Exam 2 ch 5-8 Libby 7ed Key

1. Which of the following tasks does the Financial Accounting Standards Board (FASB) perform?
A. Overseeing the work of the Securities & Exchange Commission (SEC).
B. Overseeing the work of the Public Company Accounting Oversight Board (PCAOB).
C. The responsibility for protecting investors and maintaining the integrity of the securities markets.
**D.** The development of generally accepted accounting principles.

The FASB develops generally accepted accounting principles.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 05-01 Recognize the people involved in the accounting communication process (regulators; managers; directors; auditors; information intermediaries; and users); their roles in the process; and the guidance they receive from legal and professional standards.
Libby - Chapter 05 #32
Topic Area: Players In The Accounting Communication Process*

2. Which of the following is not a responsibility of the chief executive officer (CEO) and the chief financial officer (CFO)?
**A.** The responsibility to oversee the financial statement external audit.
B. To ensure the accuracy and completeness of all reports provided to the Securities & Exchange Commission (SEC).
C. The certification of the strength of the internal control system.
D. The disclosure to the auditor committee of any frauds they are aware of.

The external auditors are hired by the board of directors and are responsible for overseeing their own audit.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 05-01 Recognize the people involved in the accounting communication process (regulators; managers; directors; auditors; information intermediaries; and users); their roles in the process; and the guidance they receive from legal and professional standards.
Libby - Chapter 05 #34
Topic Area: Players In The Accounting Communication Process*

3. For accounting information to be useful, it must be which of the following?
A. It must be consistent and comparable.
**B.** It must be relevant and reliable.
C. It must be comparable and reliable.
D. It must be relevant and consistent.

Relevance and reliability are the characteristics which allow accounting information to be useful.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 05-01 Recognize the people involved in the accounting communication process (regulators; managers; directors; auditors; information intermediaries; and users); their roles in the process; and the guidance they receive from legal and professional standards.
Libby - Chapter 05 #37
Topic Area: Players In The Accounting Communication Process*

4. Conservatism requires that special care must be taken to avoid which of the following?
A. Overstating assets and liabilities and understating revenues and expenses.
B. Understating assets and liabilities and overstating revenues and expenses.
**C.** Overstating assets and revenues and understating liabilities and expenses.
D. Understating assets and revenues and overstating liabilities and expenses.

Conservatism is concerned with overstating revenues and assets and with understating expenses and liabilities.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 05-01 Recognize the people involved in the accounting communication process (regulators; managers; directors; auditors; information intermediaries; and users); their roles in the process; and the guidance they receive from legal and professional standards.
Libby - Chapter 05 #38
Topic Area: Players In The Accounting Communication Process*

5. Which of the following would not be classified as a current asset?
A. Accounts receivable
**B.** Patents
C. Merchandise inventory
D. Cash

A patent is an intangible asset.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Easy
Learning Objective: 05-03 Recognize and apply the different financial statement and disclosure formats used by companies in practice.
Libby - Chapter 05 #44
Topic Area: A Closer Look At Financial Statement Format And Notes*

6. Which of the following are the criteria used to determine whether an item is extraordinary?
A. It is unusual in nature and occurs frequently.
**B.** It is unusual in nature and occurs infrequently.
C. It is unusual in nature or occurs infrequently.
D. It is infrequent in occurrence only.

Extraordinary items occur infrequently and are unusual in nature.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Easy
Learning Objective: 05-03 Recognize and apply the different financial statement and disclosure formats used by companies in practice.
Libby - Chapter 05 #47
Topic Area: A Closer Look At Financial Statement Format And Notes*

7. Which of the following journal entries is correct when common stock is sold for cash at a price greater than par value?
A. 
B. 
C. 
**D.** 

Common stock and additional paid-in capital are both credited when common stock is sold for more than par value.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Easy
Learning Objective: 05-03 Recognize and apply the different financial statement and disclosure formats used by companies in practice.
Libby - Chapter 05 #48
Topic Area: A Closer Look At Financial Statement Format And Notes*

8. Which of the following statements is false?
A. The common stock account has a credit balance.
B. The additional paid-in capital account has a credit balance.
C. Contributed capital consists of common stock and additional paid-in capital.
**D.** The par value of a stock represents the stock's fair value.

The par value represents the minimum amount a stockholder must contribute.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Easy
Learning Objective: 05-03 Recognize and apply the different financial statement and disclosure formats used by companies in practice.
Libby - Chapter 05 #49
Topic Area: A Closer Look At Financial Statement Format And Notes*

9. Which of the following best describes income from operations?
A. It includes the results of discontinued operations.
B. It includes extraordinary items.
C. It is sales minus cost of goods sold and income tax expense.
**D.** It is net sales minus cost of goods sold and operating expenses.

