On my honor, I have neither given nor received assistance on this test.

Signature:___________________________

All questions and parts of questions count 3 points except question 15, which totals 16 points, and question 16, which totals 12 points. Total 100 points i.e., very roughly a point a minute.
**Balance sheet computations tst1f94p**

1. At the end of its first year, Ernestine Company reported total assets of $960,000 and total liabilities of $510,000. The company earned $210,000 during the first year, and it distributed $90,000 in dividends. What was Ernestine's contributed capital?

   a. $510,000  
   b. $330,000  
   c. $300,000  
   d. $210,000

   **Answer:** b  
   Owners' equity is $450,000 = $960,000 - $510,000. Retained earnings = $210,000 - 90,000 = $120,000. Contributed capital = $450,000 - 120,000 = $330,000

**Balance sheet definitions tst1f94p**

2. Which grouping includes only non-current assets?

   a. land, equipment, accounts receivable from customers  
   b. buildings, inventories, and patents  
   c. land, buildings, and shareholders' equity  
   d. none of the above

   **Answer:** b  
   Non-current assets are those resources whose benefits will be realized over more than one year or operating cycle. Examples include: investments, pp&e, and intangible assets. Patents, goodwill, and copyrights are intangible assets.  

   a includes accounts receivable which is a current asset, so that is an incorrect answer.  
   c includes shareholder's equity which is a liability, not an asset.

**Income statement definitions tst1f94p**

3. Which listing consists of words that are all synonyms?

   a. net income, earnings, profits  
   b. assets, net income, earnings  
   c. net income, profits, total revenues  
   d. net income, profits, shareholders' equity

   **Answer:** a  
   On the income statement, net income in its most simple form is equal to revenues-expenses. The answer is not b because assets are not income. Not c because revenues are a determinant of but not synonymous with income. Not d because income is closed to shareholder's equity but is not synonymous with equity.

**Income statement definitions tst1f94p**

4. For each expense,
a. an asset increases and a liability decreases  
b. an asset decreases and a liability increases  
c. an asset decreases or a liability increases  
d. none of the above  

Answer: c  
Answer a suggests that one can somehow debit an asset and a liability (but to every debit there is an equal and opposite credit!) . Answer b suggests that one can somehow credit both assets and liabilities – again not possible. That leaves c as the only possible answer – whenever we debit an expense we credit an asset or a liability.  

Revenues definition tst1f94p  
5. Revenues measure  
a. the inflows of assets from selling goods and providing services to customers  
b. the reduction of liabilities from selling goods and providing services to customers  
c. all sources of cash received by a firm  
d. both a. and b.  

Answer: d  
Revenues are inflows or other enhancements of assets of an entity or settlements of its liabilities from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity’s ongoing major or central operations. c is incorrect because all cash that a firm receives is not used as revenue. An example of a is the inflow of cash from a sale of equipment. An example of b is an decrease in the deferred/uneearned revenue account from the delivery of a magazine subscription.  

Financial Analysis tst1f94p  
6. The objectives of financial reporting do not include  
a. providing information about financial performance  
b. providing information on competitors’ performance  
c. providing information for investment and credit decisions  
d. assessing the amount and timing of cash flows  

Answer: b  
Companies are supposed to provide “everything” except data about each other!  

Account Transactions tst1f94p  
7. Compute the missing information in the four independent cases below.  
a. Accounts receivable, Jan. 1, Year 2 $ 500  
Sales on account for year 2 1,900  
Collections from customers on account
during year 2  
Accounts receivable, Dec 31, Year 2 ---?---  
1,350

Answer: X = $500 + $1900 - $1350 = $1050

b. Salaries payable, Jan. 1, Year 2 $175  
Salary expense for year 2 ---?---  
Payments to salaried employees during Year 2 725  
Salaries payable, Dec. 31, Year 2 100

Answer: $175 + X - $725 = $100 whence X = $650

c. Equipment (net of depreciation) Jan 1, Year 2 $900  
Depreciation expense for Year 2 --?--  
Sales of equipment during Year 2 --0--  
Acquisition of equipment during Year 2 330  
Equipment (net of depreciation) Dec 31, Year 2 910

Answer: $320. $900 - X - 0 + $330 = $910 whence X = $320

**Balance Sheet Definition tst1f94p**

8. Shareholders' equity is

a. a residual interest  
b. an amount representing a claim on assets not required to meet the claims of creditors  
c. equal to Total Assets minus Total Liabilities  
d. all of the above

Answer: d

Shareholder's equity is a residual amount— what's left over after creditor claims have been subtracted from assets. SE also equals Total Assets - Total Liabilities. (A = L + SE).
Accounting Equation tst1f94p

9. Which of the following is not a correct statement concerning the effect of any single transaction?

a. It increases both an asset and a liability or shareholders' equity
b. It decreases an asset and increases a liability
c. It decreases both an asset and a liability or shareholders’ equity
d. It increases one asset and decreases another asset

Answer: b
Cannot be a because this is correctly debit an asset and credit an equity. Cannot be c because this debits and equity and credits an asset – correctly. It cannot be d because this debits one asset and credits another – correctly. It must be b which tries to credit and asset and an equity.

