MONTGOMERY COLLEGE
Department of Business and Economics
Rockville Campus

AC 201 REVIEW 2 (CHAPTERS 5-8)

I. **True/False**

T	F		
		1.	Under a perpetual inventory system, cost of goods sold is determined each time a sale occurs.
		2.	The operating cycle involves the purchase and sale of merchandise as well as the subsequent collection of cash from credit sales.
		3.	Operating expenses are subtracted from revenue for a service enterprise and from gross profit for a merchandising enterprise.
		4.	Net sales minus cost of goods sold is called gross profit.
		5.	Under the perpetual inventory system, purchases of merchandise for sale are recorded in the Merchandise Inventory account.
		6.	The terms 2/10, net/30 mean that a 2 percent discount is allowed on payments made within the 10 days discount period.
		7.	If merchandise costing $2,500, with terms 2/10, n/30, is paid within 10 days, the amount of the purchase discount is $50.
		8.	The Sales Returns and Allowances account and the Sales Discount account are both classified as expense accounts.
		9.	The revenue recognition principle applies to merchandising companies by recognizing sales revenues when they are earned.
		10.	When the terms of sale include a sales discount, it usually is advisable for the buyer to pay within the discount period.
		11.	The multiple-step income statement is considered more useful than the single-step income statement because it highlights the components of net income.
		12.	Advertising Expense appears as a selling expense on the Income Statement.
		13.	Non-operating activities include revenues and expenses that are related to the company's main line of operations.
		14.	Sales revenue, cost of goods sold, and gross profit are amounts on a merchandising company's Income Statement not commonly found on the Income Statement of a service company.
		15.	If net sales are $1,000,000 and cost of goods sold is $800,000, the gross profit rate is 20%.
		16.	Under a periodic inventory system, the merchandise on hand at the end of the period is determined by a physical count of the inventory.
		17.	Goods held on consignment should be included in the consignor's ending inventory.
		18.	If prices never changed there would be no need for alternative inventory methods.
		19.	The specific identification method of costing inventories tracks the actual physical flow of the goods available for sale.
		20.	Management may choose any inventory costing method it desires as long as the cost flow assumption chosen is consistent with the physical movement of goods in the company.
		21.	The First-In, First-Out (FIFO) inventory method results in an ending inventory valued at the most recent cost.
		22.	The matching principle requires that cost of goods sold be matched against the ending Merchandise Inventory in order to determine income.
		23.	The specific identification method of inventory valuation is desirable when a company sells a large number of low-unit cost items.
		24.	If a company has no beginning inventory and the unit cost of inventory items does not change during the year, the value assigned to the ending inventory will be the same under LIFO and average cost flow assumptions.
		25.	If the unit price of inventory is increasing during a period, a company using the LIFO inventory method will show less gross profit for the period, than if it had used the FIFO inventory method.
		26.	If a company changes its inventory valuation method, the effect of the change on net income should be disclosed in the financial statements.

