1. Retained earnings can best be described as:
   a. cash receipts minus expenses after adjustments.
   b. net income minus expenses after adjustments, and.
   c. undistributed profits.
   d. net income minus cash disbursements after adjustments.

2. Dividends on common stock are:
   a. expenses when paid,        b. incurred but never paid,        c. never paid,        d. a reduction of earnings per share.

3. Big Company acquired Small Company by exchanging 10,000 shares of its own $5 par value common stock for all 2,000 shares of Small's outstanding common stock. At the time of acquisition, Big Company's stock was selling for $15 per share and Small Company's stock was selling for $10 per share. This transaction would have which of the following effects on Big Company?

<table>
<thead>
<tr>
<th>account</th>
<th>a.</th>
<th>b.</th>
<th>c.</th>
<th>d.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common stock account</td>
<td>$80,000</td>
<td>no change</td>
<td>$50,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>Retained Earnings account</td>
<td>-$80,000</td>
<td>-$50,000</td>
<td>no change</td>
<td>$10,000</td>
</tr>
</tbody>
</table>

4. Harmon Company issued convertible bonds for a total price of $150 million. Later, when the bonds had a market value of only $120 million, they were converted to shares of common stock worth approximately $135 million. For Harmon Company, which of the following would increase as a result of this transaction?

<table>
<thead>
<tr>
<th>bond</th>
<th>a.</th>
<th>b.</th>
<th>c.</th>
<th>d.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contributed capital</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

5. Blue Rose Gold Storage Company was incorporated early in 1961. Since then, the following stock has been outstanding:

   - Preferred stock, 5%, $50 per share
   - Common stock, $20 per share

   On December 31, 1994, Blue Rose Company declared and paid a total of $50,000 in dividends. This was the first dividend declared by the firm. That is, until this date no dividends had been declared or paid during the first two years of operations. If the preferred stock is cumulative and nonparticipating, what is the total amount of the $50,000 dividend that will be available for payment to the COMMON shareholders?

   a. $25,000         b. $20,000         c. $30,000         d. $40,000     e. $50,000

6. When 10% bonds are issued at par, what happened to the carrying value (or book value) of the bonds during the period they are outstanding?

   a. it remains constant        b. it decreases        c. it increases        d. it cannot be determined

7. On January 1, 1990, the Arthur Corporation sold $100,000 (face value) of 8% bonds payable. The bonds were sold at 103%. Interest is to be paid semi-annually on June 30 and December 31. The bonds are due 10 years after the original date of January 1. In recording the bond issue, Arthur Corp. should:

   a. Decrease the cash account by $102,000
   b. Decrease the bonds payable account by $102,000
   c. Decrease the cash account by $100,000
   d. Decrease the bonds payable account by $100,000

8. The account "premium on Bonds Payable" appears on the:

   a. income statement as a revenue account
   b. income statement as an expense
   c. balance sheet as a reduction of a liability
   d. balance sheet as an increase of a liability

9. Warranty obligations, as reported on the balance sheet, arise from:

   a. goods that have been sold without any form of guarantee
   b. sales of goods on credit but not from cash sales
   c. from the desire to recognize expenses as soon as possible while delaying recognition of the related revenue as long as possible
   d. not attempt to match the expense of guarantees to the period in which the related goods were sold

10. Chamber Music Company employs are covered by a funded pension plan. In the most recent financial statements, Chamber reported a pension liability of approximately $3,000,000. This means that:

   a. Chamber's cumulative payments to its pension fund have been less than the sum of its pension expenses reported on its income statements
   b. future pension benefits owed to retired Chamber employees total $3,000,000
   c. future pension benefits owed to current and retired Chamber employees total $3,000,000
   d. total pension expense reported by Chamber on the current income statement was $3,000,000

11. Harbor Seal Company reported a Deferred Tax Liability on its December 31, 1990, balance sheet. This means that Harbor Seal:

   a. is delinquent in paying its income taxes
   b. has recognized more income on past income statements than on its tax returns
   c. has recognized certain "permanent differences" when preparing past income statements
   d. has been unprofitable in recent years but will have to start paying income taxes again when it becomes profitable.
12. Which of the following are affected by the level of interest rates?
   a. Common stock prices
   b. Bond prices
   c. Yes
   d. No

13. Baker Mountain Company reported net income of $50,000, preferred dividends of 4,000, and interest expense of $10,000 for the most recent year. The firm's comparative balance sheet reported the following additional information.

