

Additional Midterm Practice Questions - SOLUTIONS

PQMR-1

Why is financial information important to stakeholders?

As you can see from the example of Tees Inc. in Chapter 2, both the preparers of financial information and the external stakeholders, the users, have objectives (things they want from the business). The owners of Tees Inc. want a loan and they need to provide financial information to get it. The bank, an external stakeholder, wants financial information so it can decide on the amount of the loan as well as whether the loan, plus interest, will be repaid by the business. Both parties need financial information to meet their objectives.

PQMR-2

What does GAAP stand for? Why is GAAP used?

GAAP = Generally Accepted Accounting Principles. The qualitative characteristics and underlying assumptions are part of generally accepted accounting principles, called GAAP (pronounced as gap). Preparers of accounting information use GAAP as a guideline when preparing financial accounting information. The overall objective of GAAP is to provide financial information about a business that is useful to external stakeholders for decision-making.

PQMR-3

Trans. #	ASSETS	LIABILITIES	EQUITY
1	7,500		7,500
2	5,000	5,000	
3	60	60	
4	+1,296 & -1,296		
5	No entry		
6	1,356	1,356	
7	100	100	
8	40	40	
9	-40		-40
10	No entry		
11	3,450		3,450
12a	-565		-565
12b	-100		-100
13	-1,181		-1,181
14	-144		-144
15	-590		-590
16	-25		-25
17	-108		-108
18	-1,556	-1,556	
TOTAL	13,197	5,000	8,197

What is the problem with using the basic accounting equation to record all the business activities?

- Does not provide the necessary details for you to make decisions about your business. For instance, you don't know if you have enough cash to repay your parents.
- You don't know if the company has been profitable. To calculate this you would have to do manual calculations!
- You have no details about any of the elements, such as what makes up your assets?

PQMR-4

An advertising business would be in which business sector? Support your choice with reasoning.

- Tertiary because it is involved in providing services, which matches the definition of the Tertiary sector (services provided to the public or other businesses)

PQMR-5

Date	Assets			Liabilities	Equity							Dividends
					Owner's Capital	Retained earnings						
						Profit						
						Revenue			Expenses			
Cash	Accounts Receivable	Inventory	Accounts Payable	Owner's Capital	Retained Earnings	Sales	Sales Returns & Allowances	Sales Discounts	Cost of Goods Sold	Shipping Expenses		
Opening	7,289	0	4,260	0	15,000	3,451	0	0	0	0	0	
July 1	No entry											
July 2			5,900	5,900								
July 3	-130		130									
July 7			-1,000	-1,000								
July 8	No entry											
July 9		6,800					6,800					
			-4,400						4,400			
July 10	-100										100	
July 11	-4,802		-98	-4,900								
July 13		-900						-900				
			600						-600			
July 14	-85										85	
July 17	-920		920									
July 18	No entry											
July 19	5,841	-5,900							-59			
July 21	120		-120									
July 22	No entry											
July 23		7,800					7,800					
			-5,600						5,600			
July 24	No entry											
July 27		-600						-600				
July 28	6,984	-7,200							-216			
Totals:	14,197	0	592	0	15,000	3,451	14,600	-1,480	-275	9,400	185	

PQMR-5, continued

Provide the multiple step income statement to the gross profit line. NOTE: be sure to provide the appropriate title for this partial income statement!

Genoma Inc.	
Income Statement (partial)	
Month ended July 31, 2016	
Sales	\$ 14,600
Sales returns and allowances	(1,480)
Sales discounts	<u>(275)</u>
Net sales	12,845
Cost of goods sold	<u>9,400</u>
Gross profit	\$ 3,445

What was the gross profit ratio for your business, Genoma Inc.? Would you consider this gross profit margin good? Why or why not?

The gross profit is calculated as gross profit ÷ net sales, $\$3,445 \div \$12,845 = 26.8\%$. It is not possible to determine if it is good or bad. A comparison needs to be made with industry standards (what is common in the industry). In addition, gross profit must cover all the operating expenses. Unless we know all the operating expenses it is not possible to determine if the gross profit is good or bad. More information is required to make that determination.

Why is the gross profit ratio (the percentage) a better measure than gross profit (the dollar amount) to determine how well the business did for the month?

