Fact Pattern:

Tosh Enterprises reported the following account information:

Accounts receivable	400,000	Inventory	$800,000
Accounts payable	260,000	Land	500,000
Bonds payable, due in 10 years	600,000	Short-term prepaid expense	80,000
Cash	200,000		
Interest payable, due in 3 months	20,000		

1) The current ratio for Tosh Enterprises is

A. 1.68

B. 2.14

C. 5.00

D. 5.29

A. 1.68

Answer (A) is **incorrect**.
The figure of 1.68 includes long-term bonds payable among the current liabilities.

B. 2.14

Answer (B) is **incorrect**.
The figure of 2.14 is the quick ratio.

C. 5.00

Answer (C) is **incorrect**.
The figure of 5.00 excludes prepaid expenses from current assets.

D. 5.29

Answer (D) is **correct**.
The current ratio equals current assets divided by current liabilities. Current assets consist of cash, accounts receivable, inventory, and prepaid expenses, a total of $1,480,000 ($400,000 + $200,000 + $800,000 + $80,000). Current liabilities consist of accounts payable and interest payable, a total

of $280,000 ($260,000 + $20,000). Hence, the current ratio is 5.29 ($1,480,000 ÷ $280,000).

Fact Pattern:

Tosh Enterprises reported the following account information:

Accounts receivable	400,000	Inventory	$800,000
Accounts payable	260,000	Land	500,000
Bonds payable, due in 10 years	600,000	Short-term prepaid expense	80,000
Cash	200,000		
Interest payable, due in 3 months	20,000		

2) What is Tosh Enterprises' quick (acid-test) ratio?

A. 0.68

B. 1.68

C. 2.14

D. 2.31

A. 0.68

Answer (A) is **incorrect**.
This ratio includes long-term bonds payable among the current liabilities.

B. 1.68

Answer (B) is **incorrect**.
This ratio includes long-term bonds payable among the current liabilities and inventory and prepaid expenses among the quick assets.

C. 2.14

Answer (C) is **correct**.
The quick (acid-test) ratio equals the quick assets divided by current liabilities. For Tosh, quick assets consist of cash ($200,000) and accounts receivable ($400,000), a total of $600,000. Current liabilities consist of accounts payable ($260,000) and interest payable ($20,000) for a total of $280,000. Hence, the quick ratio is 2.14 ($600,000 ÷ $280,000).

D. 2.31

Answer (D) is **incorrect**.
This ratio excludes interest payable from the current liabilities.

Fact Pattern:

Tosh Enterprises reported the following account information:

Accounts receivable	400,000	Inventory	$800,000
Accounts payable	260,000	Land	500,000
Bonds payable, due in 10 years	600,000	Short-term prepaid expense	80,000
Cash	200,000		
Interest payable, due in 3 months	20,000		

3) Tosh Enterprises' amount of working capital is

A. $600,000

B. $1,120,000

C. $1,200,000

D. $1,220,000

A. $600,000

Answer (A) is **incorrect**.
The amount of $600,000 includes long-term bonds payable among the current liabilities.

B. $1,120,000

Answer (B) is **incorrect**.
The amount of $1,120,000 excludes prepaid expenses from current assets.

C. $1,200,000

Answer (C) is **correct**.
Working capital equals current assets minus current liabilities. For Tosh Enterprises, current assets consist of cash, accounts receivable, inventory, and prepaid expenses, a total of $1,480,000 ($400,000 + $200,000 + $800,000 + $80,000). Current liabilities consist of accounts payable and interest payable for a total of $280,000 ($260,000 + $20,000). Accordingly, working capital is $1,200,000 ($1,480,000 – $280,000).

D. $1,220,000

Answer (D) is **incorrect**.
The amount of $1,220,000 excludes interest payable from current liabilities.

Question4)A financial analyst has obtained the following data from financial statements:

Cash	$ 200,000
Marketable securities	100,000
Accounts receivable, net	300,000
Inventories, net	480,000
Prepaid expenses	120,000
Total current assets	$1,200,000
Accounts payable	$250,000
Income taxes	50,000
Accrued liabilities	100,000
Current portion of long-term debt	200,000
Total current liabilities	$600,000

In order to determine ability to pay current obligations, the financial analyst would calculate the cash ratio as

A. 0.50

B. 0.80

C. 1.00

D. 1.20

A. 0.50

Answer (A) is **correct**.
The cash ratio, a more conservative measure of liquidity than the quick ratio, is calculated as follows:

$$\text{Cash ratio} = (\text{Cash} + \text{Marketable securities}) \div \text{Current liabilities}$$

$$= (\$200{,}000 + \$100{,}000) \div \$600{,}000$$

$$= 0.50$$

B. 0.80

Answer (B) is **incorrect**.
Improperly including only inventories in the numerator results in a ratio of 0.80.

C. 1.00

Answer (C) is **incorrect**.
Improperly including accounts receivable in the numerator results in a ratio of 1.00.

D. 1.20

Answer (D) is **incorrect**.
Improperly including accounts receivable and prepaid expenses in the numerator results in a ratio of 1.20.

Question 5) Given an acid-test ratio of 2.0, current assets of $5,000, and inventory of $2,000, the value of current liabilities is

A. $1,500

B. $2,500

C. $3,500

D. $6,000

A. $1,500

Answer (A) is **correct**.
The acid-test, or quick, ratio equals the quick assets (cash, marketable securities, and accounts receivable) divided by current liabilities. Current assets equal the quick assets plus inventory and prepaid expenses. (This question assumes that the entity has no prepaid expenses.) Given current assets of $5,000, inventory of $2,000, and no prepaid expenses, the quick assets must be $3,000. Because the acid-test ratio is 2.0, the quick assets are double the current liabilities. Current liabilities therefore are equal to $1,500 ($3,000 quick assets ÷ 2.0).

B. $2,500

Answer (B) is **incorrect**.
Dividing the current assets by 2.0 results in $2,500. Current assets includes inventory, which should not be included in the calculation of the acid-test ratio.

C. $3,500

Answer (C) is **incorrect**.
Adding inventory to current assets rather than subtracting it results in $3,500.

D. $6,000

Answer (D) is **incorrect**.
Multiplying the quick assets by 2 instead of dividing by 2 results in $6,000.

Fact Pattern:
A company has a current ratio of 1.4, a quick, or acid-test, ratio of 1.2, and the following partial summary balance sheet:

Cash	$ 10
Accounts receivable	___
Inventory	___
Fixed assets	___
Total assets	$100
Current liabilities	$___
Long-term liabilities	40
Stockholders' equity	30
Total liabilities and equity	$___

6) The company has an accounts receivable balance of

A. $26

B. $36

C. $66

D. $100

A. $26

Answer (A) is **correct**.
Total assets equal total liabilities and equity. Hence, if total assets equal $100, total liabilities and equity must equal $100, and current liabilities must equal $30 ($100 – $40 – $30). Because the quick ratio equals the quick assets (cash + accounts receivable) divided by current liabilities, the quick assets must equal $36 ($30 × 1.2 quick ratio), and the accounts receivable balance is $26 ($36 – $10 cash).

B. $36

Answer (B) is **incorrect**.
The quick assets equal $36.

C. $66

Answer (C) is **incorrect**.
The sum of the quick assets and current liabilities equals $66.

D. $100

Answer (D) is **incorrect**.
Total assets equal $100.

7) What is the acid-test (or quick) ratio?

Cash	$ 10,000
Marketable securities	18,000
Accounts receivable	120,000
Inventories	375,000
Prepaid expenses	12,000
Accounts payable	75,000
Long-term debt -- current portion	20,000
Long-term debt	400,000
Sales	1,650,000

A. 1.56

B. 1.97

C. 2.13

D. 5.63

A. 1.56

Answer (A) is **correct**.
The acid-test (quick) ratio equals the quick assets (cash, marketable securities, and accounts receivable) divided by current liabilities. The acid-test ratio is thus 1.558 [($10,000 + $18,000 + $120,000) ÷ ($75,000 + $20,000)].

B. 1.97

Answer (B) is **incorrect**.
Improperly leaving the current portion of long-term debt from the denominator results in 1.9.

C. 2.13

Answer (C) is **incorrect**.
Improperly including prepaid expenses in the numerator and leaving the current portion of long-term debt out of the denominator results in 2.13.

D. 5.63

Answer (D) is **incorrect**.
Improperly including inventories and prepaid expenses in the numerator results in 5.63.

Question 8) A company has current assets of $400,000 and current liabilities of $500,000. The company's current ratio will be increased by

A. The purchase of $100,000 of inventory on account.

B. The payment of $100,000 of accounts payable.

C. The collection of $100,000 of accounts receivable.

D. Refinancing a $100,000 long-term loan with short-term debt.

A. The purchase of $100,000 of inventory on account.

Answer (A) is **correct**.
The current ratio equals current assets divided by current liabilities. An equal increase in both the numerator and denominator of a current ratio less than 1.0 causes the ratio to increase. The company's current ratio is .8 ($400,000 ÷ $500,000). The purchase of $100,000 of inventory on account would increase the current assets to $500,000 and the current liabilities to $600,000, resulting in a new current ratio of .833.

B. The payment of $100,000 of accounts payable.

Answer (B) is **incorrect**.
This transaction decreases the current ratio.

C. The collection of $100,000 of accounts receivable.

Answer (C) is **incorrect**.
The current ratio would be unchanged.

D. Refinancing a $100,000 long-term loan with short-term debt.

Answer (D) is **incorrect**.
This transaction decreases the current ratio.

9) A corporation has a current ratio of 2 to 1 and a quick ratio (acid test) of 1 to 1. A transaction that would change the quick ratio but **not** the current ratio is the

A. Sale of inventory on account at cost.

B. Collection of accounts receivable.

C. Payment of accounts payable.

D. Purchase of a patent for cash.

A. Sale of inventory on account at cost.

Answer (A) is **correct**.
The quick (acid test) ratio equals the quick assets (cash, marketable securities, and accounts receivable) divided by current liabilities. The current ratio is equal to current assets divided by current liabilities. The sale of inventory (not a quick current asset) on account increases accounts receivable (a quick asset), thereby changing the quick ratio. The sale of inventory on account, however, replaces one current asset with another, and the current ratio is unaffected.

B. Collection of accounts receivable.

Answer (B) is **incorrect**.
Neither ratio is changed.

C. Payment of accounts payable.

Answer (C) is **incorrect**.
The current, not the quick, ratio changes.

D. Purchase of a patent for cash.

Answer (D) is **incorrect**.
Both decrease.

Fact Pattern:

The selected data pertain to Tilghman Company at December 31:

Quick assets	$208,000
Acid test ratio	2.6 to 1
Current ratio	3.5 to 1
Net sales for the year	$1,800,000
Cost of sales for the year	$990,000
Average total assets for the year	$1,200,000

10) Tilghman Company's current liabilities at December 31 equal

A. $59,429

B. $80,000

C. $134,857

D. $187,200

A. $59,429

Answer (A) is **incorrect**.
The current liabilities at year end are determined using the quick assets total and the acid-test ratio: Current liabilities equals the quick assets divided by the acid-test ratio.

B. $80,000

Answer (B) is **correct**.
Current liabilities can be calculated using the following relationship:

$$\text{Acid-test ratio} = \text{Quick assets} \div \text{Current liabilities}$$

$$2.6 = \$208{,}000 \div \text{Current liabilities}$$

$$\text{Current liabilities} \times 2.6 = \$208{,}000$$

$$\text{Current liabilities} = \$208{,}000 \div 2.6$$

$$= \$80{,}000$$

C. $134,857

Answer (C) is **incorrect**.
The current liabilities at year end are determined using the quick assets total and the acid-test ratio: Current liabilities equals the quick assets divided by the acid-test ratio.

D. $187,200

Answer (D) is **incorrect**.
The current liabilities at year end are determined using the quick assets total and the acid-test ratio: Current liabilities equals the quick assets divided by the acid-test ratio.

11) The balance sheet of a luggage manufacturer reports the following:

Cash	$531,000
Accounts receivable	439,000
Inventory	300,000
Marketable securities	200,000
Current liabilities	500,000
Long-term liabilities	676,000

Based on the information provided, the luggage manufacturer's quick ratio is

A. 1.25

B. 1.94

C. 2.34

D. 2.94

A. 1.25

Answer (A) is **incorrect**.
Inventory is not considered in the numerator of the calculation, and the denominator should consist of only current liabilities.

B. 1.94

Answer (B) is **incorrect**.
Marketable securities should be included in the numerator for the quick ratio calculation.

C. 2.34

Answer (C) is **correct**.
The quick, or acid-test, ratio is a more conservative measure than the basic current ratio because it excludes inventories and prepaid assets from the numerator. However, the numerator does include all other current assets. Thus, the manufacturer's quick ratio is 2.34 [($531,000 + $439,000 + $200,000) ÷ $500,000].

D. 2.94

Answer (D) is **incorrect**.
Inventory should not be included in the numerator of the calculation.

12) A mobile home manufacturer has a quick ratio of 2.0. Assuming nothing else changes, which of the following actions would decrease the firm's quick ratio?

A. Collecting cash from issuing stock.

B. Writing off obsolete inventory.

C. Converting short-term debt into long-term debt.

D. Buying inventory on credit with 30-day terms.

A. Collecting cash from issuing stock.

Answer (A) is **incorrect**.
Issuing stock for cash would increase current assets (cash) and stockholders' equity (common stock). With no corresponding increase in current liabilities, this action would increase the quick ratio.

B. Writing off obsolete inventory.

Answer (B) is **incorrect**.
Inventory is not considered when calculating the quick ratio. Thus, the write-off of obsolete inventory has no effect on the quick ratio.

C. Converting short-term debt into long-term debt.

Answer (C) is **incorrect**.
Converting short-term debt into long-term debt reduces current liabilities without a corresponding reduction in current assets. Thus, the quick ratio would increase as a result of this action.

D. Buying inventory on credit with 30-day terms.

Answer (D) is **correct**.
Buying inventory on credit with 30-day terms would increase current liabilities (the denominator). Additionally, inventory is not considered in the quick ratio, so there would be no corresponding increase in the numerator. Therefore, this action would decrease the quick ratio.

Fact Pattern:

The selected data pertain to Tilghman Company at December 31:

Quick assets	$208,000
Acid test ratio	2.6 to 1
Current ratio	3.5 to 1
Net sales for the year	$1,800,000
Cost of sales for the year	$990,000
Average total assets for the year	$1,200,000

13) Tilghman Company's inventory balance at December 31 is

A. $72,000

B. $187,200

C. $231,111

D. $282,857

A. $72,000

Answer (A) is **correct**.
Ending inventory can be calculated using the following relationships:

$$\begin{aligned}\text{Acid-test ratio} &= \text{Quick assets} \div \text{Current liabilities}\\ 2.6 &= \$208{,}000 \div \text{Current liabilities}\\ \text{Current liabilities} \times 2.6 &= \$208{,}000\\ \text{Current liabilities} &= \$208{,}000 \div 2.6\\ &= \$80{,}000\end{aligned}$$

$$\begin{aligned}\text{Current assets} \div \text{Current liabilities} &= \text{Current ratio}\\ \text{Current assets} \div \$80{,}000 &= 3.5\\ \text{Current assets} &= \$280{,}000\end{aligned}$$

Assuming that Tilghman has no prepaid expenses, inventory is the only difference between current assets and quick assets. Thus, the ending balance of inventory must be $72,000 ($280,000 – $208,000).

