

UNDERSTANDING INCOME STATEMENTS

PROBLEMS

- Expenses on the income statement may be grouped by:
 - nature, but not by function.
 - function, but not by nature.
 - either function or nature.
- An example of an expense classification by function is:
 - tax expense.
 - interest expense.
 - cost of goods sold.
- Denali Limited, a manufacturing company, had the following income statement information:

Revenue	\$4,000,000
Cost of goods sold	\$3,000,000
Other operating expenses	\$500,000
Interest expense	\$100,000
Tax expense	\$120,000

Denali's gross profit is equal to:

- \$280,000.
 - \$500,000.
 - \$1,000,000.
- Under IFRS, income includes increases in economic benefits from:
 - increases in liabilities not related to owners' contributions.
 - enhancements of assets not related to owners' contributions.
 - increases in owners' equity related to owners' contributions.

5. Fairplay had the following information related to the sale of its products during 2009, which was its first year of business:

Revenue	\$1,000,000
Returns of goods sold	\$100,000
Cash collected	\$800,000
Cost of goods sold	\$700,000

Under the accrual basis of accounting, how much net revenue would be reported on Fairplay's 2009 income statement?

- A. \$200,000.
 B. \$900,000.
 C. \$1,000,000.
6. Apex Consignment sells items over the internet for individuals on a consignment basis. Apex receives the items from the owner, lists them for sale on the internet, and receives a 25 percent commission for any items sold. Apex collects the full amount from the buyer and pays the net amount after commission to the owner. Unsold items are returned to the owner after 90 days. During 2009, Apex had the following information:
- Total sales price of items sold during 2009 on consignment was €2,000,000.
 - Total commissions retained by Apex during 2009 for these items was €500,000.
- How much revenue should Apex report on its 2009 income statement?
- A. €500,000.
 B. €2,000,000.
 C. €1,500,000.
7. A company previously expensed the incremental costs of obtaining a contract. All else being equal, adopting the May 2014 IASB and FASB converged accounting standards on revenue recognition makes the company's profitability initially appear:
- A. lower.
 B. unchanged.
 C. higher.
8. During 2009, Accent Toys Plc., which began business in October of that year, purchased 10,000 units of a toy at a cost of £10 per unit in October. The toy sold well in October. In anticipation of heavy December sales, Accent purchased 5,000 additional units in November at a cost of £11 per unit. During 2009, Accent sold 12,000 units at a price of £15 per unit. Under the first in, first out (FIFO) method, what is Accent's cost of goods sold for 2009?
- A. £120,000.
 B. £122,000.
 C. £124,000.
9. Using the same information as in Question 8, what would Accent's cost of goods sold be under the weighted average cost method?
- A. £120,000.
 B. £122,000.
 C. £124,000.
10. Which inventory method is least likely to be used under IFRS?
- A. First in, first out (FIFO).
 B. Last in, first out (LIFO).
 C. Weighted average.

11. At the beginning of 2009, Glass Manufacturing purchased a new machine for its assembly line at a cost of \$600,000. The machine has an estimated useful life of 10 years and estimated residual value of \$50,000. Under the straight-line method, how much depreciation would Glass take in 2010 for financial reporting purposes?
 - A. \$55,000.
 - B. \$60,000.
 - C. \$65,000.
12. Using the same information as in Question 16, how much depreciation would Glass take in 2009 for financial reporting purposes under the double-declining balance method?
 - A. \$60,000.
 - B. \$110,000.
 - C. \$120,000.
13. Which combination of depreciation methods and useful lives is most conservative in the year a depreciable asset is acquired?
 - A. Straight-line depreciation with a short useful life.
 - B. Declining balance depreciation with a long useful life.
 - C. Declining balance depreciation with a short useful life.
14. Under IFRS, a loss from the destruction of property in a fire would most likely be classified as:
 - A. continuing operations.
 - B. discontinued operations.
 - C. other comprehensive income.
15. A company chooses to change an accounting policy. This change requires that, if practical, the company restate its financial statements for:
 - A. all prior periods.
 - B. current and future periods.
 - C. prior periods shown in a report.
16. For 2009, Flamingo Products had net income of \$1,000,000. At 1 January 2009, there were 1,000,000 shares outstanding. On 1 July 2009, the company issued 100,000 new shares for \$20 per share. The company paid \$200,000 in dividends to common shareholders. What is Flamingo's basic earnings per share for 2009?
 - A. \$0.80.
 - B. \$0.91.
 - C. \$0.95.
17. For its fiscal year-end, Calvin Water Corporation (CWC) reported net income of \$12 million and a weighted average of 2,000,000 common shares outstanding. The company paid \$800,000 in preferred dividends and had 100,000 options outstanding with an average exercise price of \$20. CWC's market price over the year averaged \$25 per share. CWC's diluted EPS is *closest to*:
 - A. \$5.33.
 - B. \$5.54.
 - C. \$5.94.

