Reading 25: Understanding Balance Sheets

Question #1 of 38

Question ID: 414251

GTO Corporation purchased all of the common stock of Charger Company for $4 million. At the time, Charger reported total assets of $3 million and total liabilities of $1 million. At the acquisition date, the fair value of Charger's assets was $3.5 million and the fair value of Charger's liabilities was $1.3 million. What amount of goodwill should GTO report as a result of the acquisition and is it necessary for GTO to amortize the goodwill?

	Goodwill	Amortization required
✗ **A)**	$2.2 million	No
✗ **B)**	$1.8 million	Yes
✓ **C)**	$1.8 million	No

Explanation

The acquisition goodwill is equal to $1.8 million [$4 million purchase price - $2.2 million fair value of net assets acquired ($3.5 million assets at fair value - $1.3 million liabilities at fair value)]. Under IFRS or U.S. GAAP, goodwill is not amortized but is subject to an annual impairment test.

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #2 of 38

Question ID: 414243

Firebird Company reported the following financial information at the end of 2007:

	in millions
Merchandise inventory	$240
Minority interest	70
Cash and equivalents	275
Accounts receivable	1,150
Accounts payable	225
Property & equipment	2,160
Accrued expenses	830
Current portion of long-term debt	120
Long-term debt	1,570
Retained earnings	4,230

Calculate Firebird's current assets and working capital.

		Current assets	Working capital
✓	**A)**	$1,665 million	$490 million
✗	**B)**	$1,665 million	$420 million
✗	**C)**	$1,735 million	$490 million

Explanation

Current assets are equal to $1,665 ($275 cash and equivalents + $1,150 accounts receivable + $240 inventory). Working capital (current assets minus current liabilities) is equal to $490 ($1,665 current assets - $225 accounts payable - $830 accrued expenses - $120 current portion of long-term debt).

References

Question From: Session 7 > Reading 25 > LOS d

Related Material:

- Key Concepts by LOS

Question #3 of 38

Question ID: 498754

A firm's balance sheet prepared under IFRS is *least likely* to include:

✗ **A)** market value of inventory.

✓ **B)** market value of the firm's equity.

✗ **C)** fair value of firm PPE.

Explanation

The market value of the firm's common equity (common stock) is not included on the balance sheet. IFRS allows some PP&E assets to be carried at fair value and some types of inventory to be carried at their market values.

References

Question From: Session 7 > Reading 25 > LOS b

Related Material:

- Key Concepts by LOS

Question #4 of 38

Question ID: 743318

A company that reports under IFRS has developed a new product which required research costs of $2 million and development costs of $3 million. The maximum amount the company can record as the value of the new product on its balance sheet is:

✗ **A)** zero.

✗ **B)** $5 million.

✓ **C)** $3 million.

Explanation

Under IFRS, research costs must be expensed but development costs, under certain circumstances, may be capitalized.

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #5 of 38

Question ID: 414255

Earlier this year, Slayton Corporation repurchased 5% of its total shares outstanding. At the time, the book value of Slayton shares exceeded their market value. The shares are expected to be reissued in the future when the market price of Slayton's stock increases. Do Slayton's repurchased shares continue to have voting rights and to pay cash dividends?

	Voting rights	Cash dividends paid
✗ **A)**	No	Yes
✓ **B)**	No	No
✗ **C)**	Yes	No

Explanation

Repurchased stock that is not cancelled is called treasury stock. Treasury stock does not have voting rights and does not receive cash dividends.

