**CHAPTER 1**

**OVERVIEW OF CORPORATE FINANCIAL REPORTING**

**CHAPTER LEARNING OBJECTIVES**

1. ***Define financial accounting and understand its relationship to economic decision-making.***

* Financial accounting is the process by which information on the transactions of an organization is captured, analyzed, and reported to external decision makers.
* These decision makers are referred to as *financial statement users* and include investors and creditors.
* The primary purpose of financial accounting information is to aid these users in making economic decisions related to the reporting organization, such as whether to invest in it or lend it money.

2. ***Identify the main users of financial accounting information and explain how they use this information.***

* The main users of financial accounting information include shareholders, the board of directors, potential investors, creditors (bankers and suppliers), regulators (stock exchanges), taxing authorities (governments), securities analysts, and others.
* Shareholders, the board of directors, and potential investors will use financial accounting information to enable them to assess how well management has run the company; determine whether they should buy, sell, or continue to hold shares in the company; assess the company’s share price relative to the financial accounting information; and so on.
* Creditors will use financial accounting information to determine whether they should lend funds to the company, establish credit terms for it, assess a company’s ability to meets its obligations, and so on.
* Regulators will use financial accounting information to determine whether a company has met its listing requirements.
* Taxing authorities will use this information in assessing the taxes owed by the organization.

3. ***Describe the major forms of business organization and explain the key distinctions between each form.***

* There are three major forms of business organization: (1) proprietorships, (2) partnerships, and (3) corporations.
* There are public corporations (whose shares trade on a public stock exchange and are widely held) and private corporations (whose shares do not trade on a public exchange and are generally owned by a small number of people).
* Corporations are separate legal entities, whereas proprietorships and partnerships are not. This means the personal assets of owners are protected in the event of legal action against corporations, whereas they are at risk in the case of proprietorships and partnerships. It also means corporations file separate tax returns, whereas the income from proprietorships and partnerships is reported on the personal tax returns of their owners.

4. ***Explain the three categories of business activities and identify examples of transactions related to each category.***

* The three categories of business activities are: (1) operating, (2) investing, and (3) financing activities.
* Operating activities are related to the company’s revenues and expenses, such as sales to customers, collections from customers, purchases of inventory, and payments of wages and other expenses.
* Investing activities include buying and selling property, plant, and equipment and buying and selling the shares of other companies.
* Financing activities include borrowing money, issuing shares, repaying loan principal, and paying dividends.

5. ***Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.***

* There are four basic financial statements: (1) the statement of income, (2) the statement of changes in equity, (3) the statement of financial position, and (4) the statement of cash flows.
* The objective of the statement of income is to measure the company’s operating performance (its profit) for a period of time. This is measured by subtracting the expenses incurred during the period from the income earned (revenues) in the same period.
* The objective of the statement of changes in equity is to provide details on how each component of shareholders’ equity changed during the period. The components of shareholders’ equity include share capital (the shares issued by the company) and retained earnings (the company’s earnings that have been kept and not distributed as dividends).
* The objective of the statement of financial position is to present information on a company’s assets, liabilities, and shareholders’ equity at a specific date. Assets must be controlled by the company and embody a future benefit. Examples include cash; accounts receivable; inventory; property, plant, and equipment; land; and so on. Liabilities are obligations of a company that will result in an outflow of resources. Examples include accounts payable, deferred revenue, long-term debt, and so on. Shareholders’ equity represents the shareholders’ interest in the assets of the company and is referred to as *net assets*. Examples include common shares and retained earnings.
* The objective of the statement of cash flows is to enable financial statement users to assess the company’s inflows and outflows of cash related to its operating, investing, and financial activities for a period of time.
* The notes to a company’s financial statements are used to provide additional detail and context for items in the financial statements. They enable the financial statements themselves to remain uncluttered, while increasing their usefulness.

**TRUE-FALSE STATEMENTS**

1. Decision makers are often referred to as users of the financial statements and include investors and creditors.

Answer: True

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Define financial accounting and understand its relationship to economic decision-making.

CPA: Financial Reporting

AACSB: Analytic

2. The primary purpose of financial accounting information is to aid users in their economic decision-making relative to the organization.

Answer: True

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Define financial accounting and understand its relationship to economic decision-making.

CPA: Financial Reporting

AACSB: Analytic

3. The section of an annual report that contains management’s discussion of the company’s operating results is referred to as the Statement of Management’s Responsibility.

Answer: False

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Define financial accounting and understand its relationship to economic decision-making.