B. $187,200

Answer (B) is **incorrect**.
Inventory equals the difference between current assets and quick assets (assuming no prepaid expenses). Multiplying the current liabilities by the current ratio gives the current assets. Subtracting the quick assets from the current assets gives the inventory balance.

C. $231,111

Answer (C) is **incorrect**.
Inventory equals the difference between current assets and quick assets (assuming no prepaid expenses). Multiplying the current liabilities by the current ratio gives the current assets. Subtracting the quick assets from the current assets gives the inventory balance.

D. $282,857

Answer (D) is **incorrect**.
Inventory equals the difference between current assets and quick assets (assuming no prepaid expenses). Multiplying the current liabilities by the current ratio gives the current assets. Subtracting the quick assets from the current assets gives the inventory balance.

Fact Pattern: The information below pertains to Devlin Company.

Statement of Financial Position as of May 31

(in thousands)

	Year 2	Year 1
Assets		
Current assets		
Cash	$ 45	$ 38
Trading securities	30	20
Accounts receivable (net)	68	48
Inventory	90	80
Prepaid expenses	22	30
Total current assets	$255	$216
Investments, at equity	38	30
Property, plant, and equipment (net)	375	400
Intangible assets (net)	80	45
Total assets	$748	$691
Liabilities		
Current liabilities		
Accounts payable	$ 70	$ 42
Accrued expenses	5	4
Notes payable	35	18
Income taxes payable	15	16
Total current liabilities	$125	$ 80
Long-term debt	35	35
Deferred taxes	3	2
Total liabilities	$163	$117
Equity		
Preferred stock, 6%, $100 par value, cumulative	$150	$150
Common stock, $10 par value	225	195
Additional paid-in capital -- common stock	114	100
Retained earnings	96	129
Total equity	$585	$574
Total liabilities and equity	$748	$691

Income Statement for the year ended May 31

(in thousands)

	Year 2	Year 1
Net sales	$480	$460
Costs and expenses		
Costs of goods sold	330	315
Selling, general, and administrative	52	51
Interest expense	8	9
Income before taxes	$ 90	$ 85
Income taxes	36	34
Net income	$ 54	$ 51

14) Devlin Company's acid-test ratio at May 31, Year 2, was

A. 0.60 to 1.

B. 0.90 to 1.

C. 1.14 to 1.

D. 1.86 to 1.

A. 0.60 to 1.

Answer (A) is **incorrect**.
The ratio of 0.60 to 1 omits receivables.

B. 0.90 to 1.

Answer (B) is **incorrect**.
The ratio of 0.90 to 1 omits trading securities.

C. 1.14 to 1.

Answer (C) is **correct**.
The acid-test, or quick, ratio equals quick assets (cash, trading securities, and accounts receivable) divided by current liabilities. Quick assets total $143 ($45 + $30 + $68), so the acid-test ratio is 1.14 ($143 ÷ $125 current liabilities).

D. 1.86 to 1.

Answer (D) is **incorrect**.
The ratio of 1.86 to 1 includes inventory among quick assets.

Fact Pattern: The Statement of Financial Position for King Products Corporation for the fiscal years ended June 30, Year 2, and June 30, Year 1, is presented below. Net sales and cost of goods sold for the year ended June 30, Year 2, were $600,000 and $440,000, respectively.

King Products Corporation
Statement of Financial Position
(in thousands)

	June 30	
	Year 2	Year 1
Cash	$ 60	$ 50
Marketable securities (at market)	40	30
Accounts receivable (net)	90	60
Inventories (at lower of cost or market)	120	100
Prepaid items	30	40
Total current assets	$ 340	$280
Land (at cost)	$ 200	$190
Building (net)	160	180
Equipment (net)	190	200
Patents (net)	70	34
Goodwill (net)	40	26
Total long-term assets	$ 660	$630
Total assets	$1,000	$910
Notes payable	$ 46	$ 24
Accounts payable	94	56
Accrued interest	30	30
Total current liabilities	$ 170	$110
Notes payable, 10% due 12/31/Year 7	$ 20	$ 20
Bonds payable, 12% due 6/30/Year 10	30	30
Total long-term debt	$ 50	$ 50
Total liabilities	$ 220	$160
Preferred stock -- 5% cumulative, $100 par, nonparticipating, authorized, issued and outstanding, 2,000 shares	$ 200	$200
Common stock -- $10 par, 40,000 shares authorized, 30,000 shares issued and outstanding	300	300
Additional paid-in capital -- common	150	150
Retained earnings	130	100
Total equity	$ 780	$750
Total liabilities & equity	$1,000	$910

15)King Products Corporation’s quick (acid-test) ratio at June 30, Year 2, was

A. 0.6

B. 1.1

C. 1.8

D. 2.0

A. 0.6

Answer (A) is **incorrect**.
The figure of 0.6 omits receivables.

B. 1.1

Answer (B) is **correct**.
The quick (acid-test) ratio equals quick assets divided by current liabilities. King's quick assets consist of cash, receivables, and marketable securities. Accordingly, the quick ratio is 1.11 [($60 cash + $40 marketable securities + $90 accounts receivable) ÷ $170 current liabilities].

C. 1.8

Answer (C) is **incorrect**.
The figure of 1.8 includes inventories.

D. 2.0

Answer (D) is **incorrect**.
The figure of 2.0 is the current ratio.

Fact Pattern: The data presented below show actual figures for selected accounts of McKeon Company for the fiscal year ended May 31, Year 1, and selected budget figures for the Year 2 fiscal year. McKeon's controller is in the process of reviewing the Year 2 budget and calculating some key ratios based on the budget. McKeon Company monitors yield or return ratios using the average financial position of the company. (Round all calculations to three decimal places if necessary.)

	5/31/Year 2	5/31/Year 1
Current assets	$210,000	$180,000
Noncurrent assets	275,000	255,000
Current liabilities	78,000	85,000
Long-term debt	75,000	30,000
Common stock ($30 par value)	300,000	300,000
Retained earnings	32,000	20,000

Year 2

Operations

Sales*	$350,000
Cost of goods sold	160,000
Interest expense	3,000
Income taxes (40% rate)	48,000
Dividends declared and paid in Year 2	60,000
Administrative expense	67,000

*All sales are credit sales.

	Current Assets	
	5/31/Year 2	5/31/Year 1
Cash	$ 20,000	$10,000
Accounts receivable	100,000	70,000
Inventory	70,000	80,000
Prepaid expenses	20,000	20,000

16) McKeon Company's current ratio for Year 2 is

A. 1.373

B. 1.176

C. 2.118

D. 2.692

A. 1.373

Answer (A) is **incorrect**.
The current ratio equals current assets divided by current liabilities.

B. 1.176

Answer (B) is **incorrect**.
The current ratio equals current assets divided by current liabilities.

C. 2.118

Answer (C) is **incorrect**.
The current ratio equals current assets divided by current liabilities.

D. 2.692

Answer (D) is **correct**.
The current ratio equals the ratio of current assets to current liabilities. Dividing $210,000 of current assets at year end by $78,000 of current liabilities at year end results in a current ratio of 2.692.

Question 17) A corporation has decided to include certain financial ratios in its year-end annual report to shareholders. Selected information relating to its most recent fiscal year is provided below.

Cash	$10,000
Accounts receivable	20,000
Prepaid expenses	8,000
Inventory	30,000
Available-for-sale securities	
At cost	9,000
Fair value at year end	12,000
Accounts payable	15,000
Notes payable (due in 90 days)	25,000
Bonds payable (due in 10 years)	35,000

The quick (acid-test) ratio at year end is

A. 2.00 to 1.

B. 1.925 to 1.

C. 1.80 to 1.

D. 1.05 to 1.

A. 2.00 to 1.

Answer (A) is **incorrect**.
The numerator should not include prepaid expenses or inventory. These assets are not very liquid, so they are not considered in the acid-test ratio.

B. 1.925 to 1.

Answer (B) is **incorrect**.
The numerator should include the available-for-sale securities at fair value at year end, and it should not include prepaid expenses, inventory, or available-for-sale securities at cost. These assets are not very liquid, so they are not considered in the acid-test ratio.

C. 1.80 to 1.

Answer (C) is **incorrect**.
The numerator should not include inventory. Inventory is not very liquid, so it is not considered in the acid-test ratio.

D. 1.05 to 1.

Answer (D) is **correct**.
The acid-test ratio is 1.05 as shown below.

($10,000 + $20,000 + $12,000) ÷ ($15,000 + $25,000) = 1.05

Question 18) Selected financial data for a corporation are shown below.

	January 1	December 31
Cash	$ 48,000	$ 62,000
Accounts receivable (net)	68,000	47,000
Trading securities	42,000	35,000
Inventory	125,000	138,000

Plant and equipment (net)	325,000	424,000
Accounts payable	32,000	84,000
Accrued liabilities	14,000	11,000
Deferred taxes	15,000	9,000
Long-term bonds payable	95,000	77,000

Net income for the year was $96,000. The current ratio at the end of the year is

A. 1.55

B. 1.71

C. 2.71

D. 2.97

A. 1.55

Answer (A) is **incorrect**.
Deferred taxes and long-term bonds payable are not current liabilities.

B. 1.71

Answer (B) is **incorrect**.
Inventory is a current asset, and accrued liabilities are current liabilities.

C. 2.71

Answer (C) is **incorrect**.
Deferred taxes are not a current liability.

D. 2.97

Answer (D) is **correct**.
Current assets ÷ Current liabilities = Current ratio
($62,000 + $47,000 + $35,000 + $138,000) ÷ ($84,000 + $11,000) = 2.97

Fact Pattern: CPZ Enterprises had the following account information.

Accounts receivable	$200,000
Accounts payable	80,000
Bonds payable, due in 10 years	300,000
Cash	100,000
Interest payable, due in 3 months	10,000
Inventory	400,000
Land	250,000
Notes payable, due in 6 months	50,000
Prepaid expenses	40,000

The company has an operating cycle of 5 months.

19)The current ratio for CPZ Enterprises is

A. 1.68

B. 2.14

C. 5.00

D. 5.29

A. 1.68

Answer (A) is **incorrect**.
Treating bonds payable as a current liability results in 1.68.

B. 2.14

Answer (B) is **incorrect**.
The quick ratio is 2.14.

C. 5.00

Answer (C) is **incorrect**.
Excluding prepaid expenses from current assets results in 5.00.

D. 5.29

Answer (D) is **correct**.
The current ratio equals current assets divided by current liabilities. This company's current assets consist of cash, accounts receivable, inventory, and prepaid expenses, a total of $740,000 ($100,000 + $200,000 + $400,000 + $40,000). The current liabilities consist of accounts payable, interest payable, and notes payable, which total $140,000 ($80,000 + $10,000 + $50,000). Thus, the current ratio is 5.29 ($740,000 ÷ $140,000).

Fact Pattern: CPZ Enterprises had the following account information.

Accounts receivable	$200,000
Accounts payable	80,000
Bonds payable, due in 10 years	300,000
Cash	100,000
Interest payable, due in 3 months	10,000
Inventory	400,000
Land	250,000
Notes payable, due in 6 months	50,000
Prepaid expenses	40,000

The company has an operating cycle of 5 months.

20) What is CPZ's acid-test (quick) ratio?

A. 0.68

B. 1.68

C. 2.14

D. 2.31

A. 0.68

Answer (A) is **incorrect**.
The quick assets divided by the sum of the current liabilities and the bonds payable equal 0.68.

B. 1.68

Answer (B) is **incorrect**.
Current assets divided by the sum of current liabilities and the bonds payable equal 1.68.

C. 2.14

Answer (C) is **correct**.
The acid-test, or quick, ratio equals quick assets divided by current liabilities. Quick assets consist of cash ($100,000) and accounts receivable ($200,000), for a total of $300,000. The current liabilities consist of accounts payable, interest payable, and notes payable, for a total of $140,000 ($80,000 + $10,000 + $50,000). Hence, the quick ratio is 2.14 ($300,000 ÷ $140,000).

D. 2.31

Answer (D) is **incorrect**.
Omitting interest payable from the current liabilities results in 2.31.

Fact Pattern:

Lisa, Inc.

Statement of Financial Position

December 31, Year 2

(000s)

Assets	Year 2	Year 1
Current assets:		

Cash	$ 30	$ 25
Trading securities	20	15
Accounts receivable (net)	45	30
Inventories (at lower of cost or market)	60	50
Prepaid items	15	20
Total current assets	170	140
Long-term investments:		
Securities (at cost)	25	20
Property, plant, & equipment:		
Land (at cost)	75	75
Building (net)	80	90
Equipment (net)	95	100
Intangible assets		
Patents (net)	35	17
Goodwill (net)	20	13
Total long-term assets	330	315
Total assets	$500	$455
Liabilities & Shareholders' Equity		
Current liabilities:		
Notes payable	$ 23	$ 12
Accounts payable	47	28
Accrued interest	15	15
Total current liabilities	85	55
Long-term debt:		
Notes payable 10% due 12/31/Year 9	10	10
Bonds payable 12% due 12/31/Year 8	15	15
Total long-term debt	25	25
Total liabilities	$110	$ 80
Shareholders' equity:		
Preferred -- 5% cumulative, $100 par, non-participating, 1,000 shares authorized, issued and outstanding	$100	$100
Common -- $10 par 20,000 shares authorized, 15,000 issued and outstanding shares	150	150
Additional paid-in capital -- common	75	75
Retained earnings	65	50
Total shareholders' equity	$390	$375
Total liabilities & equity	$500	$455

21)Lisa, Inc.'s acid-test (quick) ratio at December 31, Year 2, was

A. 1.1:1.0

B. 1.8:1.0

C. 2.0:1.0

D. 2.5:1.0

A. 1.1:1.0

Answer (A) is **correct**.
The acid-test, or quick, ratio is calculated by dividing total quick assets by current liabilities. Quick assets are those that can be quickly converted into cash. Besides cash, they include trading securities and accounts receivable. Lisa's quick assets total $95,000 ($30,000 + $20,000 + $45,000). Dividing $95,000 by the $85,000 of current liabilities results in a ratio of 1.1.

B. 1.8:1.0

Answer (B) is **incorrect**.
Erroneously including inventories in the numerator results in 1.8.

C. 2.0:1.0

Answer (C) is **incorrect**.
The ratio 2.0 is obtained by dividing total current assets by total current liabilities.

D. 2.5:1.0

Answer (D) is **incorrect**.
The quick ratio must be less than the current ratio.