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		27.	In periods of falling prices, LIFO will result in a higher ending inventory valuation than FIFO.
		28.	When the market value of inventory is lower than its cost, the inventory is written down to its market value.
		29.	The inventory turnover ratio is calculated as cost of goods sold divided by ending inventory.
		30.	An inventory turnover ratio that is too high may indicate that the company is losing sales opportunities because of inventory shortages.
		31.	The LIFO reserve is the difference between ending inventory using LIFO and ending inventory if FIFO were used instead.
		32.	The safeguarding of assets is an objective of a company's system of internal control.
		33.	An effective system of internal control centralizes functions in a single capable individual.
		34.	Requiring employees to take vacations is a weakness in the system of internal controls because it does not promote operational efficiency.
		35.	Bonding means insuring a company against theft by employees.
		36.	An effective system of internal control requires that at least two individuals be assigned to one cash drawer so that each can serve as a check on the other.
		37.	The responsibility for ordering, receiving, and paying for merchandise should be assigned to different individuals.
		38.	Control over cash disbursements is improved if major expenditures are paid by check.
		39.	An example of segregation of duties is having a check signer recording cash disbursements.
		40.	To obtain maximum benefit from a bank reconciliation, the reconciliation should be prepared by the employee authorized to sign checks.
		41.	Cash equivalents include money market accounts, commercial paper, and U.S. treasury bills held for ninety days or less.
		42.	A basic principle of cash management is to increase the speed of paying liabilities.
		43.	A cash budget contributes to more effective cash management.
		44.	The petty cash fund eliminates the need for a bank checking account.
		45.	Trade Receivables can be an Account Receivable or a Note Receivable.
		46.	Advances to employees are referred to as Trade Accounts Receivable.
		47.	Accounts Receivable are one of a company's least liquid assets.
		48.	An aging of Accounts Receivable is based on the premise that the longer the period an account remains unpaid, the greater the probability that it will eventually be collected.
		49.	The allowance method of accounting for bad debts violates the matching principle.
		50.	If a company uses the allowance method to account for uncollectible accounts, the entry to write off an uncollectible account only involves balance sheet accounts.
		51.	When the allowance method is used, the write-off of an account receivable results in an expense at the time of write-off.
		52.	When using the direct write-off method, year-end adjustments for Bad Debt Expense must be made.
		53.	Under the allowance method, the cash realizable value of receivables is the same both before and after an account has been written off.
		54.	In computing the maturity date of a note, the date the note is issued is included but the due date is omitted.
		55.	Interest on a 6-month, 10 percent, $10,000 note is calculated by multiplying $10,000 x 0.10 x 6/12.
		56.	When a note is written to settle an open account no entry is necessary.
		57.	If a promissory note is dishonored, the payee should not record interest income.
		58.	The holder of a note adjusts for accrued interest by debiting Interest Receivable and crediting Interest Revenue.

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		59.	A concentration of credit risk is a threat of nonpayment from a single customer or class of customers that could adversely affect the financial health of the company.
		60.	The receivables turnover ratio is calculated by dividing average receivables into cost of goods sold.
		61.	The average collection period is frequently used to assess the effectiveness of a company's credit and collection policies.
		62.	A factor buys receivables from businesses for a fee and collects the payment directly from customers.
		63.	A major advantage of national credit cards to retailers is that there is no charge to the retailer by the credit card companies for their services.

II. Inventory Costing

Assume the following data for Vincent Vega Company for 2005:

January 1	Beginning Inventory	10 Units at $ 7.00 per Unit
March 18	Purchase	15 Units at $ 8.00 per Unit
March 22	Sale	20 Units at $10.00 per Unit
June 10	Purchase	20 Units at $ 8.50 per Unit
June 16	Sale	22 Units at $10.00 per Unit
October 30	Purchase	12 Units at $ 9.00 per Unit

a. Compute the inventory on hand on December 31 under the FIFO Periodic Method.

b. Compute the Cost of Goods Sold under the FIFO Periodic Method.

c. Compute the inventory on hand on December 31 under the LIFO Periodic Method.

d. Compute the Cost of Goods Sold under the LIFO Periodic Method.

e. Compute the inventory on hand on December 31 under the Average Cost Periodic Method.

f. Compute the Cost of Goods Sold under the Average Cost Periodic Method.

III. **Matching**

1.		The excess of sales revenue over Cost of Goods Sold	**A.**	Gross Profit
2.		Expenses, other than Cost of Goods Sold, that are incurred in a business' major line of business	**B.**	Sales Returns and Allowances
3.		Gross profit minus operating expenses	**C.**	Single-step Income Statement
4.		Gross profit divided by net Sales Revenue	**D.**	Operating Expenses
5.		Ratio of cost of goods sold to average inventory	**E.**	Operating Income
6.		The largest single expense of most merchandising businesses	**F.**	Inventory Turnover
7.		A contra account to Sales Revenue	**G.**	Cost of Goods Sold
8.		A format that groups all revenues together and then lists and deducts all expenses together without drawing any subtotals	**H.**	Other Revenue
9.		Revenue that originates outside the main operations of a business	**I.**	Gross Profit Percentage
10.		Purchases minus Purchase Discounts and minus Purchase Returns and Allowances	**J.**	Net Purchases