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

4. The shareholders are an example of an internal user of annual report information.

Answer: False

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify the main users of financial accounting information and explain how they use this information.

CPA: Financial Reporting

AACSB: Analytic

5. Information contained in the financial statements of a company is of use to both internal and external users.

Answer: True

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify the main users of financial accounting information and explain how they use this information.

CPA: Financial Reporting

AACSB: Analytic

6. There may be a single shareholder in the case of a public company or many shareholders in the case of a private company.

Answer: False

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify the main users of financial accounting information and explain how they use this information.

CPA: Financial Reporting

AACSB: Analytic

7. A firm's activities can be divided into borrowing, investing, and operating.

Answer: False

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

8. If an investor owns 10% of the shares of a company, they normally own 10 shares of the company.

Answer: False

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

9. Dividends are payments made by the company to distribute future profits.

Answer: False

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

10. A gain or increase in the value of shares is known as capital appreciation.

Answer: True

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

11. Creditors are entities that lend money to a company rather than buying shares of a company.

Answer: True

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

12. The financial statements of a company are prepared by the shareholders.

Answer: False

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

13. Assets are listed in the order of their liquidity on the classified Statement of Financial Position.

Answer: True

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

14. Prepaid expenses can be found on the Statement of Income.

Answer: False

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

15. The Statement of Financial Position measures cash inflows and outflows of a company over a period of time.

Answer: False

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

16. Profit is determined by subtracting the income earned during the period from the expenses incurred during the same period.

Answer: False

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

17. Income can also include gains that a company generates from sales that are outside their normal course of operations.

Answer: True

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

18. Expenses are defined as increases in economic benefits.

Answer: False

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

19. Gross profit is equal to the sales received from goods and the operating expenses incurred during the period.

Answer: False

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

20. Net earnings is the amount of the company’s revenue that remains after all its expenses are accounted for.

Answer: True

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

21. Retained earnings are the earnings that have been kept and NOT paid out as dividends.

Answer: True

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

22. Liquidity refers to how long something will be received, realized, or consumed.

Answer: False

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

23. Canadian companies use a 12-month period to distinguish between items that are current from those that are non-current.

Answer: True

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

24. Working capital measures the company’s ability to meet its short-term obligations using its non-current assets.

Answer: False

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

25. Deferred revenue represents customer deposits.

Answer: True

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

26. Shareholders’ equity is often referred to as the net assets of the company.

Answer: True

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

27. Share capital records the amount that investors have received in the form of dividends.

Answer: False

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

28. Companies that are growing normally have negative cash flows from investing activities.

Answer: True

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

29. IFRS is the financial reporting standard that must be followed by Canadian public companies.

Answer: True

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

30. The MD&A section of the annual report provides a discussion of the risks facing the company and information about future plans.

Answer: True

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

**MULTIPLE CHOICE QUESTIONS**

31. The annual report includes everything, EXCEPT for

a) managerial statements.

b) management discussion and analysis.

c) financial statements.

d) notes to the financial statements.

Answer: a

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Define financial accounting and understand its relationship to economic decision-making.

CPA: Financial Reporting

AACSB: Analytic

32. Financial accounting is also referred to as

a) internal reporting.

b) management reporting.

c) external financial reporting.

d) stakeholder reporting.

Answer: c

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Define financial accounting and understand its relationship to economic decision-making.

CPA: Financial Reporting

AACSB: Analytic

33. In which section of the annual report does management comment on the company and its operating results?

a) report to the shareholders

b) management's discussion and analysis

c) corporate profile

d) selected financial data

Answer: b

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Define financial accounting and understand its relationship to economic decision-making.

CPA: Financial Reporting

AACSB: Analytic

34. Which of the following is an internal user of the annual report information?

a) creditors

b) management

c) regulators

d) shareholders

Answer: b

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify the main users of financial accounting information and explain how they use this information.

CPA: Financial Reporting

AACSB: Analytic

35. The shareholders typically elect which of the following to represent their interests?

a) senior management

b) independent auditors

c) board of directors

d) chief operating officer

Answer: c

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify the main users of financial accounting information and explain how they use this information.

CPA: Financial Reporting

AACSB: Analytic

36. All of the following are external users EXCEPT

a) labour unions.

b) management.

c) regulators.

d) journalists.

Answer: b

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify the main users of financial accounting information and explain how they use this information.

CPA: Financial Reporting

AACSB: Analytic

37. Those who lend money or otherwise extend credit rather than invest it directly in the company are known as

a) investors.

b) regulators.

c) creditors.

d) unions.

Answer: c

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify the main users of financial accounting information and explain how they use this information.