Fact Pattern:

RST Corporation Comparative Income

Statements for the Years 5 and 6

	Year 6	Year 5

Sales (all are credit)	$285,000	$200,000
Cost of goods sold	150,000	120,000
Gross profit	$135,000	$ 80,000
Selling and administrative expenses	65,000	36,000
Income before interest and income taxes	$ 70,000	$ 44,000
Interest expense	3,000	3,000
Income before income taxes	$ 67,000	$ 41,000
Income tax expense	27,000	16,000
Net income	$ 40,000	$ 25,000

RST Corporation

Comparative Balance Sheets

End of Years 5 and 6

Assets	Year 6	Year 5
Current assets:		
Cash	$ 5,000	$ 4,000
Short-term marketable investments	3,000	2,000
Accounts receivable (net)	16,000	14,000
Inventory	30,000	20,000
Total current assets	$ 54,000	$ 40,000
Noncurrent assets:		
Long-term investments	11,000	11,000
Property, plant, and equipment	80,000	70,000
Intangibles	3,000	4,000
Total assets	$148,000	$125,000
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 11,000	$ 7,000
Accrued payables	1,000	1,000
Total current liabilities	$ 12,000	$ 8,000
Long-term Liabilities:		

0% Bonds payable, due in Year 12	30,000	30,000
Total liabilities	$ 42,000	$ 38,000
Stockholders' equity:		
Common stock, 2,400 shares, $10 par	$ 24,000	$ 24,000
Retained earnings	82,000	63,000
Total stockholders' equity	$106,000	$ 87,000
Total liabilities and stockholders' equity	$148,000	$125,000

The market value of RST's common stock at the end of Year 6 was $100.00 per share.

22)RST's acid-test (or quick) ratio at the end of Year 6 is

A. 2.40 to 1.

B. 2.18 to 1.

C. 2.00 to 1.

D. 1.50 to 1.

A. 2.40 to 1.

Answer (A) is **incorrect**.
Dividing total current liabilities ($12,000) by the amount of cash ($5,000) results in 2.4, which produces no meaningful ratio.

B. 2.18 to 1.

Answer (B) is **incorrect**.
Dividing quick assets ($5,000 + $3,000 + $16,000) by accounts payable ($11,000) results in 2.18. The denominator should include all current liabilities.

C. 2.00 to 1.

Answer (C) is **correct**.
Liquidity ratios measure the ability of a company to meet its short-term obligations. A commonly

used liquidity ratio is the acid-test or quick ratio, which equals the sum of the quick assets (net accounts receivable, short-term marketable securities, and cash) divided by current liabilities. This ratio at the end of Year 6 is 2.0 [($5,000 + $3,000 + $16,000) ÷ $12,000].

D. 1.50 to 1.

Answer (D) is **incorrect**.
Dividing total current liabilities ($12,000) by the sum of cash ($5,000) and short-term marketable investments ($3,000) results in 1.5, which produces no meaningful ratio.

Fact Pattern: Broomall Corporation has decided to include certain financial ratios in its year-end annual report to shareholders. Selected information relating to its most recent fiscal year is provided below.

Cash	$ 10,000
Accounts receivable:	
– Beginning of year	24,000
– End of year	20,000
Prepaid expenses	8,000
Inventory:	
– Beginning of year	26,000
– End of year	30,000
Available-for-sale securities:	
– Historical cost	9,000
– Fair value at year end	12,000
Accounts payable	15,000
Notes payable (due in 90 days)	25,000
Bonds payable (due in 10 years)	35,000
Net credit sales for year	220,000
Cost of goods sold	140,000

23) Broomall's working capital at year end is

A. $40,000

B. $37,000

C. $28,000

D. $10,000

A. $40,000

Answer (A) is **correct**.
Working capital consists of current assets net of current liabilities. Broomall's working capital at year end can thus be calculated as follows:

Cash	$10,000
Accounts receivable	20,000
Prepaid expenses	8,000
Inventory	30,000
Available-for-sale securities	12,000
Accounts payable	(15,000)
Notes payable	(25,000)
Working capital	$40,000

B. $37,000

Answer (B) is **incorrect**.
The amount of $37,000 results from improperly including available-for-sale securities at cost rather than at fair value.

C. $28,000

Answer (C) is **incorrect**.
The amount of $28,000 results from improperly excluding available-for-sale securities from current assets.

D. $10,000

Answer (D) is **incorrect**.
The amount of $10,000 improperly treats only cash as working capital.

Fact Pattern: Broomall Corporation has decided to include certain financial ratios in its year-end annual report to shareholders. Selected information relating to its most recent fiscal year is provided below.

Cash	$ 10,000
Accounts receivable:	
– Beginning of year	24,000
– End of year	20,000
Prepaid expenses	8,000
Inventory:	
– Beginning of year	26,000
– End of year	30,000
Available-for-sale securities:	
– Historical cost	9,000
– Fair value at year end	12,000
Accounts payable	15,000
Notes payable (due in 90 days)	25,000
Bonds payable (due in 10 years)	35,000
Net credit sales for year	220,000
Cost of goods sold	140,000

24) Broomall's quick (acid-test) ratio at year end is

A. 2.00 to 1.

B. 1.925 to 1.

C. 1.80 to 1.

D. 1.05 to 1.

A. 2.00 to 1.

Answer (A) is **incorrect**.
A ratio of 2.00 results from improperly including all current assets in the numerator.

B. 1.925 to 1.

Answer (B) is **incorrect**.
A ratio of 1.925 results from improperly including accounts receivable (beginning balance), prepaid expenses, inventory, and available-for-sale securities (at cost) in the numerator. 1.925 can be calculated as follows:

$$\frac{\$10{,}000 \text{ cash} + \$24{,}000 \text{ A/R beg. balance} + \$8{,}000 \text{ proposal} \quad \$26{,}000 \text{ inventory beg. balance} + \$9{,}000 \text{ AFS at cost}}{\$15{,}000 \text{ A/P} + \$25{,}000 \text{ notes payable}}$$

C. 1.80 to 1.

Answer (C) is **incorrect**.
A ratio of 1.80 results from improperly including accounts receivable (beginning balance) and inventory in the numerator. 1.80 can be calculated as follows:

$$\frac{\$10{,}000 \text{ cash} + \$24{,}000 \text{ A/R beg. balance} + \$26{,}000 \text{ inventory beg. balance} + \$12{,}000 \text{ AFS at cost}}{\$15{,}000 \text{ A/P} + \$25{,}000 \text{ notes payable}}$$

D. 1.05 to 1.

Answer (D) is **correct**.
The quick (acid-test) ratio consists of the quick assets (cash, marketable securities, and accounts

receivable) divided by current liabilities. Broomall's quick ratio at year end is thus 1.05 [($10,000 + $12,000 + $20,000) ÷ ($15,000 + $25,000)].

Fact Pattern: Shown below are beginning and ending balances for certain of Grimaldi, Inc.'s accounts.

	January 1	December 31
Cash	$ 48,000	$ 62,000
Marketable securities	42,000	35,000
Accounts receivable (net)	68,000	47,000
Inventory	125,000	138,000
Property, plant, and equipment (net)	325,000	424,000
Accounts payable	32,000	84,000
Accrued liabilities	14,000	11,000
Deferred taxes (noncurrent)	15,000	9,000
7% long-term bonds payable	95,000	77,000

Grimaldi's net income for the year was $96,000.

25) Grimaldi's acid-test ratio or quick ratio at the end of the year is

A. 0.83

B. 1.02

C. 1.15

D. 1.52

A. 0.83

Answer (A) is **incorrect**.
A ratio of 0.83 results from improperly including bonds payable in the denominator.

B. 1.02

Answer (B) is **incorrect**.
A ratio of 1.02 results from failing to include accounts receivable in the numerator.

C. 1.15

Answer (C) is **incorrect**.
A ratio of 1.15 results from failing to include marketable securities in the numerator.

D. 1.52

Answer (D) is **correct**.
The acid-test, or quick, ratio consists of the quick assets (cash, marketable securities, and accounts receivable) divided by current liabilities. Grimaldi's quick ratio at year end is thus 1.516 [($62,000 + $35,000 + $47,000) ÷ ($84,000 + $11,000)].

Fact Pattern: Shown below are beginning and ending balances for certain of Grimaldi, Inc.'s accounts.

	January 1	December 31
Cash	$ 48,000	$ 62,000
Marketable securities	42,000	35,000
Accounts receivable (net)	68,000	47,000
Inventory	125,000	138,000
Property, plant, and equipment (net)	325,000	424,000
Accounts payable	32,000	84,000
Accrued liabilities	14,000	11,000
Deferred taxes (noncurrent)	15,000	9,000
7% long-term bonds payable	95,000	77,000

Grimaldi's net income for the year was $96,000.

26) Grimaldi's current ratio at the end of the year is

A. 1.55

B. 1.71

C. 2.71

D. 2.97

A. 1.55

Answer (A) is **incorrect**.
A ratio of 1.55 results from improperly including bonds payable in the denominator.

B. 1.71

Answer (B) is **incorrect**.
A ratio of 1.71 results from failing to include both inventory and accrued liabilities in the calculation.

C. 2.71

Answer (C) is **incorrect**.
A ratio of 2.71 results from improperly including deferred taxes in the denominator.

D. 2.97

Answer (D) is **correct**.
The current ratio, also called the working capital ratio, is the ratio of current assets to current liabilities. Grimaldi's current assets consist of cash, marketable securities, accounts receivable, and inventory ($62,000 + $35,000 + $47,000 + $138,000 = $282,000). The company's current liabilities consist of accounts payable and accrued liabilities ($84,000 + $11,000 = $95,000). Grimaldi's current ratio is thus 2.968 ($282,000 ÷ $95,000).

27) All of the following are included when calculating the acid-test ratio **except**

A. Six-month treasury bills.

B. Prepaid insurance.

C. Accounts receivable.

D. 60-day certificates of deposit.

A. Six-month treasury bills.

Answer (A) is **incorrect**.
Six-month treasury bills are marketable securities and thus are included in the numerator of the acid-test ratio.

B. Prepaid insurance.

Answer (B) is **correct**.
The acid-test (quick) ratio consists of the quick assets (cash, marketable securities, and net accounts receivable) divided by current liabilities. Prepaid insurance is an illiquid current asset and thus not appropriate to include in the numerator.

C. Accounts receivable.

Answer (C) is **incorrect**.
Accounts receivable are included in the numerator of the acid-test ratio.

D. 60-day certificates of deposit.

Answer (D) is **incorrect**.
Sixty-day certificates of deposit are cash equivalents and thus are included in the numerator of the acid-test ratio.

Question 28) A company's cash ratio will decrease if the company

A. Purchases commercial paper.

B. Purchases materials on account.

C. Sells goods for cash at a selling price lower than cost.

D. Receives cash by issuing a short-term note payable.

A. Purchases commercial paper.

Answer (A) is **incorrect**.
The cash ratio can be expressed as cash and marketable securities divided by current liabilities. The outflow of cash to purchase the commercial paper will cause a decrease in the numerator, while the inflow of the commercial paper will cause an equal increase in the numerator. These effects will cancel each other out, leaving the ratio unchanged.

B. Purchases materials on account.

Answer (B) is **correct**.
The cash ratio can be expressed as cash and marketable securities divided by current liabilities. If the company purchases materials on account, it will cause current liabilities to increase (the denominator of the cash ratio) while having no effect on cash or marketable securities (the numerator of the cash ratio). Because the denominator is increasing while the numerator is staying constant, the ratio will decrease.

C. Sells goods for cash at a selling price lower than cost.

Answer (C) is **incorrect**.
The cash ratio can be expressed as cash and marketable securities divided by current liabilities. Selling goods for cash at a selling price lower than cost will cause an increase in the numerator as cash is increasing. This transaction would have no effect on the denominator. Therefore, the cash ratio would increase, not decrease, as the numerator is increasing while the denominator is staying the same.

D. Receives cash by issuing a short-term note payable.

Answer (D) is **incorrect**.
The cash ratio can be expressed as cash and marketable securities divided by current liabilities. Receiving cash by issuing a short-term note payable would cause an equal increase in both the numerator and the denominator. This would cause the overall ratio to increase, not decrease.

29) In analyzing the short-term liquidity of a firm, many analysts prefer to use the quick (or acid-test) ratio rather than the current ratio. The primary reason for this preference is that the

A. Quick ratio excludes account receivables.

B. Current ratio includes marketable securities that may be mispriced.

C. Pro-forma cash flow statements focus on cash only.

D. Conversion of inventory into cash is less reliable.

A. Quick ratio excludes account receivables.

Answer (A) is **incorrect**.
The quick (or acid-test) ratio consists of the quick assets (cash, marketable securities, a
receivable) divided by current liabilities. Inventory is not included in the quick ratio beca
conversion of inventory into cash is less reliable. However, accounts receivables is incl

B. Current ratio includes marketable securities that may be mispriced.

Answer (B) is **incorrect**.
The quick (or acid-test) ratio consists of the quick assets (cash, marketable securities, a
receivable) divided by current liabilities. Inventory is not included in the quick ratio beca
conversion of inventory into cash is less reliable. However, marketable securities are in
both ratios.

C. Pro-forma cash flow statements focus on cash only.

Answer (C) is **incorrect**.
The quick (or acid-test) ratio consists of the quick assets (cash, marketable securities, a
receivable) divided by current liabilities. The current ratio also includes accounts receiv
marketable securities. Inventory is not included in the quick ratio because conversion o
into cash is less reliable.

D. Conversion of inventory into cash is less reliable.

Answer (D) is **correct**.
The quick (or acid-test) ratio consists of the quick assets (cash, marketable securities, a
receivable) divided by current liabilities. Inventory is not included in the quick ratio beca
conversion of inventory into cash is less reliable.

30) A firm has gathered financial statement data from three companies applying for credit as new customers. The company extends credit to customers on the credit terms 2/10, net 30. Prior to accepting the customers, a financial analyst with the firm performs a liquidity analysis. Summary data is shown below:

	Company F	Company G	Company H
Cash	$ 20,000	$ 12,850	$ 130,000
Accounts receivable	40,000	74,500	100,000
Inventory	170,000	42,240	354,300
Current assets	230,000	129,590	584,300
Total assets	567,888	260,400	780,560

Current liabilities	175,000	63,800	142,100
Total liabilities	487,120	97,680	364,760
Total shareholders' equity	80,768	162,720	415,800

When evaluating the liquidity of the three potential customers, which one of the following conclusions is correct?

A. Company H has the highest current ratio but the lowest acid-test ratio, so the firm should not accept Company H as a new customer.

B. Company G has a low debt to total assets ratio, so the firm should accept Company G as a new customer.

C. Company F has a low current ratio, so the firm should not accept Company F as a new customer.

D. Company F has a high long-term debt to equity ratio, so the firm should accept Company F as a new customer.

A. Company H has the highest current ratio but the lowest acid-test ratio, so the firm should not accept Company H as a new customer.

Answer (A) is **incorrect**.
Although Company H has the highest current ratio of 4.11 (584,300 ÷ 142,100), its acid-test ratio of 1.62 (230,000 ÷ 142,100) is not the lowest. Company F has the lowest acid-test ratio of 0.34 (60,000 ÷ 175,000).

B. Company G has a low debt to total assets ratio, so the firm should accept Company G as a new customer.

Answer (B) is **incorrect**.
Although it does have a low debt to total assets ratio, this is not the only indicator the firm should look at in order to determine whether it should accept the company as a customer.

