

**CONT 3106**  
**PROBLEMS AND EXERCISES OF CHAPTERS 11, 12 & 4**  
**SECOND SEMESTER 2012-2013**

**CHAPTER 11**

**P11-1C** Listed below are several transactions. For each transaction, indicate by letter whether the cash effect of each transaction is reported in a statement of cash flows as an operating (**O**), investing (**I**), financing (**F**), or noncash (**NC**) activity. Also, indicate whether the transaction is a cash inflow (**CI**), cash outflow (**CO**), or no effect on cash (**NE**). The first answer is provided as an example.

Type of Activity	Cash Inflow or Outflow	Transaction
<i>F</i>	<i>CI</i>	1. Issuance of common stock
		2. Issuance of bonds
		3. Investment in bonds
		4. Collection of a note receivable
		5. Sale of inventory
		6. Repayment of note payable
		7. Payment of a cash dividend
		8. Purchase of land for cash
		9. Reissue of treasury stock
		10. Collection of an account receivable
		11. Issuance of a note payable
		12. Payment of employee salaries
		13. Sale of equipment for a note receivable
		14. Payment of interest on bonds payable
		15. Sale of a building

**P11-2C** Amy Bourne completed the basic format to be used in preparing the statement of cash flows (indirect method) for Alpha Technologies. All amounts are in thousands (000's).

<b>Alpha Tecnologies</b>	
<b>Statement of Cash Flows</b>	
<b>For the Year Ended December 31, 2012</b>	
<b>Cash Flows from Operating Activities</b>	
Net income	_____
Adjustments for noncash effects:	
Net cash flows from operating activities	_____
<b>Cash Flows from Investing Activities</b>	
Net cash flows from investing activities	_____

<b>Cash Flows from Financing Activities</b>	
Net cash flows from financing activities	
Net increase (decrease) in cash	(40,000)
Cash at the beginning of the period	80,000
Cash at the end of the period	<u>\$40,000</u>

Listed below in random order are line items to be included in the statement of cash flows.

Purchase of equipment	220,000
Payment of dividends	40,000
Net income	80,000
Increase in inventory	30,000
Increase in prepaid rent	10,000
Repayment of notes payable	50,000
Cash received from the sale of land	\$ 3,000
Issuance of common stock	250,000
Increase in accounts payable	10,000
Loss on sale of land	7,000
Depreciation expense	20,000
Increase in accounts receivable	60,000

***Required:***

Prepare the statement of cash flows for Alpha Technologies using the indirect method.

**P11-4C** The income statement, balance sheets, and additional information for Communication Accessories are provided.

**Communication Accessories**  
**Income Statement**  
**For the Year Ended December 31, 2012**

Revenues		\$2,800,000
Gain on sale of land		4,000
Total revenues		<u>2,804,000</u>
Expenses:		
Cost of goods sold	1,900,000	
Operating expenses	575,000	
Depreciation expense	38,000	
Interest expense	16,000	
Income tax expense	63,000	
Total expenses		<u>2,592,000</u>
Net Income		<u><u>\$ 212,000</u></u>

<b>Communication Accessories</b>		
<b>Balance Sheet</b>		
<b>December 31</b>		
<u>Assets</u>	<u>2012</u>	<u>2011</u>
Current Assets:		
Cash	\$ 182,000	\$ 187,000
Accounts receivable	83,000	95,000
Inventory	121,000	138,000
Prepaid rent	7,000	5,000
Long-Term Assets:		
Investment in stock	195,000	100,000
Land	230,000	260,000
Equipment	305,000	225,000
Accumulated depreciation	(138,000)	(100,000)
Total Assets	<u>\$985,000</u>	<u>\$910,000</u>
<b><u>Liabilities and Stockholders' Equity</u></b>		
Current Liabilities:		
Accounts payable	\$40,000	\$ 58,000
Interest payable	1,000	2,000
Income tax payable	12,000	10,000
Long-Term Liabilities:		
Notes payable	285,000	205,000
Stockholders' Equity:		
Common stock	350,000	350,000
Retained earnings	297,000	285,000
Total Liabilities and Equity	<u>\$985,000</u>	<u>\$910,000</u>

Additional Information for 2012:

1. Purchase additional investment in stocks for \$95,000.
2. Sell land costing \$30,000 for \$34,000 resulting in a \$4,000 gain on sale of land.
3. Purchase \$80,000 in equipment by borrowing \$80,000 with a note payable due in three years.  
No cash is exchanged in the transaction.
4. The company declares and pays a cash dividend of \$200,000.

**Required:**

Prepare the statement of cash flows using the *indirect* method. Disclose any noncash transactions in an accompanying footnote.

**P11-7C** Data for Communication Accessories is provided in P11-4C.

**Required:**

Prepare the statement of cash flows for Communication Accessories using the *direct* method. Disclose any noncash transactions in an accompanying footnote.