CPA: Financial Reporting

AACSB: Analytic

38. Publicly traded corporations that fail to comply with securities regulations related to statement presentation and timing, may

a) be fraudulent.

b) be delisted.

c) face criminal charges.

d) have a questionable management team.

Answer: b

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify the main users of financial accounting information and explain how they use this information.

CPA: Financial Reporting

AACSB: Analytic

39. Creditors include which of the following?

a) suppliers

b) financial institutions

c) employees

d) All of the choices are correct.

Answer: d

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify the main users of financial accounting information and explain how they use this information.

CPA: Financial Reporting

AACSB: Analytic

40. Privately held corporations

a) always have multiple shareholders.

b) always require a board of directors to represents its interests.

c) raise capital through the sale of shares.

d) are not traded on the stock market.

Answer: d

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Identify the main users of financial accounting information and explain how they use this information.

Learning Objective: Describe the major forms of business organization and explain the key distinctions between each form.

CPA: Financial Reporting

AACSB: Analytic

41. The form of business ownership that most effectively limits the risk of ownership is

a) sole proprietorship.

b) general partnership.

c) corporation.

d) all forms of business ownership, since they are equally risky.

Answer: c

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Describe the major forms of business organization and explain the key distinctions between each form.

CPA: Financial Reporting

AACSB: Analytic

42. Jennifer is a university student looking to earn some cash for tuition over the summer months (April–August). She has decided to start a lawn care business, what business structure would best suit her needs?

a) private corporation

b) public corporation

c) general partnership

d) sole proprietorship

Answer: d

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Describe the major forms of business organization and explain the key distinctions between each form.

CPA: Financial Reporting

AACSB: Analytic

43. A corporation whose shares are held by a small number of individuals is referred to as a

a) proprietorship.

b) publicly traded corporation.

c) small business corporation.

d) privately held corporation.

Answer: d

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Describe the major forms of business organization and explain the key distinctions between each form.

CPA: Financial Reporting

AACSB: Analytic

44. Businesses can be operated in a number of different forms, such as a

a) corporation.

b) partnership.

c) proprietorship.

d) All of the choices are correct.

Answer: d

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Describe the major forms of business organization and explain the key distinctions between each form.

CPA: Financial Reporting

AACSB: Analytic

45. Which statement is INCORRECT with regard to the characteristics of a corporation?

a) It is a separate legal entity.

b) It can be sued.

c) Shareholders liability is limited to their investment.

d) It cannot be publicly accountable.

Answer: d

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Describe the major forms of business organization and explain the key distinctions between each form.

CPA: Financial Reporting

AACSB: Analytic

46. Which of the following statements best describes a proprietorship?

a) A proprietorship can be comprised of single or multiple owners.

b) The owners are taxed separately from the business.

c) It is the most expensive business structure to establish.

d) The owner is responsible for the debt of the company.

Answer: d

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Describe the major forms of business organization and explain the key distinctions between each form.

CPA: Financial Reporting

AACSB: Analytic

47. Which of the following statements best describes a partnership?

a) A partnership is a separate legal entity from its owners.

b) There is only a single owner.

c) It is the most expensive business structure to establish.

d) The owners are responsible for the debt of the company.

Answer: d

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Describe the major forms of business organization and explain the key distinctions between each form.

CPA: Financial Reporting

AACSB: Analytic

48. Which of the following statements best describes a corporation?

a) The business can be comprised of single or multiple owners.

b) The owners are taxed separately from the business.

c) It is the most expensive structure to establish.

d) All of the choices are correct.

Answer: d

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Describe the major forms of business organization and explain the key distinctions between each form.

CPA: Financial Reporting

AACSB: Analytic

49. What is the initial investment by the shareholders in a company called?

a) owners’ capital

b) shareholders’ capital

c) retained earnings

d) shareholders’ equity

Answer: d

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

50. The fundamental types of business activities that a firm typically engages in include all of the following EXCEPTfor

a) operating activities.

b) borrowing activities.

c) investing activities.

d) financing activities.

Answer: b

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

51. Which of the following is an example of an operating activity?

a) paying dividends

b) sale of investment in other companies' shares

c) purchase of property, plant, and equipment

d) payment of interest expense

Answer: d

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

52. Which of the following is a typical financing activity?

a) purchasing property, plant or equipment

b) purchasing another company’s shares

c) paying interest expense

d) paying dividends

Answer: d

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

53. All of the following are investing activities EXCEPTfor

a) earning interest income.

b) purchasing property, plant, and equipment.

c) purchasing other companies' shares.

d) selling property, plant, and equipment.