References

Question From: Session 7 > Reading 25 > LOS f

Related Material:

- Key Concepts by LOS

Question #6 of 38

Question ID: 414266

Balance sheet data for two comparable firms are presented below:

	Amplus, Inc.	Brevis, Inc.
Cash and equivalents	3,800	500
Accounts receivable	2,400	700
Inventories	5,800	1,100
Current assets	12,000	2,300
Land	400	100
Property, plant and equipment	24,600	6,400
Noncurrent assets	25,000	6,500

Total assets	**37,000**	**8,800**
Accounts payable	1,800	400
Unearned revenue	600	100
Current liabilities	2,400	500
Long-term borrowing	9,600	3,300
Total liabilities	12,000	3,800
Common stock	1,500	300
Retained earnings	23,500	4,700
Total equity	25,000	5,000
Total liabilities and equity	**37,000**	**8,800**

Based on common-size analysis of the two firms' balance sheets, Amplus Company:

✓ **A)** has a greater investment in working capital than Brevis Company.

✗ **B)** uses relatively more fixed assets then Brevis Company.

✗ **C)** is more financially leveraged than Brevis Company.

Explanation

Common-size balance sheets for the two firms are as follows:

	Amplus, Inc.	Brevis, Inc.
Cash and equivalents	10.3%	5.7%
Accounts receivable	6.5%	8.0%
Inventories	15.7%	12.5%
Current assets	32.4%	26.1%
Land	1.1%	1.1%
Property, plant and equipment	66.5%	72.7%
Noncurrent assets	67.6%	73.9%
Total assets	100.0%	100.0%
Accounts payable	4.9%	4.5%
Unearned revenue	1.6%	1.1%
Current liabilities	6.5%	5.7%
Long-term borrowing	25.9%	37.5%
Total liabilities	32.4%	43.2%
Common stock	4.1%	3.4%
Retained earnings	63.5%	53.4%
Total equity	67.6%	56.8%
Total liabilities and equity	100.0%	100.0%

Working capital (current assets minus current liabilities) is 32.4% - 6.5% = 25.9% of assets for Amplus and 26.1% - 5.7% = 20.4% of assets for Brevis. Fixed assets (property, plant, and equipment) are relatively larger for Brevis than for Amplus. Based on long-term borrowing and total liabilities, Brevis is significantly more leveraged than Amplus.

References

Question From: Session 7 > Reading 25 > LOS g

Related Material:

- Key Concepts by LOS

Question #7 of 38

Question ID: 414257

Carpenter Corporation reported the following statement of shareholders' equity as of December 31, 2006:

Common stock at par	$600,000
Additional paid-in-capital	900,000
Treasury stock	(200,000)
Retained earnings	10,500,000
Accumulated other comprehensive income	450,000
	$12,250,000

During 2007, Carpenter:

- earned net income of $1,700,000.
- declared dividends of $300,000. $75,000 of the dividends remain unpaid.
- purchased held-to-maturity securities for $100,000. The securities have a fair value of $110,000 at year-end.
- purchased available-for-sale securities for $250,000. The securities have a fair value of $225,000 at year-end.
- translated the financial statements of a foreign subsidiary and calculated a $90,000 unrealized gain.
- purchased treasury stock for $75,000. The stock was valued at $60,000 when issued.

Calculate Carpenter's retained earnings and accumulated other comprehensive income as of December 31, 2007.

	Retained earnings	Accumulated other comprehensive income
✗ **A)**	$11,900,000	$65,000
✗ **B)**	$12,125,000	$515,000
✓ **C)**	$11,900,000	$515,000

Explanation

As of December 31, 2007, Carpenter's retained earnings is $11,900,000 [$10,500,000 beginning balance + $1,700,000 net income - $300,000 dividends declared]. Accumulated other comprehensive income is $515,000 [$450,000 beginning balance - $25,000 unrealized loss from available for sale securities ($225,000 fair value - $250,000 cost) + $90,000 unrealized translation gain]. There is no impact on retained earnings or accumulated other comprehensive income from unrealized gains and losses on held-to-maturity securities since the securities are not reported at fair value on the balance sheet. The purchase of treasury stock does not affect comprehensive income because it is a transaction with shareholders.