## CHAPTER 12

**P12-1C** The Sports Warehouse operates in two distinct segments; equipment and apparel. The income statements for each operating segment are presented below.

<b>The Sports Warehouse Income Statements For the Year Ended December 31, 2012</b>				
	<b>Equipment</b>		<b>Apparel</b>	
	<b>Amount</b>	<b>%</b>	<b>Amount</b>	<b>%</b>
<b>Sales</b>	\$1,700,000		\$2,850,000	
<b>Cost of goods sold</b>	1,100,000		1,400,000	
<b>Gross profit</b>	600,000		1,450,000	
<b>Operating expenses</b>	250,000		500,000	
<b>Operating income</b>	350,000		950,000	
<b>Other income (expense)</b>	25,000		(60,000)	
<b>Income before tax</b>	375,000		890,000	
<b>Income tax expense</b>	90,000		280,000	
<b>Net income</b>	\$285,000		\$610,000	

**Required:**

1. Complete the “%” columns to be used in a vertical analysis of The Sports Warehouse’s two operating segments. Express each amount as a percentage of sales.
2. Use vertical analysis to compare the profitability of the two operating segments. Which segment is more profitable?

**P12-2C** The income statements for The Sports Warehouse for the years ending December 31, 2013, and 2012, are provided.

<b>The Sports Warehouse Income Statements For the Years Ended December 31</b>				
			<b>Increase (Decrease)</b>	
	<b>2013</b>	<b>2012</b>	<b>Amount</b>	<b>%</b>
<b>Sales</b>	\$ 4,700,000	\$ 4,550,000		
<b>Cost of goods sold</b>	2,600,000	2,500,000		
<b>Gross profit</b>	2,100,000	2,050,000		
<b>Operating expenses</b>	690,000	750,000		
<b>Operating income</b>	1,410,000	1,300,000		
<b>Other income (expense)</b>	(40,000)	(35,000)		
<b>Income before tax</b>	1,370,000	1,265,000		
<b>Income tax expense</b>	400,000	370,000		
<b>Net income</b>	\$ 970,000	\$ 895,000		

**Required:**

1. Complete the “Amount” and “%” columns to be used in a horizontal analysis of The Sports Warehouse’s income statement.
2. Discuss the major fluctuations in income statement items during the year.

**P12-3C** The following balance sheets for The Sports Shack are provided.

<b>The Sports Shack Balance Sheet December 31</b>		
<b><u>Assets</u></b>	<b><u>2012</u></b>	<b><u>2011</u></b>
Current assets:		
Cash	\$ 218,000	\$ 196,000
Accounts receivable	680,000	880,000
Inventory	1,250,000	1,100,000
Supplies	90,000	65,000
Long-term assets:		
Equipment	1,200,000	900,000
Accumulated depreciation	(350,000)	(250,000)
Total assets	<u>\$3,088,000</u>	<u>\$2,891,000</u>
<b><u>Liabilities and Stockholders' Equity</u></b>		
Current liabilities:		
Accounts payable	\$ 65,000	\$ 55,000
Interest payable	4,000	6,000
Income tax payable	40,000	30,000
Long-term liabilities:		
Notes payable	400,000	300,000
Stockholders' equity:		
Common stock	900,000	900,000
Retained earnings	1,679,000	1,600,000
Total liabilities and equity	<u>\$3,088,000</u>	<u>\$2,891,000</u>

**Required:**

1. Prepare a vertical analysis of The Sports Shack 2012 and 2011 balance sheet. Express each amount as a percentage of total assets for that year.
2. Prepare a horizontal analysis of The Sports Shack 2012 balance sheet using 2011 as the base year.

**P12-4C** The following income statement and balance sheets for The Sports Shack are provided.

<b>The Sports Shack Income Statement For the year ended December 31, 2012</b>	
Sales revenue	\$ 6,600,000
Cost of goods sold	4,700,000
Gross profit	<u>1,900,000</u>
Expenses:	
Operating expenses	1,400,000
Depreciation expense	100,000
Interest expense	50,000
Income tax expense	80,000
Total expenses	<u>1,630,000</u>
Net income	<u>\$ 270,000</u>

<b>The Sports Shack Balance Sheet December 31</b>		
<b><u>Assets</u></b>	<b><u>2012</u></b>	<b><u>2011</u></b>
Current assets:		
Cash	\$ 218,000	\$ 196,000
Accounts receivable	680,000	880,000
Inventory	1,250,000	1,100,000
Supplies	90,000	65,000
Long-term assets:		
Equipment	1,200,000	900,000
Accumulated depreciation	(350,000)	(250,000)
Total assets	<u>\$3,088,000</u>	<u>\$2,891,000</u>
<b><u>Liabilities and Stockholders' Equity</u></b>		
Current liabilities:		
Accounts payable	\$ 65,000	\$ 55,000
Interest payable	4,000	6,000
Income tax payable	40,000	30,000
Long-term liabilities:		
Notes payable	400,000	300,000
Stockholders' equity:		
Common stock	900,000	900,000
Retained earnings	1,679,000	1,600,000
Total liabilities and equity	<u>\$3,088,000</u>	<u>\$2,891,000</u>

**Required:**

Assuming that all sales were on account, calculate the following risk ratios for 2012.