Journal Entries tst1f94p

10. Where applicable create journal entries (in good form!) for each of the following events. Should a journal entry be inappropriate, very briefly explain why. I am interested only in the initial journal entry i.e., at the moment when the described event happens.

a. Sign a 3 year employment contract with the CFO for $450,000

Answer: No journal entry is required because there has been no economic exchange. No goods or services have been delivered. Only the promise of services has occurred.

b. Send a check to an insurance company for $800 for two years' insurance coverage that would normally cost $500 for a one year policy.

Answer: Dr. Prepaid Insurance    $800
            Cr. Cash       $800

For the sale of magazine subscriptions, revenue is not recognized until the product has been delivered. The cost of $500 will be incurred in the future.

c. A magazine publisher receives $1,500 in subscriptions. It will cost the publisher $500 to fulfill the subscription commitment.

Answer: Dr. Cash    $1,500
            Cr. Unearned Revenue     $1,500

For the sale of magazine subscriptions, revenue is not recognized until the product has been delivered. The cost of $500 will be incurred in the future.

d. A firm acquires inventory with a list price of $1,000 at a 2% discount for early payment. The firm treats cash discounts as a reduction of acquisition cost.
**Answer: Dr. Inventory $980**  
**Cr. Cash $980**

Aquisition cost is what the firm pays for the assets it is receiving.  
$1000-$20 = $980  Aquisition cost

e. A firm agrees to purchase 100,000 units of inventory from a supplier over the next 3 years at an agreed to cost of $1 per unit.

**Answer: No journal entry should be recorded. No exchange has occurred.**

**Income Statement Definition tst1f94p**  
11. Expenses are recognized
   
a. when they match revenue  
b. in the period in which the service is consumed  
c. both a and b  
d. neither a nor b

**Answer: c**  
The matching principle states that expenses are recognized in the same period as the related revenues.

**Income Statement Definition tst1f94p**  
12. Revenue and expense accounts  
   
a. are permanent accounts  
b. are temporary accounts  
c. reflect cumulative changes in each account since the organization of the firm  
d. none of the above

**Answer: b**  
Revenue and expense accounts are closed to Retained Earnings at the end of the period

**Interest Receivable tst1f94p**  
13. On October 1, Year 1, Shoe World received a $10,000, 120-day note from a customer. The note earns 10% interest per year. What is the amount of Interest Receivable recorded at December 31, Year 1? (Assume no other entries to record interest have been made.)

   a. $333
Answer: a
3 months have passed since the receipt of the note. 10% of 10,000 is $1000. $1000 divided by 3 months = $333 recorded at year-end.

Posting to T-accounts tst1f94p (answer not supplied here)
14. Post the following transactions to T-accounts. Note you will be graded not only on what numbers you post, but the way that you post them. You are asked to assume that these are all the entries for the month of March. Hint: Do some adjusting entries!

a. On March 1, shareholders contribute $20,000 for 10,000 shares of $1 par value stock.

b. On March 1, the company borrows $10,000 from the bank at a 12 percent interest rate.

c. Also on March 1, the company pays rent of $2,000 for the month.

d. The company acquires equipment for $1,000.

e. The company spends $800 on refurbishing the equipment.

f. The company closes the rent expense account to the income summary account.
15. Fill in the effect that each of these transactions have on items in the matrix below. Show a + for increases; a - for decreases; a 0 for no effect; a w for wash; and a ? for an ambiguous ratio.

a. Monthly manufacturing wages paid for work done in the month.
b. Manufacturing wages paid for work done last month.
c. Dividend declared and paid.
d. Credit sale made on an installment basis.

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<thead>
<tr>
<th></th>
<th>CASH</th>
<th>CURRENT ASSETS</th>
<th>OWNERS’ EQUITY</th>
<th>CURRENT RATIO</th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
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<tr>
<td>b.</td>
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<td>0</td>
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<tr>
<td>c.</td>
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<tr>
<td>d.</td>
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</table>
Income Statement tst1f94p

16. The following statement of cash receipts and disbursements was prepared for Junk Mail Galore at the end of 1993, its first year of business.

Cash receipts from sales of merchandise $25,000

Expenditures for
     Merchandise $10,000
     Salaries 5,000
     Rent 7,000

At the year end, the firm had inventory with a cost of $2,000 remaining. Also customers owed $1,000 for goods which had already been delivered. The utilities for December were $500 and were billed but not yet paid by the company. The rent of $3,500 for January, Year 2 was paid in December, Year 1.

Required: Create in the space below an income statement in good form.

Answer:

Junk Mail Galore
Income Statement
For Year ending 12/31/93

Net Sales $26,000 (Cash + AcctsRec)
Cost of Goods Sold 8,000 (0 + 10,000 - 2,000 =8,000)
Gross Margin 18,000

Expenses:
Salaries Expense $5,000
Utilities Expense 500
Rent Expense 3,500
Total Expenses 9,000

Net Income $9,000