

Name (please print) \_\_\_\_\_

Multiple Choice Points

Problem Points

Total Points

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**Financial Accounting for MBAs**  
**EGADE**  
**Test 1**  
**Answer Key**  
**Spring 2009**

Notes:

1. If you believe the information presented is inconsistent or incomplete make a note of any assumptions or corrections you made in your test booklet and continue to solve the problem.
2. Please note your answers in the space provided. Partial credit on problems can only be earned when you should your calculations.
3. I hope you do great!

Multiple Choice (50 points – 2.5 points each) - Identify the letter of the choice that best completes the statement or answers the question. Only one answer per question, circle your answer.

- \_\_\_ 1. Where would you find information on the amount of net income for the year?
  - a. Factory production reports on units produced
  - b. Auditor's report
  - c. **Income statement**
  - d. Internal Revenue Service
  
- \_\_\_ 2. An investor wants to find the amount of cash and land that a company has. Where will the investor look?
  - a. Statement of stockholders' equity
  - b. Income statement
  - c. **Balance sheet**
  - d. Statement of cash flows
  
- \_\_\_ 3. Retained earnings may be described as
  - a. **the total past profits retained in the business.**
  - b. a company's future growth.
  - c. the amount invested in the firm by its owners.
  - d. amounts retained for payments to vendors.
  
- \_\_\_ 4. Liabilities may be described as
  - a. amounts that will be used for future growth.
  - b. **the amounts owed that must be paid in the future.**
  - c. the total measured past growth of a firm less the amount distributed to the owners.
  - d. amounts the company paid during the past year.
  
- \_\_\_ 5. The board of directors
  - a. provides money to a company with the expectation that it will be paid back with interest.
  - b. **makes corporate decisions such as hiring and firing management and setting company policy.**
  - c. is responsible for the future profits of a company.
  - d. is in charge of accounting and human resources on a daily basis.
  
- \_\_\_ 6. A bank that loans money to a company is called
  - a. a supplier.
  - b. **a creditor.**
  - c. an equity investor.
  - d. a shareholder.
  
- \_\_\_ 7. Which one of the following is an equity investor?
  - a. A supplier of inventory waiting for payment
  - b. **A person who purchases common stock of a corporation**
  - c. A bank that loans money to a firm
  - d. A person who has a savings account in a bank
  - e. An employee that plans on investing in the company 10 years from now
  
- \_\_\_ 8. As used in accounting, SEC is an abbreviation for
  - a. **Securities and Exchange Commission.**
  - b. South Eccentric Commissioners.
  - c. Stockholders' Equity Commission.
  - d. Southeastern Conference.

- \_\_\_ 9. Which one of the following equations represents retained earnings activity for a year?
- Beginning balance + expenses – dividends = ending balance
  - Beginning balance + cash receipts – cash payments = ending balance
  - Beginning balance + dividends – net income = ending balance
  - Beginning balance + net income – dividends = ending balance**
- \_\_\_ 10. When an entrepreneur wishes to start a business, capital must be attracted in the form of
- net income.
  - IOUs.
  - operating activities.
  - equity or debt financing.**
- \_\_\_ 11. If the beginning and ending balances in retained earnings are \$12,000 and \$10,000, respectively, and dividends during the year are \$10,000, then net income for the year is
- \$14,000.
  - \$8,000.**
  - \$18,000.
  - \$32,000.
- \_\_\_ 12. The acquisition of equity and debt financing is considered
- a financing activity.**
  - net income.
  - an investing activity.
  - an operating activity.
- \_\_\_ 13. Expensing the cost of a pencil holder that cost \$1.25 instead of capitalizing it as a plant asset and depreciating it over its estimated useful life of 10 years
- violates the economic entity assumption.
  - violates GAAP since pencil holders are important assets.
  - is justified because of materiality.**
  - is appropriate because of the stable dollar assumption.
- \_\_\_ 14. The valuation basis used to measure long-term liabilities is
- present value.**
  - replacement cost.
  - fair market value.
  - historical cost.
- \_\_\_ 15. The stockholders' equity section of the balance sheet is
- a residual interest based on the book value of the company.**
  - the amount for which the owner could sell the company.
  - valued at the present value of the dividends paid to shareholders.
  - the difference between the fair market value and the original cost of the company's assets.
- \_\_\_ 16. Which one of the following statements best describes the concept of conservatism?
- Profits should be accelerated in all cases.
  - The measurement of an event is verifiable and reliable.
  - The value of goods and services provided is recognized when earned.
  - When uncertainty exists, understating assets, overstating liabilities, accelerating recognition of losses, and delaying recognition of gains is preferred.**