Gross profit is an absolute \$ figure. As such it tells us nothing. Only when we compare it to something can we make an assessment. By changing the number into a percentage (using net sales) can we assess if the \$ figure is large or small (in comparison to net sales). We can also use the % to compare between different businesses without getting confused by the \$ figure. For example, a large business may have a large \$ figure but a smaller gross profit margin than a smaller business. The smaller business may be doing much better even through its \$ figure is smaller. We can only see that when we compare the gross profit ratio (the %).

PQMR-5, continued

On July 13 some of the inventory sold to Vindi Inc. on July 9 was returned because it was the wrong colour. It was shipped FOB shipping point. Who paid for the return shipping costs? If you paid, which account did you charge the shipping costs to and why? Why do you think the shipping terms were FOB shipping point instead of FOB destination?

The original transaction on July 9 was a sale by us to Vindi, FOB destination. As we were the shipper, not the destination, we had to pay the freight.

Now Vindi is returning some of the goods to us, and they are sending it to us FOB shipping point. In this case, Vindi is the shipping point and we are the destination. So once again, we have to pay the freight.

It's only fair that if we had to pay the freight when the goods went out, we also have to pay when they come back in.

Remember the rule, which works regardless of whether the transaction is a sale, a purchase, or a return – you are either the shipping point or the destination, and if the FOB point is you, you don't pay the freight. If it's the other party, you do. Also remember that freight-in is inventory, while freight-out is an expense.

As a purchaser, what shipping terms would you prefer: FOB shipping point or FOB destination? Why, as a purchaser, do you prefer those shipping terms?

FOB destination because it means that the seller has to pay the freight costs and we don't have to pay for shipping. We are the destination when we make a purchase – we want the FOB point to be us, so we don't pay. The cost of shipping is added to the inventory account and makes our inventory more expensive. If we cannot increase our prices then those shipping costs will increase our cost of goods sold (when we sell the inventory) and reduce our gross profit and gross profit ratio (unless we can pass all the costs on to our customers when we sell the inventory, in which case we don't care if we have to pay for shipping – but our customers do!).

As a seller, what shipping terms would you prefer: FOB shipping point or FOB destination? Why, as a seller, do you prefer those shipping terms?

FOB shipping point because it means that the buyer has to pay the freight costs and we, the seller, don't have to pay for shipping, which is an expense and reduces our profit! We are the shipping point when we make a sale – we want the FOB point to be us, so we don't pay.

PQMR-6

Description	Amount	Element
Gas costs (used)	\$1,152	X
Money you put in to start the business	\$2,250	E
Equipment rental costs	\$4,200	X
Scooter purchased (personal)	\$1,962	***
Cash in bank (personal)	\$3,867	***
Money borrowed from parents to start business.	\$1,500	L
Cash in bank (business)	\$7,680	A
Cell phone costs (personal)	\$432	***
Advertising costs	\$450	X
Cell phone costs (business)	\$648	X
Customer payments	\$10,500	R
Container full of gas	\$120	A

***** - Not included due to separate entity assumption.**

Revenue	\$10,500
Expenses	<u>\$6,450</u>
Profit	\$4,050
Accounting Equation:	
Assets =	\$7,800 =
Liabilities +	\$1,500 +
Equity	\$6,300

PQMR-7

Why is an accounting system important to external stakeholders?

Companies record their business transactions in an accounting system: an information system that collects, groups, and communicates a business's financial position, including its financial health and profitability. Without accounting information, stakeholders would not be able to make many of the decisions that help them meet their objectives. External stakeholders do not have access to the business's accounting system because they are outside of the business. Instead, they depend on the financial statements that businesses produce. Financial statements tell a business's story, what they do and how well they do it. They provide a business's financial performance, its current financial position, and its cash flows. External stakeholders use the financial statements to analyze a business and answer questions, which allows them to make decisions and meet their objectives.

PQMR-8

Why is it important to review your financial statements regularly, even if you run your own business?

In order to make good business decisions, all stakeholders need to have a good idea of how the business has progressed in the past. By reviewing ALL the financial statements and analyzing them the stakeholders can answer the questions they have (see Chapter 1) so as to make better business decisions. This is particularly important for owners of a business as they need to make decisions that affect the business on a daily basis. Accounting information, summarized in the financial statements, can be used to help make those decisions.