Income from operations equals net sales minus cost of goods sold and operating expenses.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Easy
Learning Objective: 05-03 Recognize and apply the different financial statement and disclosure formats used by companies in practice.
Libby - Chapter 05 #51
Topic Area: A Closer Look At Financial Statement Format And Notes*

10. The Callie Company has provided the following information:

• Operating expenses were $231,000;
• Cost of goods sold was $376,000;
• Net sales were $940,000;
• Interest expense was $32,000;
• Gain on sale of a building was $76,000;
• Income tax expense was $151,000.

What was Callie's income from operations?
**A.** $333,000
B. $188,000
C. $156,000
D. $232,000

Income from operations ($333,000) equals net sales ($940,000) minus the sum of cost of goods sold ($376,000) and operating expenses ($231,000).

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 05-03 Recognize and apply the different financial statement and disclosure formats used by companies in practice.
Libby - Chapter 05 #53
Topic Area: A Closer Look At Financial Statement Format And Notes*

11. Which of the following would not typically be disclosed in the notes to the financial statements?
A. Additional detail regarding reported numbers.
B. A summary of significant accounting policies.
C. Revenues reported by business segments.
**D.** The net income earned by the business to date.

The net income earned by the business to date is included within retained earnings.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 05-03 Recognize and apply the different financial statement and disclosure formats used by companies in practice.
Libby - Chapter 05 #62
Topic Area: A Closer Look At Financial Statement Format And Notes*

12. Superior has provided the following information for its recent year of operation:

• The common stock account balance at the beginning of the year was $20,000 and the year-end balance was $25,000.
• The additional paid-in capital account balance increased $2,500 during the year.
• The retained earnings balance at the beginning of the year was $75,000 and the year-end balance was $91,000.
• Net income was $26,000.

How much did Superior sell its common stock for during the year?
A. $5,000.
B. $2,500.
**C.** $7,500.
D. $25,000.

The increase in the common stock account ($5,000) plus the increase in additional paid-in capital ($2,500) equals the selling price of the common stock ($7,500).

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 05-03 Recognize and apply the different financial statement and disclosure formats used by companies in practice.
Libby - Chapter 05 #71
Topic Area: A Closer Look At Financial Statement Format And Notes*

13. Centex, Inc. issued 50,000 shares of its $1 par value common stock for $20 per share. The journal entry to record the stock issue would include which of the following?
A. A credit to cash for $1,000,000.
B. A credit to additional paid-in capital for $1,000,000.
C. A credit to additional paid-in capital for $50,000.
**D.** A credit to common stock for $50,000.

The credit to common stock is for the par value of the shares issued.

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Easy
Learning Objective: 05-03 Recognize and apply the different financial statement and disclosure formats used by companies in practice.
Libby - Chapter 05 #79
Topic Area: A Closer Look At Financial Statement Format And Notes*

14. A company sells magazines and collects subscription fees prior to the publication and distribution of the magazine. Which of the following correctly describes the impact on the financial statements when cash is received in advance from customers?
A. Current assets increase and gross profit increases.
B. Current liabilities aren't affected and stockholders' equity isn't affected.
C. Current assets increase and stockholders' equity increases.
**D.** Current liabilities increase and gross profit is not affected.

Receiving payments in advance of providing goods and/or services creates and liability and does not create revenue or gross profit.

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Hard
Learning Objective: 06-02 Analyze the impact of credit card sales; sales discounts; and sales returns on the amounts reported as net sales.
Libby -* ***Chapter 06*** *#28
Topic Area: Accounting For Sales Revenue*

15. Newark Company has provided the following information:

• Cash sales, $450,000
• Credit sales, $1,350,000
• Selling and administrative expenses, $330,000
• Sales returns and allowances, $90,000
• Depreciation expense, $101,000
• Gross profit, $1,360,000
• Increase in accounts receivable, $55,000
• Bad debt expense, $33,000
• Sales discounts, $43,000

How much is Newark's cost of goods sold?
**A.** $307,000
B. $252,000
C. $440,000
D. $340,000

Net sales ($450,000 + $1,350,000 - $90,000 - $43,000) minus cost of goods sold ($307,000) equals gross profit ($1,360,000).