C. Company F has a low current ratio, so the firm should not accept Company F as a new customer.

Answer (C) is **correct**.
Low current and acid-test ratios indicate that a company may not be able to repay its debts. Therefore, the firm would not want to accept it as a credit customer.

D. Company F has a high long-term debt to equity ratio, so the firm should accept Company F as a

new customer.

Answer (D) is **incorrect**.
A high long-term debt to equity ratio is a bad indicator; therefore, the firm would not accept Company F for this reason.

31) A corporation has $90 million in current assets. If the corporation has a current ratio of 1.2 and a quick ratio of 0.9, what is net working capital?

A. $10 million.

B. $15 million.

C. $81 million.

D. $108 million.

A. $10 million.

Answer (A) is **incorrect**.
Current assets, not quick assets, are given, so the current, not quick, ratio should be used for finding current liabilities. Also, net working capital is current assets minus current liabilities, not the other way around.

B. $15 million.

Answer (B) is **correct**.
Net working capital is Current assets – Current liabilities. The current ratio is Current assets ÷ Current liabilities. Current liabilities can be found as follows:

$$\text{Current ratio} = \text{Current assets} \div \text{Current liabilities}$$

$$1.2 = \$90 \text{ million} \div \text{Current liabilities}$$

$$\text{Current liabilities} = \$90 \text{ million} \div 1.2$$

$$= \$75 \text{ million}$$

Therefore, net working capital is $15 million ($90 million – $75 million).

C. $81 million.

Answer (C) is **incorrect**.
Multiplying current assets by the quick ratio does not give net working capital.

D. $108 million.
Answer (D) is **incorrect**.
Multiplying current assets by the current ratio does not give net working capital.

32) A credit manager considering whether to grant trade credit to a new customer is **most** likely to place primary emphasis on

A. Profitability ratios.

B. Valuation ratios.

C. Growth ratios.

D. Liquidity ratios.

A. Profitability ratios.
Answer (A) is **incorrect**.
Equity investors are concerned with profitability ratios.

B. Valuation ratios.
Answer (B) is **incorrect**.
Equity investors are concerned with valuation ratios.

C. Growth ratios.
Answer (C) is **incorrect**.
Equity investors are concerned with growth ratios.

D. Liquidity ratios.
Answer (D) is **correct**.
Liquidity is a firm's ability to pay its short-term obligations as they come due. Trade payables are the most common form of short-term obligation. Thus, a credit manager is most interested in assessing a potential customer's liquidity.

33) A financial analyst has gathered the following select financial data on three companies.

Company A	Company B	Company C

Total current assets	€500,000	€1,250,000	€870,000
Total current liabilities	€445,000	€970,000	€620,000

On the basis of the information provided above, the financial analyst is able to conclude that

A. Company A and Company B both have a higher liquidity than Company C.

B Company B has the highest liquidity.

C. C mpany B and Company C both have a higher liquidity than Company A.

D. Company A has the highest liquidity.

A. Company A and Company B both have a higher liquidity than Company C.
Answer (A) is **incorrect**.
Company A has a lower liquidity than Company C.

B. Company B has the highest liquidity.
Answer (B) is **incorrect**.
Company C has the highest liquidity.

C. Company B and Company C both have a higher liquidity than Company A.
Answer (C) is **correct**.
The current ratio is determined by dividing current assets by current liabilities. The current ratio of Company A is 1.12 (€500,000 ÷ €445,000). The current ratio of Company B is 1.29 (€1,250,000 ÷ €970,000). The current ratio of Company C is 1.40 (€870,000 ÷ €620,000). Company B and Company C both have a higher liquidity than Company A.

D. Company A has the highest liquidity.
Answer (D) is **incorrect**.
Company A has the lowest liquidity.

34) A company has a current ratio of 2.0. Cash is 20%, accounts receivable is 40%, and inventory is 40% of total current assets. What is the acid-test ratio for the company?

A. 0.8

B. 1.2

C. 1.6

D. 2.0

A. 0.8

Answer (A) is **incorrect**.
Cash should be included in the quick asset.

B. 1.2

Answer (B) is **correct**.
The acid-test (quick) ratio equals the quick assets (cash, marketable securities, and accounts receivable) divided by current liabilities. Since the current ratio is 2, we can assume current assets to be 2 and current liabilities to be 1. Then, cash is 0.4 (20% × 2) and accounts receivable is 0.8 (40% × 2). Thus, the acid-test ratio is 1.2 [(0.4 cash + 0.8 accounts receivable) ÷ 1 current liabilities].

C. 1.6

Answer (C) is **incorrect**.
The acid-test (quick) ratio equals the quick assets (cash, marketable securities, and accounts receivable) divided by current liabilities. The acid-test ratio is 1.2.

D. 2.0

Answer (D) is **incorrect**.
The acid-test (quick) ratio equals the quick assets divided by current liabilities. Inventory is not included in the quick asset.

35) A company has the following account balances.

Cash	$160,000

Equipment	50,000
Inventory	35,000
Accounts receivable	25,000
Accrued wages	10,000
Long-term debt	30,000
Accounts payable	5,000

What is the company's net working capital?

A. $180,000

B. $205,000

C. $220,000

D. $225,000

A. $180,000

Answer (A) is **incorrect**.
Long-term debt is not a current liability. Accounts payable is a current liability.

B. $205,000

Answer (B) is **correct**.
Net working capital equals current assets minus current liabilities. Thus, the net working capital is $205,000 [($160,000 cash + $35,000 inventory + $25,000 accounts receivable) – ($10,000 accrued wages + $5,000 accounts payable)].

C. $220,000

Answer (C) is **incorrect**.
Total current assets are $220,000.

D. $225,000

Answer (D) is **incorrect**.

Equipment is not a current asset. Long-term debt is not a current liability.

36) The balance sheet of Company XYZ as of 12/31/20X3 is shown below.

Assets		Liabilities and Shareholders' Equity	
Cash	$ 110	Accounts payable	$ 208
Accounts receivables	280	Notes payable	150
Inventories	175	Accrued expenses	50
Prepaid expenses	20	Deferred taxes	112
Property, plant, and equipment	700	Long-term debt	485
Intangible assets	100	Stockholders' equity	380
Total assets	$1,385	Total liabilities and shareholders' equity	$1,385

What was Company XYZ's net working capital as of 12/31/20X3?

A. $157

B. $65

C. $177

D. $227

A. $157

Answer (A) is **incorrect**.
The amount of $157 fails to include prepaid expenses as a current asset.

B. $65

Answer (B) is **incorrect**.
The amount of $65 is derived by overstating the current liabilities by the amount of the deferred taxes. Deferred taxes is not a current liability (according to a FASB pronouncement effective beginning in 2017 and 2018 which aligns U.S. GAAP with IFRS requirements).

C. $177

Answer (C) is **correct**.
Net working capital is calculated by subtracting the total of current liabilities from the total of current assets. Current assets total $585 ($110 + $280 + $175 + $20) and current liabilities total $408 ($208 + $150 + $50). Thus, net working capital equals $177 ($585 of current assets minus $408 of current liabilities).

D. $227

Answer (D) is **incorrect**.
The amount of $227 fails to include accrued expenses as a current liability.

37) A company located in China has reported on its first quarter balance sheet CNY 100,000 in cash, CNY 200,000 in accounts receivables, and CNY 90,000 in current liabilities. The controller has forecasted that during the second quarter, there will be no change in the accounts receivables, but the cash balance will increase by 5% and the current liabilities will decrease by 10%. Based on the controller's forecast, what is the forecasted quick ratio for the second quarter?

A. 1.30

B. 3.39

C. 3.70

D. 3.77

A. 1.30

Answer (A) is **incorrect**.
The amount of 1.30 results from omitting accounts receivable as a quick asset.

B. 3.39

Answer (B) is **incorrect**.
The amount of 3.39 does not consider the decline in current liabilities during the second quarter.

C. 3.70

Answer (C) is **incorrect**.
The amount of 3.70 does not consider the 5% increase in cash in the second quarter.

D. 3.77

Answer (D) is **correct**.
The quick ratio is calculated by dividing the quick assets (cash and accounts receivable) by current liabilities. The initial calculation is to divide the CNY 300,000 of quick assets (100,000 + 200,000) by the CNY 90,000 of current liabilities, resulting in a quick ratio of 3.33. For the second quarter, cash increases by 5% to 105,000 and liabilities decrease by 10% to 81,000. Therefore, the calculation for the second quarter is (105,000 + 200,000) ÷ 81,000 = 3.77.

38) A company has current liabilities of $2,000,000 and net working capital of $300,000. If the company has a quick ratio of 0.8, the company has inventory of

A. $240,000

B. $700,000

C. $1,360,000

D. $1,600,000

A. $240,000

Answer (A) is **incorrect**.
The amount of $240,000 incorrectly multiplies the $300,000 of net working capital by the quick ratio.

B. $700,000

Answer (B) is **correct**.
If the company has current liabilities of $2,000,000 and net working capital of $300,000, then current assets must be $2,300,000. The quick ratio of .8 indicates that quick assets must be $1,600,000 (.8 × $2,000,000 of current liabilities). Thus, if quick assets total $1,600,000 and current assets total $2,300,000, the difference of $700,000 is represented by inventory.

C. $1,360,000

Answer (C) is **incorrect**.

The amount of $1,360,000 incorrectly deducts the net working capital from total liabilities to calculate the total current assets.

D. $1,600,000

Answer (D) is **incorrect**.
The amount of $1,600,000 is the total of quick assets, not the amount of inventory.

39) North Bank is analyzing Belle Corp.'s financial statements for a possible extension of credit. Belle's quick ratio is significantly better than the industry average. Which of the following factors should North consider as a possible limitation of using this ratio when evaluating Belle's creditworthiness?

A. Fluctuating market prices of short-term investments may adversely affect the ratio.

B. Increasing market prices for Belle's inventory may adversely affect the ratio.

C. Belle may need to sell its available-for-sale investments to meet its current obligations.

D. Belle may need to liquidate its inventory to meet its long-term obligations.

A. Fluctuating market prices of short-term investments may adversely affect the ratio.

Answer (A) is **correct**.
The quick ratio equals current assets minus inventory and prepaid expenses, divided by current liabilities. Because short-term marketable securities are included in the numerator, fluctuating market prices of short-term investments may adversely affect the ratio if Belle holds a substantial amount of such current assets.

B. Increasing market prices for Belle's inventory may adversely affect the ratio.

Answer (B) is **incorrect**.
Inventory is excluded from the calculation of the quick ratio.

C. Belle may need to sell its available-for-sale investments to meet its current obligations.

Answer (C) is **incorrect**.
If the available-for-sale securities are not current, they are not included in the calculation of the ratio. If they are classified as current, their sale to meet current obligations is consistent with normal current assets management practices.

D. Belle may need to liquidate its inventory to meet its long-term obligations.
Answer (D) is **incorrect**.
Inventory is not liquid enough to include in the calculation of the quick ratio.

40) In comparing the current ratios of two companies, why is it invalid to assume that the company with the higher current ratio is the better company?

A. The current ratio includes assets other than cash.

B. A high current ratio may indicate inadequate inventory on hand.

C. A high current ratio may indicate inefficient use of various assets and liabilities.

D. The two companies may define working capital in different terms.

A. The current ratio includes assets other than cash.
Answer (A) is **incorrect**.
The composition of the assets in the current ratio does not, by itself, indicate whether a higher or lower ratio is preferable.

B. A high current ratio may indicate inadequate inventory on hand.
Answer (B) is **incorrect**.
A high ratio more likely indicates excess inventory on hand.

C. A high current ratio may indicate inefficient use of various assets and liabilities.
Answer (C) is **correct**.
The current ratio measures only the ratio of current assets to current liabilities. It does not measure the efficiency of handling the individual current asset accounts. A high ratio may indicate, for example, slow collection of accounts receivable, holding of excess inventory, or retention of more cash than needed for the cash flow requirements of the firm. The weaker and less efficient company may have the higher current ratio.

D. The two companies may define working capital in different terms.

Answer (D) is **incorrect**.
Working capital is always defined as the excess of current assets over current liabilities.

Fact Pattern:
Tosh Enterprises reported the following account information:

Accounts receivable	$400,000	Inventory	$800,000
Accounts payable	260,000	Land	500,000
Bonds payable, due in 10 years	600,000	Short-term prepaid expense	80,000
Cash	200,000		
Interest payable, due in 3 months	20,000		

41) What will happen to the ratios below if Tosh Enterprises uses cash to pay 25% of the accounts payable?

Current Ratio	Quick Ratio

A. Increase Increase

B. Decrease Decrease

C. Increase Decrease

D. Decrease Increase

A. Increase Increase

Answer (A) is **correct**.
Tosh's current ratio is 5.29 ($1,480,000 current assets ÷ $280,000 current liabilities), and its quick ratio is 2.14 ($600,000 quick assets ÷ $280,000 current liabilities). Using cash to pay 25% of the accounts payable decreases the numerator and denominator by $65,000 ($260,000 accounts payable × 25%). The new current ratio will be 6.58 ($1,415,000 ÷ $215,000), and the new quick ratio will be 2.49 ($535,000 ÷ $215,000). If a ratio exceeds 1.0, equal decreases in the numerator and denominator increase the ratio.

B. Decrease Decrease

Answer (B) is **incorrect**.
Given that both ratios initially exceeded 1.0, decreasing cash and accounts payable by equal amounts will increase both ratios.

C. Increase Decrease

Answer (C) is **incorrect**.
Given that both ratios initially exceeded 1.0, decreasing cash and accounts payable by equal amounts will increase both ratios.

D. Decrease Increase

Answer (D) is **incorrect**.
Given that both ratios initially exceeded 1.0, decreasing cash and accounts payable by equal amounts will increase both ratios.

42) A company uses the allowance method to account for credit losses. An account receivable that was previously determined uncollectible and written off was collected during May. The effect of the collection on the company's current ratio and total working capital is

Current Ratio	Working Capital

A. None None

B. Increase Increase

C. Decrease Decrease

D. None Increase

A. None None

Answer (A) is **correct**.
The entry to record this transaction is to increase receivables and the allowance, increase cash, and decrease receivables. The result is to increase both an asset (cash) and a contra asset (allowance for credit losses). These appear in the current asset section of the balance sheet. Thus, the collection changes neither the current ratio nor working capital because the effects are offsetting. The company had previously estimated its credit losses and established an appropriate allowance. It then wrote off the account as uncollectible.

B. Increase Increase

Answer (B) is **incorrect**.
Neither the current ratio nor working capital is affected.

C. Decrease Decrease

Answer (C) is **incorrect**.
Neither the current ratio nor working capital is affected.

D. None Increase

Answer (D) is **incorrect**.
Neither the current ratio nor working capital is affected.

43) A company has a 2-to-1 current ratio. This ratio would increase to more than 2 to 1 if

A. A previously declared stock dividend were distributed.

B. The company wrote off an uncollectible receivable.

C. The company sold merchandise on open account that earned a normal gross margin.

D. The company purchased inventory on open account.

A. A previously declared stock dividend were distributed.

Answer (A) is **incorrect**.
The distribution of a stock dividend affects only stockholders' equity accounts.