IV. **Matching**

1.		A concept by which the least favorable figures are presented in the financial statements	**A.**	LIFO
2.		A principle requiring the use of the same accounting methods and procedures from period to period	**B.**	Lower-of-cost-or-market Rule
3.		A principle requiring the financial statements to report enough information for outsiders to make knowledgeable decisions about the business	**C.**	Conservatism
4.		Requires that an asset be reported in the financial statements at whichever is lower, its historical cost or its current replacement cost	**D.**	FIFO
5.		Inventory costing method in which ending inventory is based on the costs of the most recent purchases	**E.**	Consistency Principle
6.		Inventory costing method in which ending inventory is based on the oldest costs	**F.**	Full Disclosure Principle
7.		Inventory system maintaining a continual count of inventory	**G.**	Perpetual Inventory System
8.		Cost to the merchant for accepting a credit card	**H.**	Allowance for Doubtful Accounts
9.		A contra account to accounts receivable that holds the estimated amount of collection losses	**J.**	Direct Write-off Method
10.		The sum of the principal and interest due on the due date of a note	**K.**	Maturity Value
11.		A method of accounting for uncollectible accounts by which the company waits until the credit department decides that a customer's account is uncollectible, and then writes it off directly to Bad Debt Expense	**L.**	Allowance Method
12.		A method of recording collection losses based on estimates made before identification of specific uncollectible accounts	**M.**	Service Charge Expense

V. **Bank Reconciliation**

The following information is available to prepare the Jules Winnfield Company's December 31 bank reconciliation.

1. Check No. 453, written for $250, was outstanding on November 30 and was not returned with the December bank statement.
2. Check No. 478, written on December 26 for $400, was not returned with the canceled checks.
3. Check No. 480, correctly written for $96 was incorrectly entered in the Cash Disbursements Journal and posted as though it were for $69.
4. A deposit of $2,000, placed in the bank's night depository after banking hours on November 30, appeared on the December bank statement.
5. A deposit of $1,500, placed in the bank's night depository after banking hours on December 31, did not appear on the December bank statement.
6. Enclosed with the December bank statement was a debit memorandum for the monthly bank service charge of $25.
7. Enclosed with the December bank statement was a memorandum that a $738 check received from Zed and deposited on December 27 was returned by the bank marked "Non-Sufficient Funds."
8. The Cash balance on the December bank statement was $10,000.
9. Winnfield Company's Cash ledger balance on December 31 is $11,640.

a. Prepare the appropriate bank reconciliation, in good form, in the space provided on page 7.

b. Certain of the above items require entries on Jules Winnfield Company's books. Prepare the necessary adjusting journal entries in the space provided on page 7.

General Journal			
Date	Description	Debit	Credit

VI. **Recording Transactions**

Journalize the following transactions for M. Wallace Company using the perpetual inventory method.

January 4 Purchased $5,300 merchandise from Marvin Company on account, terms 3/10, n/30.

January 7 Paid $700 freight on January 4 transaction.

January 12 Received $300 credit from Marvin Company for merchandise returned.

January 13 Paid Marvin Company for merchandise in full, less discounts.

January 20 Made sales of $10,000 to customers on account, terms 2/10, n/30. The merchandise cost $8,000.

January 22 Gave credit of $1,500 to customers for merchandise returns. The merchandise cost $1,200.

January 29 Received payment in full, less discounts, from customers.

General Journal				
Date		Description	Debit	Credit

VII. **Recording Transactions**

Journalize the following transactions for M. Wallace Company using the periodic inventory method.

January 4 Purchased $5,300 merchandise from Marvin Company on account, terms 3/10, n/30.

January 7 Paid $700 freight on January 4 transaction.

January 12 Received $300 credit from Marvin Company for merchandise returned.

January 13 Paid Marvin Company for merchandise in full, less discounts.

January 20 Made sales of $10,000 to customers on account, terms 2/10, n/30. The merchandise cost $8,000.

January 22 Gave credit of $1,500 to customers for merchandise returns. The merchandise cost $1,200.

January 29 Received payment in full, less discounts, from customers.

General Journal				
Date		Description	Debit	Credit

VIII. Maturity Values

Calculate the maturity value for each of the following notes.

TERM	INTEREST RATE	PRINCIPAL	MATURITY VALUE
60 Days	10%	$ 8,000	
3 Months	12%	$60,000	
90 Days	5%	$ 4,000	

IX. Allowance Method

Butch Coolidge Company has accounts receivable of $340,000 and a normal balance in allowance for doubtful accounts of $7,180.

a. Assuming that the aging of accounts receivable method is used, create the journal entry needed to record bad debt expense if 4% of receivables will become uncollectible.

b. Assume the same facts as above, but now assume a debit balance in allowance for doubtful accounts of $2,000.

c. What is the difference between the direct write-off method versus the allowance method for bad debts?