<table>
<thead>
<tr>
<th></th>
<th>Current Year</th>
<th>Previous Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets</td>
<td>$450,000</td>
<td>$400,000</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>150,000</td>
<td>125,000</td>
</tr>
<tr>
<td>Total stockholders' equity</td>
<td>300,000</td>
<td>275,000</td>
</tr>
</tbody>
</table>

What was the firm's return on equity for the year?
   a. 15.3%
   b. 18.0%
   c. 18.3%
   d. 19.5%

14. The Artistic Tile Company uses the equity method for its investment in Design Corporation. This year, Design Corp. earned $50,000 and paid $4,000 in dividends. Upon receipt of the cash dividend, Artistic's accountant recorded Investment Revenue. This procedure:
   a. is correct.
   b. will cause an overstatement of net income.
   c. will cause an understatement of net income.
   d. is incorrect according to GAAP, but will not cause any errors on the financial statements.

15. A bond is purchased at a discount. What will happen to the carrying value of the bond on the balance sheet as its maturity date approaches?
   a. increases
   b. stays the same
   c. decreases
   d. cannot be determined from the data given

16. Accelerated depreciation:
   a. results in higher net income in earlier years and lower net income in later years.
   b. is used more often on the income statement than in the straight-line method.
   c. leads to higher book values for depreciable assets than does the straight-line method.
   d. allocates smaller portions of cost to later periods than to earlier.

17. Machinery with a cost of $50,000 and a book value of $17,000 was sold for $5,000 plus a note receivable of $12,500. No gain or loss was recorded for this transaction. What was the effect of this accounting procedure on the 19A financial statement items listed below?
   a. Assets
   b. Correct
   c. Overstate
   d. Net Income
   e. Correct
   f. Overstate

18. Keep-on Trucking owned a truck which cost $20,000 when it was purchased on January 1, 1992. It had accumulated depreciation of $8,000 at December 31, 1993. Keep-on originally estimated the truck would have a residual value after using it for four years of $2,000. It sold the truck for $15,000 cash on January 1, 1994. The amount of gain (loss) on the sale of the truck was:
   a. $3,000 gain
   b. $12,000 gain
   c. $1,000 loss
   d. $7,000 gain

19. The payment of cash dividends on common stock is:
   a. never the expense to the paying firm
   b. always beneficial to common stockholders
   c. Yes
   d. Yes

20. Company A has a higher ratio of fixed to variable costs than Company B. The sales revenues of both companies increased by 10%. If the firms are similar in size you would expect Company A's:
   a. expenses to increase more rapidly than Company B's.
   b. expenses to decrease while Company B's increase.
   c. net income to decrease while Company B's increase.
   d. net income to increase more rapidly than Company B's.

21. Company A and Company B are similar in size and in many other respects. The Companies reported the following net cash flows from operations for 1994 in millions of dollars. (used for) investing activities in their 1994 annual reports.

<table>
<thead>
<tr>
<th></th>
<th>1994</th>
<th>1993</th>
<th>1992</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company A</td>
<td>400</td>
<td>300</td>
<td>330</td>
</tr>
<tr>
<td>Company B</td>
<td>250</td>
<td>300</td>
<td>80</td>
</tr>
</tbody>
</table>

From this information you would expect:
   a. Company A to be growing more rapidly than Company B.
   b. Company B to be growing more rapidly than Company A.
   c. Company A to have better investment alternatives than company B.
   d. Company B to have less profitable than Company A.

22. Match the following sources of cash flows to their primary uses.
   a. operating cash flows
   b. financing cash flows
   c. financing cash flows
   d. financing cash flows
   e. operating cash flows
   f. operating cash flows
   g. operating cash flows
   h. operating cash flows
20. Which if the following net cash flow patterns is typical of a company with high growth potential and strong financial performance?  
   a. Cash flow from operating activities outflow outflow inflow inflow  
   b. Cash flow from investing activities outflow inflow inflow outflow  

24. In reviewing the financial statements of Contamina Company you note that in most years the cash flow from operations greatly exceeds net income. One possible reason for this is that the firm:  
   a. is paying out dividends in excess of net income.  
   b. has very high operating leverage as a result of a large investment in depreciable assets.  
   c. utilizes a rate in excess of its cost of capital when computing the net present value of potential investment opportunities.  
   d. has a low debt to equity ratio.  

25. Which of the following items is reported on an income statement?  
   Income from continuing operations a. Yes b. Yes c. No d. No  
   Cash provided by operations a. Yes b. No c. Yes d. No  

26. High-Tech Construction Company specializes in sophisticated long-term construction projects that make many years to complete. Which of the following is TRUE concerning the firm’s revenue recognition policy?  
   a. It can choose to use either the percentage-of-completion method or the completed-contract method as long as it does so consistently.  
   b. The firm should use the percentage-of-completion method.  
   c. The firm should use the completed-contract method.  
   d. It should use the percentage-of-completion method unless considerable uncertainty exists regarding profits or collections.  

27. Revenues should be recognized on a transaction:  
   a. at the point of the sale  
   b. when the cash has been collected from the buyer.  
   c. when the seller has earned the right to payment from the buyer.  
   d. as soon as the seller is confident that he has a buyer for the goods under consideration.  

