




Question #1 of 42

Question ID: 1457404

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?

| | <u>Voting rights</u> | <u>Cash dividends</u> <u>paid</u> | |
|--------|----------------------|--------------------------------------|---|
| A) No | No | |  |
| B) No | Yes | |  |
| 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.

(Module 19.7, LOS 19.f)

Question #2 of 42

Question ID: 1457390

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) Both should be classified as current. 
- B) Both should be classified as non-current. 
- C) One should be classified as current and one 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.

(Module 19.3, LOS 19.d)

Question #3 of 42

Question ID: 1457392

What is the appropriate measurement basis for equipment used in the manufacturing process?

A) Lower of cost or net realizable value.



B) Fair value.



C) Historical cost.



Explanation

Equipment is reported in the balance sheet at historical cost less accumulated depreciation.

(Module 19.4, LOS 19.e)

Question #4 of 42

Question ID: 1457381

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

| | <i>in millions</i> |
|--------------------------------------|--------------------|
| 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.

| <u>Liabilities</u> | <u>Stockholders'</u> <u>equity.</u> | |
|--------------------|--|---|
| A) \$3,550 million | \$7,840 million |  |
| B) \$3,790 million | \$3,420 million |  |
| C) \$3,790 million | \$7,420 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).

(Module 19.1, LOS 19.a)

Question #5 of 42

Question ID: 1457386

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

- A) bank. 

B) manufacturer.



C) retailer.



Explanation

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

(Module 19.2, LOS 19.c)

Question #6 of 42

Question ID: 1457387

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

A) distinguishes between current and noncurrent assets.



B) groups accounts by subcategories.



C) presents the net equity of each asset by subtracting its related liability.



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.

(Module 19.2, LOS 19.c)

Question #7 of 42

Question ID: 1457410

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) is more financially leveraged than Brevis Company.



C) uses relatively more fixed assets 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.

(Module 19.7, LOS 19.g)

Question #8 of 42

Question ID: 1457391

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

- A) marketable securities.
- B) cash equivalents.
- C) accounts receivable.



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.

(Module 19.3, LOS 19.e)

Question #9 of 42

Question ID: 1457398

According to International Financial Reporting Standards, how do cash dividends received from trading securities and financial securities measured at fair value through OCI affect net income?

| | <u>Trading securities</u> | <u>Fair value through OCI</u> | |
|--------------|---------------------------|-------------------------------|---|
| 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.

(Module 19.6, LOS 19.e)

Question #10 of 42

Question ID: 1457409

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.

(Module 19.7, LOS 19.f)

Question #11 of 42

Question ID: 1462817

A classified balance sheet categorizes assets and liabilities based on whether they are:

- A) internally generated or acquired. 
- B) current or non-current items. 
- C) measured at cost or fair value. 




Explanation

Classified balance sheets have categories for current assets, non-current assets, current liabilities, and non-current liabilities. (Module 19.2, LOS 19.c)

Question #12 of 42

Question ID: 1457383

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.

(Module 19.2, LOS 19.b)

Question #13 of 42

Question ID: 1457405

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?

| | <u>Treasury shares</u> | <u>Reported as an asset</u> | |
|----------------|------------------------|-----------------------------|---|
| A) 600,000 | Yes | |  |
| B) 1.6 million | Yes | |  |
| C) 600,000 | No | |  |

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.

(Module 19.7, LOS 19.f)

Question #14 of 42

Question ID: 1457380

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?

| | <u>Bad debt expense</u> | <u>Warranty expense</u> | |
|--------------|-------------------------|-------------------------|---|
| A) No effect | Increase | |  |
| B) No effect | No effect | |  |
| C) Increase | 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.

(Module 19.1, LOS 19.a)

Question #15 of 42

Question ID: 1457411

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

A) assets.



B) sales.



C) equity.



Explanation

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

(Module 19.7, LOS 19.g)

Question #16 of 42

Question ID: 1457414

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 | <u>(150)</u> |
| Total Assets | 2750 |

Liabilities and Equity

| | |
|--------------------------------------|------------|
| Accounts Payable | 300 |
| Short-Term Debt | 130 |
| Long-Term Debt | 700 |
| Common Stock | 1000 |
| Retained Earnings | <u>620</u> |
| Total Liab. and Stockholder's equity | 2750 |

Income Statement

| | |
|------------------|-------------|
| Sales | 1500 |
| COGS | <u>1100</u> |
| Gross Profit | 400 |
| SG&A | 150 |
| Operating Profit | 250 |
| Interest Expense | 25 |
| Taxes | <u>75</u> |
| Net Income | 150 |

What is the quick ratio?