- \_\_\_ 17. The fiscal period assumption states that the operating life of an economic entity
- is generally for a period of one year.
  - can be any period management decides it to be.
  - must be an entity separately distinct from its owners.
  - can be divided into time periods over which measures can be developed and applied.
- \_\_\_ 18. The stable dollar assumption assumes that
- the monetary unit is the functional currency of any country in which a company operates.
  - inflationary effects should be recognized in the financial statements.
  - economic wealth is not measurable.
  - the monetary unit is stable across time.
- \_\_\_ 19. The matching principle states that
- expenses should be recognized in the period that the related revenue is recognized.
  - after expenses have been identified in a particular accounting period in which they were incurred, revenues can be recognized.
  - each company should use the same accounting principles as other companies use.
  - for every dollar of revenue recognized, the company should recognize a corresponding dollar of expenses.
- \_\_\_ 20. The most common point of revenue recognition is
- when the cash is collected from the customer.
  - when the customer elects to issue the check to pay for goods shipped.
  - when the goods are delivered to the customer.
  - as the goods are being produced.

Problems (50 points)

Problem 1 (16 points)

The following balances appeared in the accounting system of CrossBow Corporation at the end of 2007. All accounts have their normal balances.

Accounts Payable	250
Accounts Receivable	345
Accrued Expenses Payable	355
Accumulated Depreciation	2000
Bonds Payable	5440
Buildings and Equipment	7500
Cash	1220
Common Stock	10550
Cost of Goods Sold	1500
Current Maturities of Long-Term Debt	60
Deferred Revenue	75
Dividends	315
Income Tax Expense	565
Intangible Assets	1700
Interest Expense	40
Inventory	600
Long-Term Investments	4000
Long-Term Notes Payable	1500
Prepaid Expenses	100
Property (Land)	6000
Retained Earnings (Beginning Balance)	900
Sales Revenue	5000
Selling, General and Administrative Expenses	2095
Short-Term Investments	150

Compute each of the following – Show your computations and circle your answer.

1. Net Income for the Year

Sales	5,000
Less:	
Cost of Goods Sold	1,500
Selling, General and Admin. Exp.	2,095
Interest Expense	40
Income Tax Expense	565
<b>Net Income</b>	<b>800</b>

2. Ending Balance in Retained Earnings

Retained Earnings – Beginning Balance	900
Add: Net Income	800
Less: Dividends	315
<b>Retained Earnings – Beginning Balance</b>	<b>1,385</b>

3. Current Assets

Cash	1,220
Accounts Receivable	345
Inventory	600
Prepaid Expenses	100
Short-Term Investments	150
<b>Total Current Assets</b>	<b>2,415</b>

4. Total Assets

Current Assets	2,415
Property	6,000
Buildings and Equipment	7,500
Less: Acc. Dep.	(2,000)
Intangible Assets	1,700
Long-Term Investments	4,000
<b>Total Assets</b>	<b>19,615</b>

5. Current Liabilities

Accounts Payable	250
Accrued Expenses Payable	355
Current Maturities of LT Debt	60
Deferred Revenue	75
<b>Total Current Liabilities</b>	<b>740</b>

6. Total Liabilities

Current Liabilities	740
Bonds Payable	5,440
Long-Term Notes Payable	1,500
<b>Total Liabilities</b>	<b>7,680</b>

7. Total Stockholder's Equity

Common Stock	10,550
Retained Earnings	1,385
<b>Total Stockholders' Equity</b>	<b>11,935</b>

8. Total Liabilities and Stockholders' Equity

Total Liabilities	7,680
Total Stockholders' Equity	11,935
<b>Total Current Liabilities</b>	<b>19,615</b>

Problem 2 (10 points)

Morales and Guzman, a small engineering services company, entered into the following transactions during January 2009.

