

CLEP

Financial Accounting

Time—90 Minutes
75 Questions

For each question below, choose the best answer from the choices given.

1. The business entity concept means that
 - (A) the owner is part of the business entity
 - (B) an entity is organized according to state or federal statutes
 - (C) an entity is organized according to the rules set by the FASB
 - (D) the entity is an individual economic unit for which data are recorded, analyzed, and reported
 - (E) an entity must be a corporation
2. The objectivity principle requires that
 - (A) business transactions must be consistent with the objectives of the entity
 - (B) the Financial Accounting Standards Board must be fair and unbiased in its deliberations over new accounting standards
 - (C) accounting principles must meet the objectives of the Securities and Exchange Commission
 - (D) amounts recorded in the financial statements must be based on independently verifiable evidence
 - (E) the objective of financial reporting is match revenue and expenses
3. A debit may signify a(n)
 - (A) decrease in asset accounts
 - (B) decrease in liability accounts
 - (C) increase in the capital account
 - (D) decrease in the drawing account
 - (E) increase in the revenue account
4. Which of the following statements about the rules of debit and credit is true?
 - (A) Decrease Prepaid Insurance with a credit and the normal balance is a credit.
 - (B) Increase Accounts Payable with a credit and the normal balance is a debit.
 - (C) Increase Supplies with a credit and the normal balance is a credit.
 - (D) Decrease Cash with a debit and the normal balance is a credit.
 - (E) Increase Supplies Expense with a debit and the normal balance is a debit.

CLEP Financial Accounting

5. Which of the following entries records the payment of an account payable?
- (A) Debit Cash; credit Accounts Payable
 - (B) Debit Accounts Receivable; credit Cash
 - (C) Debit Cash; credit Supplies Expense
 - (D) Debit Accounts Payable; credit Cash
 - (E) Debit Supplies; credit Accounts Payable
6. Office supplies purchased by J's Appliance Repair on account were returned. Which of the following entries for J's Appliance Repair records this transaction?
- (A) Cash, debit; Office Supplies, credit
 - (B) Office Supplies, debit; Accounts Receivable, credit
 - (C) Accounts Payable, debit; Office Supplies, credit
 - (D) Office Supplies, debit; Accounts Payable, credit
 - (E) Accounts Payable, debit; Cash credit
7. If the effect of the debit portion of an adjusting entry is to increase the balance of an expense account, which of the following describes the effect of the credit portion of the entry?
- (A) Decreases the balance of an owner's equity account
 - (B) Increases the balance of a liability account
 - (C) Increases the balance of an asset account
 - (D) Decreases the balance of an expense account
 - (E) Increases the balance of a revenue account
8. The balance in the prepaid rent account before adjustment at the end of the year is \$15,000, which represents three months' rent paid on December 1. The adjusting entry required on December 31 is
- (A) debit Rent Expense, \$5,000; credit Prepaid Rent, \$5,000
 - (B) debit Prepaid Rent, \$10,000; credit Rent Expense, \$5,000
 - (C) debit Rent Expense, \$10,000; credit Prepaid Rent, \$5,000
 - (D) debit Prepaid Rent, \$5,000; credit Rent Expense, \$5,000
 - (E) debit Rent Expense, \$5,000; credit Cash, \$5,000
9. The cost of office supplies to be used in future periods is ordinarily shown on the balance sheet as a(n)
- (A) capital
 - (B) asset
 - (C) contra asset
 - (D) liability
 - (E) drawing

10. Which of the statements below indicates that a company earned a net income for the period?

- (A) The sum of the debits exceeds the sum of the credits in the Balance Sheet columns on the work sheet.
- (B) The sum of the credits exceeds the sum of the debits in the Income Statement columns on the work sheet.
- (C) The sum of the debits exceeds the sum of the credits in the Income Statement columns on the work sheet.
- (D) Cash inflows exceeded cash outflows.
- (E) The adjusted trial balance columns of the worksheet are equal.