18. A company with no debt or convertible securities issued publicly traded common stock three times during the current fiscal year. Under both IFRS and US GAAP, the company's:
- A. basic EPS equals its diluted EPS.
 - B. capital structure is considered complex at year-end.
 - C. basic EPS is calculated by using a simple average number of shares outstanding.

19. Laurelli Builders (LB) reported the following financial data for year-end December 31:

Common shares outstanding, January 1	2,020,000
Common shares issued as stock dividend, June 1	380,000
Warrants outstanding, January 1	500,000
Net income	\$3,350,000
Preferred stock dividends paid	\$430,000
Common stock dividends paid	\$240,000

Which statement about the calculation of LB's EPS is *most* accurate?

- A. LB's basic EPS is \$1.12.
 - B. LB's diluted EPS is equal to or less than its basic EPS.
 - C. The weighted average number of shares outstanding is 2,210,000.
20. Cell Services Inc. (CSI) had 1,000,000 average shares outstanding during all of 2009. During 2009, CSI also had 10,000 options outstanding with exercise prices of \$10 each. The average stock price of CSI during 2009 was \$15. For purposes of computing diluted earnings per share, how many shares would be used in the denominator?
- A. 1,003,333.
 - B. 1,006,667.
 - C. 1,010,000.
21. For its fiscal year-end, Sublyme Corporation reported net income of \$200 million and a weighted average of 50,000,000 common shares outstanding. There are 2,000,000 convertible preferred shares outstanding that paid an annual dividend of \$5. Each preferred share is convertible into two shares of the common stock. The diluted EPS is *closest to*:
- A. \$3.52.
 - B. \$3.65.
 - C. \$3.70.
22. When calculating diluted EPS, which of the following securities in the capital structure increases the weighted average number of common shares outstanding without affecting net income available to common shareholders?
- A. Stock options.
 - B. Convertible debt that is dilutive.
 - C. Convertible preferred stock that is dilutive.
23. Which statement is *most* accurate? A common-size income statement:
- A. restates each line item of the income statement as a percentage of net income.
 - B. allows an analyst to conduct cross-sectional analysis by removing the effect of company size.
 - C. standardizes each line item of the income statement but fails to help an analyst identify differences in companies' strategies.

24. Selected year-end financial statement data for Workhard are shown below.

	\$ millions
Beginning shareholders' equity	475
Ending shareholders' equity	493
Unrealized gain on available-for-sale securities	5
Unrealized loss on derivatives accounted for as hedges	-3
Foreign currency translation gain on consolidation	2
Dividends paid	1
Net income	15

Workhard's comprehensive income for the year:

- A. is \$18 million.
 - B. is increased by the derivatives accounted for as hedges.
 - C. includes \$4 million in other comprehensive income.
25. When preparing an income statement, which of the following items would *most likely* be classified as other comprehensive income?
- A. A foreign currency translation adjustment.
 - B. An unrealized gain on a security held for trading purposes.
 - C. A realized gain on a derivative contract not accounted for as a hedge.

Shares outstanding	1,000,000
Options exercises	10,000
Treasury shares purchased	(6,667)
Denominator	1,003,333

