Financial Accounting for Executives & MBAs, 4th Edition by Simko, Ferris & Wallace

Solutions to Practice Quiz

Chapter 5 – Operating Cycle, Revenue Recognition, and Receivable Valuation

Multiple Choice
Identify the answer that BEST completes the statement or answers the question.

1. A partial balance sheet for Smith & Sons appears below.

Balance Sheet	December 31
Cash	$534,000
Accounts receivable, net of allowance of $5,600	460,000

Which one of the following statements is *true* concerning the company's accounts receivable as of December 31?

a. The company expects to collect $465,600 from its customers.
b. The net realizable value of the company's accounts receivable is $465,600.
c. The company thinks its customers will not pay $5,600 of the amount owed.
d. The company wrote off $5,600 of uncollectible accounts during the year.

Answer: c

2. Accounts receivable for the Claremont Company totaled $52,000 and the Allowance for Uncollectible Accounts balance was $1,140 at year end after write offs but before recording the year-end estimate of uncollectible accounts. The company wrote of $980 of uncollectible accounts during the year. Management estimated that 2.8% of its net sales of $96,000 would not be collected.

What is the bad debt expense for the year?

a. $ 160
b. $1,140
c. $ 980
d. $2,688

Answer: d
Rationale: (0.028 x $96,000)

3. Pomona Inc uses the aging method in accounting for uncollectible accounts. On March 31, the company wrote off an uncollectible account in the amount of $2,600.

What effect does the write off have on the company's financial statements?

a. Decreases shareholders' equity and total assets by $2,600
b. Decreases bad debt expense and total assets by $2,600
c. Increases and decreases assets by the same amount, $2,600
d. Increase total assets and decreases shareholders' equity by $2,600

Answer: c

4. Smith & Sons sold merchandise to a customer on credit for $8,000 with credit terms of 1/10, n/30. The invoice was dated April 14.

Which one of the following statements is *true*?

a. The customer can take a $80 discount if the invoice is paid by May 13.
b. The customer should pay $7,200 if the invoice is paid by April 24.
c. The customer must pay $8,000 if paid after April 24.
d. The customer must pay an $80 penalty if payment is made after May 13.

Answer: c

5. The following information is taken from the annual report of the Claremont Company:

(in thousands)	**Year 2**	**Year 1**
Net sales	$145,700	$135,200
Accounts receivable, net	17,200	16,400

What is the receivable collection period for Year 2?

a. 43.1 days
b. 45.6 days
c. 50.3 days
d. 60.0 days

Answer: a
Rationale: [365 / ($145,700 / $17,200)]

6. On July 31, Household Electronics sold a Plasma television to a customer for $5,000. The television had a cost basis of $2,200. The customer is required to make a $500 down payment and to pay the $4,500 balance in equal $100 payments over the next 45 months on the last day of each month.

Under the installment method of revenue recognition, how much gross profit will the company recognize during the year?

a. $ 280
b. $ 560
c. $ 780
d. $1,000

Answer: b
Rationale: [$500 + (5 x $100)] – [($1,000 / $5,000) x $2,200]

7. On June 30, Household Electronics sold a Plasma television to a customer for $3,000. The television had a cost basis of $2,200. The customer is required to make a $100 down payment and to pay the $2,900 balance in equal $100 payments over the next 29 months on the last day of each month. The company uses the installment method of revenue recognition. What is the company's opportunity cost over the 29 months assuming an annual 6% cost of borrowing?

The present value factor of 29 payments of $100 at 6% is 26.93.

a. $ 800
b. $2,693
c. $ 207
d. $ 493

Answer: c
Rationale: [$2,900 – (26.93 x $100)]

8. Unearned revenue typically arises because:

a. Cash is received as security that will be paid back in the future.
b. Cash is received from customers prior to the rendering of services or delivery of products.
c. A company temporarily requires cash for operations.
d. Merchandise is sold to customers prior to payment.

Answer: b

Use the following information for Questions 9 and 10:

Morgan Company performs an aging analysis to determine the amount of its bad debts expense to record at the end of each year. At the end of the current year, Morgan's aging schedule appeared as follows:

	Amount	**Fraction Expected to be Uncollectable**
Current receivables	$10,200	1%
Past-due receivables:		
1-30 days	1,650	2%
31-60 days	3,050	6%
61-90 days	980	25%
91+ days	630	40%

The balance in Morgan's Allowance for Doubtful Accounts was $260 negative (this means the balance was opposite what is expected).

9. Based on the aging information, what is the amount of accounts receivable that Morgan estimates that it will *not* collect?

a. $ 815
b. $2,443
c. $ 555
d. $1,075

Answer: a
Rationale:
[(1% x $10,200) + (2% x $1,650) + (6% x $3,050) + (25% x $980) + (40% x $630)]

10. What is the amount of Morgan's bad debt expense for the year?

a. $ 815
b. $2,443
c. $ 555
d. $1,075

Answer: d
Rationale: ($815 + $260)