

**TEST III**  
**Spring 2004**

NAME \_\_\_\_\_

Section \_\_\_\_\_

TIME 8:00 or 9:00 or 11:00

(please circle time)

MULTIPLE CHOICE (2 POINTS EACH):

1.	<u>  <b>A</b>  </u>	11.	<u>  <b>D</b>  </u>	Multiple Choice	40
2.	<u>  <b>A</b>  </u>	12.	<u>  <b>D</b>  </u>	Problem I	15
3.	<u>  <b>C</b>  </u>	13.	<u>  <b>C</b>  </u>	Problem II	25
4.	<u>  <b>B</b>  </u>	14.	<u>  <b>C</b>  </u>	Problem III	20
5.	<u>  <b>D</b>  </u>	15.	<u>  <b>C</b>  </u>		_____
6.	<u>  <b>A</b>  </u>	16.	<u>  <b>A</b>  </u>		<u>  100  </u>
7.	<u>  <b>B</b>  </u>	17.	<u>  <b>D</b>  </u>		
8.	<u>  <b>C</b>  </u>	18.	<u>  <b>B</b>  </u>		
9.	<u>  <b>D</b>  </u>	19.	<u>  <b>D</b>  </u>		
10.	<u>  <b>C</b>  </u>	20.	<u>  <b>B</b>  </u>		

**Multiple Choice – There is only ONE best answer (2 points each)**

1. Which of the following combination of turnover ratios indicates a company which has the shortest operating cycle
  - A. **Coastal Beverage/ inventory turnover 15, receivable turnover 20.**
  - B. Harley Davidson/ inventory turnover 12, receivable turnover 8
  - C. Miller Brewing/ inventory turnover 8, receivable turnover 24
  - D. Cannot be determined with the information provided
  
2. Which of the following is not a limitation of internal control?
  - A. **Cost of establishing control procedures should not exceed their benefit**
  - B. The human element
  - C. Collusion
  - D. The size of the company
  
3. Internal auditors
  - A. are hired by CPA firms to audit business firms.
  - B. are employees of the IRS who evaluate the internal controls of companies filing tax returns.
  - C. **evaluate the system of internal controls for the companies that employ them.**
  - D. cannot evaluate the system of internal controls of the company that employs them because they are not independent.
  
4. From an internal control standpoint, the asset most susceptible to improper diversion and use is
  - A. prepaid insurance.
  - B. **cash.**
  - C. buildings.
  - D. land.
  
5. A consequence of separation of duties is that
  - A. theft by employees becomes impossible.
  - B. operations become extremely inefficient because of constant training of employees.
  - C. more employees will need to be bonded.
  - D. **theft is possible only when several employees are involved.**
  
6. Two individuals at a retail store work the same cash register. You evaluate this situation as
  - A. **a violation of establishment of responsibility.**
  - B. a violation of separation of duties.
  - C. supporting the establishment of responsibility.
  - D. supporting internal independent verification.
  
7. The reconciliation of the cash register tape with the cash in the register is an example of
  - A. other controls.
  - B. **independent internal verification.**
  - C. establishment of responsibility.

- D. segregation of duties.
8. A bank reconciliation should be prepared
- A. whenever the bank refuses to lend the company money.
  - B. when an employee is suspected of fraud.
  - C. **to explain any difference between the depositor's balance per books with the balance per bank.**
  - D. by the person who is authorized to sign checks.
9. Cash equivalents do not include
- A. money market accounts.
  - B. commercial paper.
  - C. U.S. Treasury bills.
  - D. **NSF checks.**
10. The lower of cost or market basis of valuing inventories is an example of
- A. comparability.
  - B. the cost principle.
  - C. **conservatism.**
  - D. consistency.
11. When paying bills in a company with good internal controls, which of the following is true?
- A. Accounting should mail the check to the vendor after signature.
  - B. Original documentation of bill payment should never be stamped paid or otherwise marked
  - C. Accounting should always reconcile the bank account
  - D. **Accounting should compare the purchase order to the invoice to the receiving report**
12. Which of these would cause the inventory turnover ratio to increase the most?
- A. Increasing the amount of inventory on hand.
  - B. Keeping the amount of inventory on hand constant but increasing sales.
  - C. Keeping the amount of inventory on hand constant but decreasing sales.
  - D. **Decreasing the amount of inventory on hand and increasing sales.**

Use the following information for questions 13-14.