References

Question From: Session 7 > Reading 25 > LOS f

Related Material:

- Key Concepts by LOS

Question #8 of 38

Question ID: 414269

Given the following income statement and balance sheet for a company:

Balance Sheet

Assets	*Year 2003*	*Year 2004*
Cash	500	450
Accounts Receivable	600	660
Inventory	500	550
Total CA	1600	1660
Plant, prop. equip	1000	1250
Total Assets	2600	2910
Liabilities		
Accounts Payable	500	550
Long term debt	700	1002
Total liabilities	1200	1552
Equity		
Common Stock	400	538
Retained Earnings	1000	820
Total Liabilities & Equity	2600	2910

Income Statement

Sales	3000
Cost of Goods Sold	(1000)
Gross Profit	2000
SG&A	(500)
Interest Expense	(151)
EBT	1349
Taxes (30%)	(405)
Net Income	944

What is the current ratio for 2004?

- ✗ **A)** 0.331.
- ✓ **B)** 3.018.
- ✗ **C)** 2.018.

Explanation

Current ratio = (CA / CL) = (1,660 / 550) = 3.018

References

Question From: Session 7 > Reading 25 > LOS h

Related Material:

- Key Concepts by LOS

Question #9 of 38

Question ID: 414259

Which of the following transactions is *most likely* to be recognized on a firm's statement of changes in equity?

✗ **A)** Buying a machine from an equipment dealer.
✓ **B)** Declaring a dividend on common shares.
✗ **C)** Investing cash in an exchange-traded fund.

Explanation

Declaring a dividend decreases shareholders' equity and is reflected on the statement of changes in shareholders' equity. Buying a machine is unlikely to change shareholders' equity at the time of purchase. Investing cash in a security is an exchange of one asset for another and is also unlikely to change shareholders' equity at the time of the investment.

References

Question From: Session 7 > Reading 25 > LOS f

Related Material:

- Key Concepts by LOS

Question #10 of 38

Question ID: 414267

Common size balance sheets express all balance sheet items as a percentage of:

✗ **A)** sales.
✗ **B)** equity.
✓ **C)** assets.

Explanation

Common size balance sheets express all balance sheet items as a percentage of assets. Note that common size income statements express all income statement items as a percentage of sales.

References

Question From: Session 7 > Reading 25 > LOS g

Related Material:

- Key Concepts by LOS

Question #11 of 38

Question ID: 496417

Selected balance sheet data for Parker Company are as follows:

Current assets	3,000
Long-lived assets	7,000
Total assets	10,000
Current liabilities	2,000
Long-term liabilities	4,000
Total liabilities	6,000
Shareholders' equity	4,000

On a common-size balance sheet, Parker's current liabilities would be stated as:

- ✗ **A)** 33%.
- ✓ **B)** 20%.
- ✗ **C)** 67%.

Explanation

On a common-size balance sheet, each line item is stated as a percentage of total assets: 2,000 / 10,000 = 20%.

References

Question From: Session 7 > Reading 25 > LOS g

Related Material:

- Key Concepts by LOS

Question #12 of 38

Question ID: 414256

Ascot Corporation has 4 million shares of common stock authorized, 2.4 million shares of common stock issued, and 1.8 million shares of common stock outstanding. How many shares of treasury stock does Ascot own and is the treasury stock reported as an asset in Ascot's balance sheet?

	Treasury shares	Reported as an asset
✓ **A)**	600,000	No
✗ **B)**	1.6 million	No
✗ **C)**	600,000	Yes

Explanation

Shares that were issued previously but are not outstanding are treasury shares (owned by the firm). Thus, there are 600,000 treasury shares (2.4 million issued - 1.8 million outstanding). Treasury shares are reported as a reduction in shareholders' equity on the balance sheet. Treasury stock is not an asset.

References

Question From: Session 7 > Reading 25 > LOS f

Related Material:

- Key Concepts by LOS

Question #13 of 38

Question ID: 414238

A liquidity-based balance sheet, on which assets and liabilities are not classified as current or non-current, is permitted under:

✓ **A)** IFRS only.

✗ **B)** Both IFRS and U.S. GAAP.

✗ **C)** U.S. GAAP only.

