

## EXAM #7 REVIEW

The answers to the questions below will be gone over in class Thursday, December 10<sup>th</sup> and then posted on my webpage after class on Thursday.

1. Use of the same accounting principles and methods from year to year within a company is called **Consistency**
2. The monetary unit assumption states that only transactions that can be measured in terms of money should be recorded in the accounting records.
  - a. **True**
  - b. False
3. The time period assumption states that the business will remain in operation for the foreseeable future. **One-year reporting periods**
  - a. True
  - b. **False**
4. What Assumption of accounting would require that you keep two sets of books & records in total, one for each company, when you own and operate two different companies? **Separate entity**
5. The matching principle states that expenses should be matched with revenues. Another way of stating the principle is to say that
  - a. assets should be matched with liabilities.
  - b. **efforts should be matched with accomplishments.**
  - c. dividends should be matched with stockholder investments.
  - d. cash payments should be matched with cash receipts.
6. The revenue recognition principle dictates that revenue should be recognized in the accounting period it is **Earned – service performed or product delivered**
7. Jim's Tune-up Shop follows the revenue recognition principle. Jim finished repairing a car on July 31. The customer picked up the vehicle on August 1 and mailed the payment to Jim on August 5. Jim received the check in the mail on August 6. What date should Jim show that the revenue was earned?  
**July 31 when the service was performed and completed**
8. Depreciation is a process of
  - a. asset devaluation.
  - b. cost accumulation.
  - c. **cost allocation. Spread the cost over the years of benefit to the company**
  - d. asset valuation.

9. Recording depreciation each period is necessary in accordance with the
- going concern principle.
  - cost principle.
  - matching principle.**
  - asset valuation principle.
10. In performing vertical analysis on the income statement, the base (divisor, denominator) is
- total selling expenses.
  - net sales (net revenues).**
  - gross sales (total revenues).
  - total expenses.
11. Why are Discontinued operations and Extraordinary items shown separately on an income statement?
- Because they are always material (large) in dollar amount.
  - Because they are considered non-recurring and need to be separated from the rest of the items that are considered recurring.**
  - Because they cause a great amount of additional taxes.
  - Because that is the format of a multiple-step income statement.
12. The discontinued operations section of the income statement refers to
- discontinuance of a product line.
  - the income or loss on products that have been completed and sold.
  - obsolete equipment and discontinued inventory items.
  - the disposal of a significant segment of a business.**
13. Name the ratio that is calculated as follows: net income divided by average total assets. **Return on assets**
14. A company with a 20% tax rate had an Extraordinary Loss of \$60,000. How much would the net of tax amount be that is shown on the income statement?  
 **$60,000 - (.20 \times 60,000) = \$48,000 \text{ loss}$**

15. Use the following information to calculate the times interest earned ratio:

Current liabilities	.	.	.	\$280,000
Long-term liabilities	.	.	.	800,000
Interest Expense	.	.	.	100,000
Income tax expense.	.	.	.	120,000
Net income				400,000
Net cash provided by operating activities.				480,000

The times interest earned ratio for 2007 is:

$$\text{net } i / i = ( 400,000 + 100,000 + 120,000 ) / 100,000 = 6.200$$

16. Use the following information to calculate the average collection period:

	2007	2006
Accounts receivable	\$360,000	\$400,000
Allowance for doubtful accounts	30,000	40,000
Inventory	280,000	320,000
Net Credit Sales	3,000,000	1,400,000
Cost of goods sold	1,200,000	1,060,000
Net income	300,000	170,000

The average collection period for 2007 is:

$$3,000,000 / [ (360,000 - 30,000) + (400,000 - 40,000) ] / 2 = 8.6956521$$

$$365 / 8.6956521 = 41.975 \text{ days}$$

17. Ownership of the company is limited to one person.

**Sole Proprietorship**

18. Financial events can be identified with a particular business and are not combined with those of the owner. **Separate entity**

19. Assets should be recorded at their original price paid. **Historical Cost principle**

20. Rules and practices recognized as a guide in recording transactions and preparing financial statements.

**Generally Accepted Accounting Principles (GAAP)**

21. Future economic benefits that can be expressed in monetary terms.

**Assets**

22. The business will continue to operate for a very long time.

**Going concern (continuity) assumption**

23. Information that makes a difference to financial statement users should be reported in the financial statements or the footnotes.

**Full disclosure**

24. Only transactions and events that can be expressed in financial terms are recorded in the book of the company.

**Monetary Unit assumption**

25. Following GAAP may not be necessary when something is insignificant. Which constraint is this? **Materiality**

26. An item is considered material if
- it costs a lot of money.
  - it is of a tangible nature.
  - it is likely to influence the decision of an investor or creditor.**
  - the cost of reporting the item is greater than its benefits.
27. The time period assumption states
- the business will remain in operation for the foreseeable future.
  - the business can be divided into distinct periods and useful reports can be prepared even though some transactions have not been finalized.**
  - every economic entity can be separately identified and accounted for.
  - only those things that can be expressed in money are included in the accounting records.
28. The matching principle matches
- customers with businesses.
  - assets with liabilities.
  - creditors with businesses.
  - expenses with revenues.**
31. Recording depreciation each period is necessary because of the **Matching** principle.
29. The revenue recognition principle dictates that revenue should be recognized in the accounting records
- when cash is received.
  - when the service has been completed.**
  - at the end of the month.
  - in the period that income taxes are paid.
30. How much is the interest for the fourth month on a loan with a beginning principal balance of \$30,000, monthly payments of \$400, and an annual interest rate of 12%.

$$\begin{aligned}
 &30000 \times .12 \times 1/12 = 300 \\
 &+300 \\
 &-400 \\
 &=29900 \times .12 \times 1/12 = 299 \\
 &+299 \\
 &-400 \\
 &=29799 \times .12 \times 1/12 = 297.99 \\
 &+297.99 \\
 &-400 \\
 &=29696.99 \times .12 \times 1/12 = 296.97
 \end{aligned}$$

32. When the market rate of interest is greater than the nominal (face) rate of interest, bonds will sell

- a. at a premium.
- b. at face value.
- c. at a discount.**
- d. only after the stated rate of interest is increased.

33. The market rate of interest is also called the

- a. stated rate.
- b. effective rate.**
- c. coupon rate.
- d. contractual rate.

34. A \$10,000 face value bond with a quoted price of 98 is selling for

$$10,000 \times .98 = 9,800$$

35. We sold 5 year bonds that have a face value of \$400,000 for \$415,000. These bonds have a stated interest rate of 10%. What is the interest **payment** for one year?

**Face value x stated interest rate = interest payment**

$$400,000 \times .10 = 40,000$$

36. We sold 5 year bonds that have a face value of \$400,000 for \$415,000. These bonds have a stated interest rate of 10%. What is the interest **expense** for one year?

**Bonds sold at a discount:**

**Interest payment plus the discount amortized = interest expense.**

**Bonds sold at a premium:**

**Interest payment minus the premium amortized = interest expense.**

$$40,000 - ( 15,000 / 5 ) = 37,000$$