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Hard
Learning Objective: 06-02 Analyze the impact of credit card sales; sales discounts; and sales returns on the amounts reported as net sales.
Learning Objective: 06-03 Analyze and interpret the gross profit percentage.
Libby -* ***Chapter 06*** *#29
Topic Area: Accounting For Sales Revenue, Measuring And Reporting Receivables*

16. Flyer Company has provided the following information:

• Cash sales, $150,000
• Credit sales, $450,000
• Selling and administrative expenses, $110,000
• Sales returns and allowances, $30,000
• Gross profit, $490,000
• Accounts receivable, $110,000
• Sales discounts, $14,000
• Allowance for doubtful accounts credit balance, $1,200

How much is bad debt expense assuming that 5% of accounts receivable is estimated to be uncollectible?
A. $5,500
B. $6,700
C. $4,240
**D.** $4,300

Bad debt expense ($4,300) = 5% of accounts of accounts receivable (5% × $110,000) - allowance for doubtful accounts credit balance ($1,200).

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 06-04 Estimate; report; and evaluate the effects of uncollectible accounts receivable (bad debts) on financial statements.
Libby -* ***Chapter 06*** *#32
Topic Area: Measuring And Reporting Receivables*

17. Flyer Company has provided the following information:

• Cash sales, $150,000
• Credit sales, $450,000
• Selling and administrative expenses, $110,000
• Sales returns and allowances, $30,000
• Gross profit, $290,000
• Accounts receivable, $110,000
• Sales discounts, $14,000
• Allowance for doubtful accounts credit balance, $1,200

Flyer estimates bad debt expense assuming that 1.5% of credit sales are uncollectible. What is the balance in the allowance for doubtful accounts after bad debt expense is recorded?
**A.** $7,950
B. $6,750
C. $5,550
D. $7,800

The allowance for doubtful accounts ($7,950) = Bad debt expense (1.5% × $450,000) plus the allowance for doubtful accounts credit balance ($1,200).

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 06-04 Estimate; report; and evaluate the effects of uncollectible accounts receivable (bad debts) on financial statements.
Libby -* ***Chapter 06*** *#34
Topic Area: Measuring And Reporting Receivables*

18. Which of the following journal entries correctly records bad debt expense?
A. 
B. 
C. 
**D.** 

The journal entry to record bad debt expense involves a debit to bad debt expense and a credit to allowance for doubtful accounts.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Easy
Learning Objective: 06-04 Estimate; report; and evaluate the effects of uncollectible accounts receivable (bad debts) on financial statements.
Libby -* ***Chapter 06*** *#38
Topic Area: Measuring And Reporting Receivables*

19. Which of the following journal entries correctly records the write-off of an uncollectible account receivable?
A. 
**B.** 
C. 
D. 

The journal entry to write-off an account receivable requires a debit to allowance for doubtful accounts and a credit to accounts receivable.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 06-04 Estimate; report; and evaluate the effects of uncollectible accounts receivable (bad debts) on financial statements.
Libby -* ***Chapter 06*** *#39
Topic Area: Measuring And Reporting Receivables*

20. Which of the following journal entries correctly records the collection of an account receivable for which a 1% sales discount was recorded at the time of collection?
**A.** 
B. 
C. 
D. 

The journal entry involves a debit to both cash and sales discounts and a credit to accounts receivable.

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 06-02 Analyze the impact of credit card sales; sales discounts; and sales returns on the amounts reported as net sales.
Libby -* ***Chapter 06*** *#45
Topic Area: Accounting For Sales Revenue*

21. Which of the following correctly describes credit terms of 2/10, n/30?
A. A two percent discount for early payment is available if the invoice is paid before the tenth day of the month following the month the sale.
**B.** A two percent discount for early payment is available within ten days of the date of sale.
C. A ten percent discount for early payment is available if the invoice is paid within two days of the date of the invoice.
D. A two percent discount for early payment is available if the invoice is paid after the tenth day, but before the thirtieth day of the invoice date.

The credit term 2/10 implies that a 2% discount is available within ten days of the date of sale and the term n/30 implies that the full sales price is due within 30 days of the sale.