Answer: a

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

54. Which of the following is a typical financing activity?

a) payment of dividends

b) payment of interest expense

c) payment of wages

d) purchases of inventory

Answer: a

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

55. Operating activities include all of the following EXCEPT for

a) collections of accounts receivable.

b) payment of tax expense.

c) payment of dividends.

d) payment of interest expense.

Answer: c

Bloomcode: Comprehension

Difficulty: Easy

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

56. Which of the following is NOT a typical operating activity?

a) payment of accounts payable

b) payment of long-term notes payable

c) payment of wages

d) collection of accounts receivable

Answer: b

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

57. An example of a financing activity is

a) purchase of property.

b) issuing shares.

c) sales to customers.

d) payment of taxes.

Answer: b

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

58. An example of an investing activity is

a) purchase of inventory.

b) collections of amounts owed by customers.

c) purchase of shares of other companies.

d) payment of taxes.

Answer: c

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

59. An example of an operating activity is

a) repaying loan principal.

b) paying dividends.

c) purchase of shares of other companies.

d) payments of taxes owed to the government.

Answer: d

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

60. A friend is looking to purchase shares as an investment, but would like information about whether the company has paid dividends in the last year. Where would your friend find this information in the financial statements?

a) Income Statement

b) Operating Activities on the Cash Flow Statement

c) Investing Activities on the Cash Flow Statement

d) Financing Activities on the Cash Flow Statement

Answer: d

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

61. A positive \_\_\_ represents an internal source of funding.

a) cash flow

b) revenue account

c) dividends account

d) share capital account

Answer: d

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

62. Capital Appreciation refers to

a) the sale of shares at a price higher than the purchase price.

b) the gain on the sale of an asset.

c) the allocation of the value of an asset over its useful life.

d) the sale of shares at cost.

Answer: a

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

63. Which of the following statements best describes financial accounting?

a) an information system in which the underlying transactions of an organization are captured, analyzed, and reported

b) the reports that management prepares for the owners of the company summarizing how the company performed during the period

c) an information system in which all transactions with the company are accurately reported

d) the reports that management prepares for use in making decisions related to the financing, investing, and operating activities of a company

Answer: a

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

64. Where would the information about company operations be found?

a) on the Statement of Income

b) on the Statement of Financial Position

c) in the notes of the financial statements

d) in the statement of management responsibility

Answer: a

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

65. Muller Ltd. earned gross revenues of $2,500,000 and had net income of $480,000 in the current year. During the year, the company had 200,000 common shares outstanding and its average shareholders’ equity was $1,000,000. Muller’s basic earnings per share for the year is

a) $2.50.

b) $2.40.

c) $12.50.

d) $0.48.

Answer: b

Bloomcode: Application

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

66. All of the following can be found on the Statement of Income EXCEPT for

a) interest expense.

b) depreciation expense.

c) prepaid rent expense.

d) other income.

Answer: c

Bloomcode: Knowledge

Difficulty: Hard

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

67. Which of the financial statements provides information about the company’s financial position?

a) Statement of Income

b) Statement of Financial Position

c) Statement of Cash Flows

d) Statement of Changes in Equity

Answer: b

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

68. Which of the following is the proper order to list current assets on the Statement of Financial Position?

a) Cash, Short-Term Investments, Inventory, Prepaid Expenses

b) Cash, Short-Term Investments, Prepaid Expenses, Accounts Receivable

c) Cash, Inventory, Accounts Receivable, Short-Term Investments

d) Cash, Accounts Receivable, Short-Term Investments, Inventory

Answer: a

Bloomcode: Comprehension

Difficulty: Hard

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

69. Which of the following is the basic accounting equation?

a) Assets = liabilities – shareholders' equity

b) Assets = liabilities × shareholders' equity

c) Assets = liabilities ÷ shareholders' equity

d) Assets = liabilities + shareholders' equity

Answer: d

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

70. Which of the following are the two components of Shareholders’ equity?

a) Dividends and Retained Earnings

b) Share Capital and Retained Earnings

c) Share Capital and Net Income

d) Net Income and Dividends

Answer: b

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

71. The change in retained earnings can be calculated as follows

a) Net Income – Dividends

b) Net Income + Dividends

c) Net Income – Interest

d) Net Income + Interest

Answer: a

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

72. Dividends are paid when approved by the

a) board of directors.

b) management.

c) shareholders.

d) creditors.

Answer: a

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

73. The following information is NOT found on the Statement of Income:

a) EPS.

b) Depreciation Expense.

c) Goodwill.

d) Cost of Goods Sold.