1. Issued 10,000 shares of common stock for \$5 each.
2. Purchased equipment to be used in the business for \$20,000 on account.
3. Provided services worth \$24,000 for a customer on account.
4. Paid the salaries of \$7,000 to the employees.
5. Paid a \$5,000 dividend.

Required: Prepare a journal entry for each transaction described. Skip a line between each entry in your solution.

Trans.	Accounts	Debit	Credit
1	Cash	50,000	
	Common Stock		50,000
2	Equipment	20,000	
	Accounts Payable		20,000
3	Accounts Receivable	24,000	
	Service Revenue		24,000
4	Salaries Expense	7,000	
	Cash		7,000
5	Dividends	5,000	
	Cash		5,000

Problem 3 (10 points)

The accounts for Diabetes Company are listed below, identified by number. Following the list of accounts is a series of adjusting entries (**a** through **e**) prepared by Diabetes Company. For each entry, identify the number(s) of the accounts to be debited and credited and place them in the space provided adjacent to each adjusting entry.

Accounts	
1. Cash	11. Notes Payable
2. Accounts Receivable	12. Capital Stock
3. Prepaid Rent	13. Retained Earnings
4. Office Supplies	14. Service Revenue
5. Automobiles	15. Office Supplies Expense
6. Accumulated Depreciation	16. Utilities Expense
7. Accounts Payable	17. Salaries and Wages Expense
8. Interest Payable	18. Depreciation Expense
9. Salaries and Wages Payable	19. Interest Expense
10. Income Tax Payable	20. Income Tax Expense

Adjusting Entries	Debit	Credit
a. Accrued wages earned by employees that will be paid next month	17	9
b. Recognized office supplies used during the month	15	4
c. Recorded the current month of depreciation expense	18	6
d. Recorded monthly utilities expenses which are not yet paid	16	7
e. Recognized the amount of interest due to the bank on a note	19	8

Problem 4 (8 points)

Consider each of the following two independent situations.

Question 1

Before adjusting entries, Gareth's 12/31/2008 records included accounts receivable and allowance for doubtful accounts are \$42,000 and \$300 (credit balance), respectively. Gareth determined that 0.4% of net sales would probably be uncollectible. Sales during the year were \$500,000 and sales returns amounted to \$6,000.

a. What amount of Bad Debts Expense would Gareth record for 2008?

$$(500,000 - 6,000) \times .004 = 1,976$$

b. After adjustment what is the balance in the Allowance for Doubtful Accounts?

ADA	
	300
	1,976
	<hr/>
	2,276
	<hr/>

Question 2

The balances of the allowance for doubtful accounts on the balance sheets dated December 31 of 2010 and 2009 were \$21,000 and \$14,000, respectively. During 2010, \$13,000 of accounts receivable were written off as uncollectible. Assuming there were no recoveries of accounts previously written off, how much bad debts expense is recognized during 2010?

ADA	
	14,000 (BB)
(WO) 13,000	20,000 BDE
	<hr/>
	21,000 (EB)
	<hr/>

$$\mathbf{BDE = 20,000}$$

Problem 5 (6 points)

On December 11, 2010, Paloma Co. purchased capsules from a Canadian company for 10,000 Canadian dollars (10,000 C\$) to be paid on January 2, 2011. The exchange rates on December 11 and December 31, 2010 are US\$0.79 = 1C\$ and US\$0.82 = 1C\$, respectively.

Prepare all necessary journal entries, including adjusting entries if necessary, for Paloma to record the purchase and payment for the capsules.

Date	Accounts	Debit	Credit
12/11/10	Inventory	7,900	
	Accounts Payable		7,900
	10,000 C\$ X .79 US\$/C\$		
12/31/10	Exchange Rate Loss	300	
	Accounts Payable		300
	10,000 C\$ X .82 US\$/C\$ = 8,200-7,900		
1/2/11	Accounts Payable	8,200	
	Cash		8,200