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 06-02 Analyze the impact of credit card sales; sales discounts; and sales returns on the amounts reported as net sales.
Libby -* ***Chapter 06*** *#48
Topic Area: Accounting For Sales Revenue*

22. A customer purchased and received $5,000 of goods on credit from Discount Paper Supply on September 1. The customer received the bill on September 13 and mailed a $5,000 check on September 30. Discount Paper Supply received the check on October 4. On which of the following dates should Discount Paper Supply record sales revenue?
**A.** September 1
B. September 13
C. September 30
D. October 4

Sales revenue should be recorded on the date of sale.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 06-01 Apply the revenue principle to determine the accepted time to record sales revenue for typical retailers; wholesalers; manufacturers; and service companies.
Libby -* ***Chapter 06*** *#49
Topic Area: Accounting For Sales Revenue*

23. Oakwood Company had accounts receivable of $750,000 and an allowance for doubtful accounts of the $21,500 just prior to writing off as worthless an account receivable for Hyland Company of $5,000. The net realizable value of accounts receivable as shown by the accounting records before and after the write-off was as follows:

 
A. Option A
B. Option B
C. Option C
**D.** Option D

Writing-off an uncollectible account involves a debit to allowance for doubtful accounts (a contra-asset account) and a credit to accounts receivable (an asset account). Therefore the net realizable value (accounts receivable minus allowance for doubtful accounts) does not change; it is $728,500 both before and after the write-off.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 06-04 Estimate; report; and evaluate the effects of uncollectible accounts receivable (bad debts) on financial statements.
Libby -* ***Chapter 06*** *#58
Topic Area: Measuring And Reporting Receivables*

24. The Tanner Company's April 1, 2010 pre-reconciliation cash balance on their books was $35,000. While preparing the April 1 bank reconciliation, Tanner determined that outstanding checks total $11,000, deposits in transit total $7,000, and bank service charges are $50. How much was Tanner's April 1, 2010 cash balance per the bank statement?
A. $31,000
B. $30,950
**C.** $38,950
D. $39,000

Bank cash balance ($38,950) = Corrected book balance ($35,000 - $50) + Outstanding checks ($11,000) - Deposits in transit ($7,000).

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Hard
Learning Objective: 06-06 Report; control; and safeguard cash.
Libby -* ***Chapter 06*** *#64
Topic Area: Reporting And Safeguarding Cash*

25. When a depositor receives a bank statement indicating that there was a "NSF check", the depositor should do which of the following?
**A.** Reduce the cash account per the books for the amount of the "NSF check".
B. Reduce the cash account per the bank statement for the amount of the "NSF check".
C. Credit allowance for doubtful accounts for the amount of the check.
D. Increase the sales returns and allowances account.

NSF checks are deducted from the book cash balance when preparing a bank reconciliation.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Remember
Difficulty: Medium
Learning Objective: 06-06 Report; control; and safeguard cash.
Libby -* ***Chapter 06*** *#67
Topic Area: Reporting And Safeguarding Cash*

26. Coleman Company has provided the following information: beginning inventory, $100,000; cost of goods sold, $450,000; and ending inventory, $80,000. How much were Coleman's inventory purchases?
A. $450,000
B. $410,000
**C.** $430,000
D. $420,000

Cost of goods sold ($450,000) = Beginning inventory ($100,000) + Purchases ($430,000) - Ending inventory ($80,000)

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 07-01 Apply the cost principle to identify the amounts that should be included in inventory and the matching principle to determine cost of goods sold for typical retailers; wholesalers; and manufacturers.
Libby -* ***Chapter 07*** *#32
Topic Area: Nature Of Inventory And Cost Of Goods Sold*

27. Lauer Corporation uses the periodic inventory system and has provided the following information about one of their laptop computers:

 

During the year, 750 laptop computers were sold.
What was ending inventory using the FIFO cost flow assumption?
A. $60,000
**B.** $52,500
C. $52,000
D. $40,000

Ending inventory ($52,500) = ($1,050 × 50)

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 07-02 Report inventory and cost of goods sold using the four inventory costing methods.
Libby -* ***Chapter 07*** *#38
Topic Area: Inventory Costing Methods*

28. Lauer Corporation uses the periodic inventory system and has provided the following information about one of their laptop computers:

 

During the year, 750 laptop computers were sold.
What was cost of goods sold using the LIFO cost flow assumption?
A. $717,500
**B.** $730,000
C. $703,125
D. $725,500

Cost of goods sold ($730,000) = (200 × $1,050) + (300 × $1,000) + (200 × $900) + (50 × $800)

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 07-02 Report inventory and cost of goods sold using the four inventory costing methods.
Libby -* ***Chapter 07*** *#40
Topic Area: Inventory Costing Methods*

29. Which of the following statements is correct when inventory prices are decreasing?
A. LIFO will result in lower net income and a higher inventory valuation than will FIFO.
**B.** LIFO will result in higher net income and a higher inventory valuation than will FIFO.
C. FIFO will result in higher net income and a higher inventory valuation than will LIFO.
D. FIFO will result in higher net income and a lower inventory valuation than will LIFO.