11. Closing entries

- (A) need not be journalized if reversing entries are prepared
- (B) need not be posted if the financial statements are prepared from the work sheet
- (C) are not needed if adjusting entries are prepared
- (D) must be journalized and posted
- (E) are not required if financial statements are prepared

12. If total assets decreased by \$47,000 during a period of time and owner's equity increased by \$24,000 during the same period, then the amount and direction (increase or decrease) of the period's change in total liabilities is a

- (A) \$23,000 increase
- (B) \$47,000 decrease
- (C) \$71,000 decrease
- (D) \$71,000 increase
- (E) \$23,000 decrease

13. How does the purchase of supplies on account affect the accounting equation?

- (A) Assets increase; owner's equity decreases
- (B) Assets increase; liabilities increase
- (C) Assets increase; liabilities decrease
- (D) Liabilities increase; owner's equity decreases
- (E) Assets increase and decrease by the same amount

- 14.** Al Shea was the sole owner and operator of SawTooth Company. As of the end of its accounting period, December 31, 2005, SawTooth Company had assets of \$925,000 and liabilities of \$285,000. During 2006, Al Shea invested an additional \$50,000 and withdrew \$30,000 from the business. What was the amount of net income during 2006, assuming that as of December 31, 2006, assets were \$980,000, and liabilities were \$255,000?
- (A) \$95,000
 - (B) \$65,000
 - (C) \$165,000
 - (D) \$725,000
 - (E) \$55,000
- 15.** The financial statement that presents a summary of the revenues and expenses of a business for a specific period of time, such as a month or year, is called a(n)
- (A) prior period statement
 - (B) statement of owner's equity
 - (C) income statement
 - (D) balance sheet
 - (E) statement of cash flows
- 16.** Allowance for Doubtful Accounts has a credit balance of \$800 at the end of the year (before adjustment), and an analysis of accounts in the customer's ledger indicates Doubtful Accounts of \$15,000. Which of the following entries records the proper provision for Doubtful Accounts?
- (A) Debit Uncollectible Accounts Expense, \$800; credit Allowance for Doubtful Accounts, \$800
 - (B) Debit Uncollectible Accounts Expense, \$14,200; credit Allowance for Doubtful Accounts, \$14,200
 - (C) Debit Allowance for Doubtful Accounts, \$800; credit Uncollectible Accounts Expense, \$800
 - (D) Debit Allowance for Doubtful Accounts, \$15,800; credit Uncollectible Accounts Expense, \$15,800
 - (E) Debit Uncollectible Accounts Expense, \$14,200; credit Accounts Receivable, \$14,200
- 17.** Allowance for Doubtful Accounts has a debit balance of \$500 at the end of the year (before adjustment), and uncollectible accounts expense is estimated at 3% of net sales. If net sales are \$600,000, the amount of the adjusting entry to record the provision for Doubtful Accounts is
- (A) \$18,500
 - (B) \$17,500
 - (C) \$18,000
 - (D) \$19,000
 - (E) None of the above

18. A 60-day, 10% note for \$8,000, dated April 15, is received from a customer on account. The face value of the note is

- (A) \$8,600
- (B) \$7,200
- (C) \$8,800
- (D) \$8,000
- (E) \$8,133

19. Under which method of cost flows is the inventory assumed to be composed of the most recent costs?

- (A) Average cost
- (B) Last-in, first-out
- (C) First-in, first-out
- (D) Weighted average
- (E) Specific identification

20. The inventory data for an item for November are

Using the perpetual system, costing by the last-in, first-out method, what is the cost of the merchandise inventory of 30 units on November 30?

- (A) \$640
- (B) \$610
- (C) \$620
- (D) \$630
- (E) \$660

21. The following lots of a particular commodity were available for sale during the year

The firm uses the periodic system and there are 20 units of the commodity on hand at the end of the year. What is the amount of inventory at the end of the year according to the first-in, first-out method?

- (A) \$1,030
- (B) \$1,140
- (C) \$1,170
- (D) \$1,060
- (E) \$1,080

- 22.** During a period of consistently rising prices, the method of inventory that will result in reporting the greatest cost of merchandise sold is
- (A) FIFO
 - (B) LIFO
 - (C) average cost
 - (D) weighted average
 - (E) lower of cost or market
- 23.** Which of the following should a company typically do before updating the appropriate ledger accounts?
- (A) Construct a trial balance
 - (B) Record transactions in the journal
 - (C) Prepare adjusting entries
 - (D) Prepare an adjusted trial balance
 - (E) None of the above
- 24.** A building with an appraisal value of \$137,000 is made available at an offer price of \$142,000. The purchaser acquires the property for \$30,000 in cash, a 90-day note payable for \$40,000, and a mortgage amounting to \$60,000. The cost basis recorded in the buyer's accounting records to recognize this purchase is
- (A) \$137,000
 - (B) \$142,000
 - (C) \$130,000
 - (D) \$100,000
 - (E) \$70,000
- 25.** The method of determining depreciation that yields successive reductions in the periodic depreciation charge over the estimated life of the asset is
- (A) units-of-production
 - (B) declining-balance
 - (C) straight-line
 - (D) time-valuation
 - (E) All of the above

