

FINANCIAL ACCOUNTING
Self-Assessment

Multiple Choice

1. Which of the following statements is true concerning assets?
 - a. They are recorded at cost and adjusted for inflation.
 - b. They are recorded at market value for financial reporting because historical cost is arbitrary.
 - c. Accounting principles require that companies report assets on the income statement.
 - d. Assets are measured using the cost concept.

2. Which of the following is a correct expression of the accounting equation?
 - a. $\text{Assets} - \text{Liabilities} + \text{Owners' Equity}$
 - b. $\text{Assets} = \text{Liabilities} - \text{Owners' Equity}$
 - c. $\text{Assets} + \text{Owners' Equity} = \text{Liabilities}$
 - d. $\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$

3. How is the balance sheet linked to the other financial statements?
 - a. The beginning retained earnings balance on the statement of retained earnings becomes the amount of retained earnings reported on the balance sheet.
 - b. Retained earnings is added to total assets and reported on the balance sheet.
 - c. Net income increases retained earnings on the statement of retained earnings, which ultimately increases retained earnings on the balance sheet.
 - d. There is no link between the balance sheet and the other statements.

4. Information that is material means that an error or alternative method of handling a transaction
 - a. would possibly affect the judgment of someone relying on the financial statements.
 - b. would not affect the decisions of users.
 - c. might cause a company to understate its earnings for the accounting period.
 - d. could increase the profitability of a company.

5. The process of recording the economic effects of business transactions in a book of original entry:
 - a. double entry system
 - b. debit
 - c. credit
 - d. journalizing
 - e. posting

6. If the sum of the debits and credits in a trial balance is not equal, then
 - a. there is no concern because the two amounts are not meant to be equal.
 - b. the chart of accounts also does not balance.
 - c. it is safe to proceed with the preparation of financial statements.
 - d. most likely an error was made in posting journal entries to the general ledger or in preparing the trial balance.

7. Treml Corp. had \$1800 of supplies on hand at January 1, 2006. During 2006, supplies with a cost of \$7,000 were purchased. At December 31, 2006, the actual supplies on hand amounts to \$2,300. After the adjustments are recorded and posted at December 31, 2006, the balances in the Supplies and Supplies Expense accounts will be:
 - a. Supplies, \$7,000; Supplies Expense, \$2,300.
 - b. Supplies, \$1,800; Supplies Expense, \$7,000.
 - c. Supplies, \$2,300; Supplies Expense, \$6,500.
 - d. Supplies, \$2,300; Supplies Expense, \$3,900.

8. Which one of the following ratios is a common analytical tool used by merchandise corporations, but not by service corporations?
 - a. gross margin percentage
 - b. earnings per share
 - c. current ratio
 - d. profit margin

9. An entity's internal control structure consists of three basic elements: the control environment, the accounting system, and
 - a. the outsiders on a company's board of directors.
 - b. internal auditors.
 - c. control procedures.
 - d. management's philosophy and style.

10. Which of the following statements regarding changing inventory methods is true?
 - a. A change in inventory methods can be justified if the change is made to better match profits with revenue.
 - b. The effect of changing inventory method does not need to be disclosed.
 - c. Tax advantages are valid justification for changing inventory methods.
 - d. One place that the reader of an annual report would be able to identify that a company changed inventory methods is the footnotes to the financial statements.

Use the information presented below to answer the questions that follow.

Solid Co. received a non-interest-bearing note from Bedrock Co. on October 1, 2006. The amount of the note due at the maturity date is \$6,200. The note was accepted by Solid for merchandise sold to Bedrock with a selling price of \$6,000. The note is due in 3 months.

11. The difference of \$200 between the amount of the note (\$6,200) and the sales price of the merchandise (\$6,000)
 - a. is the interest explicitly included in the amount of the note.
 - b. will be recorded in a contra account, Discount on Notes Receivable, by Solid Co.
 - c. will be recorded as interest revenue on October 1, 2006.
 - d. is an error made in preparing the note.

12. Which of the following combination of financial statements would provide the most in-depth information to help understand a company's liquidity?
 - a. income statement and statement of cash flows
 - b. balance sheet and statement of cash flows
 - c. balance sheet and income statement
 - d. statement of retained earnings and statement of cash flows

13. Boston Bean Company sold equipment for \$4,000. This resulted in a \$1,500 loss. What is the impact of this sale on the working capital?
 - a. reduces working capital
 - b. increases working capital
 - c. has no affect on working capital at all
 - d. the increase offsets the decrease

14. If a company's asset turnover rate increased from 2005 to 2006, which of the following conclusions can be made?
 - a. The company was less efficient during 2006 in using its assets to produce profits.
 - b. The company produced more sales in 2006 for each dollar invested in assets.
 - c. The company was more profitable in 2005.
 - d. The company is over-invested in assets in 2006.