PQMR-9

The chart is on the next page. The financial statements follow.

Review your income statement. Can you use this information to predict how you will do over the upcoming 11 months? If you were not profitable do you feel that you should quit your business? Why or why not? Be sure to explain fully!!

You were profitable for the month, earning profit (net income) of \$1,950. It would be difficult to predict how much you will make over the upcoming 11 months since you have only had one month of business and that is not enough to try and predict the future of your business. Also, the amount of time you can devote to the business may vary, depending on what your courses require re: your time.

If you had not been profitable it should not have caused you to close your business after just one month. Most businesses are not profitable for the first 2 - 5 years.

Trans.	Assets							Liabilities					Equity											
													Owner's Capital	Retained earnings										Dividends
														Retained Earnings	Profit									
															Revenue	Expenses								
Cash	Accounts Receivable	Office Supplies	Prepaid Conference	Prepaid Insurance	Business Licence	Prepaid Advertising	Accounts Payable	Unearned Revenue	Income Tax Payable	Loan Payable	Owner's Capital	Service Revenue	Bank Charges	Office Supplies	Utilities	Telephone	Insurance	Rent	Income Tax	Advertising				
1	2500										2500													
2	2000									2000														
3	No entry																							
4					60		60																	
5	-648			648																				
6		452					452																	
7						226	226																	
8						113	113																	
9			791				791																	
10	No entry																							
11						-113																113		
12	2450											2450												
13		950										950												
14			-177											177										
15	-84															84								
16	-350														100			250						
17	500							500																
18	-22												22											
19				-54														54						
20									650												650			
21	-1250						-1250																	
Totals:	5096	950	275	791	594	60	226	392	500	650	2000	2500	3400		22	177	100	84	54	250	650	113		

Websites NOW		
Income Statement		
Period ending October 31, 2015		
Service revenue		\$ 3,400
Operating expenses:		
Bank charges	\$ 22	
Office supplies	177	
Utilities	100	
Advertising	113	
Telephone	84	
Insurance	54	
Rent	<u>250</u>	
Total		<u>800</u>
Income before income tax		2,600
Income tax		<u>650</u>
Net income		\$ 1,950

Websites NOW		
Statement of Retained Earnings		
Period ending October 31, 2015		
Opening balance		\$ 0
Add net income		<u>1,950</u>
		1,950
Deduct dividends		<u>0</u>
Ending balance		\$ 1,950

Websites NOW
Balance Sheet
As at October 31, 2015

Assets		
Current assets		
Cash	\$ 5,096	
Accounts receivable	950	
Office supplies	275	
Prepaid conference	791	
Prepaid insurance	594	
Prepaid advertising	<u>226</u>	
Total current assets		\$ 7,932
Intangible assets		
Business licence		<u>60</u>
Total assets		<u>\$ 7,992</u>
Liabilities		
Current liabilities		
Accounts payable	\$ 392	
Unearned revenue	500	
Income taxes payable	<u>650</u>	
Total current liabilities		\$ 1,542
Long-term liabilities		
Loan payable		<u>2,000</u>
Total liabilities		3,542
Owner's equity		
Owner's capital	2,500	
Retained earnings	<u>1,950</u>	
Total owner's equity		<u>4,450</u>
Total liabilities and owner's equity		<u>\$ 7,992</u>

PQMR-10

What are the critical and enhancing questions? Why are they so important?

The best way to analyze any business activity is to have a set of questions that you ALWAYS ask when analyzing any activity.

Critical Questions	Enhancing Questions
What did the business get?	What did the business earn? (Revenue)
What did the business give away?	What did the business use, consume, or incur? (Expense)
	What does the business owe? (Liabilities or Owner's Capital)

Again, keep in mind that you stand in the shoes of THE BUSINESS when you are asking yourself these questions because you are recording these events in the business's accounting system, not the owner's. That point of view, the business's point of view, is very important.

Ask yourself the critical questions first. If there is still confusion about how the activity affects the financial reporting elements then use the enhancing questions to clarify your understanding.