CLEP Financial Accounting

- 26.** Equipment with a cost of \$160,000 has an estimated residual value of \$10,000 and an estimated life of 5 years or 12,000 hours. It is to be depreciated by the straight-line method. What is the amount of depreciation for the first full year, during which the equipment was used 3,300 hours?
- (A) \$30,000
 - (B) \$32,500
 - (C) \$34,000
 - (D) \$40,000
 - (E) \$64,000
- 27.** A fixed asset with a cost of \$40,000 and accumulated depreciation of \$36,500 is traded for a similar asset priced at \$60,000. Assuming a trade-in allowance of \$3,000, the recognized loss on the trade is
- (A) \$1,000
 - (B) \$3,500
 - (C) \$500
 - (D) \$1,500
 - (E) \$20,000
- 28.** On June 8, Acme Co. issued an \$80,000, 6%, 120-day note payable to Still Co. What is the maturity value of the note?
- (A) \$80,100
 - (B) \$84,800
 - (C) \$81,600
 - (D) \$81,200
 - (E) \$80,000
- 29.** The journal entry a company uses to record the estimated accrued product warranty liability is
- (A) debit Product Warranty Expense; credit Product Warranty Payable
 - (B) debit Product Warranty Payable; credit Cash
 - (C) debit Product Warranty Expense; credit Cash
 - (D) debit Product Warranty Payable; credit Product Warranty Expense
 - (E) debit Cash; credit Product Warranty Expense

- 30.** If the straight-line method of amortization of bond premium or discount is used, which of the following statements is true?
- (A) Annual interest expense will increase over the life of the bonds with the amortization of bond premium.
 - (B) Annual interest expense will remain the same over the life of the bonds with the amortization of bond discount.
 - (C) Annual interest expense will decrease over the life of the bonds with the amortization of bond discount.
 - (D) Annual interest expense will increase over the life of the bonds with the amortization of bond discount.
 - (E) Annual interest expense will decrease over the life of the bonds with the amortization of bond premium.
- 31.** During the current year, the North Company purchased 200 shares of the South Company stock for \$12,000 as a temporary investment. At the end of the year, the market value of the stock was \$10,000. The North Company's financial statements for the current year should show
- (A) a loss of \$2,000 on the income statement and temporary investments of \$12,000 on the balance sheet
 - (B) no loss on the income statement and temporary investments of \$12,000 on the balance sheet
 - (C) a gain of \$2,000 on the income statement and temporary investments of \$10,000 on the balance sheet
 - (D) a loss of \$2,000 on the income statement and temporary investments of \$10,000 on the balance sheet
 - (E) no loss on the income statement and temporary investments of \$10,000 on the balance sheet
- 32.** Bean Corporation purchased 35% of the outstanding shares of common stock of Williams Corporation as a long-term investment. Subsequently, Williams Corporation reported net income and declared and paid cash dividends. What journal entry would Bean Corporation use to record its share of the earnings of Williams Corporation?
- (A) Debit Investment in Williams Corporation Stock; credit Cash
 - (B) Debit Cash; credit Dividend Revenue
 - (C) Debit Investment in Williams Corporation; credit Income of Williams Corporation
 - (D) Debit Cash; credit Investment in Williams Corporation
 - (E) Debit Investment in Williams Corporation; credit Dividend Revenue