LIFO reports a lower cost of goods sold and a higher net income when prices are decreasing.

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 07-02 Report inventory and cost of goods sold using the four inventory costing methods.
Libby -* ***Chapter 07*** *#45
Topic Area: Inventory Costing Methods*

30. A corporation has provided the following information about one of their products:

 

During the year, 400 units were sold.
What is ending inventory using the average cost method?
**A.** $48,000
B. $64,000
C. $50,000
D. $62,000

Average cost ($160) = {(200 × $140) + (400 × $160) + (100 × $200)} ÷ 700 units Ending inventory ($48,000) = Average cost ($160) × 300 units

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 07-02 Report inventory and cost of goods sold using the four inventory costing methods.
Libby -* ***Chapter 07*** *#48
Topic Area: Inventory Costing Methods*

31. Moore Company purchased an item for inventory that cost $20 per unit and was priced to sell at $30. It was determined that the replacement cost is $18 per unit. Using the lower-of-cost-or- market rule, what amount should be reported on the balance sheet for inventory?
**A.** $18
B. $20
C. $12
D. $30

Inventory is reported on the balance sheet at replacement cost when it is less than cost.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Remember
Difficulty: Easy
Learning Objective: 07-04 Report inventory at the lower of cost of market (LCM).
Libby -* ***Chapter 07*** *#51
Topic Area: Valuation At Lower Of Cost Or Market*

32. Tinker's 2011 cost of goods sold was $750,000 and 2010 cost of goods sold was $770,000. The inventory at the end of 2011 was $188,000 and $208,000 at the end of 2010. What was Tinker's inventory turnover during 2011?
**A.** 3.79
B. 3.99
C. 3.84
D. 3.89

Inventory turnover (3.79) = Cost of goods sold ($750,000) ÷ Average inventory ($188,000 + $208,000) ÷ 2

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 07-05 Evaluate inventory management using the inventory turnover ratio and analyze the effects of inventory on cash flows.
Libby -* ***Chapter 07*** *#55
Topic Area: Evaluating Inventory Management*

33. Tinker's 2011 cost of goods sold was $750,000 and 2010 cost of goods sold was $770,000. The inventory at the end of 2011 was $188,000 and $208,000 at the end of 2010. What is Tinker's average number of days to sell their inventory during 2011?
**A.** 96.3
B. 91.5
C. 95.1
D. 93.8

Inventory turnover (3.79) = Cost of goods sold ($750,000) ÷ Average inventory ($188,000 + $208,000) ÷ 2
Average days to sell inventory (96.3) = 365 days ÷ Inventory turnover (3.79)

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 07-05 Evaluate inventory management using the inventory turnover ratio and analyze the effects of inventory on cash flows.
Libby -* ***Chapter 07*** *#56
Topic Area: Evaluating Inventory Management*

34. A $25,000 overstatement of the 2010 ending inventory was discovered after the financial statements for 2010 were prepared. Which of the following describes the effect of the inventory error on the 2010 financial statements?
A. Current assets were overstated and net income was understated.
B. Current assets were understated and net income was understated.
**C.** Current assets were overstated and net income was overstated.
D. Current assets were understated and net income was overstated.

An overstatement of ending inventory overstates current assets and understates cost of goods sold and therefore overstates net income.

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Hard
Learning Objective: 07-07 Understand methods for controlling and keeping track of inventory and analyze the effects of inventory errors on financial statements.
Libby -* ***Chapter 07*** *#59
Topic Area: Control Of Inventory*

35. A company using the periodic inventory system correctly recorded a purchase of merchandise, but the merchandise was not included in the physical inventory count at the end of the accounting period. The error caused which of the following?
**A.** An understatement of both net income and assets.
B. An overstatement of inventory, purchases, and accounts payable.
C. An understatement of inventory, purchases, and accounts payable.
D. An overstatement of net income and assets.

The understatement of the ending inventory causes both net income and assets to be understated.

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Hard
Learning Objective: 07-07 Understand methods for controlling and keeping track of inventory and analyze the effects of inventory errors on financial statements.
Libby -* ***Chapter 07*** *#66
Topic Area: Control Of Inventory*

36. On March 15, 2010, Ryan Company purchased $10,000 of merchandise on credit subject to terms of 2/10, n/30. Ryan Company records its purchases using the gross amount. The periodic inventory system is used. Which of the following journal entries is correct when Ryan Company pays for these goods on March 20, 2010?
A. 
B. 
**C.** 
D. 