Explanation

Liquidity-based balance sheet presentation is an exception, under IFRS only, to the requirement (under both IFRS and U.S. GAAP) for assets and liabilities to be classified as current or non-current. Under IFRS, a firm may present a liquidity-based balance sheet if this format is more reliable and relevant than a classified balance sheet.

References

Question From: Session 7 > Reading 25 > LOS c

Related Material:

- Key Concepts by LOS

Question #14 of 38

Question ID: 434279

Consider the following statements.

Statement #1:	Par value is a nominal dollar value assigned to shares of stock in a corporation's charter.
Statement #2:	The par value of common stock represents the amount the corporation received when the stock was issued.

With respect to these statements:

✗ **A)** both statements are correct.

✗ **B)** only statement #2 is correct.

✓ **C)** only statement #1 is correct.

Explanation

The par value of common stock is the stated or nominal value assigned to the stock. Par value has no relationship to market value. The amount the corporation receives from the issuance of common stock is equal to the par value plus the additional paid-in-capital (proceeds in excess of par).

References

Question From: Session 7 > Reading 25 > LOS f

Related Material:

- Key Concepts by LOS

Question #15 of 38

Question ID: 414235

Duster Company reported the following financial information at the end of 2007:

	in millions
Unearned revenue	$240
Common stock at par	30
Capital in excess of par	440
Accounts payable	1,150
Treasury stock	2,000
Retained earnings	5,160
Accrued expenses	830
Accumulated other comprehensive loss	210
Long-term debt	1,570

Calculate Duster's liabilities and stockholders' equity as of December 31, 2007.

	Liabilities	Stockholders' equity
✗ **A)**	$3,790 million	$7,420 million
✗ **B)**	$3,550 million	$7,840 million
✓ **C)**	$3,790 million	$3,420 million

Explanation

Liabilities are equal to $3,790 million ($240 million unearned revenue + $1,570 long-term debt + $1,150 accounts payable + $830 accrued expenses). Stockholders' equity is equal to $3,420 million ($30 common stock at par + $440 capital in excess of par - $2,000 treasury stock + $5,160 retained earnings - $210 accumulated other comprehensive loss).

References

Question From: Session 7 > Reading 25 > LOS a

Related Material:

- Key Concepts by LOS

Question #16 of 38

Question ID: 414254

Current assets that arise from the accrual process *most likely* include:

✓ **A)** accounts receivable.

✗ **B)** cash equivalents.

✗ **C)** marketable securities.

Explanation

The accrual process refers to accounting for transactions when revenue or expense recognition does not coincide with the exchange of cash. Accounts receivable, for example, represent sales of goods and services that have been recognized as revenue, but for which the firm has not yet been paid cash. Cash equivalents are highly liquid marketable securities, such as Treasury bills, in which a firm typically invests its short-term cash balances.

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #17 of 38

Question ID: 414234

Galaxy Corporation manufactures custom motorcycles. Galaxy finances the motorcycles over 36 months for customers who make a minimum down payment of 10%. Historically, Galaxy has experienced bad debt losses equal to 1% of sales. Galaxy also provides a 24 month unlimited warranty on all new motorcycles. In the past, warranty expense has averaged 3% of sales. Ignoring taxes, how does the recognition of bad debt expense and warranty expense at the time of sale affect Galaxy's liabilities?

	Bad debt expense	Warranty expense
✓ **A)**	No effect	Increase
✗ **B)**	Increase	Increase
✗ **C)**	No effect	No effect

Explanation

The recognition of bad debt expense has no effect on liabilities, current revenues are reduced by the expected amount of uncollectable accounts. Bad debt expense reduces net income and reduces assets. The recognition of expected warranty expense decreases net income (following the matching principle), and since it is not currently paid (doesn't reduce assets) it creates or increases a liability at the time of sale.