28. The bookkeeper at Hernandez Company is recording information into the accounting system to recognize the estimated amount of bad debt expense for the fiscal period. The entry into the accounting system will affect which of the account balances below?  
   Accounts Receivable a. Yes b. Yes c. No d. No  
   Bad Debts Expense a. Yes b. No c. Yes d. No  

29. The inventory valuation method that results in the recognition of the most recent inventory costs on the balance sheet and income statement, respectively, is:  
   balance sheet a. FIFO b. FIFO c. LIFO d. FIFO  
   income statement a. LIFO b. FIFO c. LIFO d. FIFO  

30. If the prices are rising steadily during an accounting period:  
   a. gross margin will be lower with LIFO than with FIFO.  
   b. LIFO will ensure that the ending inventory is stated at or near current market values on the balance sheet.  
   c. cost of goods sold will be closest to current costs with FIFO.  
   d. FIFO will minimize income taxes.  

31. May's Pie Shoppe reported a decrease in its deferred tax obligation account of $2,300 in 1984. As a result of this event, one could determine that the:  
   a. company's current tax liability was greater than its income tax expense.  
   b. company's current tax liability was less than its income tax expense.  
   c. company did not pay as much tax as it owed during the year.  
   d. company had a net loss.  

32. Discounted operations, extraordinary items, and cumulative effects are all similar in that way:  
   a. result in an increase in net income for the period reported.  
   b. have no effect on the cash flow statement (have no cash flow consequences).  
   c. are all reported separately on the income statement.  
   d. all are caused by management having made poor decisions in the past.
Use the following information for the next four questions.

Thornhill Company reported the following information for the most recent three years.

<table>
<thead>
<tr>
<th></th>
<th>19x3</th>
<th>19x2</th>
<th>19x1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sales</td>
<td>$109.4</td>
<td>$111.3</td>
<td>$118.0</td>
</tr>
<tr>
<td>Cost of Products Sold</td>
<td>42.8</td>
<td>42.9</td>
<td>43.2</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>66.6</td>
<td>58.4</td>
<td>48.7</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>4.3</td>
<td>4.2</td>
<td>4.1</td>
</tr>
<tr>
<td>Distribution expenses</td>
<td>18.5</td>
<td>13.5</td>
<td>8.0</td>
</tr>
<tr>
<td>Selling and Adm. expenses</td>
<td>38.4</td>
<td>32.0</td>
<td>24.4</td>
</tr>
<tr>
<td>Total costs and expenses</td>
<td>61.2</td>
<td>49.7</td>
<td>36.5</td>
</tr>
<tr>
<td>Operating Income</td>
<td>5.4</td>
<td>8.7</td>
<td>10.2</td>
</tr>
<tr>
<td>Interest expense (net)</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Income before taxes</td>
<td>4.4</td>
<td>7.7</td>
<td>9.2</td>
</tr>
<tr>
<td>Provision for income taxes</td>
<td>1.8</td>
<td>3.1</td>
<td>3.7</td>
</tr>
<tr>
<td>Net Income</td>
<td>2.5</td>
<td>4.6</td>
<td>5.5</td>
</tr>
</tbody>
</table>

33. Select the true statement below regarding the three-year period.
   a. The firm has experienced increasing effectiveness.
   b. The reduction in "provision for income taxes" over the three years is an encouraging sign for the firm.
   c. The company has taken on significant new amounts of debt.
   d. The company has greatly expanded its plant, property, and equipment.

34. Which of the following categories of expense appears to be "getting out of control" over the three years?
   a. Selling and Adm. Expenses
   b. Distribution Expenses
   c. Selling and Adm. Expenses
   d. Distribution Expenses

35. Over the three years, the firm became more and more efficient regarding which of the following categories of expense?
   a. Selling and Adm. Expenses
   b. Distribution Expenses
   c. Selling and Adm. Expenses
   d. Distribution Expenses

36. If you were advising management, you would direct their attention to which of the following categories for immediate attention?
   a. cost of production sold
   b. depreciation and amortization
   c. interest expenses
   d. selling and administrative expenses

37. Which of the following has been included when operating income has been computed?
   a. marketing, general, and administrative expenses
   b. interest expenses and/or interest revenue
   c. inventory turnover
   d. accounts receivable turnover

38. Generally, one would prefer to see what type of values for the following?
   a. high
   b. high
   c. low
   d. low

39. Which of the following can cause difficulty when comparing corporate performance among companies?
   a. use of historical costs
   b. use of varying depreciation methods
   c. financial leverage at especially high levels.
   d. a decreasing rate of return on assets over time.

40. The existence of resources available to the firm over and above those measured and reported on the balance sheet may be indicated by:
   a. cash flow per share exceeding earnings per share.
   b. market value per share exceeding book value per share.
   c. financial leverage at especially high levels.
   d. a decreasing rate of return on assets over time.