PQMR-11

What do businesses record in the Sales Returns and Allowances and Sales Discount accounts? Why do businesses have separate Sales Returns and Allowances as well as Sales Discount accounts? Why not record all these entries into the Sales account?

When you're the seller and your customer takes a discount (pays you less than the amount of their accounts receivable) you use a separate account called Sales Discounts. This account provides management with better information for decision-making as they can track the amount of the discounts that they provided to their customers and compare it to the total revenue. It will help them decide, in the future, whether to increase or decrease the discounts offered to their customers.

Returns are exactly the same. Instead of using the Sales Revenue account the seller uses the contra-revenue account called Sales Returns and Allowances. You use a separate account because it provides management with better information for decision-making as they know how many returns there are in comparison to the sales revenue. If the number is high management would want to investigate why there are so many returns.

PQMR-12

	Assets	=	Liabilities	+	Equity	
				Owner's Capital	+	Retained Earnings
					Profit	Dividends
Tran #					Revenue	-Expenses
1	7,500			7,500		
2	5,000		5,000			
3	No entry					
4	60		60			
5	+1,296 & - 1,296					
6	1,356		1,356			
7	100		100			
8	40		40			
9	-40					40
10	No entry					
11a	-565					565
11b	-100					100
12	3,450				3,450	
13	-1,181					1,181
14	-144					144
15	-590					590
16	-25					25
17	-108					108
18	-1,556		-1,556			
Total	13,197		5,000	7,500	3,450	2,753

In what way is the expanded accounting equation better than the basic accounting equation?

- Provides information about the profitability of the business (total revenues and expenses)

What does the expanded accounting equation NOT provide to business owners that they need for decision-making?

- The details about the business's operations.
- There are no details about what the major costs on the income statement are.
- There is no detail about what makes up the assets.
- You, as the owner, can't even tell if you have enough cash to repay your parents' loan at the end of the period!

PQMR-13

Name and define the financial statement elements. Why are they so important?

Remember that for data to be useful it must first be categorized or grouped. GAAP stipulates the categories, called elements, into which all business activities are divided. These elements are then used to produce the financial information and then the financial statements, which external stakeholders analyze to make decisions. By grouping business activities we can change financial data into information (categorized, analyzed, and presented) that is useful for decision making.

- Asset = Owned, benefits the business in the future, due to a past transaction
- Liabilities = Owed (obligation), will be settled in the future (through giving up cash, goods, or services), due to a past transaction.
- Equity = wealth due to the owners of the business BY the business, made up of owner's capital and retained earnings. Owner's capital is the direct investment by owners. Retained earnings is profit from the operations of the business less dividends paid to the owners.
- Revenue = income earned by a business by services provided, goods delivered (note past tense...must already have happened)
- Expense = costs of goods or services the business has used, consumed, or incurred to help generate revenue. Revenues must LEAD, expenses follow behind (are caused by) generating revenue.

PQMR-14

What does 2/10, n/30 mean if you are selling inventory? Why would you, as a seller, offer this?

You are the seller selling inventory to your customers. If you are the seller you are offering your customers a 2% discount if they pay you within 10 days from the date of delivery. If they don't pay you within 10 days you want the customer to pay you the full amount within 30 days of the date of delivery. Remember that if you collect the cash from your sales earlier you can use that cash to pay bills. In addition, you may not need to borrow as much from the bank. Remember, if you borrow money from the bank you have to pay the bank the principal (the amount you borrowed) plus interest. The interest is an expense on the income statement (incurred to help generate revenue) and that means that you will have less profit for expansion of the business and paying dividends to the owners.

PQMR-15

What is the difference between financial data and financial information?

Chapter 3: Businesses are involved in thousands of business activities every day. These activities, when recorded, result in financial data. The problem is that financial data is not financial information. What's the difference? Information is the end product of data processing. Once data has been categorized, analyzed, and formatted for presentation purposes it becomes information which can be used for decision making.