References

Question From: Session 7 > Reading 25 > LOS a

Related Material:

- Key Concepts by LOS

Question #18 of 38

Question ID: 414242

Peterson Painting Company is a commercial painting contractor. At the beginning of 20X7, Peterson's net working capital was $350,000. The following transactions occurred during 20X7:

Performed services on credit	$150,000
Purchased office equipment for cash	10,000
Recognized salaries expense	54,000
Purchased paint supplies on on credit	25,000
Consumed paint supplies	20,000

Paid salaries	50,000
Collected accounts receivable	157,000
Recognized straight-line depreciation expense	2,000
Paid accounts payable	15,000

Calculate Peterson's working capital at the end of 20X7 and the change in cash for the year 20X7.

	Working capital	Change in cash
✗ **A)**	$416,000	$80,000
✗ **B)**	$414,000	$82,000
✓ **C)**	$416,000	$82,000

Explanation

Transaction	Amount	Working capital	Cash
Performed services on credit	$150,000	Increase A/R	
Purchased PP&E for cash	10,000	Decrease cash	-$10,000
Recognized salaries expense	54,000	Increase A/P	
Purchased paint supplies on on credit	25,000	Increase inventories, increase A/P	
Consumed paint supplies	20,000	Decrease inventories	
Paid salaries	50,000	Decrease cash, decrease A/P	-$50,000
Collected accounts receivable	157,000	Increase cash, decrease A/R	+$157,000
Recognized straight-line depreciation expense	2,000		
Paid accounts payable	15,000	Decrease cash, decrease A/P	-$15,000

The change in cash was $82,000 ($157,000 collections - $10,000 from equipment purchase - $50,000 salaries paid - $15,000 for payables).

Working capital at the end of 20X7 is $416,000 ($350,000 beginning working capital + $150,000 increase in accounts receivable from services - $10,000 office equipment purchase - $54,000 salaries expense accrual - $20,000 consumed supplies).

- Purchasing $25,000 of paint supplies on credit has no net effect on working capital (current assets and current liabilities increase). Consuming $20,000 of these supplies reduces working capital (current assets decrease).
- Salary expense reduces working capital by $54,000 when recognized (current liabilities increase). Paying $50,000 of these salaries has no net effect on working capital (current assets and current liabilities decrease).
- Collecting accounts receivable has no net effect on working capital (one current asset increases and another decreases).
- Recognizing depreciation does not affect working capital.
- Paying accounts payable has no net effect on working capital (current assets and current liabilities decrease).

References

Question From: Session 7 > Reading 25 > LOS d

Related Material:

- Key Concepts by LOS

Question #19 of 38

Question ID: 414268

An analyst has gathered the following information about a company:

Balance Sheet	
Assets	
Cash	100
Accounts Receivable	750
Marketable Securities	300
Inventory	850
Property, Plant & Equip	900
Accumulated Depreciation	(150)
Total Assets	2750
Liabilities and Equity	
Accounts Payable	300
Short-Term Debt	130
Long-Term Debt	700
Common Stock	1000
Retained Earnings	620
Total Liab. and Stockholder's equity	2750
Income Statement	
Sales	1500
COGS	1100
Gross Profit	400
SG&A	150
Operating Profit	250
Interest Expense	25
Taxes	75
Net Income	150

What is the quick ratio?

✗ **A)** 0.62.

✗ **B)** 1.53.

✓ **C)** 2.67.

Explanation

Quick ratio = [100(cash) + 750(AR) + 300(marketable securities)] / [300(AP) + 130(short-term debt)] = (1,150 / 430) = 2.67

References

Question From: Session 7 > Reading 25 > LOS h

Related Material:

- Key Concepts by LOS

Question #20 of 38

Question ID: 414236

The balance sheet is *most likely* to provide an analyst with information about a firm's:

- ✗ **A)** internal controls.
- ✗ **B)** operating profitability.
- ✓ **C)** solvency.

Explanation

An analyst can use the balance sheet to assess a firm's solvency and liquidity. Operating profitability can be assessed by examining the income statement. Information on a firm's internal controls appears in management's commentary and the auditor's report.

