A.1. Financial Statements: Part 1

Question

How is *gross margin* calculated?

FC-01501 CSO: 1A1a LOS: 1A1a #1

Answer

$$\text{Gross margin} = \frac{\text{Sales (net)} - \text{Cost of goods sold}}{\text{Sales (net)}}$$

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A.1. Financial Statements: Part 1

Question

Who are the primary users of general purpose financial reports?

FC-00546 CSO: 1A1a LOS: 1A1a #2

Answer

Existing and potential:

- Investors
- Lenders
- Other creditors

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A.1. Financial Statements: Part 1

Question

Name the expense that each of the following unexpired costs turn into as they expire:

1. Inventory
2. Unexpired (prepaid) cost of insurance
3. Net book value of fixed assets
4. Unexpired cost of patents

FC-01518 CSO: 1A1a LOS: 1A1a #3

Answer

1. Cost of goods sold
2. Insurance expense
3. Depreciation expense
4. Amortization expense

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A.1. Financial Statements: Part 1

Question

Are gains and losses on the disposal of assets shown on a "gross basis" (i.e., where both the sale proceeds and the net book value of the disposed asset are reported) or on the "net basis" (i.e., where only the difference between the sale price and the net book value of the disposed asset is reported)?

FC-01519 CSO: 1A1a LOS: 1A1a #4

Answer

Gains and losses are reported at their *net* amounts (i.e., proceeds less net book value).

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A.1. Financial Statements: Part 1

Question

How does a "multiple-step" income statement differ from a "single-step" income statement?

FC-01520 CSO: 1A1a LOS: 1A1a #5

Answer

- A multiple-step income statement reports operating revenues and expenses separately from nonoperating revenues and expenses and other gains and losses.
- On a single-step income statement's presentation of income from continuing operations, total expenses are subtracted from total revenues without separation between operating and nonoperating revenues and expenses.

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A.1. Financial Statements: Part 1

Question

What is meant by a "classified" balance sheet?

FC-01521 CSO: 1A1a LOS: 1A1a #6

Answer

A classified balance sheet distinguishes *current* and *non-current* assets and liabilities.

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A.1. Financial Statements: Part 1

Question

Define *cash and cash equivalents.*

FC-00674 CSO: 1A1a LOS: 1A1a #7

Answer

- Cash includes both currency and demand deposits with banks and/or other financial institutions.
- Cash equivalents include short-term, highly liquid investments that are both readily convertible to cash and so near their maturity when acquired by the entity (90 days or less from date of purchase) that they represent insignificant risk of changes in value.

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A.1. Financial Statements: Part 1

Question

Identify the three ranges of likelihood that a future event will confirm a contingent liability.

FC-00906 CSO: 1A1a LOS: 1A1a #8

Answer

- Probable
- Reasonably possible
- Remote

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A.1. Financial Statements: Part 1

Question

When are *contingent liabilities* accrued?

FC-00907 CSO: 1A1a LOS: 1A1a #9

Answer

- When the loss is both probable and can be reasonably estimated, then record and disclose.
- Financial statement disclosure only for reasonably possible contingent losses.
- Remote contingent losses are not disclosed, unless they are "guarantee-type" contingent losses, which must be disclosed.

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A.1. Financial Statements: Part 1

Question

How are notes payable recorded in the financial statements?

FC-01333 CSO: 1A1a LOS: 1A1a #10

Answer

Notes payables must be recorded at present value at the date of issuance.

If a note is non-interest bearing or the interest rate is unreasonable (usually below market), the value of the note must be determined by imputing the market rate of the note and by using the effective interest method.

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A.1. Financial Statements: Part 1

Question

What is the accounting treatment of *gain contingencies*?

FC-00908 CSO: 1A1a LOS: 1A1a #11

Answer

Gain contingencies are not reflected on the balance sheet but are disclosed as to their nature and amount if likelihood is probable and to do so would not be misleading.

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A.1. Financial Statements: Part 1

Question

Define *common stock* and list the basic properties.

FC-00757 CSO: 1A1a LOS: 1A1a #12

Answer

Common stock: Residual ownership interest

Basic rights include:

- Voting rights
- Dividend rights
- Rights to share in distribution of assets if corporation is liquidated, after satisfaction of creditor and preferred stockholders' claims

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A.1. Financial Statements: Part 1

Question

List some common properties of *preferred stock*.

FC-00758 CSO: 1A1a LOS: 1A1a #13

Answer

- Convertible, callable
- Redeemable
- Dividends can be cumulative and/or participating

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A.1. Financial Statements: Part 1

Question

What are the two alternative methods of accounting for treasury stock?

FC-00760 CSO: 1A1a LOS: 1A1a #14

Answer

Cost method: Treasury stock is debited at cost of shares repurchased.

Legal (par value method/stated value method): Treasury stock is debited at par value of shares repurchased.

Remember, no gains/losses are recognized on the income statement; income and retained earnings may never increase by the transaction; *Additional Paid-in Capital—Treasury Stock* account used to record "gains" and absorb "losses."

Treasury stock is not an asset; cash and property dividends are not paid on treasury stock; stock dividends may be paid on treasury stock.

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A.1. Financial Statements: Part 1

Question

Summarize the *cost* method of accounting for treasury stock.

FC-00761 CSO: 1A1a LOS: 1A1a #15

Answer

- Recorded, carried, and reissued at reacquisition cost
- Any "gain" is credited to *Paid-in Capital—Treasury Stock*
- Any "loss" is charged against previous "gains," then retained earnings
- Reported as a deduction from total stockholders' equity

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A.1. Financial Statements: Part 1

Question

Summarize the *par value* method of accounting for treasury stock.

FC-00762 CSO: 1A1a LOS: 1A1a #16

Answer

- Recorded at par value with cost of stock that is in excess of par value recorded as a deduction to *Paid-in Capital—Treasury Stock* and then from retained earnings after *Paid-in Capital—Treasury Stock* is depleted.
- Reported as a deduction from capital stock.

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A.1. Financial Statements: Part 1

Question

What are the three sections of the *statement of cash flows*? What cash flows are included in each section?

FC-00777 CSO: 1A1a LOS: 1A1a #17

Answer

- Operating activities—cash flows from income statement transactions and current assets/liabilities
- Investing activities—cash flows from non-current assets
- Financing activities—cash flows from debt and equity

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A.1. Financial Statements: Part 1

Question

Define *cash equivalents*.

FC-00778 CSO: 1A1a LOS: 1A1a #18

Answer

Cash equivalents: Cash equivalents are highly liquid investments with maturities of three months or less that are readily convertible into cash with insignificant risk of changes in value.

Note: "Maturities of three months or less" is of original instrument or from purchase date of instrument.

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A.1. Financial Statements: Part 1

Question

Current assets are defined as...

FC-00671 CSO: 1A2a LOS: 1A2a #19

Answer

Those resources that are reasonably expected to be realized in cash, sold, or consumed (prepaid items) during the normal operating cycle of a business or one year, whichever is longer.

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A.1. Financial Statements: Part 2

Question

For finance and operating leases, which cash flows are treated as operating cash flows?

FC-01623 CSO: 1A1a LOS: 1A1a #20

Answer

For finance leases, the interest payments and any variable and short-term lease payments not included in the lease liability are treated as cash flows from operations (principal payments are cash flows from financing).

For operating leases, lease payments, variable lease payments, and short-term lease payments are all treated as cash flows from operations.

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