Answer: c

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

74. Which of the following statements is correct?

a) The market value and the book value of a company’s shareholders’ equity are usually the same.

b) The market value is usually less than the book value of a company’s shareholders’ equity.

c) The market value is usually more than the book value of a company’s shareholders’ equity.

d) The value of the shareholders’ equity on the Statement of Financial Position is based on the value of the company’s shares in the market.

Answer: c

Bloomcode: Comprehension

Difficulty: Hard

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

75. Which of the following is a section found in the Statement of Cash Flows?

a) cash from lending activities

b) cash from shareholder activities

c) cash from financing activities

d) cash from borrowing activities

Answer: c

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

76. On the Statement of Cash Flows, the repayment of long-term obligations would be considered

a) a financing activity.

b) an investing activity.

c) an operating activity.

d) a reduction in a liability.

Answer: a

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

77. The starting point in the operating activities section of the cash flow statement is

a) Sales Revenue.

b) Retained Earnings.

c) Beginning Cash Balance.

d) Net Income.

Answer: d

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

78. Where in the financial statements would a user find out which accounting policies management has selected to use?

a) Statement of Management Responsibility

b) Notes to the Financial Statements

c) Auditors’ Report

d) Management Discussion and Analysis

Answer: b

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

79. The Statement of Income is also known as

a) Statement of Operations.

b) Statement of Earnings.

c) Statement of Profit or Loss.

d) All of the choices are correct.

Answer: d

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

80. Who determines the amount of earnings to be paid as dividends?

a) management

b) board of directors

c) shareholders

d) regulators

Answer: b

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

81. The working capital equation is

a) Working Capital = Current Assets – Current Liabilities.

b) Working Capital = Current Assets + Current Liabilities.

c) Working Capital = Current Assets – Non-Current Liabilities.

d) Working Capital = Non-current Assets + Current Liabilities.

Answer: a

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

82. The accounting equation is

a) Assets = Liabilities – Shareholders’ Equity.

b) Assets + Liabilities = Shareholders’ Equity.

c) Assets = Liabilities + Shareholders’ Equity.

d) Shareholders’ Equity – Liabilities = Assets.

Answer: c

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

83. A characteristic of an asset is

a) a resource controlled by an entity.

b) a future economic outflow.

c) an event that will happen in the future.

d) that it results in an outflow of resources.

Answer: a

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

84. Licences, patents, trademarks, and copyrights are all examples of

a) current assets.

b) goodwill.

c) intangible assets.

d) short-term investments.

Answer: c

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

85. Goods held for resale to customers are called

a) Inventory.

b) Prepaid Deposits.

c) Property, Plant, and Equipment.

d) Intangible Assets.

Answer: a

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

86. Amounts owed to customers for advance payments until the related goods or services have been provided are called

a) Accounts Payable.

b) Deferred Revenue.

c) Accrued Liabilities.

d) Deferred Income Taxes.

Answer: b

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

87. Measures the resources controlled by a company and the claims on resources at a given point in time.

a) Statement of Financial Position

b) Statement of Income

c) Statement of Cash Flows

d) Statement of Changes in Equity

Answer: a

Bloomcode: Knowledge

Difficulty: Easy

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

**EXERCISES**

88. Algoma District Hospital (ADH) has over 100 employees and has the capacity to service up to 220 patients at any given time. ADH is a non-profit organization that receives most of its funding from the provincial government and various donations made by individuals and companies. Although there are no shareholders, ADH does have outstanding loans from its local bank. ADH has an active board of directors that assists with governance activities.

**Instructions**

Describe the various users of Algoma District Hospital financial information, including what information they would find useful. Also, indicate which of these users are considered internal or external.

**Solution** (15 min.)

The key users of ADH can be summarized as follows. Note: additional users beyond this list may be relevant.

|  |  |  |
| --- | --- | --- |
| User | Internal/External | Useful Information |
| Staff/Workers | Internal | Staff/workers would care about how well their organization is operating. The statement of operations/income statement would be of most interest to this group of users. |
| Local bank | External | The bank would care about certain key ratios such as interest coverage ratio and debt ratio, and whether it will recover its investment. Operating income and cash flow management would be of interest to the bank. |
| Provincial government | External | The provincial government would be interested in how its funding was spent and how ADH is managing its operations and cash flows. The statement of operations/income statement would identify the revenues and expenses, and the statement of cash flows would assist this group of users in assessing cash management. |
| ADH management | Internal | Management is concerned managing its financial assets and liabilities, in addition to keeping the organization out of a deficit position. |
| Board of directors | Internal | The board of directors would be interested in assessing the performance of management by examining key liquidity ratios such as current ratio and debt ratio. This group of users would also be interested in the statement of operations/income statement to assess the performance of the organization's various programs and overall performance. |
| Suppliers | External | Suppliers would be interested in the amount of ADH’s accounts payable and liquidity ratios such as current ratio and debt ratio to assess its ability to pay supplier invoices. |

Note: As a non-profit organization, ADH would not be subject to income taxes. Therefore, stating the taxing authority as a key user may not be accurate. The organization may still have to comply with sales tax regulations, making the taxing authority a relevant user.