15. To determine whether a lottery winner would prefer to receive the money in a single lump sum immediately or receive an equal amount over a period of years, you would use which type of time value of money calculation?
 - a. the future value of a single amount
 - b. the present value of a single amount
 - c. the future value of an annuity
 - d. the present value of an annuity

16. Quartermaine Corp. issued 10-year, 8%, \$100,000 bonds paying interest on an annual basis, at a \$5,200 premium. Which one of the following statements is true?
- Quartermaine's annual interest expense on the bonds will be greater than the amount of interest payments to bondholders each year.
 - Quartermaine's annual interest expense on the bonds will be less than the amount of interest payments to bondholders each year.
 - Quartermaine will receive \$94,800 as the issue price.
 - The cash paid to bondholders will be \$520 each interest period.
17. The book value per share for a corporation is
- the market price of the stock.
 - the cost of investments in stock of other corporations.
 - based on the excess of total assets over total liabilities.
 - the amount shareholders would receive if they sold their shares back to the corporation.
18. Which of the following is not an operating activity?
- cash collections from credit customers
 - cash payments for operating expenses
 - cash receipts for interest earned
 - cash payments for dividends to shareholders
19. Comparability of information results when:
- the information would influence a decision.
 - different companies use the same accounting principles.
 - the amounts involved are material.
 - a company uses the same accounting principles and methods from year to year.
20. Items such as a sales slip, a check, a bill, or a cash register tape are examples of:
- balance sheet accounts.
 - income statement accounts.
 - cost of goods sold.
 - source documents.
21. Unearned revenues are:
- prepayments.
 - liabilities.
 - temporary accounts.
 - both a and b above.

22. The revenue recognition principle requires that sales revenues be recognized:
- when cash is received.
 - when the merchandise is ordered.
 - when the goods are transferred from the seller to the buyer.
 - None of the above.
23. All of the following are “other receivables” except:
- petty cash.
 - interest receivable.
 - income taxes refundable.
 - advances to employees.
24. Depreciation is dependent on a number of estimates. When a change in an estimate is required, the change is made:
- in the current year.
 - in the future year.
 - to prior periods.
 - both a and b above.
25. In order to pay a dividend:
- the corporation must have adequate retained earnings.
 - the board of directors must declare a dividend.
 - the corporation must have adequate cash.
 - all of the above.
26. Upon receiving a stock dividend:
- you own more shares.
 - your ownership interest has increased.
 - your ownership interest has not changed.
 - both a and c above.
27. In the accounting for stock investments of less than 20%, what method is used?
- Entity method
 - Equity method
 - Cost method
 - Market method
28. Cash flow activities that include the cash effects of transactions that create revenues and expenses and thus enter into the determination of net income are referred to as:

- a. investing activities.
 - b. financing activities.
 - c. operating activities.
 - d. all of the above.
29. Cash outflows to purchase property, plant and equipment; to purchase debt or equity securities or other entities; to make loans to other entities are examples of:
- a. investing activities.
 - b. financing activities.
 - c. operating activities.
 - d. all of the above.
30. All of the following are used in preparing a statement of cash flows except:
- a. a trial balance.
 - b. comparative balance sheet.
 - c. current income statement.
 - d. additional information.

True-False

31. An entity's assets come from three primary sources: creditors, investors, and profits retained in the business.
32. The amount of earnings returned to stockholders can be found in the income statement.
33. The statement of cash flows like the income statement, reports only on the operating activities of a company.
34. Funds raised from financing activities should be invested in assets which can be used to carry on business operations.
35. The issuance of stock decreases a company's assets and increases its owners' equity.
36. The accounting equation must balance after each transaction.
37. Financial statements can be prepared before the adjustments are recorded in the journal if a work sheet is completed at the end of the accounting period.
38. During the closing process, revenues, expenses, and dividends are closed to income summary, and then income summary is closed to retained earnings.
39. Gross margin as a percentage of sales is a common analytical tool for merchandising companies.
40. Like revenue, cost of goods sold represents an inflow of assets.
41. If ending inventory is overstated, then net income is overstated as well.

42. The lower of cost or market (LCM) rule is a departure from the cost basis of accounting.
43. Accounts receivable are shown on the balance sheet at their net realizable amount.
44. A subsidiary is a separate legal entity that is owned or controlled by another entity.
45. Because plant and equipment are reported as long-term assets on the balance sheet, they have no impact on net income for the period unit they are sold.
46. Capitalizing interest increases the recorded cost of a plant asset.
47. A contingent liability is recorded if it is probable and can be reasonably estimated.
48. If the annual interest is 12%, but the compounding is done quarterly, then the interest rate is 4% per period.
49. The statement of cash flows summarizes the operating, investing and financing activities of a business for a period of time.
50. The accrual-based income statement is considered to be a good indicator of current cash inflows and outflows.