B. The company wrote off an uncollectible receivable.

Answer (B) is **incorrect**.
Writing off an uncollectible receivable does not affect total current assets. The allowance account absorbs the credit loss. Thus, the balance of net receivables is unchanged.

C. The company sold merchandise on open account that earned a normal gross margin.

Answer (C) is **correct**.
The current ratio equals current assets divided by current liabilities. Thus, an increase in current assets or a decrease in current liabilities, by itself, increases the current ratio. The sale of inventory at a profit increases current assets without changing liabilities. Inventory decreases, and receivables increase by a greater amount. Thus, total current assets and the current ratio increase.

D. The company purchased inventory on open account.
Answer (D) is **incorrect**.
The purchase of inventory increases current assets and current liabilities by the same amount. The transaction reduces a current ratio in excess of 1.0 since the numerator and denominator of the ratio increase by the same amount.

Fact Pattern: Depoole Company is a manufacturer of industrial products that uses a calendar year for financial reporting purposes. Assume that total quick assets exceeded total current liabilities both before and after the transaction described. Further assume that Depoole has positive profits during the year and a credit balance throughout the year in its retained earnings account.

44) Depoole's payment of a trade account payable of $64,500 will

A. Increase the current ratio, but the quick ratio would not be affected.

B. Increase the quick ratio, but the current ratio would not be affected.

C. Increase both the current and quick ratios.

D. Decrease both the current and quick ratios.

A. Increase the current ratio, but the quick ratio would not be affected.
Answer (A) is **incorrect**.
The current ratio and the quick ratio will increase.

B. Increase the quick ratio, but the current ratio would not be affected.
Answer (B) is **incorrect**.
The current ratio and the quick ratio will increase.

C. Increase both the current and quick ratios.

Answer (C) is **correct**.
Current assets consist of more assets than quick assets; thus, if quick assets exceed current liabilities, then current assets do also. It can also be concluded that both ratios are greater than 1. An equal reduction in the numerator and the denominator, such as a payment of a trade payable, will cause each ratio to increase.

D. Decrease both the current and quick ratios.

Answer (D) is **incorrect**.
The current ratio and the quick ratio will increase.

Fact Pattern: Depoole Company is a manufacturer of industrial products that uses a calendar year for financial reporting purposes. Assume that total quick assets exceeded total current liabilities both before and after the transaction described. Further assume that Depoole has positive profits during the year and a credit balance throughout the year in its retained earnings account.

Question 45) Depoole's purchase of raw materials for $85,000 on open account will

A. Increase the current ratio.

B. Decrease the current ratio.

C. Increase net working capital.

D. Decrease net working capital.

A. Increase the current ratio.

Answer (A) is **incorrect**.
The current ratio is decreased.

B. Decrease the current ratio.

Answer (B) is **correct**.
The purchase increases both the numerator and denominator of the current ratio by adding inventory to the numerator and payables to the denominator. Because the ratio before the purchase

was greater than 1, the ratio is decreased.

C. Increase net working capital.

Answer (C) is **incorrect**.
The purchase of raw materials on account has no effect on working capital (current assets and current liabilities change by the same amount).

D. Decrease net working capital.

Answer (D) is **incorrect**.
The purchase of raw materials on account has no effect on working capital (current assets and current liabilities change by the same amount).

Fact Pattern: Depoole Company is a manufacturer of industrial products that uses a calendar year for financial reporting purposes. Assume that total quick assets exceeded total current liabilities both before and after the transaction described. Further assume that Depoole has positive profits during the year and a credit balance throughout the year in its retained earnings account.

46) Depoole's collection of a current accounts receivable of $29,000 will

A. Increase the current ratio.

B. Decrease the current ratio and the quick ratio.

C. Increase the quick ratio.

D. Not affect the current or quick ratios.

A. Increase the current ratio.

Answer (A) is **incorrect**.
Collecting current accounts receivable does not create a net change in current assets, quick assets, or current liabilities, which means the current and quick ratios are not changed.

B. Decrease the current ratio and the quick ratio.

Answer (B) is **incorrect**.
Collecting current accounts receivable does not create a net change in current assets, quick assets, or current liabilities, which means the current and quick ratios are not changed.

C. Increase the quick ratio.

Answer (C) is **incorrect**.
Collecting current accounts receivable does not create a net change in current assets, quick assets, or current liabilities, which means the current and quick ratios are not changed.

D. Not affect the current or quick ratios.

Answer (D) is **correct**.
Collecting current accounts receivable has no effect on either the current ratio or the quick ratio because assets (both current and quick) are reduced for the collection of receivables and increased by the same amount for the receipt of cash. Current liabilities are unchanged by the transaction.

Fact Pattern: Depoole Company is a manufacturer of industrial products that uses a calendar year for financial reporting purposes. Assume that total quick assets exceeded total current liabilities both before and after the transaction described. Further assume that Depoole has positive profits during the year and a credit balance throughout the year in its retained earnings account.

47) Obsolete inventory of $125,000 was written off by Depoole during the year. This transaction

A. Decreased the quick ratio.

B. Increased the quick ratio.

C. Increased net working capital.

D. Decreased the current ratio.

A. Decreased the quick ratio.

Answer (A) is **incorrect**.
The quick ratio was not affected.

B. Increased the quick ratio.

Answer (B) is **incorrect**.
The quick ratio was not affected.

C. Increased net working capital.

Answer (C) is **incorrect**.
Working capital was decreased.

D. Decreased the current ratio.

Answer (D) is **correct**.
Writing off obsolete inventory reduces current assets, but not quick assets (cash, marketable securities, and accounts receivable). Thus, the current ratio was reduced and the quick ratio was unaffected.

Fact Pattern: Depoole Company is a manufacturer of industrial products that uses a calendar year for financial reporting purposes. Assume that total quick assets exceeded total current liabilities both before and after the transaction described. Further assume that Depoole has positive profits during the year and a credit balance throughout the year in its retained earnings account.

48) Depoole's early liquidation of a long-term note with cash affects the

A. Current ratio to a greater degree than the quick ratio.

B. Quick ratio to a greater degree than the current ratio.

C. Current and quick ratio to the same degree.

D. Current ratio but not the quick ratio.

A. Current ratio to a greater degree than the quick ratio.

Answer (A) is **incorrect**.
The quick ratio is affected to a greater degree than the current ratio.

B. Quick ratio to a greater degree than the current ratio.

Answer (B) is **correct**.
The numerators of the quick and current ratios are decreased when cash is expended. Early payment of a long-term liability has no effect on the denominator (current liabilities). Since the numerator of the quick ratio, which includes cash, net receivables, and marketable securities, is less than the numerator of the current ratio, which includes all current assets, the quick ratio is affected to a greater degree.

C. Current and quick ratio to the same degree.

Answer (C) is **incorrect**.
The quick ratio is affected to a greater degree than the current ratio.

D. Current ratio but not the quick ratio.

Answer (D) is **incorrect**.
The quick ratio is affected to a greater degree than the current ratio.

Fact Pattern: Excerpts from the statement of financial position for Landau Corporation as of September 30 of the current year are presented as follows.

Cash	$ 950,000
Accounts receivable (net)	1,675,000
Inventories	2,806,000
Total current assets	$5,431,000
Accounts payable	$1,004,000
Accrued liabilities	785,000
Total current liabilities	$1,789,000

The board of directors of Landau Corporation met on October 4 of the current year and declared the regular quarterly cash dividend amounting to $750,000 ($.60 per share). The dividend is payable on October 25 of the current year to all shareholders of record as of October 12 of the current year. Assume that the only transactions to affect Landau Corporation during October of the current year are the dividend transactions and that the closing entries have been made.

49) Landau Corporation's working capital was

A. Unchanged by the dividend declaration and decreased by the dividend payment.

B. Decreased by the dividend declaration and increased by the dividend payment.

C. Unchanged by either the dividend declaration or the dividend payment.

D. Decreased by the dividend declaration and unchanged by the dividend payment.

A. Unchanged by the dividend declaration and decreased by the dividend payment.

Answer (A) is **incorrect**.
The declaration of a cash dividend reduces working capital and the dividend payment has no effect on working capital.

B. Decreased by the dividend declaration and increased by the dividend payment.

Answer (B) is **incorrect**.
The subsequent payment of a previously declared dividend has no effect on working capital.

C. Unchanged by either the dividend declaration or the dividend payment.

Answer (C) is **incorrect**.
The declaration of a cash dividend reduces working capital.

D. Decreased by the dividend declaration and unchanged by the dividend payment.

Answer (D) is **correct**.
Working capital is the excess of current assets over current liabilities. The declaration of a dividend requires a decrease to retained earnings and an increase to dividends payable (a current liability). Thus, working capital is decreased by the amount of the increased current liability. The subsequent payment of the dividend has no effect on working capital because current assets (cash) and current liabilities (dividends payable) are both decreased by the same amount.

Fact Pattern: Excerpts from the statement of financial position for Landau Corporation as of September 30 of the current year are presented as follows.

Cash	$ 950,000
Accounts receivable (net)	1,675,000
Inventories	2,806,000

Total current assets	$5,431,000
Accounts payable	$1,004,000
Accrued liabilities	785,000
Total current liabilities	$1,789,000

The board of directors of Landau Corporation met on October 4 of the current year and declared the regular quarterly cash dividend amounting to $750,000 ($.60 per share). The dividend is payable on October 25 of the current year to all shareholders of record as of October 12 of the current year. Assume that the only transactions to affect Landau Corporation during October of the current year are the dividend transactions and that the closing entries have been made.

50) Landau Corporation's current ratio was

A. Decreased by the dividend declaration and increased by the dividend payment.

B. Unchanged by either the dividend declaration or the dividend payment.

C. Decreased by the dividend declaration and unchanged by the dividend payment.

D. Increased by the dividend declaration and unchanged by the dividend payment.

A. Decreased by the dividend declaration and increased by the dividend payment.

Answer (A) is **correct**.
The dividend declaration decreased retained earnings and increased current liabilities by $750,000. The subsequent payment decreased both current assets and current liabilities by $750,000. Before the dividend declaration, the current ratio was 3.03 (5,431,000 ÷ $1,789,000). The declaration increased current liabilities to $2,539,000, and the new current ratio was 2.14 ($5,431,000 ÷ $2,539,000). The payment reduced current assets to $4,681,000 and current liabilities to $1,789,000. Thus, after the payment, the current ratio was 2.61 ($4,681,000 ÷ $1,789,000).

B. Unchanged by either the dividend declaration or the dividend payment.

Answer (B) is **incorrect**.
A dividend declaration reduces the current ratio.

C. Decreased by the dividend declaration and unchanged by the dividend payment.

Answer (C) is **incorrect**.
Payment of the dividend increased the ratio. Reducing the numerator and denominator by equal amounts always increases a ratio that is greater than 1.0.

D. Increased by the dividend declaration and unchanged by the dividend payment.
Answer (D) is **incorrect**.
The current ratio is reduced, not increased, by a dividend declaration.

Fact Pattern: Excerpts from the statement of financial position for Markham Corporation as of April 30 of the current year are presented as follows:

Cash	$ 725,000
Accounts receivable (net)	1,640,000
Inventories	2,945,000
Total current assets	$5,310,000
Accounts payable	$1,236,000
Accrued liabilities	831,000
Total current liabilities	$2,067,000

The board of directors of Markham met on May 5 of the current year and declared a quarterly cash dividend in the amount of $800,000 ($.50 per share). The dividend was paid on May 28 of the current year to shareholders of record as of May 15 of the current year. Assume that the only transactions that affected Markham during May of the current year were the dividend transactions and that the closing entries have been made.

51) Markham's working capital would be

A. Decreased by the dividend declaration and increased by the dividend payment.

B. Unchanged by either the dividend declaration or the dividend payment.

C. Decreased by the dividend declaration and unchanged by the dividend payment.

D. Increased by the dividend declaration and unchanged by the dividend payment.

A. Decreased by the dividend declaration and increased by the dividend payment.
Answer (A) is **incorrect**.
The dividend payment will not change working capital, but the declaration of the dividend decreases

working capital.

B. Unchanged by either the dividend declaration or the dividend payment.

Answer (B) is **incorrect**.
The dividend payment will not change working capital, but the declaration of the dividend decreases working capital.

C. Decreased by the dividend declaration and unchanged by the dividend payment.

Answer (C) is **correct**.
Working capital is the excess of current assets over current liabilities. The declaration of a dividend reduces retained earnings and creates a new current liability. Thus, the declaration of a dividend reduces working capital because current liabilities are increased without a corresponding increase in current assets. The subsequent payment of the dividend has no effect on working capital because current assets (cash) will be reduced by the same amount that current liabilities (dividends payable) are reduced.

D. Increased by the dividend declaration and unchanged by the dividend payment.

Answer (D) is **incorrect**.
The dividend payment will not change working capital, but the declaration of the dividend decreases working capital.

Fact Pattern: Excerpts from the statement of financial position for Markham Corporation as of April 30 of the current year are presented as follows:

Cash	$ 725,000
Accounts receivable (net)	1,640,000
Inventories	2,945,000
Total current assets	$5,310,000
Accounts payable	$1,236,000
Accrued liabilities	831,000
Total current liabilities	$2,067,000

The board of directors of Markham met on May 5 of the current year and declared a quarterly cash dividend in the amount of $800,000 ($.50 per share). The dividend was paid on May 28 of the current

year to shareholders of record as of May 15 of the current year. Assume that the only transactions that affected Markham during May of the current year were the dividend transactions and that the closing entries have been made.

52) Markham's current ratio would be

A. Decreased by the dividend declaration and increased by the dividend payment.

B. Increased by the dividend declaration and unchanged by the dividend payment.

C. Unchanged by either the dividend declaration or the dividend payment.

D. Unchanged by the dividend declaration and decreased by the dividend payment.

A. Decreased by the dividend declaration and increased by the dividend payment.
Answer (A) is **correct**.
The current ratio equals current assets divided by current liabilities. The declaration of a dividend results in a decrease in retained earnings and an increase in current liabilities. The effect is to decrease the current ratio because current liabilities are increased at the time of the declaration without a change in current assets. The April 30 current ratio is 2.57 ($5,310,000 ÷ $2,067,000). Following the declaration of an $800,000 dividend, the current ratio is 1.85 ($5,310,000 ÷ $2,867,000). The subsequent payment of the dividend will increase the ratio because the ratio is greater than 1.0 and both current assets and current liabilities will decline by the same amount. The current ratio after the payment is 2.18 ($4,510,000 ÷ $2,067,000).

B. Increased by the dividend declaration and unchanged by the dividend payment.
Answer (B) is **incorrect**.
The dividend declaration decreases the current ratio, and the payment increases the ratio.

C. Unchanged by either the dividend declaration or the dividend payment.
Answer (C) is **incorrect**.
The dividend declaration decreases the current ratio, and the payment increases the ratio.

D. Unchanged by the dividend declaration and decreased by the dividend payment.
Answer (D) is **incorrect**.
The dividend declaration decreases the current ratio, and the payment increases the ratio.