The payment was within 10 days, so the 2% discount can be taken.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 07-01 Apply the cost principle to identify the amounts that should be included in inventory and the matching principle to determine cost of goods sold for typical retailers; wholesalers; and manufacturers.
Libby -* ***Chapter 07*** *#76
Topic Area: Nature Of Inventory And Cost Of Goods Sold*

37. Which of the following would not be included in Latimer Company's ending inventory?
A. Goods shipped from a supplier with terms of FOB shipping point.
B. Goods shipped to customers with terms of FOB destination.
C. Samples provided to a customer with the understanding that they would be returned to Latimer at the beginning of the next year.
**D.** Goods shipped to customers with terms of FOB shipping point.

Title passes to the customer when the goods are shipped FOB shipping point.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 07-01 Apply the cost principle to identify the amounts that should be included in inventory and the matching principle to determine cost of goods sold for typical retailers; wholesalers; and manufacturers.
Libby -* ***Chapter 07*** *#86
Topic Area: Nature Of Inventory And Cost Of Goods Sold*

38. Which of the following accounts would not be considered a tangible asset?
A. Buildings
B. Land
C. Equipment
**D.** Patents

Tangible assets have physical substance, whereas intangible assets lack physical substance.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Easy
Learning Objective: 08-01 Define; classify; and explain the nature of long-lived productive assets and interpret the fixed asset turnover ratio.
Libby - Chapter 08 #33
Topic Area: Acquisition And Maintenance Of Plant And Equipment*

39. Which of the following accounts would not be considered an intangible asset?
A. Goodwill
B. Patents
**C.** Research and development costs
D. Trademarks

Tangible assets have physical substance, whereas intangible assets lack physical substance. Research and development costs are expensed as incurred.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Easy
Learning Objective: 08-01 Define; classify; and explain the nature of long-lived productive assets and interpret the fixed asset turnover ratio.
Libby - Chapter 08 #34
Topic Area: Acquisition And Maintenance Of Plant And Equipment*

40. The Wilson Company has provided the following information:

• Net sales, $100,000;
• Net operating income, $40,000;
• Net income, $20,000;
• Average total assets, $120,000;
• Average net fixed assets; $80,000.

What is Wilson's fixed asset turnover ratio?
A. 0.83
**B.** 1.25
C. 0.25
D. 0.50.

Fixed asset turnover ratio (1.25) = Net sales ($100,000) ÷ Average net fixed assets ($80,000)

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 08-01 Define; classify; and explain the nature of long-lived productive assets and interpret the fixed asset turnover ratio.
Libby - Chapter 08 #39
Topic Area: Acquisition And Maintenance Of Plant And Equipment*

41. Salvia Company recently purchased a truck. The price negotiated with the dealer was $40,000. Salvia also paid sales tax of $2,000 on the purchase, shipping and preparation costs of $3,000, and insurance for the first year of operation of $4,000. At what amount should the truck be recorded on the balance sheet prior to recording depreciation expense?
A. $40,000
B. $42,000
C. $43,000
**D.** $45,000

$45,000 = $40,000 + $2,000 + $3,000

*AACSB: Application
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 08-02 Apply the cost principle to measure the acquisition and maintenance of property; plant; and equipment.
Libby - Chapter 08 #43
Topic Area: Acquisition And Maintenance Of Plant And Equipment*

42. Which of the following is correct for Smith Company when Smith issues 10,000 shares of $10 par value common stock and pays $20,000 cash in exchange for a building? The market price of the Smith stock on the exchange date was $35 per share and the building's book value on the books of the seller was $200,000.
**A.** Total assets increase $350,000.
B. Stockholders' equity increases $200,000.
C. Stockholders' equity increases $330,000.
D. Total assets increase $330,000.

The building account increases $370,000 {(10,000 × $35) + $20,000} and the cash account decreases $20,000.

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 08-02 Apply the cost principle to measure the acquisition and maintenance of property; plant; and equipment.
Libby - Chapter 08 #46
Topic Area: Acquisition And Maintenance Of Plant And Equipment*

43. Which of the following is incorrect for Smith Company when Smith issues 10,000 shares of $10 par value common stock and pays $20,000 cash in exchange for a building? The market price of the Smith stock on the exchange date was $35 per share and the building's book value on the books of the seller was $200,000.
A. The common stock account increases by $100,000.
**B.** The building account increases by $350,000.
C. Stockholders' equity increases $350,000.
D. The additional paid-in capital account increases by $250,000.

The building account increases $370,000 {(10,000 × $35) + $20,000}.