A) 0.62.



B) 1.53.



C) 2.67.



Explanation

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

(Module 19.7, LOS 19.h)

Question #17 of 42

Question ID: 1457379

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.

| | <u>Characteristic #1</u> | <u>Characteristic #2</u> | |
|--------|--------------------------|--------------------------|--|
| A) No | No | | |
| B) Yes | No | | |
| C) No | 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.

(Module 19.1, LOS 19.a)

Question #18 of 42

Question ID: 1457382

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

A) solvency.



B) operating profitability.



C) investing and financing activities.



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 investing and financing activities appears in a firm's statement of cash flows.

(Module 19.2, LOS 19.b)

Question #19 of 42

Question ID: 1457396

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) \$5 million.



B) zero.



C) \$3 million.



Explanation

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

(Module 19.5, LOS 19.e)

Question #20 of 42

Question ID: 1457399

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 | \$950,000 |  |
| B) \$30,000 unrealized gain | \$980,000 |  |
| 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).

(Module 19.6, LOS 19.e)

Question #21 of 42

Question ID: 1457408

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

- | | |
|--|---|
| A) comprehensive income. |  |
| B) repayment of bond principal. |  |
| 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.

(Module 19.7, LOS 19.f)

Question #22 of 42

Question ID: 1482630

The average number of days that it takes to turn raw materials into cash proceeds is a firm's:

A) inventory turnover cycle.



B) receivables cycle.



C) operating cycle.

**Explanation**

Operating cycle = days of inventory + days of receivables, and is the number of days that it takes to turn raw materials into cash from sales.

(Module 19.3, LOS 19.d)

Question #23 of 42

Question ID: 1457407

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 #1 is correct.



C) only statement #2 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).

(Module 19.7, LOS 19.f)

Question #24 of 42

Question ID: 1457416

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 $60 / 40 = 1.5$.

(Module 19.7, LOS 19.h)

Question #25 of 42

Question ID: 1457412

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:
 $2,000 / 10,000 = 20\%$.

(Module 19.7, LOS 19.g)

Question #26 of 42

Question ID: 1462821

For which of the following balance sheet items is a change in market value *most likely* to affect net income?

- A) Debt securities that the firm intends to hold until maturity. 
- B) Equity securities purchased by the firm. 
- C) Debt securities issued by the firm. 

Explanation

Listed equity securities are measured at fair value through profit and loss, unless the firm chooses at the time of purchase to measure them at fair value through other comprehensive income. Debt securities issued by the firm, and debt securities that the firm intends to hold until maturity, are both reported at amortized cost unless the firm chooses to report them at market value. (Module 19.6, LOS 19.e)

Question #27 of 42

Question ID: 1457406

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 | <u>450,000</u> |
| | \$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 accumulated other comprehensive income as of December 31, 2007.

A) \$515,000.



B) \$440,000.



C) \$65,000.



Explanation

As of December 31, 2007, Carpenter's 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 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.

(Module 19.7, LOS 19.f)

Question #28 of 42

Question ID: 1457385

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

A) Both IFRS and U.S. GAAP.



B) IFRS only.



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.

(Module 19.2, LOS 19.c)

Question #29 of 42

Question ID: 1457413

A segment of a common-size balance sheet for Olsen Company in its most recent year shows the following data:

Common stock 1%

Additional paid-in capital 19%

Preferred stock 15%

How should an analyst most appropriately interpret these data?

A) Preferred stock is 15% of shareholders' equity.



B) Shareholders' equity is 35% of total assets.



C) Proceeds from the issuance of common stock are 20% of total assets.



Explanation




Common-size balance sheets express each balance sheet item as a percentage of total assets. Contributed capital from issuing common shares may be included in common stock (at par value) or additional paid-in capital (for proceeds in excess of par value). Shareholders' equity is unlikely to consist only of common and preferred stock, as it also includes components such as retained earnings and accumulated other comprehensive income.

(Module 19.7, LOS 19.g)

Question #30 of 42

Question ID: 1462818

Under U.S. GAAP, land owned by the firm is *most likely* to be reported on the balance sheet at:

- A) fair market value minus selling costs. 
- B) historical cost. 
- C) historical cost less accumulated depreciation. 