References

Question From: Session 7 > Reading 25 > LOS b

Related Material:

- Key Concepts by LOS

Question #21 of 38

Question ID: 414239

Liquidity-based presentation of a balance sheet is *most likely* to be used by a:

- ✗ **A)** manufacturer.
- ✗ **B)** retailer.
- ✓ **C)** bank.

Explanation

The liquidity-based format of balance sheet presentation is most common in the banking industry.

References

Question From: Session 7 > Reading 25 > LOS c

Related Material:

- Key Concepts by LOS

Question #22 of 38

Question ID: 414233

Which of the following characteristics are required for recognition of a balance sheet asset?

Characteristic #1: Future economic benefits to the firm are probable.

Characteristic #2: The asset is tangible and is obtained at a cost.

	Characteristic #1	Characteristic #2
✗ **A)**	No	No
✓ **B)**	Yes	No
✗ **C)**	Yes	Yes

Explanation

An asset is recognized on the balance sheet only if it is probable that it will provide future economic benefits. Assets can be tangible or intangible. In some cases, assets are acquired without cost, but will be reported to the extent that they will provide future economic benefit, and thus have value.

References

Question From: Session 7 > Reading 25 > LOS a

Related Material:

- Key Concepts by LOS

Question #23 of 38

Question ID: 414232

Two of the elements of a balance sheet are:

✓ **A)** assets and equity.

✗ **B)** income and liabilities.

✗ **C)** equity and cash flows.

Explanation

The three elements of a balance sheet are assets, liabilities, and equity.

References

Question From: Session 7 > Reading 25 > LOS a

Related Material:

- Key Concepts by LOS

Question #24 of 38

Question ID: 414241

One of a firm's assets is 270-day commercial paper that the firm intends to hold to maturity. One of its liabilities is a short position in a common stock, which the firm holds for trading purposes. How should this asset and this liability be classified on the firm's balance sheet?

✗ **A)** One should be classified as current and one should be classified as non-current.

✓ **B)** Both should be classified as current.

✗ **C)** Both should be classified as non-current.

Explanation

The commercial paper should be classified as current because it will be converted to cash in less than a year. A liability that is held primarily for trading purposes, such as this short position, should also be classified as current.

References

Question From: Session 7 > Reading 25 > LOS d

Related Material:

- Key Concepts by LOS

Question #25 of 38

Question ID: 414245

According to International Financial Reporting Standards, how do cash dividends received from trading securities and available-for-sale securities affect net income?

	Trading securities	Available-for-sale securities
✓ **A)**	Increase	Increase
✗ **B)**	Increase	No effect
✗ **C)**	No effect	Increase

Explanation

Dividends received from trading securities and available-for-sale securities are recognized in the income statement. The difference in trading and available-for-sale classifications relates to the treatment of any unrealized gains and losses.

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #26 of 38

Question ID: 414247

Earlier this year, Ponca Corporation purchased non-dividend paying equity securities which it classified as trading securities. Information related to the securities follows:

Security	Cost	Fair value at year-end
X	$400,000	$435,000
Y	$550,000	$545,000

What amounts should Ponca report in its year-end income statement and balance sheet as a result of its investment in securities X and Y?

Income Statement Balance Sheet

✓ **A)**	$30,000 unrealized gain	$980,000
✗ **B)**	$30,000 unrealized gain	$950,000
✗ **C)**	No gain or loss	$980,000

Explanation

Trading securities are reported in the balance sheet at fair value. At the end of the year, the fair value of the securities was $980,000 ($435,000 + $545,000). The unrealized gains and losses from trading securities are recognized in the income statement. Thus, Ponca would recognize an unrealized gain of $30,000 ($980,000 fair value - $950,000 cost).

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #27 of 38

Question ID: 414260

The statement of changes in equity is *least likely* to provide information on the firm's:

✓ **A)** repayment of bond principal.

✗ **B)** comprehensive income.

✗ **C)** payment of dividends.