The following information was available for Rawley Company at December 31, 2003: beginning inventory \$80,000; ending inventory \$120,000; cost of goods sold \$600,000; and sales \$900,000.

13. Rawley's inventory turnover ratio in 2003 was
- A. 9.0 times.
  - B. 7.5 times.
  - C. **6.0 times.**
  - D. 5.0 times.

14. Rawley's days in inventory in 2003 was
- 40.6 days.
  - 48.7 days.
  - 60.8 days.**
  - 73.0 days.
15. The direct write-off method of accounting for bad debts
- uses an allowance account.
  - uses a contra asset account.
  - does not require estimates of bad debt losses.**
  - is the preferred method under generally accepted accounting principles.
16. Manning Company uses the percentage of receivables method for recording bad debts expense. The accounts receivable balance is \$200,000 and credit sales are \$1,000,000. Management estimates that 5% of sales will be uncollectible. What adjusting entry will Manning Company make if the Allowance for Doubtful Accounts has a credit balance of \$2,000 before adjustment?
- |  |               |
|--|---------------|
| <b>Bad Debts Expense</b>               | <b>50,000</b> |
| <b>Allowance for Doubtful Accounts</b> | <b>50,000</b> |
  - |                                 |        |
|---------------------------------|--------|
| Bad Debts Expense               | 48,000 |
| Allowance for Doubtful Accounts | 48,000 |
  - |                     |        |
|---------------------|--------|
| Bad Debts Expense   | 52,000 |
| Accounts Receivable | 52,000 |
  - |                     |        |
|---------------------|--------|
| Bad Debts Expense   | 10,000 |
| Accounts Receivable | 10,000 |
17. When an account is written off using the allowance method, the
- cash realizable value of total accounts receivable will increase.
  - net accounts receivable will decrease.
  - The allowance account will increase.
  - net accounts receivable will stay the same.**
18. The matching principle relates to credit losses by stating that bad debt expense should be recorded
- in the same period as allowed for tax purposes.
  - in the period of the sale.**
  - for an exact amount.
  - in the period of the loss.
19. Welsh Company purchased an item for inventory that cost \$10 per unit and was marked to sell at \$14. It was determined that the replacement cost is \$9 per unit. No purchases in the near future are anticipated. Using the lower-of-cost-or-market rule, the per unit valuation for inventory should be
- \$14.00.
  - \$12.00.
  - \$10.00.
  - \$9.00.**

20. Application of the lower-of-cost-or-market rule is most clearly an example of the accounting principle of
- A. matching.
  - B. **conservation.**
  - C. materiality.
  - D. consistency.

**Problem I (15 points)**

The Kemp Company has just completed a physical inventory count at year end, December 31, 2003. Only the items on the shelves, in storage, and in the receiving area were counted and costed on the FIFO basis. The inventory amounted to \$95,000. During the audit, the independent CPA discovered the following additional information:

- (a) There were goods in transit on December 31, 2003, from a supplier with terms FOB destination, costing \$10,000. Because the goods had not arrived, they were excluded from the physical inventory count.
- (b) On December 27, 2003, a regular customer purchased goods for cash amounting to \$1,000 and left them for pickup on January 4, 2004. Kemp Company had paid \$500 for the goods and, because they were on hand, included them in the physical inventory count.
- (c) Kemp Company, on the date of the inventory, received notice from a supplier that goods ordered earlier, at a cost of \$4,000, had been delivered to the transportation company on December 28, 2003; the terms were FOB shipping point. Because the shipment had not arrived on December 31, 2003, it was excluded from the physical inventory.
- (d) On December 31, 2003, there were goods in transit to customers, with terms FOB shipping point, amounting to \$800 (expected delivery on January 8, 2004). Because the goods had been shipped, they were excluded from the physical inventory count.
- (e) On December 31, 2003, Kemp Company shipped \$2,500 worth of goods to a customer, FOB destination on January 5, 2004. Because the goods were not on hand, they were not included in the physical inventory count.
- (f) Kemp Company, as the consignee, had goods on consignment that cost \$3,000. Because these goods were on hand as of December 31, 2003, they were included in the physical inventory count.