Explanation

Unless impairment has been recognized, land is reported at historical cost and is not subject to depreciation. Increases in value are not reflected in balance sheet values under U.S. GAAP. (Module 19.4, LOS 19.e)

Question #31 of 42

Question ID: 1462820

Under IFRS, firms may report an investment in the equity securities of other companies at fair value through:

- A) profit and loss only. 
- B) other comprehensive income only. 
- C) either profit and loss, or other comprehensive income. 

Explanation

Under IFRS, firms have an irrevocable choice at the time of purchase to report equity securities at fair value through other comprehensive income. If they do not make this election, equity securities are reported at fair value through profit and loss. (Module 19.6, LOS 19.e)

Question #32 of 42

Question ID: 1457377

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

- A) equity. 
- B) assets. 

C) liabilities.



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.

(Module 19.1, LOS 19.a)

Question #33 of 42

Question ID: 1457388

Which of the following firms is *most likely* to present a liquidity-based balance sheet rather than a classified balance sheet?

A) Manufacturing firm.



B) Chain of retail stores.



C) Banking institution.



Explanation

Banks often present liquidity-based balance sheets, which list all assets and liabilities in order of liquidity, because for banks this format is typically more relevant and reliable than a classified balance sheet. Firms in most other industries typically present classified balance sheets.

(Module 19.2, LOS 19.c)

Question #34 of 42

Question ID: 1457384

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

A) market value of the firm's equity.



B) fair value of firm PPE.



C) market value of inventory.



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.

(Module 19.2, LOS 19.b)

Question #35 of 42

Question ID: 1457378

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.

(Module 19.1, LOS 19.a)

Question #36 of 42

Question ID: 1457376

Liabilities are *best* described as:

- A) resources that are expected to provide future benefits.
- B) residual ownership interest in an entity's assets.
- 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. Assets are resources that are expected to provide future benefits. Equity is residual ownership interest in an entity's assets (i.e., assets minus liabilities).

(Module 19.1, LOS 19.a)

Question #37 of 42

Question ID: 1457397

The *most appropriate* measurement base for unimpaired goodwill is:

- A) fair value.
- B) amortized cost.
- C) historical cost.



Explanation

Goodwill is measured at historical cost and is not amortized. Goodwill must be tested for impairment at least annually and written down to fair value if it is impaired.

(Module 19.5, LOS 19.e)

Question #38 of 42

Question ID: 1462819

A U.S. GAAP reporting company invests \$50 million in a bond portfolio yielding 4% with an average maturity of seven years. After one year, interest rates have fallen by 50 basis points. The company will report the highest retained earnings if the securities in the portfolio are classified as:

- A) held-to-maturity.
- B) available-for-sale.
- C) trading securities.



Explanation

The trading securities classification includes the unrealized gain from the bond in net income, which increases retained earnings. Unrealized gains on available-for-sale securities are reported as other comprehensive income for the period and are recorded in accumulated other comprehensive income, a component of owner's equity. Unrealized gains on held-to-maturity securities are not reported on the financial statements. (Module 19.6, LOS 19.e)

Question #39 of 42

Question ID: 1457415

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

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

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

What is the current ratio for 2004?

A) 0.331.



B) 2.018.



C) 3.018.



Explanation

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

(Module 19.7, LOS 19.h)

Question #40 of 42

Question ID: 1457395

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?

| | <u>Goodwill</u> | <u>Amortization required</u> | |
|----|-----------------|----------------------------------|--|
| A) | \$1.8 million | No | |
| B) | \$1.8 million | Yes | |
| C) | \$2.2 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.

(Module 19.5, LOS 19.e)

Question #41 of 42

Question ID: 1457394

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 #1 is incorrect. 
- C) only statement #2 is incorrect. 

Explanation

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


(Module 19.5, LOS 19.e)

Question #42 of 42

Question ID: 1457400

At the beginning of the year, Alpha Corporation, which reports under U.S. GAAP, 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?

| | <u>Available-for-sale</u> | <u>Trading security</u> |
|--|---------------------------|-------------------------|
|--|---------------------------|-------------------------|

- | | | |
|------------|----------|---|
| A) \$0 | \$22,000 |  |
| B) \$2,000 | \$22,000 |  |
| C) \$0 | \$20,000 |  |

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.

(Module 19.6, LOS 19.e)