Explanation

The statement of changes in equity shows a firm's comprehensive income (net income and other comprehensive income) and transactions with shareholders, such as dividends paid and issuance or repurchases of stock. Repayment of bond principal is not a change in equity: assets (cash) decrease and liabilities (long-term debt) decrease.

References

Question From: Session 7 > Reading 25 > LOS f

Related Material:

- Key Concepts by LOS

Question #28 of 38

Question ID: 414244

Do the following characteristics have to be met in order to classify a liability as current on the balance sheet?

Characteristic #1 - Settlement is expected within one year or operating cycle, whichever is less.
Characteristic #2 - Settlement will require the use of cash within one year or operating cycle, whichever is greater.

	Characteristic #1	Characteristic #2
✗ **A)**	Yes	No
✗ **B)**	No	Yes

✓ **C)** No No

Explanation

A current liability is expected to be settled within one year or operating cycle, whichever is *greater*. It is not necessary to settle a current liability with cash. There are a number of ways to settle a current liability. For example, unearned revenue is a liability that is settled by providing goods or services.

References

Question From: Session 7 > Reading 25 > LOS d

Related Material:

- Key Concepts by LOS

Question #29 of 38

Question ID: 414240

Which of the following statements about a classified balance sheet is *least likely* accurate? A classified balance sheet:

✓ **A)** presents the net equity of each asset by subtracting its related liability.

✗ **B)** groups accounts by subcategories.

✗ **C)** distinguishes between current and noncurrent assets.

Explanation

A classified balance sheet groups assets and liabilities by subcategories. It distinguishes between current and noncurrent assets and current and noncurrent liabilities. The assets and related liabilities are reported separately, they are not netted.

References

Question From: Session 7 > Reading 25 > LOS c

Related Material:

- Key Concepts by LOS

Question #30 of 38

Question ID: 414248

At the beginning of the year, Alpha Corporation purchased 10,000 shares of Beta Corporation for $20 per share. During the year, Beta paid a $2,000 cash dividend to Alpha. At the end of the year, Beta's stock was selling for $22 per share. What amount should Alpha recognize in its year-end income statement if the investment is treated as an available-for-sale security and what amount should be recognized in the income statement if the investment is treated as a trading security?

	Available-for-sale	Trading security
✓ **A)**	$2,000	$22,000
✗ **B)**	$2,000	$20,000
✗ **C)**	$0	$22,000

Explanation

Unrealized gains and losses from trading securities are recognized in the income statement while unrealized gains and losses from available-for-sale securities bypass the income statement and are reported as other comprehensive income, a component of stockholders' equity. Cash dividends are recognized in the income statement for both trading and available-for-sale securities. Thus, Alpha will recognize only the $2,000 dividend if the shares are considered available-for-sale and will recognize $22,000 ($2,000 dividend + $20,000 unrealized gain) if the shares are considered trading securities.

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #31 of 38

Question ID: 414250

Consider the following:

Statement #1 - Copyrights and patents are tangible assets that can be separately identified.
Statement #2 - Purchased copyrights and patents are amortized on a straight line basis over 30 years.
With respect to the statements about copyrights and patents acquired from an independent third party:

✓ **A)** both are incorrect.
✗ **B)** only statement #2 is incorrect.
✗ **C)** only statement #1 is incorrect.

Explanation

Acquired copyrights and patents are *intangible* assets that can be separately identified. Identifiable intangible assets are amortized over their useful lives.

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #32 of 38

Question ID: 414246

When the market value of an investment in a debt security is less than its carrying value, how should the investor report the investment on the balance sheet if the security is classified as held-to-maturity and what amount should be reported if the security is classified as available-for-sale?

	Held-to-maturity	Available-for-sale
✓ **A)**	Amortized cost	Fair value
✗ **B)**	Amortized cost	Amortized cost
✗ **C)**	Fair value	Fair value

Explanation

Held-to-maturity securities are reported on the balance sheet at amortized cost while available-for-sale securities are reported at fair value. Amortized cost includes the amortization of a premium or discount that was created when the security was purchased.