Bloomcode: Analysis

Difficulty: Hard

Learning Objective: Identify the main users of financial accounting information and explain how they use this information.

CPA: Financial Reporting

AACSB: Analytic

89. The following data was taken from the books of Jeepers Creepers Inc. as of December 31:

Cost of goods sold $ 15,300 Selling & administrative expense $3,500

Income tax expense 6,120 Accounts payable 12,000

Cash 3,500 Common shares, (3,250 shares) 20,000

Retained earnings (Jan 1) 8,000 Dividends 6,000

Other income 1,500 Interest expense 900

Sales revenue 35,000 Depreciation expense 1,500

Equipment 39,680

**Instructions**

a) Calculate total assets.

b) Calculate total revenue and expenses.

c) Calculate total liabilities.

**Solution** (10 min.)

a) Total Assets

Cash $3,500

Equipment 39,680

Total 43,180

b) Total revenue

Sales $35,000

Other income 1,500

Total Revenue $36,500

Total expenses

Cost of goods sold $15,300

Selling & administrative expense 3,500

Interest expense 900

Depreciation expense 1,500

Income tax expense 6,120

Total expenses $27,320

c) Total Liabilities

Accounts payable $12,000

Bloomcode: Application

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

90. The following data was taken from the books of Scodnick Supplies Ltd. as of December 31:

Accounts payable $ 9,000 Income tax payable $ 36,800

Cost of goods sold 214,000 Selling expense 80,000

Cash 12,000 General expense 50,000

Long-term notes payable 19,000 Accounts receivable 10,000

Sales revenue 480,000 Prepaid rent 2,000

Short-term investment 5,000 Dividends payable 5,000

Inventory 66,000 Income tax expense 40,800

Common shares 60,000 Equipment 100,000

Retained earnings 65,200 Number of common shares 20,000

**Instructions**

From the list above, determine which items should NOT be reported on the Statement of Financial Position.

**Solution** (10 min.)

Cost of goods sold 214,000

Selling expense 80,000

General expense 50,000

Sales revenue 480,000

Income tax expense 40,800

Number of common shares 20,000

Bloomcode: Application

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

91 The following data was taken from the books as at December 31 of Harman Inc.:

Cash $15,000 Common shares $15,000

Income tax expense 2,300 Cost of goods sold 39,000

Sales revenue 85,000 Retained earnings (as of January 1) 8,500

Inventory 21,500 Notes payable 50,750

Accounts payable 32,000 Equipment 125,000

Operating expenses 28,900 Dividends paid 4,000

Interest expense 5,600 Accounts Receivable 10,000

Prepaid expenses 750

**Instructions**

a) Determine the gross profit.

b) List the current assets in order of liquidity.

**Solution** (10 min.)

a) Gross profit = $85,000 – 39,000 = $46,000

b) Cash 15,000

Accounts receivable 10,000

Inventory 21,500

Prepaid expenses 750

Bloomcode: Application

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

92. The following data was taken from the books of Xiao Inc. as of December 31:

Cost of goods sold $ 35,300 Selling & administrative expense $9,500

Income tax expense 6,120 Accounts payable 14,225

Cash 4,755 Common shares, (3,250 shares) 20,000

Retained earnings (Jan 1) 8,000 Dividends 3,250

Other income 2,225 Interest expense 250

Sales revenue 57,250 Depreciation expense 2,850

PPE (net) 34,425 Accounts Receivable 5,250

**Instructions**

a) Calculate total assets.

b) Calculate total revenue, expenses and net income.

c) Calculate total liabilities.

d) Calculate earnings per share.