**Instructions**

Analyze the above information and calculate a corrected amount for the ending inventory. Explain the basis for your treatment of each item.

Inventory before adjustment.....	\$95000
<b>(a)</b>	<b>0 EXCLUDE</b>
<b>(b)</b>	<b>0 EXCLUDE</b>
<b>(c)</b>	<b>+ 4,000 INCLUDE</b>
<b>(d)</b>	<b>0 EXCLUDE</b>

(e)	+2,500	INCLUDE
(f)	(3,000)	EXCLUDE
<b>Adjusted Investment</b> .....		<b><u>98,500</u></b>

**Problem II (20 points)**

The bank statement for Barber Company indicates a balance of \$930 on July 31. The cash balance per books had a balance of \$435 on this date. The following information pertains to the bank transactions for the company.

1. Deposit of \$880, representing cash receipts of July 31, did not appear on the bank statement.
2. Outstanding checks totaled \$290.
3. Bank service charges for July amounted to \$30.
4. The bank collected a note receivable for the company for \$800 plus \$48 interest revenue.
5. A NSF check for \$228 from a customer was returned with the statement.
6. Check No. 210 for \$594 was correctly issued and paid by bank but incorrectly entered in the cash payments journal as payment on account for \$549.
7. A payment on account was incorrectly entered in the cash payments journal and posted to the accounts payable subsidiary ledger for \$824 when Check No. 318 was correctly prepared for \$284. The check cleared the bank for the correct amount in July.

**Instructions**

- a. Prepare the Bank Reconciliation at July 31:

7-31	Balance per Bank	930	7-31	Balance per books	435
	Add: Deposit in Transit	+880		Less: Service Charge	(30)
	Less: Outstanding Checks	(290)		NSF Check	(228)
				Chk #210 erro	(45)
	Adjusted Balance	<u>1,520</u>		Add: Note collection	800
				Int. Income	48
				Chk #318	540
				Adjusted Balance	<u>1,520</u>

- b. Prepare the General Journal entries required:

Date	Description	Debit	Credit
7-31	Service Charge Expense	30	
	A/R (NSF Check).	228	

	Accounts Payable Cash in Bank	45	303
	Cash in Bank Notes Receivable Interest Income Accounts Payable	1,388	800 48 540

**Problem III (20 points) Internal Controls**

Sam Hill has worked for Dr. Lee Chang for several years. Sam demonstrates a loyalty that is rare among employees. He hasn't taken a vacation in the last three years. One of Sam's primary duties at the medical office is to open the mail and list the checks received. He also takes cash from patients at the cashier window as patients leave. At times it is so hectic that Sam doesn't bother with giving patients a receipt for the cash paid on their accounts. He assures them he will see to it that they receive the proper credit. Patient receipts are kept in an unlocked drawer until Friday afternoon when Sam takes prepares the deposit ticket and takes the deposit to the bank. When the traffic is slow in the office Sam offers to help Mary post the payments to the patients' accounts receivable. She is always happy to receive his help, because he is a very conscientious worker.

Required: Using the information in the case, indicate one example of each of the six types of internal controls and indicate whether it is a strength or weakness.

<u>Type of Internal Control</u>	<u>Case Application</u>	<u>Strength or Weakness</u>
1. Establishment of responsibility	2 people take collection	Weakness
2. Segregation of duties	Cash collection	Weakness
3. Physical, mechanical, and electronic control devices	Unlocked drawer Deposits only weekly	Weakness
4. Independent internal verification	None independent	Weakness
5. Other controls	No vacation No bonding	Weakness.
6. Documentation	Receipt not Always given	Weakness