- 33.** The amortization of discount on bonds purchased as a long-term investment
- (A) decreases the amount of interest expense
 - (B) increases the amount of the investment account
 - (C) decreases the amount of the investment account
 - (D) increases the amount of interest expense
 - (E) has no effect on the amount of interest expense
- 34.** A corporation issues 2,000 shares of common stock for \$32,000. The stock has a stated value of \$10 per share. The journal entry to record the stock issuance would include a credit to Common Stock for
- (A) \$20,000
 - (B) \$32,000
 - (C) \$12,000
 - (D) \$2,000
 - (E) \$64,000
- 35.** The entry to record the issuance of common stock at a price above par includes a debit to
- (A) Organizational Expenses
 - (B) Common Stock
 - (C) Cash
 - (D) Paid-In Capital in Excess of Par-Common Stock
 - (E) Preferred Stock
- 36.** The charter of a corporation provides for the issuance of 100,000 shares of common stock. Assume that 50,000 shares were originally issued and 5,000 were subsequently reacquired. What is the amount of cash dividends to be paid if a \$1 per share dividend is declared?
- (A) \$50,000
 - (B) \$5,000
 - (C) \$100,000
 - (D) \$55,000
 - (E) \$45,000
- 37.** A company with 100,000 authorized shares of \$4 par common stock issued 40,000 shares at \$8. Subsequently, the company declared a 2% stock dividend on a date when the market price was \$11 a share. What is the amount transferred from the retained earnings account to paid-in capital accounts as a result of the stock dividend?
- (A) \$3,200
 - (B) \$6,400
 - (C) \$4,800
 - (D) \$8,800
 - (E) \$8,000

38. How is treasury stock shown on the balance sheet?

- (A) As an asset
- (B) As a decrease in stockholders' equity
- (C) As an increase in stockholders' equity
- (D) As a liability
- (E) None of the above

39. Treasury stock that had been purchased for \$5,400 last month was reissued this month for \$7,500. The journal entry to record the reissuance would include a credit to

- (A) Treasury Stock for \$7,500
- (B) Paid-In Capital from Treasury Stock for \$7,500
- (C) Paid-In Capital in Excess of Par/Common for \$2,100
- (D) Treasury Stock for \$2,100
- (E) Paid-In Capital from Treasury Stock for \$2,100

40. Using a perpetual inventory system, the entry to record the return from a customer of merchandise sold on account includes a

- (A) credit to Sales Returns and Allowances
- (B) debit to Merchandise Inventory
- (C) credit to Merchandise Inventory
- (D) debit to Cost of Merchandise Sold
- (E) debit to Accounts Receivable

41. Merchandise with a sales price of \$500 is sold on account with terms 2/10, n/30. The journal entry to record the sale would include a

- (A) Debit to Cash for \$500
- (B) Debit to Sales Discounts for \$10
- (C) Credit to Sales for \$500
- (D) Debit to Accounts Receivable for \$490
- (E) Credit to Sales for \$490

42. Which of the following accounts has a normal credit balance?

- (A) Sales Returns and Allowances
- (B) Sales
- (C) Merchandise Inventory
- (D) Transportation Out
- (E) Sales Discounts

- 43.** Which of the following would appear as an extraordinary item on the income statement?
- (A) Loss resulting from the sale of fixed assets
 - (B) Gain resulting from the disposal of a segment of the business
 - (C) Loss from land condemned for public use
 - (D) Liquidating dividend
 - (E) Inventory shrinkage costs
- 44.** When the number of common shares outstanding has changed during the year, net income is divided by
- (A) weighted-average shares outstanding of both common and preferred
 - (B) weighted-average shares outstanding of common
 - (C) number of common shares outstanding at the balance sheet date
 - (D) number of common shares outstanding at the beginning of the accounting period
 - (E) number of common shares authorized
- 45.** A person authorized to write checks drawn on a checking account at a bank must sign and have on file with the bank a
- (A) signature card
 - (B) deposit ticket
 - (C) checkbook
 - (D) bank card
 - (E) withdrawal slip
- 46.** The amount of deposits in transit is included on the bank reconciliation as a(n)
- (A) deduction from the balance per the depositor's books
 - (B) deduction from the balance per bank statement
 - (C) addition to the balance per bank statement
 - (D) addition to the balance per depositor books
 - (E) None of the above
- 47.** Fred and Ethel share income equally. During the current year the partnership net income was \$40,000. Fred made withdrawals of \$12,000 and Ethel made withdrawals of \$17,000. At the beginning of the year, the capital account balances were: Fred capital, \$42,000; Ethel capital, \$58,000. Fred's capital account balance at the end of the year is
- (A) \$76,500
 - (B) \$64,500
 - (C) \$62,000
 - (D) \$50,000
 - (E) \$42,000