- |                               |                                |
|-------------------------------|--------------------------------|
| 1. Receivables turnover ratio | 5. Current ratio               |
| 2. Average collection period  | 6. Acid-test ratio             |
| 3. Inventory turnover ratio   | 7. Debt to equity ratio        |
| 4. Average days in inventory  | 8. Times interest earned ratio |

**P12-5C** Data for The Sports Shack is provided in P12-4C. Earnings per share for the year ended December 31, 2012, are \$0.30. The closing stock price on December 31, 2012, is \$5.40.

**Required:**

Calculate the following profitability ratios for 2012.

- |                       |                         |
|-----------------------|-------------------------|
| 1. Gross profit ratio | 4. Asset turnover       |
| 2. Return on assets   | 5. Return on equity     |
| 3. Profit margin      | 6. Price-earnings ratio |

## **CHAPTER 4**

Answer true-or-false questions about occupational fraud (**LO1**)

**E4-1** Below are several statements about occupational fraud.

1. For most large companies, occupational fraud is minimal and internal controls procedures are unnecessary.
2. Managers have a variety of reasons for manipulating the numbers in financial statements, such as maximizing their compensation, increasing the company's stock price, and preserving their jobs.
3. Internal control procedures include formal policies and procedures related to (1) safeguarding the company's assets and (2) improving the accuracy and reliability of accounting information.
4. "Cooking the books" is a phrase used by accountants to indicate the preparation of financial statements that are free of manipulation.
5. Most occupational fraud cases involve misuse of the company's resources.
6. Common types of financial statement fraud include creating fictitious revenues from a phantom customer, improperly valuing assets, hiding liabilities, and mismatching revenues and expenses.

**Required:**

State whether the answer to each of the statements is true or false.

Answer true-or-false questions about the Sarbanes-Oxley Act (**LO1**)

**E4-2** Below are several statements about the Sarbanes-Oxley Act (SOX).

1. SOX represents legislation passed in response to several accounting scandals in the early 2000s.
2. The requirements outlined in SOX apply only to those companies expected to have weak internal controls or to have manipulated financial statements in the past.
3. Section 404 of SOX requires both company management and auditors to document and assess the effectiveness of a company's internal controls processes that could affect financial reporting.
4. Severe financial penalties and the possibility of imprisonment are consequences of fraudulent misstatement.
5. With the establishment of SOX, management now has primary responsibility for hiring an external



audit firm.

6. The lead auditor in charge of auditing a particular company must rotate off that company only when occupational fraud is suspected.

**Required:**

State whether the answer to each of the statements is true or false.

Answer true-or-false questions about internal controls (**LO2**)

**E4-3** Below are several statements about internal controls.

1. The components of internal control are built on the foundation of the ethical tone set by top management.
2. Once every three months, managers need to review operations to ensure that control procedures work effectively.
3. Collusion refers to the act of a single individual circumventing internal control procedures.
4. Detective control procedures are designed to detect errors or fraud that have already occurred, while preventive control procedures are designed to keep errors or fraud from occurring in the first place.
5. Fraud committed by top-level employees is more difficult to detect because those employees more often have the ability to override internal control features.
6. A good example of separation of duties would be having one person collect cash from customers and account for it, while having another person order inventory and maintain control over it.
7. Employee tips historically have been the most common means of detecting employee fraud.
8. Detective controls include reconciling the physical assets of the company with the accounting records and comparing actual performance of individuals or processes against their expected performance.
9. Effective internal controls and ethical employees ensure a company's success.

**Required:**

State whether the answer to each of the statements is true or false.

Determine control activity violations (**LO2**)

**E4-4** Below are several scenarios related to control activities of a company.

1. A manufacturing company compares total sales in the current year to that in the previous year but does not compare the cost of production.
2. So that employees can have easy access to office supplies, a company keeps supplies in unlocked cabinets in multiple locations.
3. At the end of each day, a single employee collects all cash received from customers, records the total, and makes the deposit at the bank.
4. At the end of the year only, the company's compares its cash records to the bank's records of cash deposited and withdrawn during the year.
5. A company encourages employees to call an anonymous hotline if they believe other employees are circumventing internal control features.
6. All employees have the authority to refund a customer's money.

**Required:**

For each scenario, determine which control activity is violated. Control activities include separation of duties, physical controls, proper authorization, employee management, reconciliations, and performance reviews. If no control activity is violated, state "none."