53) The following transactions occurred during a company's first year of operations:

I. Purchased a delivery van for cash
II. Borrowed money by issuance of short-term debt
III. Purchased treasury stock

Which of the items above caused a change in the amount of working capital?

A. I only.
B. I and II only.
C. II and III only.
D. I and III only.

A. I only.
Answer (A) is **incorrect**.
The purchases of the van and treasury stock affect working capital.

B. I and II only.
Answer (B) is **incorrect**.
The purchases of the van and treasury stock but not the issuance of short-term debt affect wo
capital.

C. II and III only.
Answer (C) is **incorrect**.
The purchases of the van and treasury stock but not the issuance of short-term debt affect wo
capital.

D. I and III only.
Answer (D) is **correct**.
Working capital is computed by deducting total current liabilities from total current assets. The
purchase of a delivery van for cash reduces current assets and has no effect on current liabili
The borrowing of cash by incurring short-term debt increases current assets by the same amo
it increases current liabilities; hence, it will have no effect on working capital. The purchase of
treasury stock decreases current assets but has no effect on current liabilities. Thus, the purc
of the van and treasury stock affect working capital.

Fact Pattern: CPZ Enterprises had the following account information.

Accounts receivable	$200,000
Accounts payable	80,000
Bonds payable, due in 10 years	300,000
Cash	100,000
Interest payable, due in 3 months	10,000
Inventory	400,000
Land	250,000
Notes payable, due in 6 months	50,000
Prepaid expenses	40,000

The company has an operating cycle of 5 months.

54) What will happen to the ratios below if CPZ Enterprises uses cash to pay 50% of the accounts payable?

	Current Ratio	Quick Ratio
A.	Increase	Increase
B.	Decrease	Decrease
C.	Increase	Decrease
D.	Decrease	Increase

A. Increase Increase

Answer (A) is **correct**.
Using cash to pay accounts payable will affect both ratios in a positive way. For instance, before the payment, current assets totaled $740,000 and current liabilities were $140,000, yielding a current ratio of 5.29. Paying $40,000 of the accounts payable ($80,000 × 50%) would reduce current assets to $700,000 and current liabilities to $100,000, for a new current ratio of 7.00. The quick assets would decline from $300,000 to $260,000, and the current liabilities from $140,000 to $100,000, for a new quick ratio of 2.60, an increase over the old ratio of 2.14.

B. Decrease Decrease

Answer (B) is **incorrect**.
Both ratios will increase as a result of using cash to pay 50% of the accounts payable.

C. Increase Decrease

Answer (C) is **incorrect**.
Both ratios will increase as a result of using cash to pay 50% of the accounts payable.

D. Decrease Increase

Answer (D) is **incorrect**.
Both ratios will increase as a result of using cash to pay 50% of the accounts payable.

Fact Pattern: Jensen Corporation's board of directors met on June 3 and declared a regular quarterly cash dividend of $.40 per share for a total value of $200,000. The dividend is payable on June 24 to all stockholders of record as of June 17. Excerpts from the statement of financial position for Jensen Corporation as of May 31 are presented as follows.

Cash	$ 400,000
Accounts receivable (net)	800,000
Inventories	1,200,000
Total current assets	$2,400,000
Total current liabilities	$1,000,000

Assume that the only transactions to affect Jensen Corporation during June are the dividend transactions.

55) Jensen's working capital would be

A. Unchanged by the dividend declaration and decreased by the dividend payment.

B. Decreased by the dividend declaration and increased by the dividend payment.

C. Unchanged by either the dividend declaration or the dividend payment.

D. Decreased by the dividend declaration and unchanged by the dividend payment.

A. Unchanged by the dividend declaration and decreased by the dividend payment.

Answer (A) is **incorrect**.
The declaration of a dividend increases current liabilities and reduces working capital. The subsequent payment has no effect on working capital.

B. Decreased by the dividend declaration and increased by the dividend payment.

Answer (B) is **incorrect**.
The declaration of a dividend increases current liabilities and reduces working capital. The subsequent payment has no effect on working capital.

C. Unchanged by either the dividend declaration or the dividend payment.

Answer (C) is **incorrect**.
The declaration of a dividend increases current liabilities and reduces working capital. The subsequent payment has no effect on working capital.

D. Decreased by the dividend declaration and unchanged by the dividend payment.

Answer (D) is **correct**.
Working capital is defined as current assets minus current liabilities. The declaration of a dividend increases current liabilities and thus reduces working capital. The subsequent payment has no effect on working capital since current assets and current liabilities decrease by the same amount.

Fact Pattern: Jensen Corporation's board of directors met on June 3 and declared a regular quarterly cash dividend of $.40 per share for a total value of $200,000. The dividend is payable on June 24 to all stockholders of record as of June 17. Excerpts from the statement of financial position for Jensen Corporation as of May 31 are presented as follows.

Cash	$ 400,000
Accounts receivable (net)	800,000

Inventories	1,200,000
Total current assets	$2,400,000
Total current liabilities	$1,000,000

Assume that the only transactions to affect Jensen Corporation during June are the dividend transactions.

56) Jensen's current ratio would be

A. Unchanged by the dividend declaration and decreased by the dividend payment.

B. Decreased by the dividend declaration and increased by the dividend payment.

C. Unchanged by either the dividend declaration or the dividend payment.

D. Decreased by the dividend declaration and unchanged by the dividend payment.

A. Unchanged by the dividend declaration and decreased by the dividend payment.

Answer (A) is **incorrect**.
The dividend declaration increases liabilities and decreases the current ratio. The subsequent payment decreases both current assets and current liabilities by the same amount, thereby increasing a current ratio in excess of one.

B. Decreased by the dividend declaration and increased by the dividend payment.

Answer (B) is **correct**.
The current ratio is computed by dividing current assets by current liabilities. The declaration of a dividend increases liabilities (to $1,200,000) and thus decreases the ratio. After the declaration, the ratio is 2.0 ($2,400,000 ÷ $1,200,000). It was originally 2.4 ($2,400,000 ÷ $1,000,000). The subsequent payment decreases both current assets and current liabilities by $200,000. The ratio is then 2.2 ($2,200,000 ÷ $1,000,000). Therefore, the payment of the current liability increases the current ratio.

C. Unchanged by either the dividend declaration or the dividend payment.

Answer (C) is **incorrect**.

The dividend declaration increases liabilities and decreases the current ratio. The subsequent payment decreases both current assets and current liabilities by the same amount, thereby increasing a current ratio in excess of one.

D. Decreased by the dividend declaration and unchanged by the dividend payment.

Answer (D) is **incorrect**.
The dividend declaration increases liabilities and decreases the current ratio. The subsequent payment decreases both current assets and current liabilities by the same amount, thereby increasing a current ratio in excess of one.

Fact Pattern: Jensen Corporation's board of directors met on June 3 and declared a regular quarterly cash dividend of $.40 per share for a total value of $200,000. The dividend is payable on June 24 to all stockholders of record as of June 17. Excerpts from the statement of financial position for Jensen Corporation as of May 31 are presented as follows.

Cash	$ 400,000
Accounts receivable (net)	800,000
Inventories	1,200,000
Total current assets	$2,400,000
Total current liabilities	$1,000,000

Assume that the only transactions to affect Jensen Corporation during June are the dividend transactions.

57) Jensen's quick (acid test) ratio would be

A. Unchanged by the dividend declaration and decreased by the dividend payment.

B. Decreased by the dividend declaration and increased by the dividend payment.

C. Unchanged by either the dividend declaration or the dividend payment.

D. Decreased by the dividend declaration and unchanged by the dividend payment.

A. Unchanged by the dividend declaration and decreased by the dividend payment.

Answer (A) is **incorrect**.
The dividend declaration increases current liabilities and decreases the quick ratio. The subsequent payment of a cash dividend decreases quick assets and current liabilities by the same amount.

Accordingly, the ratio (1.0) remains unchanged by the payment.

B. Decreased by the dividend declaration and increased by the dividend payment.

Answer (B) is **incorrect**.
The dividend declaration increases current liabilities and decreases the quick ratio. The subsequent payment of a cash dividend decreases quick assets and current liabilities by the same amount. Accordingly, the ratio (1.0) remains unchanged by the payment.

C. Unchanged by either the dividend declaration or the dividend payment.

Answer (C) is **incorrect**.
The dividend declaration increases current liabilities and decreases the quick ratio. The subsequent payment of a cash dividend decreases quick assets and current liabilities by the same amount. Accordingly, the ratio (1.0) remains unchanged by the payment.

D. Decreased by the dividend declaration and unchanged by the dividend payment.

Answer (D) is **correct**.
The quick ratio is computed by dividing quick assets (cash, marketable securities, and receivables) by current liabilities. The dividend declaration will increase current liabilities to $1,200,000 and decrease the quick ratio to 1.0 ($1,200,000 quick assets ÷ $1,200,000 current liabilities). The payment of a cash dividend will decrease quick assets (cash) and the current liabilities by the same amount. Accordingly, the ratio (1.0) remains unchanged by the payment.

58) All of the following are affected when merchandise is purchased on credit **except**

A. Total current assets.

B. Net working capital.

C. Total current liabilities.

D. Current ratio.

A. Total current assets.

Answer (A) is **incorrect**.
Current assets are increased by the amount of inventory purchased.

B. Net working capital.

Answer (B) is **correct**.
Working capital is the net of current assets and current liabilities. When merchandise is purchased on credit, inventory (a current asset) is increased, and accounts payable (a current liability) is increased by the same amount. Thus, no net change in working capital results.

C. Total current liabilities.

Answer (C) is **incorrect**.
Current liabilities are increased by the amount of the credit purchase.

D. Current ratio.

Answer (D) is **incorrect**.
The numerator (current assets) and the denominator (current liabilities) of the current ratio are increased by the same amount.

59) An entity has total assets of $7,500,000 and a current ratio of 2.3 times before purchasing $750,000 of merchandise on credit for resale. After this purchase, the current ratio will

A. Remain at 2.3 times.

B. Be higher than 2.3 times.

C. Be lower than 2.3 times.

D. Be exactly 2.53 times.

A. Remain at 2.3 times.

Answer (A) is **incorrect**.
The current ratio is the ratio of current assets to current liabilities. When the ratio is greater than one, any change of equal dollar amount on both the numerator and denominator will result in a lowering of the overall ratio (since the denominator will increase by a proportionally greater amount). The purchase of merchandise on credit is an example of such a change: inventory increases in the numerator and accounts payable increase in the denominator by an equal dollar amount.

B. Be higher than 2.3 times.

Answer (B) is **incorrect**.
The current ratio is the ratio of current assets to current liabilities. When the ratio is greater than one, any change of equal dollar amount on both the numerator and denominator will result in a lowering of the overall ratio (since the denominator will increase by a proportionally greater amount). The purchase of merchandise on credit is an example of such a change: inventory increases in the numerator and accounts payable increase in the denominator by an equal dollar amount.

C. Be lower than 2.3 times.

Answer (C) is **correct**.
The current ratio is the ratio of current assets to current liabilities. When the ratio is greater than one, any change of equal dollar amount on both the numerator and denominator will result in a lowering of the overall ratio (since the denominator will increase by a proportionally greater amount). The purchase of merchandise on credit is an example of such a change: Inventory increases in the numerator and accounts payable increases in the denominator by an equal dollar amount.

D. Be exactly 2.53 times.

Answer (D) is **incorrect**.
The current ratio is the ratio of current assets to current liabilities. When the ratio is greater than one, any change of equal dollar amount on both the numerator and denominator will result in a lowering of the overall ratio (since the denominator will increase by a proportionally greater amount). The purchase of merchandise on credit is an example of such a change: inventory increases in the numerator and accounts payable increase in the denominator by an equal dollar amount.

60) If allowance for credit losses is increased, this adjustment will

A. Increase the acid test ratio.

B. Increase working capital.

C. Reduce debt-to-asset ratio.

D. Reduce the current ratio.

A. Increase the acid test ratio.

Answer (A) is **incorrect**.
By reducing net receivables, an increase in the allowance for credit losses lowers the acid test (quick) ratio.

B. Increase working capital.

Answer (B) is **incorrect**.
By reducing net receivables, an increase in the allowance for credit losses lowers the level of working capital.

C. Reduce debt-to-asset ratio.

Answer (C) is **incorrect**.
By reducing net receivables, an increase in the allowance for credit losses lowers total assets, raising the debt-to-asset ratio.

D. Reduce the current ratio.

Answer (D) is **correct**.
The current ratio is the ratio of current assets to current liabilities. By reducing net receivables, an increase in the allowance for credit losses lowers the amount of current assets (the numerator), reducing the overall ratio.

61) A firm must increase its acid test ratio above the current 0.9 level in order to comply with the terms of a loan agreement. Which one of the following actions is **most** likely to produce the desired results?

A. Expediting collection of accounts receivable.

B. Selling auto parts on account.

C. Making a payment to trade accounts payable.

D. Purchasing marketable securities for cash.

A. Expediting collection of accounts receivable.

Answer (A) is **incorrect**.
Converting accounts receivable into cash has no net effect on the numerator of the acid test ratio.

B. Selling auto parts on account.

Answer (B) is **correct**.
The acid test (quick) ratio consists of the quick assets (cash, marketable securities, and net accounts receivable) divided by current liabilities. Exchanging merchandise inventory for accounts receivable increases the numerator while having no effect on the denominator, resulting in an increase in the overall ratio.

C. Making a payment to trade accounts payable.

Answer (C) is **incorrect**.
Paying down accounts payable decreases both the numerator and denominator by the same dollar amount, resulting in a decrease of the acid test ratio.

D. Purchasing marketable securities for cash.

Answer (D) is **incorrect**.
Purchasing marketable securities for cash has no net effect on the numerator.

62) The owner of a chain of grocery stores has bought a large supply of mangoes and paid for the fruit with cash. This purchase will adversely impact which one of the following?

A. Working capital.

B. Current ratio.

C. Quick or acid test ratio.

D. Price earnings ratio.

A. Working capital.

Answer (A) is **incorrect**.
One current asset is exchanged for another, leaving working capital unchanged.

B. Current ratio.

Answer (B) is **incorrect**.
The current ratio is current assets divided by current liabilities; exchanging one current asset for another leaves the numerator unchanged.

C. Quick or acid test ratio.

Answer (C) is **correct**.
The quick (acid test) ratio consists of the quick assets (cash, marketable securities, and net accounts receivable) divided by current liabilities. Buying merchandise inventory with cash reduces the numerator, lowering the overall ratio.

D. Price earnings ratio.

Answer (D) is **incorrect**.
The price earnings ratio does not pertain to balance sheet accounts.

63) Both the current ratio and the quick ratio for Spartan Corporation have been slowly decreasing. For the past two years, the current ratio has been 2.3-to-1 and 2.0-to-1. During the same time period, the quick ratio has decreased from 1.2-to-1 to 1.0-to-1. The disparity between the current and quick ratios can be explained by which one of the following?

A. The current portion of long-term debt has been steadily increasing.

B. The cash balance is unusually low.

C. The accounts receivable balance has decreased.

D. The inventory balance is unusually high.

A. The current portion of long-term debt has been steadily increasing.

Answer (A) is **incorrect**.
The only difference between the current ratio and the quick ratio is the removal of inventories from the numerator of the quick ratio; a change in current liabilities (the denominator) cannot account for the discrepancy.