- 48.** X and Y have original investments of \$50,000 and \$100,000, respectively, in a partnership. The articles of partnership include the following provisions regarding the division of net income: interest on original investment at 10%; salary allowances of \$27,000 and \$18,000, respectively; and the remainder equally. How much of the net income of \$90,000 is allocated to X?
- (A) \$60,000
 - (B) \$43,000
 - (C) \$45,000
 - (D) \$47,000
 - (E) \$5,000
- 49.** A ten-year bond was issued at par for \$150,000 cash. This transaction should be shown on a statement of cash flows under
- (A) investing activities
 - (B) financing activities
 - (C) noncash investing and financing activities
 - (D) operating activities
 - (E) None of the above
- 50.** Land costing \$47,000 was sold for \$78,000 cash. The gain on the sale was reported on the income statement as other income. On the statement of cash flows, what amount should be reported as an investing activity from the sale of land?
- (A) \$78,000
 - (B) \$47,000
 - (C) \$109,000
 - (D) \$31,000
 - (E) \$125,000
- 51.** Sales for the year were \$600,000. Accounts receivable were \$100,000 and \$80,000 at the beginning and end of the year. Cash received from customers to be reported on the cash flow statement using the direct method is
- (A) \$700,000
 - (B) \$600,000
 - (C) \$580,000
 - (D) \$620,000
 - (E) \$680,000

- 52.** The following financial information was summarized from the accounting records of Block Corporation for the current year ended December 31:

The gross profit for the Software Division is

- (A) \$47,800
 - (B) \$20,600
 - (C) \$13,240
 - (D) \$33,280
 - (E) \$67,800
- 53.** Stevenson Corporation had \$275,000 in invested assets, sales of \$330,000, income from operations amounting to \$49,500 and a desired minimum rate of return of 7.5%. The rate of return on investment for Stevenson Corporation is
- (A) 8%
 - (B) 10%
 - (C) 18%
 - (D) 7.5%
 - (E) 15%
- 54.** Based on the following data, what is the amount of quick assets?
- (A) \$163,000
 - (B) \$195,000
 - (C) \$121,000
 - (D) \$56,000
 - (E) \$85,000
- 55.** The numerator used to calculate accounts receivable turnover is
- (A) total sales
 - (B) net sales on account
 - (C) accounts receivable at year-end
 - (D) average accounts receivable
 - (E) net accounts receivable

56. The balance sheets at the end of each of the first two years of operations indicate the following:

If net income is \$115,000 and interest expense is \$30,000 for 2006 what is the rate earned on total assets for 2006 (round percent to one decimal point)?

- (A) 9.3%
- (B) 10.1%
- (C) 8.0%
- (D) 7.4%
- (E) 12.0%

57. Suppose that at the end of a reporting period, Company A has revenues of \$25,000. Which of the following is a proper step in the closing of the Revenues account?

- (A) Debit Income Summary, \$25,000
- (B) Credit Revenues, \$25,000
- (C) Debit Retained Earnings, \$25,000
- (D) Credit Income Summary, \$25,000
- (E) None of the above

58. When should a company typically prepare and post adjusting entries?

- (A) Immediately after recording all transactions in the journal
- (B) Immediately after preparing an adjusted trial balance
- (C) Immediately after producing formal financial statements
- (D) Immediately after constructing a trial balance
- (E) Immediately before producing formal financial statements

59. Which of the following practices is unethical?

- (A) Depreciating an asset over its useful life
- (B) Using the FIFO costing method for inventory
- (C) Using the LIFO costing method for inventory
- (D) Declaring goodwill as an asset
- (E) Changing the costing method for inventory to improve income in a certain period

60. According to the principle of periodicity, which of the following is true?

- (A) A company should file a financial statement only once in its lifetime
- (B) Business activity should be divided into clearly demarcated intervals
- (C) A company has to file a financial statement within a two week period
- (D) Accountants should be conservative in their projections
- (E) None of the above

61. A company's financial statements should do which of the following?

- I. Convince investors to invest in the company
- II. Inform investors about the financial condition of the company
- III. Disclose the revenues generated and expenses incurred by the company over a specific period

- (A) I only
- (B) II only
- (C) III only
- (D) I and II only
- (E) II and III only

62. Which of the following financial statements will be affected by an increase in revenues (without an offsetting increase in expenses)?