PQMR-16

Company Name		
Income Statement		
Year ended December 31, 2015		
Revenues		
Service Revenue		225,000
Operating Expenses		
Salaries expense	85,500	
Rent expense	32,460	
Supplies expense	20,250	
Travel and entertainmen	17,100	
Insurance expense	10,800	
Interest expense	10,800	
Total operating expenses		176,910
Profit before income tax		48,090
Income tax expense		13,380
Profit		34,710

Company Name	
Statement of Retained Earnings	
Year ended December 31, 2015	
Opening retained earnings	38,235
Add Profit	34,710
Deduct Dividend	26,700
Closing retained earnings	46,245

Company Name		
Balance Sheet		
At December 31, 2015		
Assets		
Current Assets		
	Cash	54,000
	Accounts Receivable	52,350
	Supplies	15,750
	Prepaid Insurance	10,800
Total current assets		132,900
Intangibles		
	Website design	14,340
	Business License	1,080
Total intangibles		15,420
Total assets		148,320
Liabilities		
Current liabilities		
	Accounts payable	18,540
	Unearned revenue	2,400
	Interest payable	135
	Income tax payable	6,000
Total current liabilities		27,075
Long term liabilities		
	Loan Payable, 2019	27,000
Total liabilities		54,075
Equity		
	Owner's Capital	48,000
	Closing retained earnings	46,245
Total equity		94,245
Total liabilities and equity		148,320

Company Name		
Statement of Cash Flows		
Year ended December 31, 2015		
Cash flows from operating activities		
Cash receipts from customers	212,220	
Cash payments to suppliers	- 181,335	
Cash paid in financing charges (interest)	- 10,665	
Cash inflow from operating activities		20,220
Cash flows from investing activities		
Purchase of intangibles	- 14,340	
Cash outflow from investing activities		- 14,340
Cash flows from financing activities		
Additional cash received from owners	24,000	
Cash received from the bank	27,000	
Cash paid for dividends	- 26,700	
Cash inflow from financing activities		24,300
Net inflow of cash		30,180
Beginning cash, Jan. 1		23,820
Ending cash, Dec. 31		54,000

INCOME STATEMENT:

The business is profitable, earning a total of \$34,710 of profit for the year. The profit margin is determined by dividing profit by the Service Revenue, $\$34,710 \div \$225,000 = 15\%$. The largest expense is Salaries, which is common for a service business as services depend on human capital.

BALANCE SHEET:

The liquid assets (which are cash or close to cash, such as accounts receivable) total \$106,350. The current liabilities which must be paid off are \$24,675. NOTE: unearned revenue is not included as it will not be paid off but provided in services! Therefore, there is enough cash to pay off the current liabilities immediately if there was a need to do so.

There is nothing of concern in this business. The business has good liquidity. Their cash position is such that it would be able to deal with any unexpected costs because its current assets at \$132,900 are well above its current liabilities of \$27,075.

The business is equity financed because equity makes up 64% of the total liabilities and equity ($94,245 \div 148,320$).

CASH FLOW STATEMENT:

The main source of cash is financing activities, with a cash inflow of \$24,300. This appears to be a negative trend. The cash flow from operating activities was \$20,220, which was enough to finance the purchase of the intangibles for \$14,340. There appears to be no need to have a cash inflow from financing activities, from the loan and the additional cash from the owners. In fact, it appears that the cash inflow from the owners was immediately paid out as dividends. It is possible that the business has plans to expand in the future, which is why they have an inflow from financing activities. However, from the statements, it is not clear why the business felt the need for additional funds from the owners and the bank unless it was to pay dividends, which would not be a good use of funds at this time.

PQMR-17

Account/Activity Name	Amount	Element / Activity	Financial Statement
Cash payments to suppliers	6,760.97	O, -	CF
Unearned revenue	1,450.00	L, current	BS
Purchase of intangibles	180.00	I, -	CF
Bank Charges Expense	44.97	X	IS
Accounts Receivable	2,850.00	A, current	BS
Cash payments for interest on debt	100.00	O, -	CF
Interest payable	50.00	L, current	BS
Cash receipts from customers	8,850.00	O, +	CF
Cash received from debt	6,000.00	F, +	CF
Utilities expense	300.00	X	IS
Prepaid Insurance	1,782.00	A, current	BS
Cash	15,309.03	A, current	BS
Loan payable	6,000.00	L, long term	BS
Income tax expense	2,010.00	X	IS
Accounts payable	650.52	L, current	BS
Capital contributions by owners	7,500.00	F, +	CF
Telephone Expense	252.00	X	IS
Insurance expense	162.00	X	IS
Income tax payable	2,010.00	L, current	BS
Interest expense	150.00	X	IS
Rent expense	750.00	X	IS
Office supplies	1,028.38	A, current	BS
Owner's Capital	7,500.00	E	BS
Office supplies expense	516.58	X	IS
Business License	180.00	A, intangible	BS
Service Revenue	10,200.00	R	IS
Prepaid Rent Expense	2,525.55	A, current	BS