B. The cash balance is unusually low.

Answer (B) is **incorrect**.
The only difference between the current ratio and the quick ratio is the removal of inventories from the numerator of the quick ratio; a change in cash cannot account for the discrepancy.

C. The accounts receivable balance has decreased.

Answer (C) is **incorrect**.
The only difference between the current ratio and the quick ratio is the removal of inventories from the numerator of the quick ratio; a change in accounts receivable cannot account for the discrepancy.

D. The inventory balance is unusually high.

Answer (D) is **correct**.
The only difference between the current ratio and the quick ratio is the removal of inventories from the numerator of the quick ratio. Thus, a high inventory balance can account for the disparity between the current and quick ratios.

64) The acid test ratio shows the ability of a company to pay its current liabilities without having to

A. Reduce its cash balance.

B. Borrow additional funds.

C. Collect its receivables.

D. Liquidate its inventory.

A. Reduce its cash balance.

Answer (A) is **incorrect**.
Reducing cash is the normal way of paying current liabilities.

B. Borrow additional funds.

Answer (B) is **incorrect**.

The acid test measures the liquidity of assets on hand, not the ability to borrow funds.

C. Collect its receivables.

Answer (C) is **incorrect**.
Accounts receivable are in the numerator of the acid test ratio; the ability to collect them is crucial.

D. Liquidate its inventory.

Answer (D) is **correct**.
The acid test (quick) ratio consists of the quick assets (cash, marketable securities, and net accounts receivable) divided by current liabilities. Thus, the numerator consists of those assets that are more liquid than inventory.

65) If a company has a current ratio of 2.1 and pays off a portion of its accounts payable with cash, the current ratio will

A. Decrease.

B. Increase.

C. Remain unchanged.

D. Move closer to the quick ratio.

A. Decrease.

Answer (A) is **incorrect**.
Since the numerator before the transaction was greater than the denominator, a reduction to both factors of an equal dollar amount will have a proportionally greater effect on the denominator, causing the ratio as a whole to increase.

B. Increase.

Answer (B) is **correct**.
The current ratio is the ratio of current assets to current liabilities. Since the numerator before the transaction was greater than the denominator, a reduction to both factors of an equal dollar amount will have a proportionally greater effect on the denominator, causing the ratio as a whole to increase.

C. Remain unchanged.

Answer (C) is **incorrect**.
Since the numerator before the transaction was greater than the denominator, a reduction to both factors of an equal dollar amount will have a proportionally greater effect on the denominator, causing the ratio as a whole to increase.

D. Move closer to the quick ratio.

Answer (D) is **incorrect**.
Since the numerator before the transaction was greater than the denominator, a reduction to both factors of an equal dollar amount will have a proportionally greater effect on the denominator, causing the ratio as a whole to increase.

66) A condensed comparative balance sheet for a company appears below:

	12/31/Year 1	12/31/Year 2
Cash	$ 40,000	$ 30,000
Accounts receivable	120,000	100,000
Inventory	200,000	300,000
Property, plant, & equipment	500,000	550,000
Accumulated depreciation	(280,000)	(340,000)
Total assets	$ 580,000	$ 640,000
Current liabilities	$ 60,000	$ 100,000
Long-term liabilities	390,000	420,000
Stockholders' equity	130,000	120,000
Total liabilities and equity	$ 580,000	$ 640,000

In looking at liquidity ratios at both balance sheet dates, what happened to the (1) current ratio and (2) acid test (quick) ratio?

(1) Current Ratio	(2) Acid Test Ratio

A. Increased Increased

B. Increased Decreased

C. Decreased Increased

D. Decreased Decreased

A. Increased Increased

Answer (A) is **incorrect**.
Both ratios decreased.

B. Increased Decreased

Answer (B) is **incorrect**.
Both ratios decreased.

C. Decreased Increased

Answer (C) is **incorrect**.
Both ratios decreased.

D. Decreased Decreased

Answer (D) is **correct**.
The current ratio is determined by dividing current assets by current liabilities. The acid test ratio is determined by dividing quick assets by current liabilities. At December 31, Year 1, the current ratio is 6 to 1 [($40,000 + $120,000 + $200,000) ÷ $60,000]. At December 31, Year 2, the current ratio is 4.3 to 1 [($30,000 + $100,000 + $300,000) ÷ $100,000]. Hence, there was a decrease in the current ratio. At December 31, Year 1, the acid test ratio is 2.667 to 1 [($40,000 + $120,000) ÷ $60,000]. At December 31, Year 2, the acid test ratio is 1.3 to 1 [($30,000 + $100,000) ÷ $100,000]. Thus, the acid test ratio also declined.

67) A firm has the following current assets.

Cash	€	250,000
Marketable securities		100,000

Accounts receivable	800,000
Inventories	1,450,000
Total current assets	€ 2,600,000

If current liabilities are €1,300,000, the firm's

A. Current ratio will decrease if a payment of €100,000 cash is used to pay €100,000 of accounts payable.

B. Current ratio will not change if a payment of €100,000 is used to pay €100,000 of accounts payable.

C. Acid-test (quick) ratio will decrease if a payment of €100,000 cash is used to purchase inventory.

D. Acid-test (quick) ratio will not change if a payment of €100,000 cash is used to purchase inventory.

A. Current ratio will decrease if a payment of €100,000 cash is used to pay €100,000 of accounts payable.

Answer (A) is **incorrect**.
The numerator of the current ratio is twice the denominator. For this reason, the same dollar-amount reduction in each produces a greater percentage reduction in the denominator, driving the ratio up.

B. Current ratio will not change if a payment of €100,000 is used to pay €100,000 of accounts payable.

Answer (B) is **incorrect**.
The numerator of the current ratio is twice the denominator. For this reason, the same dollar-amount reduction in each produces a greater percentage reduction in the denominator, driving the ratio up.

C. Acid-test (quick) ratio will decrease if a payment of €100,000 cash is used to purchase inventory.

Answer (C) is **correct**.
The only difference between the current ratio and the quick ratio is the removal of inventories from the numerator of the quick ratio. Thus, a shift from cash to inventory will have a reducing effect on the quick ratio but not on the current ratio.

D. Acid-test (quick) ratio will not change if a payment of €100,000 cash is used to purchase inventory.

Answer (D) is **incorrect**.
The quick ratio, unlike the current ratio, will be reduced if cash is used to pay for inventory.

68) A company has $80 million in current assets, comprised of $30 million in inventory and $50 million in cash and marketable securities. The company's current liabilities total $50 million. If the company purchases an additional $10 million in inventory with $10 million in cash, the

effect of this transaction on the company would be to

A. Decrease the current ratio and increase the quick ratio.

B. Decrease the quick ratio while the current ratio remains unchanged.

C. Leave both the current ratio and the quick ratio unchanged.

D. Decrease the current ratio and decrease the quick ratio.

A. Decrease the current ratio and increase the quick ratio.

Answer (A) is **incorrect**.
Since the decrease in cash is offset by an increase in inventory, the current ratio remains unchanged. Also, the decrease in cash decreases the quick ratio.

B. Decrease the quick ratio while the current ratio remains unchanged.

Answer (B) is **correct**.
The quick ratio decreases from 1.00 ($50 million ÷ $50 million) to .80 ($40 million ÷ $50 million) due to the $10 million decrease in cash. The current ratio remains unchanged because the $10 million decrease in cash is offset by the $10 million increase in inventory.

C. Leave both the current ratio and the quick ratio unchanged.

Answer (C) is **incorrect**.
The decrease in cash lowers the numerator in the quick ratio, which decreases the quick ratio.

D. Decrease the current ratio and decrease the quick ratio.

Answer (D) is **incorrect**.
Since the decrease in cash is offset by an increase in inventory, the current ratio remains unchanged.

69) During the current year, Corporation A had 100,000 shares of common stock outstanding. On July 1, Corporation A issued a 4-for-1 stock split. Additionally, on September 2, A declared a dividend of $0.75 per common share, and the payment is expected to be made in January of the following year. If A had current assets of $2,000,000 and current liabilities of $1,200,000

before the declaration of the stock dividend, what is the percentage change in the current ratio as a result of the dividend declaration?

A. 15% decrease.

B. 20% decrease.

C. 2% decrease.

D. 6% decrease.

A. 15% decrease.

Answer (A) is **incorrect**.
A 15% decrease results from the assumption that the dividends are paid within the current year.

B. 20% decrease.

Answer (B) is **correct**.
Prior to the dividend, the current ratio is 1.67 ($2,000,000 ÷ $1,200,000). The stock split increases the number of outstanding shares to 400,000. The declaration of dividends increases current liabilities by $300,000 (400,000 × $0.75). Additionally, because the dividends are not paid until the next year, current assets is unaffected by the declaration. Thus, the new current ratio after the dividend declaration is 1.33 ($2,000,000 ÷ $1,500,000). Accordingly, the current ratio has decreased by 20% [(1.67 – 1.33) ÷ 1.67].

C. 2% decrease.

Answer (C) is **incorrect**.
A 2% decrease results from treating the stock split as a reverse stock split.

D. 6% decrease.

Answer (D) is **incorrect**.
A 6% decrease does not account for the 4-for-1 stock split.

70) At the beginning of the year, Company C had the following items on its balance sheet:

Cash	$100,000
Marketable securities	70,000
Inventory	25,000
Prepaid assets	50,000
Net accounts receivable	30,000
Current liabilities	125,000

During the course of the year, C declared and paid dividends of $1 per share on its 40,000 shares of common stock. Assuming that the dividend payment is the only transaction in the year, what is the percentage change in the quick ratio as a result of the dividends?

A. 18% increase.

B. 15% decrease.

C. 26% increase.

D. 20% decrease.

A. 18% increase.

Answer (A) is **incorrect**.
An 18% increase neglects to consider that the overall current liabilities do not change as a result of the dividends. The declaration increases current liabilities by $40,000, and the payment of dividends decreases current liabilities by $40,000, resulting in no net change to current liabilities.

B. 15% decrease.

Answer (B) is **incorrect**.
A 15% decrease is the change in current ratio as a result of the dividends. However, unlike the current ratio, the quick ratio does not consider inventory or prepaid assets as current assets.

C. 26% increase.

Answer (C) is **incorrect**.
A 26% increase assumes that the current ratio is considered and that the overall current liabilities will decrease by $40,000 as a result of the dividends.

D. 20% decrease.

Answer (D) is **correct**.
The quick ratio does not include inventory or prepaid assets as current assets; thus, the quick ratio prior to the dividend declaration and payment is 1.6 [($100,000 + $70,000 + $30,000) ÷ $125,000]. Accordingly, the declaration of dividends increases current liabilities by $40,000. However, the payment of dividends decreases current liabilities by $40,000 as well as current assets (cash) by $40,000. As such, the quick ratio after the dividend is 1.28 [($60,000 + $70,000 + $30,000) ÷ $125,000]. Therefore, the dividends reduce the quick ratio by 20% [(1.6 – 1.28) ÷ 1.6].

71) Corporation M had the following items on its balance sheet at the end of Year 1:

Cash	$ 55,000
Marketable securities	60,000
Inventory	35,000
Land	70,000
Office building	100,000
Accounts payable (due 2/1/Y2)	40,000
Interest payable (due 6/1/Y3)	20,000
Wages payable (due 1/5/Y2)	10,000

What is M's working capital at the end of Year 1?

A. $170,000

B. $100,000

C. $80,000

D. $250,000

A. $170,000

Answer (A) is **incorrect**.
Land is not a current asset and therefore should not be included in the calculation of working capital.

B. $100,000

Answer (B) is **correct**.
Working capital is equal to current assets minus current liabilities. In this scenario, the cash, marketable securities, and inventory represent the current assets, while the accounts payable and wages payable (both due in Year 2) represent the current liabilities. Accordingly, the working capital is $100,000 [($55,000 + $60,000 + $35,000) – ($40,000 + $10,000)].

C. $80,000

Answer (C) is **incorrect**.
The interest payable is due in Year 3 and therefore is not a current liability.

D. $250,000

Answer (D) is **incorrect**.
A working capital of $250,000 incorrectly includes land and the office building as current assets and incorrectly includes the interest payable due in Year 3 as a current liability.

72) At the beginning of the current year, Corporation G had current assets of $300,000 and current liabilities of $100,000. Additionally, noncurrent assets were $200,000 and noncurrent liabilities were $150,000. By the end of the year, current assets had increased by 10% and current liabilities increased by 25%. Also, noncurrent assets and liabilities each increased by 5% by the end of the year. By what amount does working capital change by the end of the year?

A. $2,500 increase.

B. $7,500 increase.

C. $5,000 increase.

D. $50,000 increase.

A. $2,500 increase.

Answer (A) is **incorrect**.
A $2,500 increase is the amount by which the difference between noncurrent assets and noncurrent liabilities changed.

B. $7,500 increase.

Answer (B) is **incorrect**.
A $7,500 increase is the change in total assets minus total liabilities over the current year.

C. $5,000 increase.

Answer (C) is **correct**.
Working capital is equal to current assets minus current liabilities. Therefore, the working capital at the beginning of the year is $200,000 ($300,000 – $100,000). The working capital at the end of the year is $205,000 [($300,000 × 1.10) – ($100,000 × 1.25)]. Accordingly, working capital has increased by $5,000 over the course of the year.

D. $50,000 increase.

Answer (D) is **incorrect**.
A $50,000 increase assumes that both the current assets and current liabilities increased by 25% over the year.

73) Corporation H had current assets of $250,000 at the beginning of the year and $50,000 of current liabilities. Which of the following transactions would result in an increase of working capital?

A. A declaration of dividends.

B. Purchasing $50,000 of inventory with cash.

C. Purchasing $50,000 of inventory on account.

D. Issuing a $10,000 10-year bond with principal and interest due in 10 years.

A. A declaration of dividends.

Answer (A) is **incorrect**.
A declaration of dividends increases current liabilities and has no effect on current assets. Accordingly, working capital would decrease as a result of declaring dividends.

B. Purchasing $50,000 of inventory with cash.

Answer (B) is **incorrect**.
Purchasing inventory with cash increases inventory but decreases cash (both current assets) by $50,000. Additionally, current liabilities remains unaffected. Accordingly, working capital does not change.

C. Purchasing $50,000 of inventory on account.

Answer (C) is **incorrect**.
Purchasing inventory on account increases inventory (a current asset) by $50,000 and increases current liabilities by $50,000. Thus, there is no net change on working capital.

D. Issuing a $10,000 10-year bond with principal and interest due in 10 years.

Answer (D) is **correct**.
The working capital for the beginning of the year is $200,000 ($250,000 – $50,000). By issuing long-term debt, H's cash account (a current asset) will increase by $10,000, and noncurrent liabilities will increase by $10,000. However, current liabilities will remain constant at $50,000. Accordingly, issuing long-term debt will increase the working capital to $210,000 ($260,000 – $50,000).