- I. Income statement
- II. Balance sheet
- III. Statement of retained earnings

- (A) I only
- (B) II only
- (C) III only
- (D) I and II only
- (E) I, II, and III

63. Suppose that a company purchases land, which it pays for by issuing a long-term bond at par. If the company does not have to pay interest on the bond for a year, the land purchase will lead to which of the following for the current fiscal year?

- (A) Increase in assets
- (B) Decrease in liabilities
- (C) Decrease in net income
- (D) Increase in net income
- (E) Decrease in assets

64. When assets increase, which of the following must occur?

- (A) Liabilities increase
- (B) The sum of liabilities and owners' equity increases
- (C) Retained earnings increase
- (D) Net income increases
- (E) Retained earnings decrease

- 65.** When a company receives cash for an item that was purchased on credit during the previous fiscal year, which of the following is true?
- (A) The company's balance sheet is affected because assets decrease
 - (B) The company's balance sheet is affected because assets increase
 - (C) The company's income statement is unaffected
 - (D) The company's income statement is affected because revenue increases
 - (E) The company's statement of retained earnings is affected because retained earnings rise
- 66.** Which of the following statements about a corporation is not true?
- (A) It must be publicly traded.
 - (B) It exists as a separate legal entity.
 - (C) It permits people to join in mutual ownership of a business concern.
 - (D) It can exist even after the death of incorporators.
 - (E) All of the above
- 67.** Limited liability is generally seen to be an advantage associated with corporations. What does limited liability mean?
- (A) Shareholders cannot lose money from their investment in a corporation.
 - (B) Shareholders cannot gain more than they invested.
 - (C) Shareholders cannot lose more than they invested.
 - (D) Shareholders have no control over the appointment of corporate directors.
 - (E) Shareholders must limit their stake to no more than 5% of a corporation.
- 68.** Which of the following lines should be included on the income statement of a company with a loss from an available for sale security?
- (A) Extraordinary item
 - (B) Uninsured loss
 - (C) Other operating expenses
 - (D) Other comprehensive income adjustments from certain investments
 - (E) None of the above
- 69.** Of the following choices, which of the following is typically located lowest on the income statement?
- (A) Gross profit
 - (B) Cost of goods sold
 - (C) Income before tax
 - (D) Income tax expense
 - (E) Net income

- 70.** Double taxation in the United States typically includes which of the following?
- (A) Taxation of corporate income and dividends
 - (B) Taxation of personal income and dividends
 - (C) Taxation of capital gains and capital losses
 - (D) Taxation at twice the maximum rate
 - (E) None of the above
- 71.** Under which of the following circumstances must a company report results from discontinued operations?
- (A) When the company sells a key piece of equipment
 - (B) When the company exits a separate business unit
 - (C) When the company buys back shares
 - (D) When the company loses money
 - (E) When the company experiences an extraordinary loss
- 72.** Suppose that a company estimates that 10% of its sales will not be collectible. If it sells \$1,000,000 worth of goods, which of the following journal entries reflects the company's estimate?
- (A) Debit Allowance for Uncollectible Accounts, \$100,000; credit Uncollectible Accounts Expense, \$100,000
 - (B) Credit Allowance for Uncollectible Accounts, \$100,000
 - (C) Debit Uncollectible Accounts Expense, \$100,000; credit Allowance for Uncollectible Accounts, \$100,000
 - (D) Debit Uncollectible Accounts Expense, \$100,000; credit Allowance for Uncollectible Accounts, \$1,000,000
 - (E) Debit Uncollectible Accounts Expense, \$1,000,000; credit Allowance for Uncollectible Accounts, \$100,000
- 73.** Suppose that a company purchases a patent with a useful life of 10 years for \$100,000. If it chooses to account for the cost of the patent on a straight-line basis, which of the following annual expenses should it record?
- (A) Depreciation Expense of \$10,000
 - (B) Depletion Expense of \$10,000
 - (C) Amortization Expense of \$10,000
 - (D) Depreciation Expense of \$100,000
 - (E) None of the above

74. If a company facing a 35% tax rate has income before taxes of \$100,000, sales returns and allowances of \$30,000, and sales of \$160,000, what is its net profit on sales?
- (A) 30%
 - (B) 40.625%
 - (C) 45%
 - (D) 50%
 - (E) 62.5%
75. Suppose that a company has purchased an oil well for \$5,000,000 that it plans to sell for \$1,000,000 once it has finished extracting 100,000 barrels of oil. What is the depletion per barrel of oil?
- (A) \$10
 - (B) \$40
 - (C) \$50
 - (D) \$60
 - (E) \$1,000,000

ANSWER. KEY.