4U Consulting Inc.		
Income Statement		
Period ending December 31, 2017		
Revenues		
Service Revenue		10,200.00
Operating Expenses		
Rent expense	750.00	
Office supplies expense	516.58	
Utilities expense	300.00	
Telephone Expense	252.00	
Insurance expense	162.00	
Interest expense	150.00	
Bank Charges Expense	44.97	
Total operating expenses		2,175.55
Profit before income tax		8,024.45
Income tax expense		2,010.00
Profit (net income)		<u>6,014.45</u>

4U Consulting Inc.	
Statement of Retained Earnings	
Period ending December 31, 2017	
Opening retained earnings	0
Add Profit	6,014.45
Deduct Dividend	-
Closing retained earnings	<u>\$6,014.45</u>

PQMR-17, continued

4U Consulting Inc.		
Balance Sheet		
At December 31, 2017		
Assets		
Current Assets		
Cash	15,309.03	
Accounts Receivable	2,850.00	
Office supplies	1,028.38	
Prepaid Rent Expense	2,525.55	
Prepaid Insurance	1,782.00	
Total current assets		23,494.96
Intangibles		
Business License		180.00
Total assets		<u>23,674.96</u>
Liabilities		
Current liabilities		
Accounts payable	650.52	
Unearned revenue	1,450.00	
Income tax payable	2,010.00	
Interest payable	50.00	
Total current liabilities		4,160.52
Long term liabilities		
Loan payable		6,000.00
Total liabilities		10,160.52
Equity		
Owner's Capital	7,500.00	
Closing retained earnings	6,014.45	
Total equity		13,514.45
Total liabilities and equity		<u>23,674.97</u>

PQMR-17, continued

4U Consulting Inc.		
Statement of Cash Flows		
Period ending December 31, 2017		
Cash flows from operating activities		
Cash receipts from customers	8,850.00	
Cash payments to suppliers	-6,760.97	
Cash payments for interest on debt	-100.00	
Cash provided by operating activities		1,989.03
Cash flows from investing activities		
Purchase of intangibles	-180.00	
Cash outflow from investing activities		-180.00
Cash flows from financing activities		
Capital contributions by owners	7,500.00	
Cash received from debt	6,000.00	
Cash provided by financing activities		13,500.00
Net inflow of cash		15,309.03
Beginning cash		0
Ending cash		15,309.03

What questions can you answer by using the financial statements that you are not able to provide when you analyze transactions using the expanded accounting equation?

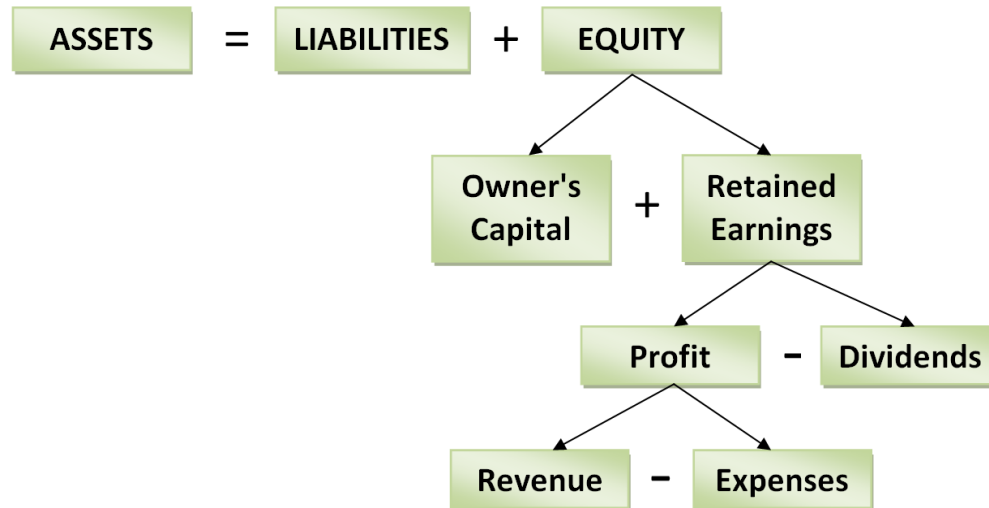
- Although the expanded accounting equation allows you to determine your overall profit, it does not provide details about the expenses, so it is difficult for a business to make decisions with regard to their future actions.
- In addition, the expanded accounting equation does not provide any details about the makeup of the assets and liabilities, against hindering a business owner's ability to make decisions about the future or review results from the past.

