights. Preferred stockholders do not have voting rights, but do get dividends. Treasury stockholders do not have voting rights and do not get dividends.

 

30. A is correct. Preferred shares with mandatory redemption are classified as financial liabilities.

31. B is correct. A common-size balance sheet expresses all balance sheet accounts as a percentage of total assets and provides insight into what portion of a company's assets is liquid. In contrast, cash and current ratios measure liquidity relative to current liabilities, not relative to total assets.

32. C is correct. In a vertical common size balance sheet analysis, each balance sheet item is presented as a percentage of total assets.

33. A is correct. Acid test ratio, also called the quick ratio, is a liquidity ratio.

34. C is correct.

$$\text{Cash Ratio} = \frac{\text{Cash} + \text{Marketable Securities}}{\text{Current Liabilities}}$$

$$\text{Cash Ratio for 2012} = \frac{130{,}000 + 75{,}000}{90{,}000 + 50{,}000 + 80{,}000} = 0.93$$

$$\text{Cash Ratio for 2011} = \frac{160{,}000 + 75{,}000}{70{,}000 + 39{,}000 + 78{,}000} = 1.26$$

35. B is correct. Lack of homogeneity of a company's operations can limit comparability. A company with different lines of business will have different industry-specific ratios.

36. C is correct.

$$\text{Quick ratio} = \frac{\text{Cash+Marketable securities+Accounts receivable}}{\text{Current liabilities}} = \frac{7{,}000+31{,}000+274{,}000}{307{,}000} = 1.02.$$

37. B is correct. The cash ratio is the best indicator of a company's near-term obligations.

38. C is correct. Debt-to-equity is a solvency ratio which measures financial leverage.

39. A is correct. The cash ratio = (cash + marketable securities) / current liabilities.

 