Chapter 3 Introduction to Accounting

Section 3 Uses of Financial Statements

1. C	2. B	3. C	4. D	5. A	6. A	7. D	8. A	9. C	10. A
11. D	12. B	13. D	14. A						

1. **C**

   (1) is incorrect. Financial statements only provide information in monetary terms. Qualitative information of a business such as the productivity and morale of workers cannot be revealed from financial statements.

   (2) is correct. Financial statements provide information about the profits earned in each accounting period, as well as the financial position of the firm, showing the performance of a company.

   (3) is incorrect. Statement of financial position shows the amount of assets, liabilities, and capital at a particular time instead.

2. **B**

   Lenders of a company have to assess the credit risks of the company. Whether a company is able to meet its debts can be revealed from the liquidity and solvency positions of the firm.

3. **C**

   Investors have to consider the return and risks before making investment decisions. Financial statements provide potential investors with information concerning the profitability and management efficiency of the firm. Investors can therefore assess the risks of investments.

4. **D**

   Managers have to gather ideas about the situation of the business, so as to make future plans and decisions. Low managerial efficiency acts as an alert for managers to take remedial actions.

5. **A**

   (1) is correct. Customers use the financial statements to assess whether the company is financially healthy enough to continue to provide them with goods.

   (2) is correct. The government needs the financial statements to calculate how much tax the company needs to pay.

   (3) is incorrect. Creditors but not debtors need the financial statements to evaluate the repayment ability of the company.

6. **A**

   (1) is correct. Financial statements provide information to different users for decision-making.

   (2) is correct. Companies need to prepare financial statements to meet the legal requirements.

   (3) is incorrect. Financial statements report past results only. It does not boost the competitiveness of the business.

7. **D**

(1) is correct. Various accounting methods and policies are adopted in different companies. It would be misleading to make comparison between companies.

(2) is correct. Financial statements report past results only. They may not be relevant to future decision-making.

(3) is correct. Financial statements provide information expressed in monetary terms only. Little qualitative information, such as managers' experience and staff morale, can be shown.

8. **A**

(1) is correct. Financial statements involve personal judgments made by accountants and managers. Thus, they may be subjective.

(2) is correct. It would be misleading to make comparisons between companies given that different companies may adopt various accounting policies.

(3) is incorrect. Lack of qualitative information would not render the information of companies incomparable.

9. **C**

(1) is correct. Financial statements may be subjective as they are prepared by different accountants. Personal judgments are thus involved in the process, like when an accountant estimates the allowance for doubtful accounts.

(2) is incorrect. Financial statements do not deal with the change in the purchasing power of the currency. As the values of currency across different accounting periods may be different, intra-comparison of performance with the past is not always reliable.

(3) is incorrect. Finding out the amount of net current assets is one aim of preparing a balance sheet instead. An income statement only reports expenses and revenues of the firm within a period.

10. **A**

By assessing the company's financial capacity, such as the ability of the firm to meet its short-term debts, the supplier can evaluate the bad debt risk.

B is incorrect. It is unethical to adjust the product price according to the performance of a company as products produced at the same cost should be sold at the same price to be fair to all customers.

C is incorrect. It is not the suppliers' greatest concern.

D is incorrect. The willingness of repaying debts cannot be revealed from financial information easily because this is a kind of qualitative information.

11. **D**

Marketing manager is an internal user of the financial statements.

12. **B**

Labour unions use the financial statements to know the company's prospect and see if there is room for wage rise. They use statistics like profits on the financial statements to prove that workers should be paid more.

A is incorrect. Government bodies read companies' financial statements to calculate tax and investigate business crimes. Yet, it does not modify accounting standards with reference to existing financial statements.

C is incorrect. Managers read financial statements for the purpose of predicting the future and devising strategies.

D is incorrect. Even owners may not manage the business, they use information in financial statement to know the profit generating ability of the company and decide whether to continue their investments.

13. **D**

(1) is correct. Accounting jargons are seldom used in daily communication between colleagues and the use of financial statement is not related to the use of accounting jargon in companies.

(2) is correct. Knowing the firms' ability to pay debts and interests is the use of financial statements for creditors, but not employees.

(3) is correct. The decision on whether to continue the business or not is made by the owner(s), but not employees.

Note: The use of financial statements for employees should be evaluating business prospects and planning for wage negotiations.

14. **A**

(1) is incorrect. Quantitative information is the information that can be expressed in numbers while qualitative information cannot. Financial statements can show quantitative information but not qualitative ones like staff morale.

(2) is correct. Only past results can be shown in the financial statements. They may be irrelevant for decision-making. Future results, which are more relevant, cannot be shown in the financial statements.

(3) is incorrect. Although items that are insignificant should not be shown*, it will not affect the use of financial statements. Also, it will be easier for the users to read financial statements.

* Further information: Materiality concept is applied.