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 08-02 Apply the cost principle to measure the acquisition and maintenance of property; plant; and equipment.
Libby - Chapter 08 #47
Topic Area: Acquisition And Maintenance Of Plant And Equipment*

44. Which of the following best describes the objective of depreciation?
**A.** To allocate the cost of a tangible asset to the periods in which its use contributes to earning revenue.
B. To estimate the remaining useful life of the asset.
C. To report the asset on the balance sheet at the estimated amount for which the asset could be sold on the balance sheet date.
D. To estimate the current replacement cost of the asset.

Depreciation is an allocation process, not a valuation process.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 08-03 Apply various cost allocation methods as assets are held and used over time.
Libby - Chapter 08 #56
Topic Area: Use, Impairment, And Disposal Of Plant And Equipment*

45. Which of the following describes the effect of recording depreciation expense at year-end?
A. Net income decreases and total assets aren't affected.
B. Total assets decrease and stockholders' equity is not affected.
**C.** Net income decreases and total assets decrease.
D. Stockholders' equity is not affected and net income decreases.

The journal entry increases expenses, which decreases both net income and total assets. Total assets decrease because the contra-account accumulated depreciation is increased.

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 08-03 Apply various cost allocation methods as assets are held and used over time.
Libby - Chapter 08 #58
Topic Area: Use, Impairment, And Disposal Of Plant And Equipment*

46. Why is the continuity assumption important with respect to the accounting for long-lived tangible assets?
A. It helps a company decide whether to use straight-line depreciation or an accelerated depreciation method.
**B.** It justifies depreciating the asset over its expected useful life, without anticipating that the business will liquidate in the near future.
C. It provides justification for including residual values in calculating depreciation.
D. It is consistent with maintaining assets in the accounting records at market value rather than acquisition cost.

The justification for allocating an asset's cost over its useful life is that the business entity is a going concern.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 08-03 Apply various cost allocation methods as assets are held and used over time.
Libby - Chapter 08 #59
Topic Area: Use, Impairment, And Disposal Of Plant And Equipment*

47. Warren Company plans to depreciate a new building using the double declining-balance depreciation method. The building cost $800,000. The estimated residual value of the building is $50,000 and it has an expected useful life of 25 years. Assuming the first year's depreciation expense was recorded properly, what would be the amount of depreciation expense for the second year?
A. $30,720
B. $32,000
**C.** $58,880
D. $64,000

Year 1 depreciation expense ($64,000) = $800,000 × 2/25
Year 2 depreciation expense ($58,880) = ($800,000 - $64,000) × 2/25

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 08-03 Apply various cost allocation methods as assets are held and used over time.
Libby - Chapter 08 #63
Topic Area: Use, Impairment, And Disposal Of Plant And Equipment*

48. On January 1, 2010, Wasson Company purchased a delivery vehicle costing $40,000. The vehicle has an estimated 6-year life and a $4,000 residual value. Wasson estimates that the vehicle will be driven 100,000 miles. What is the vehicle's book value as of December 31, 2011 assuming Wasson uses the units-of-production depreciation method and the vehicle was driven 10,000 miles during 2010 and 18,000 miles during 2011?
**A.** $29,920
B. $28,800
C. $24,800
D. $25,920

Depreciation expense per mile ($0.36) = ($40,000 - $4,000) ÷ 100,000
December 31, 2011 accumulated depreciation balance ($10,080) = $0.36 × 28,000
December 31, 2011 book value ($29,920) = $40,000 - $10,080

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 08-03 Apply various cost allocation methods as assets are held and used over time.
Libby - Chapter 08 #71
Topic Area: Use, Impairment, And Disposal Of Plant And Equipment*

49. Which of the following statements about the Modified Accelerated Cost Recovery System (MACRS) is correct?
A. It is similar to the units-of-production depreciation method.
B. It is applied using longer asset lives than the estimated useful lives required by GAAP.
**C.** It provides a short-term tax benefit because of the higher depreciation expense reported in the early years of an asset's life.
D. It is acceptable for use when preparing financial statements.

MACRS is an accelerated depreciation method, which results in higher amounts of depreciation expense and less taxable income during the earlier years of an asset's life.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Understand
Difficulty: Medium
Learning Objective: 08-03 Apply various cost allocation methods as assets are held and used over time.
Libby - Chapter 08 #76
Topic Area: Use, Impairment, And Disposal Of Plant And Equipment*

50. Carter Company disposed of an asset at the end of the eighth year of its estimated life for $10,000 cash. The asset's life was originally estimated to be 10 years. The original cost was $50,000 with an estimated residual value of $5,000. The asset was being depreciated using the straight-line method. What was the gain or loss on the disposal?
A. $1,000 loss
**B.** $4,000 loss
C. $5,500 gain
D. $10,000 gain

Annual straight-line depreciation expense ($4,500) = ($50,000 - $5,000) ÷ 10;
End of year eight book value ($14,000) = $50,000 - ($4,500 × 8); A $4,000 loss occurs because the selling price ($10,000) is less than book value ($14,000).

*AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 08-05 Analyze the disposal of property; plant; and equipment.
Libby - Chapter 08 #83
Topic Area: Use, Impairment, And Disposal Of Plant And Equipment*

Exam 2 ch 5-8 Libby 7ed Summary

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| --- | --- |
| *Category* | *# of Questions* |
| AACSB: Analytic | 26 |
| AACSB: Application | 1 |
| AACSB: Reflective Thinking | 23 |
| AICPA BB: Critical Thinking | 50 |
| AICPA FN: Measurement | 3 |
| AICPA FN: Reporting | 20 |
| AICPA FN: Reporting, Measurement | 27 |
| Blooms: Apply | 1 |
| Blooms: Apply | 1 |
| Blooms: Apply | 1 |
| Blooms: Apply | 1 |
| Blooms: Apply | 1 |
| Blooms: Apply | 1 |
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| Blooms: Remember | 1 |
| Blooms: Remember | 1 |
| Blooms: Remember | 1 |
| Blooms: Remember | 1 |
| Blooms: Understand | 1 |
| Difficulty: Easy | 10 |
| Difficulty: Hard | 5 |
| Difficulty: Medium | 35 |
| Learning Objective: 05-01 Recognize the people involved in the accounting communication process (regulators; managers; directors; auditors; information intermediaries; and users); their roles in the process; and the guidance they receive from legal and professional standards. | 4 |
| Learning Objective: 05-03 Recognize and apply the different financial statement and disclosure formats used by companies in practice. | 9 |
| Learning Objective: 06-01 Apply the revenue principle to determine the accepted time to record sales revenue for typical retailers; wholesalers; manufacturers; and service companies. | 1 |
| Learning Objective: 06-02 Analyze the impact of credit card sales; sales discounts; and sales returns on the amounts reported as net sales. | 4 |
| Learning Objective: 06-03 Analyze and interpret the gross profit percentage. | 1 |
| Learning Objective: 06-04 Estimate; report; and evaluate the effects of uncollectible accounts receivable (bad debts) on financial statements. | 5 |
| Learning Objective: 06-06 Report; control; and safeguard cash. | 2 |
| Learning Objective: 07-01 Apply the cost principle to identify the amounts that should be included in inventory and the matching principle to determine cost of goods sold for typical retailers; wholesalers; and manufacturers. | 3 |
| Learning Objective: 07-02 Report inventory and cost of goods sold using the four inventory costing methods. | 4 |
| Learning Objective: 07-04 Report inventory at the lower of cost of market (LCM). | 1 |
| Learning Objective: 07-05 Evaluate inventory management using the inventory turnover ratio and analyze the effects of inventory on cash flows. | 2 |
| Learning Objective: 07-07 Understand methods for controlling and keeping track of inventory and analyze the effects of inventory errors on financial statements. | 2 |
| Learning Objective: 08-01 Define; classify; and explain the nature of long-lived productive assets and interpret the fixed asset turnover ratio. | 3 |
| Learning Objective: 08-02 Apply the cost principle to measure the acquisition and maintenance of property; plant; and equipment. | 3 |
| Learning Objective: 08-03 Apply various cost allocation methods as assets are held and used over time. | 6 |
| Learning Objective: 08-05 Analyze the disposal of property; plant; and equipment. | 1 |
| Libby - Chapter 05 | 13 |
| Libby - **Chapter 06** | 12 |
| Libby - **Chapter 07** | 12 |
| Libby - Chapter 08 | 13 |
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| Topic Area: Accounting For Sales Revenue | 4 |
| Topic Area: Accounting For Sales Revenue, Measuring And Reporting Receivables | 1 |
| Topic Area: Acquisition And Maintenance Of Plant And Equipment | 6 |
| Topic Area: Control Of Inventory | 2 |
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| Topic Area: Players In The Accounting Communication Process | 4 |
| Topic Area: Reporting And Safeguarding Cash | 2 |
| Topic Area: Use, Impairment, And Disposal Of Plant And Equipment | 7 |
| Topic Area: Valuation At Lower Of Cost Or Market | 1 |