Does the current cash position of the business come from the cash you generated from your operations or another source?

- Only \$1,989.03 of the current cash position came from operating activities.
- The majority of the cash came from the contributions from the owner and the loan from your parents.
- This information is available from the statement of cash flows.

PQMR-18

Provide the flowchart that shows the interconnection between the financial reporting elements.



PQMR-19

If you are a merchandising business and you purchase inventory with credit terms 3/5, n/20, what would you want to do and why?

You would want to pay for your inventory purchase within the 5 days. If you pay early your inventory costs less because you get a discount. That means you can either make more profit when you sell your goods (if you don't change your selling price from before you got the discount) or you can reduce the price of your goods and be more competitive. A discount on your purchases means you reduce the cost of your inventory by the amount of the discount. For example, if you buy inventory online for \$1,000 and you receive a 2% discount if you pay within 15 days, you will save \$20 (\$1,000 x 0.02). The cost of the inventory would be \$980. It is true that \$20 may not seem like a lot but if a business pays a large number of invoices within the discount period the total discounts can end up saving the business a lot of money.

PQMR-20

How does GAAP help turn financial data into financial information?

Remember that for data to be useful it must first be categorized or grouped. GAAP stipulates the categories, called elements, into which all business activities are divided. These elements are then used to produce the financial information and then the financial statements which external stakeholders analyze to make decisions.

PQMR-21

	Assets	Liabilities	Equity	
Beg.	478,000	202,000	276,000	
			Owner's Capital	R/E Beg
			180,000	96,000
During	72,000	48,000	Profit	Dividends
			36,000	12,000
			Revenue	Expenses
			434,000	398,000
End	550,000	250,000	300,000	
			Owner's Capital	R/E End
			180,000	120,000

PQMR-22

Which element does interest which is owed on a loan belong to and why?

It belongs in liabilities because it is owed to the bank at some future date and will be settled in cash. It is also due to a past transaction, which was taking out a loan from the bank.

PQMR-23

Read the following scenario and choose the assumption that you think applies. Indicate if it has been VIOLATED (not followed) or FOLLOWED. Be sure to explain WHY you think that is true (which ties into the definition of the assumption)!

A business's cash balance in its financial statements includes two bank accounts at the local bank, one related to the business and the other a personal savings account for the major shareholder.

Assumption	Description:
Separate Entity	Only the activities of the business are included in the business's financial information.

The separate entity assumption is violated. The assumption says that the activities of a business must be kept separate from the owner's financial activities. In this case the owner's personal bank account is included with the business's bank account on the financial statements and therefore the assumption is violated.

PQMR-24

	Revenues	Expenses	Profit
Q1	\$94,856	\$72,367	\$22,489
Q2	\$1,471,326	\$485,126	\$986,200
Q3	\$475,210	\$245,810	\$229,400

PQMR-25

Compare and contrast a retailer and a wholesaler.

A **retailer** earns a profit by reselling goods or providing services to consumers (also called the public) in order to satisfy their wants and needs. A **wholesaler** buys large quantities of goods from manufacturers, warehouses them, and then resells them to retailers. Wholesalers do not sell to consumers (the public).

PQMR-26

Define the secondary sector and give three examples of businesses that would be included in this sector.

The secondary sector takes raw materials and produces finished goods and products from them. Car manufacturers, bakeries that sell to retail stores, and clothing manufacturers are all examples of businesses in the secondary sector.