**Solution** (15 min.)

a) Total Assets

Cash $ 4,755

A/R $ 5,250

PPE $34,425

TOTAL $44,430

b) Total revenue

Sales $57,250

Other income 2,225

Total Revenue $59,475

Total expenses

Cost of goods sold $35,300

Selling & administrative expense 9,500

Interest expense 250

Depreciation expense 2,850

Income Tax Expense 6,120

Total expenses $54,020

Net Income $59,475 – $54,020 = $5,455

c) Total Liabilities

Accounts payable $14,225

d) EPS = $5,455 / 3,250 = $1.68

Bloomcode: Analysis

Difficulty: Hard

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

93. The following data was taken from the books as at December 31 of Malibu Inc.:

Cash $13,500 Common shares $15,000

Income tax expense 5,250 Cost of goods sold 59,000

Sales revenue 105,550 Retained earnings (as of January 1) 80,450

Inventory 31,500 Bank Loan payable 50,750

Accounts payable 32,750 Equipment 125,000

Operating expenses 28,900 Dividends paid 5,250

Interest expense 3,600 Accounts Receivable 11,250

Prepaid expenses 1,250

**Instructions**

a) Determine the gross profit and net income.

b) Calculate the balance in the retained earnings account as of December 31.

c) Calculate the working capital.

**Solution** (18 min.)

1. Gross profit = $105,550 – 59,000 = $46,550

Net Income = $46,550 – 28,900 – 3,600 – 5,250 = $8,800

1. Balance in R/E account: $80,450 + $8,800 – $5,250 = $84,000
2. Current Assets = $13,500 + 11,250 + 31,500 + 1,250 = $57,500

Current Liabilities = $32,750

Working Capital: $57,500 – $32,750 = $24,750

Bloomcode: Analysis

Difficulty: Hard

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

**MATCHING**

94. Match each of the following activities to the transactions listed below by placing the appropriate letter in the space provided.

ACTIVITIES

a) Operating

b) Investing

c) Financing

\_\_\_ 1. Borrowing money

\_\_\_ 2. Payment of salaries and wages

\_\_\_ 3. Payment of dividends

\_\_\_ 4. Sale of long-term assets

\_\_\_ 5. Purchase of another company's shares

\_\_\_ 6. Receipt of dividends

\_\_\_ 7. Collections of amounts owed by customers

\_\_\_ 8. Issuing shares

\_\_\_ 9. Purchase of another company’s bonds

\_\_\_ 10. Purchase of inventory

\_\_\_ 11. Sales to customers

\_\_\_ 12. Share repurchase

**Solution** (5 min.)

1. c

2. a

3. c

4. b

5. b

6. a

7. a

8. c

9. b

10. a

11. a

12. c

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

95. Match each of the following financial statement lines to the correct financial statement by placing the appropriate letter in the space provided.

Financial Statement

a) Statement of Financial Position

b) Statement of Income

c) Statement of changes in equity

d) Statement of Cash Flows

\_\_\_ 1. Income Taxes Payable

\_\_\_ 2. Cost of Goods Sold

\_\_\_ 3. Property, plant and equipment

\_\_\_ 4. Cash from Operating activities

\_\_\_ 5. Dividends Declared

\_\_\_ 6. Inventory

\_\_\_ 7. Operating expenses

\_\_\_ 8. Gain on machinery

\_\_\_ 9. Prepaid Expenses

\_\_\_ 10. Accounts Receivable

\_\_\_ 11. Net Income

\_\_\_ 12. Goodwill

**Solution** (5 min.)

1. a

2. b

3. a

4. d

5. c

6. a

7. b

8. b

9. a

10. a

11. b

12. a

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

**SHORT-ANSWER ESSAY QUESTIONS**

96. How do internal users differ from external users of financial statements? Identify one internal and two external users of annual reports.

**Solution** (5 min.)

Internal users are using the information to make decisions regarding product/service pricing, operational expenses, buy versus lease decisions, and cost control measures.

External users use the information in a variety of ways

* Shareholders – to make buy/sell decisions
* Board of Directors – to assess how well management is running the business
* Creditors – to see if the company can fulfill its debt obligations in both the short- and long-term
* Regulators – are looking for corporate compliance
* Tax authorities – tax assessment and compliance

Internal—management

External—board of directors, shareholders, creditors, regulators, taxing authorities, other corporations, security analysts, credit-rating agencies, unions

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify the main users of financial accounting information and explain how they use this information.

CPA: Financial Reporting

AACSB: Analytic

97. Briefly explain the relationship between the management, the board of directors, and the shareholders in a public company.

**Solution** (5 min.)

The shareholders are the owners of the company. In a large public company, they are generally not involved in the day-to-day operations of the company. The shareholders elect the members of the board of directors to represent them. The board then hires (and fires) senior management to manage the operations of the company.