74) A characteristic of all assets and liabilities included in working capital is that they are

A. Cash equivalents.

B. Current.

C. Monetary.

D. Marketable.

A. Cash equivalents.

Answer (A) is **incorrect**.
The assets and liabilities included in working capital are not limited to cash equivalents.

B. Current.

Answer (B) is **correct**.
Working capital is the excess of current assets over current liabilities. Working capital identifies the

relatively liquid portion of the capital of the entity available for meeting obligations within the operating cycle of the firm.

C. Monetary.

Answer (C) is **incorrect**.
Although assets and liabilities may be any combination of monetary, marketable, or cash equivalents in addition to cash, they must be current to be part of working capital.

D. Marketable.

Answer (D) is **incorrect**.
Assets need not be marketable to be current.

75) Which of the following ratios is(are) useful in assessing a company's ability to meet currently maturing or short-term obligations?

Acid-Test Ratio	Debt-to-Equity Ratio

A. No No

B. No Yes

C. Yes Yes

D. Yes No

A. No No

Answer (A) is **incorrect**.
The acid-test ratio measures liquidity and is therefore useful in assessing a company's ability to meet currently maturing or short-term obligations.

B. No Yes

Answer (B) is **incorrect**.
The acid-test ratio but not the debt-to-equity ratio is useful in assessing a company's ability to meet currently maturing or short-term obligations.

C. Yes Yes

Answer (C) is **incorrect**.
The debt-to-equity ratio measures leverage and therefore is not useful in assessing a company's ability to meet currently maturing or short-term obligations.

D. Yes No

Answer (D) is **correct**.
The acid-test, or quick, ratio measures liquidity, which is the ability of a company to meet its short-term obligations. The debt-to-equity ratio is a leverage ratio. Leverage ratios measure the impact of debt on profitability and risk.

76) Selected financial data from Drew Company follow:

	As of December 31
Cash	$ 75,000
Accounts receivable (net)	225,000
Merchandise inventory	270,000
Trading securities	40,000
Land and building (net)	500,000
Mortgage payable -- current portion	30,000
Accounts payable and accrued liabilities	120,000
Short-term notes payable	50,000

	Year Ended December 31
Sales	$1,500,000
Cost of goods sold	900,000

Drew's quick (acid-test) ratio as of December 31 is

A. 3.6 to 1.

B. 3.1 to 1.

C. 2.0 to 1.

D. 1.7 to 1.

A. 3.6 to 1.

Answer (A) is **incorrect**.
The ratio 3.6 to 1 results from including inventory in quick assets and excluding the mortgage payable--current portion from current liabilities.

B. 3.1 to 1.

Answer (B) is **incorrect**.
The ratio 3.1 to 1 is the current ratio.

C. 2.0 to 1.

Answer (C) is **incorrect**.
The ratio 2.0 to 1 results from excluding the mortgage payable--current portion from current liabilities.

D. 1.7 to 1.

Answer (D) is **correct**.
The quick or acid-test ratio is a measure of the firm's ability to pay its maturing liabilities in the short run. It is defined as quick assets (cash, short-term investment securities, and net receivables) divided by current liabilities. Drew Company's quick assets equal $340,000 ($75,000 + $40,000 + $225,000). The current liabilities equal $200,000 ($30,000 + $120,000 + $50,000). Dividing the $340,000 of quick assets by the $200,000 of current liabilities results in a quick (acid-test) ratio of 1.7 to 1.

77) Redwood Co.'s financial statements had the following information at year-end:

Cash	$ 60,000
Accounts receivable	180,000
Allowance for credit losses	8,000
Inventory	240,000
Short-term marketable securities	90,000

Prepaid rent	18,000
Current liabilities	400,000
Long-term debt	220,000

What was Redwood's quick ratio?

A. 0.81 to 1

B. 0.83 to 1

C. 0.94 to 1

D. 1.45 to 1

A. 0.81 to 1

Answer (A) is **correct**.
The quick ratio is equal to quick assets divided by current liabilities. Quick assets are current assets excluding inventory and prepaid expenses. The ratio is therefore 0.81 to 1 {[$60,000 cash + $90,000 short-term investment securities + ($180,000 – $8,000) net accounts receivable] ÷ $400,000 current liabilities}.

B. 0.83 to 1

Answer (B) is **incorrect**.
The allowance for credit losses must be subtracted from accounts receivable.

C. 0.94 to 1

Answer (C) is **incorrect**.
The ratio of 0.94 to 1 is equal to the current assets divided by total liabilities.

D. 1.45 to 1

Answer (D) is **incorrect**.
The ratio of 1.45 to 1 is the current ratio.

78) Heath Co.'s current ratio is 4:1. Which of the following transactions will normally increase its current ratio?

A. Purchasing inventory on account.

B. Selling inventory on account.

C. Collecting an account receivable.

D. Purchasing machinery for cash.

A. Purchasing inventory on account.

Answer (A) is **incorrect**.
The purchase of inventory on open account increases current assets (the numerator) and current liabilities (the denominator) by the same amount, thereby decreasing the ratio.

B. Selling inventory on account.

Answer (B) is **correct**.
The current ratio is equal to current assets divided by current liabilities. An increase in current assets (the numerator) or decrease in current liabilities (the denominator) would cause the ratio to increase. If the company sold merchandise on open account that earned a normal gross margin, receivables would be increased at the time of recording the sales revenue in an amount greater than the decrease in inventory from recording the cost of goods sold. The effect would be an increase in the current assets and no change in the current liabilities. Thus, the current ratio would be increased.

C. Collecting an account receivable.

Answer (C) is **incorrect**.
Collecting an account receivable decreases one current asset and increases another by the same amount.

D. Purchasing machinery for cash.

Answer (D) is **incorrect**.
Purchasing machinery for cash decreases a current asset and increases a noncurrent asset, thereby decreasing the ratio.

79) Information from Dominic Company's year-end financial statements is as follows:

	Year 1	Year 2
Current assets	$ 4,000,000	$ 4,200,000
Current liabilities	2,000,000	1,800,000
Equity	5,000,000	5,400,000
Net sales	16,600,000	17,600,000
Cost of goods sold	12,400,000	12,800,000
Operating income	1,000,000	1,100,000

What is the current ratio at December 31, Year 2?

A. 1.38 to 1.

B. 2.94 to 1.

C. 2.33 to 1.

D. 3.00 to 1.

A. 1.38 to 1.

Answer (A) is **incorrect**.
The current ratio is not net sales divided by cost of goods sold.

B. 2.94 to 1.

Answer (B) is **incorrect**.
The current ratio does not include operating income.

C. 2.33 to 1.

Answer (C) is **correct**.
The current ratio equals current assets divided by current liabilities. For Year 2, the current ratio equals $4,200,000 divided by $1,800,000, or 2.33. The other information is irrelevant.

D. 3.00 to 1.

Answer (D) is **incorrect**.
The current ratio is not the ratio between equity and current liabilities.

80) At December 30, Vida Co. had cash of $200,000, a current ratio of 1.5:1, and a quick ratio of .5:1. On December 31, all cash was used to reduce accounts payable. How did these cash payments affect the ratios?

	Current Ratio	Quick Ratio
A.	Increased	Decreased
B.	Increased	No effect
C.	Decreased	Increased
D.	Decreased	No effect

A. Increased Decreased

Answer (A) is **correct**.
The current ratio (1.5) equals current assets (cash, marketable securities, and net accounts receivable) divided by current liabilities (accounts payable, etc.). If a ratio is greater than 1.0, equal decreases in the numerator and denominator (debit accounts payable and credit cash for $200,000) increase the ratio. The quick ratio (.5) equals quick assets (cash, trading securities, net accounts receivable) divided by current liabilities. If a ratio is less than 1.0, equal decreases in the numerator and denominator (debit accounts payable and credit cash for $200,000) decrease the ratio.

B. Increased No effect

Answer (B) is **incorrect**.
The quick ratio decreased.

C. Decreased Increased

Answer (C) is **incorrect**.
The current ratio increased and the quick ratio decreased.

D. Decreased No effect

Answer (D) is **incorrect**.
The current ratio increased and the quick ratio decreased.

81) Galad Corp. has current assets of $180,000 and current liabilities of $360,000. Which of the following transactions would improve Galad's current ratio?

A. Refinancing a $60,000 long-term mortgage with a short-term note.

B. Purchasing $100,000 of merchandise inventory with a short-term account payable.

C. Paying $40,000 of short-term accounts payable.

D. Collecting $20,000 of short-term accounts receivable.

A. Refinancing a $60,000 long-term mortgage with a short-term note.

Answer (A) is **incorrect**.
Refinancing a $60,000 long-term mortgage with a short-term note results in an increase in the denominator and no change in the numerator

B. Purchasing $100,000 of merchandise inventory with a short-term account payable.

Answer (B) is **correct**.
If a current ratio is less than 1.0, a transaction that results in equal increases in the numerator and denominator will improve the ratio. The current ratio is .5 ($180,000 ÷ $360,000). Debiting inventory and crediting accounts payable increases the ratio to .61 ($280,000 ÷ $460,000).

C. Paying $40,000 of short-term accounts payable.

Answer (C) is **incorrect**.
Decreasing the denominator and the numerator by the same amount decreases a current ratio that is lower than 1.0.

D. Collecting $20,000 of short-term accounts receivable.

Answer (D) is **incorrect**.
Collecting $20,000 of short-term accounts receivable has no effect on the amount of the numerator or denominator.

82) A company has a current ratio of 2 to 1. This ratio will decrease if the company

A. Receives a 5% stock dividend on one of its marketable securities.

B. Pays a large account payable which had been a current liability.

C. Borrows cash on a 6-month note.

D. Sells merchandise for more than cost and records the sale using the perpetual inventory method.

A. Receives a 5% stock dividend on one of its marketable securities.
Answer (A) is **incorrect**.
Stock dividends do not affect the carrying value of the securities.

B. Pays a large account payable which had been a current liability.
Answer (B) is **incorrect**.
Paying a current liability decreases current assets and liabilities equally, thereby increasing the ratio.

C. Borrows cash on a 6-month note.
Answer (C) is **correct**.
If a ratio is greater than 1.0, an equal increase in the numerator (current assets) and denominator (current liabilities), like borrowing cash on a short-term basis, decreases the ratio.

D. Sells merchandise for more than cost and records the sale using the perpetual inventory method.
Answer (D) is **incorrect**.
This transaction increases the numerator with no effect on the denominator, which causes the ratio to increase.

83) If a company converts a short-term note payable into a long-term note payable, this transaction

will

A. Decrease working capital only.

B. Decrease both working capital and the current ratio.

C. Increase working capital only.

D. Increase both working capital and the current ratio.

A. Decrease working capital only.
Answer (A) is **incorrect**.
A reduction in current liabilities increases working capital.

B. Decrease both working capital and the current ratio.
Answer (B) is **incorrect**.
A reduction in current liabilities with no change in current assets increases both working capital and the current ratio.

C. Increase working capital only.
Answer (C) is **incorrect**.
A decrease in current liabilities increases the current ratio as well as working capital.

D. Increase both working capital and the current ratio.
Answer (D) is **correct**.
Converting a short-term note to a long-term note reduces current liabilities but not current assets. Thus, the transaction increases both working capital and the current ratio.

84) A company's year-end balance sheet is shown below:

Assets	
Cash	$ 300,000

Accounts receivable	350,000
Inventory	600,000
Property, plant, and equipment (net)	2,000,000
	$3,250,000
Liabilities and Shareholder Equity	
Current liabilities	$ 700,000
Long-term liabilities	600,000
Common stock	800,000
Retained earnings	1,150,000
	$3,250,000

What is the current ratio as of December 31?

A. 1.79

B. 0.93

C. 0.67

D. 0.43

A. 1.79

Answer (A) is **correct**.
The current ratio equals current assets divided by current liabilities [($300,000 + $350,000 + $600,000) ÷ $700,000 = 1.79].

B. 0.93

Answer (B) is **incorrect**.
Inventory is included in current assets.

C. 0.67

Answer (C) is **incorrect**.
Retained earnings is not included in current liabilities.

D. 0.43

Answer (D) is **incorrect**.
Accounts receivable and inventory are included in current assets.

85) On June 30 of this year, Oliva Co., a calendar-year entity, issued a 6-month note payable in exchange for stock that it intends to hold as a long-term investment. Oliva Company's current and quick ratios are 1.8 and 1.5, respectively. What is the effect of issuing the note?

	Current Ratio	Quick Ratio	Working Capital
A.	Increase	Increase	Increase
B.	Increase	Increase	Decrease
C.	Increase	Decrease	Decrease
D.	Decrease	Decrease	Decrease

A. Increase Increase Increase

Answer (A) is **incorrect**.
All of the ratios decrease.

B. Increase Increase Decrease

Answer (B) is **incorrect**.
The current and quick ratios decrease.

C. Increase Decrease Decrease

Answer (C) is **incorrect**.
The current ratio decreases.

D. Decrease Decrease Decrease

Answer (D) is **correct**.

Issuing a short-term note payable in exchange for a long-term investment increases current liabilities and noncurrent assets. The current ratio (Current assets ÷ Current liabilities), the quick ratio [(Current assets – Inventory) ÷ Current liabilities], and the working capital (Current assets – Current liabilities) will decrease. The increase in noncurrent assets has no effect on these ratios.

86) Assuming a current ratio of 1.5, which of the following decreases the current ratio but has no effect on working capital?

A. Purchase of inventory on credit.

B. Recognition of a credit sale.

C. Recognition of a sale for cash.

D. Sale of a trading security for cash.

A. Purchase of inventory on credit.

Answer (A) is **correct**.
The current ratio is defined as current assets divided by current liabilities. Working capital is defined as current assets minus current liabilities. A purchase of inventory on credit results in an equal increase in current assets (inventory) and current liabilities (accounts payable). If the current ratio is greater than 1, equal increases in the numerator and the denominator decrease the current ratio. However, equal increases in current assets and liabilities will have no effect on working capital.

B. Recognition of a credit sale.

Answer (B) is **incorrect**.
Recognition of a credit sale increases the current ratio.

C. Recognition of a sale for cash.

Answer (C) is **incorrect**.
Recognition of a cash sale increases the current ratio.

D. Sale of a trading security for cash.

Answer (D) is **incorrect**.

Sale of a security for cash has no effect on the current ratio.

87) Stent Co. had total assets of $760,000, capital stock of $150,000, and retained earnings of $215,000. What was Stent's debt-to-equity ratio?

A. 2.63

B. 1.08

C. 0.52

D. 0.48

A. 2.63

Answer (A) is **incorrect**.
The ratio of 2.63 equals total liabilities divided by capital stock.

B. 1.08

Answer (B) is **correct**.
The debt-to-equity ratio equals total liabilities divided by total equity. Total liabilities equal $395,000 ($760,000 total assets – $150,000 capital stock – $215,000 retained earnings). Consequently, the debt-to-equity ratio is 1.08 (rounded) [$395,000 ÷ ($150,000 + $215,000)].

C. 0.52

Answer (C) is **incorrect**.
The ratio of 0.52 equals total liabilities divided by total liabilities and equity.

D. 0.48

Answer (D) is **incorrect**.
The ratio of 0.48 equals total equity divided by total liabilities and equity.