PQMR-27

Assets beg	258,500		
Liabilities beg	122,400	Owner's Capital	R/E
Equity beg	136,100	75000	61,100
Revenues	596,500		
Expenses	567,850		
Profit	28,650	Dividends	7,000
		R/E	82,750
Assets end	309,100		
Liabilities end	151,350	Owner's Capital	R/E
Equity end	157,750	75000	82,750

PQMR-28

Name two external stakeholders and their main objectives with regards to a business.

Answers may vary.

All stakeholders have **objectives**, something they want from their relationship with the business. Below are listed the external users and the questions they might ask about a business so they can meet their objectives.

External Stakeholders:	
Stakeholder	What They Want
Shareholders (of a corporation)	Decide to invest or not invest, earn income from their investment
Governments	Ensure businesses pay taxes, employ more people, follow laws
Customers	Buy quality products at low prices, get the best warranties on products or services
Suppliers	Sell products/services to the business, get paid on time and in full
Creditors (banks)	Decide whether to lend money and how much, ensure business repays loan plus interest on time
Society/Community	Employ people from the community, improve the standard of living, run their businesses in an ethical manner, reduce/eliminate any negative environmental effects of their business practices, support local charities

PQMR-29

What qualities does financial information need in order to make it useful for decision making?

Qualitative characteristics: qualities that stakeholders want financial information to have so they can use the information for decision making. Let's look at each of the qualities that stakeholders want.

Quality:	Description:
Faithful	Truthful, meaning it is complete, free of error, and neutral (unbiased).
Relevant	Applicable or pertinent to your decision making, helps you predict the future and/or confirm decisions you made in the past.
Comparable	Can compare the same business from year to year OR between two different businesses in the same industry.
Verifiable	Anyone looking at the information would determine similar amounts.
Timely	Information is provided quickly (as old information is less useful).
Understandable	Group and present information so it is clear and concise.

In order to use information to make decisions it is important to understand the quality of that information (how trustworthy it is). If information does not have these qualitative characteristics then it may mislead the stakeholders, causing them to make wrong decisions.

PQMR-30

Assets	Liabilities	Equity
\$425,600	\$297,200	\$128,400
\$771,000	\$527,000	\$244,000
\$298,000	\$170,800	\$127,200

PQMR-31

What are financial reporting assumptions and why are they important?

Assumptions specify how accountants must record, measure, and report information. By following the qualitative characteristics and these assumptions, preparers of financial information ensure that financial information has the qualities that external shareholders need in order to use the information for decision making. See the assumptions on the next page.

Assumption	Description:
Separate Entity	Only the activities of the business are included in the business's financial information.
Unit-of-Measure	All transactions must be reported using the monetary unit of the country the business's head office is located in, even if the business has offices in many countries.
Going Concern	Businesses will continue their operations well into the future.
Historic Cost	All purchases will be recorded at the amount that was paid for them.
Time Period (Periodicity)	Information is broken into artificial time periods such as a month, quarter or year, so that stakeholders can analyze and compare information to make decisions.
Full Disclosure	If something will affect the decisions of the external stakeholders, it must be reported.

PQMR-32

Which statements are bankers most likely to use and why?

Bankers want to answer questions like is there enough cash to pay debts and the interest on debt. The bank would therefore want to check out the cash flow statement, particularly the cash flow from operations, since that would help them determine if there was enough cash available to pay interest on debt. The bank would also like to check out the balance sheet to see the financial position of the business, including the amount of debt the business owes to other parties.

PQMR-33

	Assets	Liabilities	Equity
Beg.		63,450	
During		63,450	
End	286,400	126,900	159,500

PQMR-34

Define stakeholders. What is the difference between an internal and external stakeholder?

Stakeholders are individuals or groups who either affect the business or are affected by the actions of the business. Every stakeholder has an **objective**, something they want from their relationship with the business. Stakeholders can be either internal or external. **Internal stakeholders** work for the business. Their objectives generally relate to their ability to keep their jobs, do their jobs more efficiently, get promoted, and get paid for their work. **External stakeholders** are outside of the business and their objectives generally relate to decisions they will make about money (also called resource allocation decisions) or about how the business can affect them, either positively or negatively.