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Describe the major forms of business organization and explain the key distinctions between each form.

CPA: Financial Reporting

AACSB: Analytic

98. Identify and describe the two main types of corporate structure. What impact, if any, does the structure have on management and financial reporting requirements?

**Solution** (8 min.)

Publicly traded companies trade on public stock exchanges such as the TSX. Shares are widely held and owned by a large number of individuals and / or entities. Some portion of the ownership will usually change hands every day. Typically a board of directors is elected to represent the interest of the shareholders. The board of directors has the authority to hire a management team who will manage day-to-day operations. The management team periodically reports to the shareholders. Financial statements are typically prepared quarterly. Annual financial statements are prepared and included in the company’s annual report.

Privately held corporations shares are not available through public exchanges. The shares are narrowly held and owned by a small number of shareholders. It is not as easy to transfer ownership and shareholders are often involved in the day-to-day operations of the business.

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Describe the major forms of business organization and explain the key distinctions between each form.

CPA: Financial Reporting

AACSB: Analytic

99. Identify the three types of business activities a firm engages in. Provide an example of an inflow and outflow for each type of activity. Which type of activity is most critical to the company’s success and why?

**Solution** (10 min)

The three types of activities include:

Operating activities – example of an inflow: collection of A/R, example of an outflow: purchase of inventory

Investing activities – example of an inflow: sale of PPE, example of an outflow: purchase of PPE

Financing activities – example of an inflow: share issue or borrowing, example of an outflow: payment of dividends, loan repayment

Operating activates is considered the most critical to the company’s long run success or failure. If the company is not successful at generating cash flows from its operations it will ultimately run out of cash as financing sources dry up because it will not be able to attract new lenders or investors. It would begin selling PPE that is uses, further compromising operations.

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

100. Identify and describe the three primary financial statements prepared by accountants. How do these statements differ?

**Solution** (10 min.)

Statement of Income

* Measures the operating activities and performance of a company over a period of time, normally a year. Calculates the net income for a period of time by deducting expenses from sales revenues. Revenues – Expenses = Net Income

Statement of Financial Position

* Can be represented by the equation: Assets = Liabilities + Shareholders’ equity.
* Measures the resources controlled by a company (assets) and the claims on those resources (liability and equity holders) at a given point in time.

Statement of Cash Flow

* Measures the cash inflows and outflows or change in cash flow over a period of time, normally a year, and groups the cash flows into operating, investing, and financing activities.

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

101. List the three types of business activities that are measured and reflected on the cash flow statement and provide three examples of transactions found within each activity.

**Solution** (5 min.)

Financing

These activities involve raising long-term capital to finance the purchase of long-term assets. Typically, this includes borrowing money, repaying loans, issuing shares, repurchasing shares, and paying dividends.

Investing

These activities involve the sale or purchase of long-term assets. This includes purchasing property, plant, and equipment; selling property, plant, and equipment; investing in other companies' shares; selling the investment in other companies' shares.

Operating

These are day-to-day activities the firm engages in, including sales to customers, collections on accounts receivable, purchase of inventory, payments on accounts payable, operating expenses, and taxes.

Bloomcode: Knowledge

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

**ESSAY QUESTIONS**

102. What are consolidated statements? Do these statements provide useful information to users?

**Solution** (12 min.)

Consolidated statements are the combination of all the elements of the subsidiary’s financial statements with that of the parent company. When businesses expand, they will often establish other companies or buy shares in other companies. This enables them to expand operations and diversify their risk.

When subsidiary companies are similar to the parent company’s business, the consolidated financial statements provide much more useful information because they cover the entire group of companies that are under common ownership.

When the business subsidiary is very different from the parent company, it may be difficult to interpret the financial statements due to the complexity.

Bloomcode: Comprehension

Difficulty: Hard

Learning Objective: Explain the three categories of business activities and identify examples of transactions related to each category.

CPA: Financial Reporting

AACSB: Analytic

103. What are the “notes to the financial statements”? Why are they used?

**Solution** (15 min).

The notes to the financial statements are a critical part of the financial statements. In them, management gives more detail about specific items such as the various types of inventory held by the company and details on their long-term assets. By including additional explanations in notes rather than in the financial statements, management keeps the company’s statements simple and uncluttered. Note disclosures help to increase the usefulness of the financial statements and enhance the user’s understanding of the various components of the statements.

Bloomcode: Comprehension

Difficulty: Medium

Learning Objective: Identify and explain the content and reporting objectives of the four basic financial statements and the notes to the financial statements.

CPA: Financial Reporting

AACSB: Analytic

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