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #33 of 38

Question ID: 414252

On January 1, 20X7, Omega Corporation paid $45,000 to renew its property insurance for 3 years. What amount of insurance expense should Omega report for the year-ended December 31, 20X7 and what is the balance of Omega's prepaid insurance account on December 31, 20X8?

	Insurance expense	Prepaid insurance
✗ **A)**	$45,000	$15,000
✗ **B)**	$15,000	$30,000
✓ **C)**	$15,000	$15,000

Explanation

At the beginning of 20X7, the prepaid insurance account (asset) will have a balance of $45,000. Insurance expense will be recognized at a rate of $15,000 per year. At the end of 20X8, one year's insurance remains; thus, the balance of the prepaid insurance account will equal $15,000 ($45,000 beginning balance - $15,000 insurance expense for 20X7 - $15,000 insurance expense for 20X8).

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #34 of 38

Question ID: 414270

The following data is from Delta's common size financial statement:

Earnings after taxes	18%
Equity	40%
Current assets	60%
Current liabilities	30%
Sales	$300
Total assets	$1,400

What is Delta's total-liabilities-to-equity ratio?

- ✗ **A)** 1.0.
- ✓ **B)** 1.5.
- ✗ **C)** 2.0.

Explanation

If equity = 40% of assets, total liabilities = 60% of assets, thus 60 / 40 = 1.5.

References

Question From: Session 7 > Reading 25 > LOS h

Related Material:

- Key Concepts by LOS

Question #35 of 38

Question ID: 414231

Resources controlled as a result of past transactions that are expected to provide future benefits are referred to as:

- ✓ **A)** assets.
- ✗ **B)** liabilities.
- ✗ **C)** equity.

Explanation

Assets are resources that are expected to provide future benefits and are controlled as a result of past transactions. Liabilities are obligations resulting from past events that are expected to require a future outflow of resources. Equity is a residual interest in assets after deducting liabilities.

References

Question From: Session 7 > Reading 25 > LOS a

Related Material:

- Key Concepts by LOS

Question #36 of 38

Question ID: 414249

According to the Financial Accounting Standards Board, what is the appropriate measurement basis for equipment used in the manufacturing process and inventory that is held for sale?

	Equipment	Inventory
✓ **A)**	Historical cost	Lower of cost or market
✗ **B)**	Historical cost	Historical cost
✗ **C)**	Fair value	Lower of cost or market

Explanation

Equipment is reported in the balance sheet at historical cost less accumulated depreciation. Inventory is reported in the balance sheet at the lower of cost or market.

References

Question From: Session 7 > Reading 25 > LOS e

Related Material:

- Key Concepts by LOS

Question #37 of 38

Question ID: 414237

A key limitation of balance sheets in financial analysis is that:

✓ **A)** different balance sheet items may be measured differently.

✗ **B)** liquidity and solvency ratios require information from other financial statements.

✗ **C)** some items are recognized when they are unlikely to reflect a flow of economic benefits.

Explanation

Balance sheet values may use a mixture of measurement bases (historical cost, fair value, etc.). As a result, balance sheet values of assets, liabilities, and equity may not reflect their intrinsic values. Balance sheets provide the information necessary to calculate the firm's solvency and liquidity ratios. Items are recognized on the balance sheet only if a flow of future economic benefits to or from the firm is probable.

References

Question From: Session 7 > Reading 25 > LOS b

Related Material:

- Key Concepts by LOS

Question #38 of 38

Question ID: 414230

Liabilities are *best* described as:

✗ **A)** resources that are expected to provide future benefits.

✗ **B)** residual ownership interest.

✓ **C)** obligations that are expected to require a future outflow of resources.

Explanation

Liabilities are obligations resulting from past events that are expected to require a future outflow of resources.

References

Question From: Session 7 > Reading 25 > LOS a

Related Material:

- Key Concepts by LOS