Peterson's Practice Test for CLEP Financial Accounting

- 1. The correct answer is D.** Under the business entity concept, the activities of a business are recorded separately from the activities of the stakeholders.
 - 2. The correct answer is D.** The objectivity concept requires that the accounting records and reports be based upon objective evidence. For example, amounts paid are verifiable and considered objective.
 - 3. The correct answer is B.** Debits increase assets, drawing, and expense accounts, and decrease liabilities, capital, and revenue accounts.
 - 4. The correct answer is E.** Accounts that are increased with a debit (assets, expenses, and drawing) will normally have a debit balance. Accounts that are increased with a credit (liabilities, capital, and revenue) will normally have a credit balance.
 - 5. The correct answer is D.** A payment of an account payable is a decrease of cash (an asset) and a decrease of the payable (a liability). Assets are decreased with a credit and liabilities are decreased with a debit.
 - 6. The correct answer is C.** The amount owed (account payable, which is a liability) and the office supplies (an asset) decreased. Assets are decreased with a credit and liabilities are decreased with a debit.
 - 7. The correct answer is B.** Adjusting entries affect one balance sheet account and one income statement account. Owner's equity is affected by revenues and expenses, therefore, either assets or liabilities are the balance sheet accounts affected by adjusting entries. An increase to an expense would increase a liability or a contra asset.
 - 8. The correct answer is A.** As the assets are used up, they become expenses. Prepaid Rent used during a period becomes Rent Expense.
 - 9. The correct answer is B.** Resources available for use by an entity are considered assets.
 - 10. The correct answer is B.** Credits in the Income Statement columns of the work sheet represent revenues and debits in the Income Statement represent expenses. If the total of the credits exceeds the total of the debits, then revenues have exceeded expenses and the result is net income.
 - 11. The correct answer is D.** Account balances are not updated unless journal entries are prepared and posted. Therefore, revenues, expenses, and drawings are not transferred to the owner's equity unless closing entries are recorded and posted.
 - 12. The correct answer is C.** The accounting equation must always be in balance; therefore, when the total assets change, there will be an equal change to the total liabilities and owner's equity. Since the owner's equity increased and the total assets decreased, the change in total liabilities must be a \$71,000 decrease (\$47,000 + \$24,000) to balance both of those changes.
 - 13. The correct answer is B.** Supplies are an asset until they are used. The purchase increases assets.
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Because the purchase has not yet been paid for, a liability has been incurred.

14. The correct answer is B. The accounting equation must always be in balance. Therefore, total liabilities can be deducted from total assets to determine owner's equity. At the end of 2005, the owner's equity was \$640,000. The beginning owner's equity balance was increased for additional investments and revenues, and decreased for withdrawals and expenses to arrive at the owner's equity balance at the end of the year. With the investment of \$50,000 and the withdrawal of \$30,000, the owner's equity in 2006 should have a net gain of \$20,000 and be \$660,000. However, the actual owner's equity at the end of 2006 was \$725,000; therefore, the net income during 2006 must be \$65,000 (\$725,000 – \$660,000).

15. The correct answer is C. The income statement shows revenues less expenses to arrive at net income (loss) for the accounting period.

16. The correct answer is B. When the estimate for doubtful accounts is based on the amount and the age of the receivable accounts at the end of the period, the adjusting entry is recorded so that the balance of the allowance account will equal the estimated doubtful accounts at the end of the period.

17. The correct answer is C. When the estimate for doubtful accounts is based on the amount of sales for the period, the adjusting entry is made without regard to the balance of the allowance account. Therefore, the adjusting entry is: $0.03 \times \$600,000 = \$18,000$.

18. The correct answer is D. The face value of a promissory note is the amount borrowed.

19. The correct answer is C. Under the FIFO method, the oldest inventory is assumed to be sold first, leaving the most recent purchases in ending inventory.

20. The correct answer is D. Under the LIFO method, the newest inventory is assumed to be sold first, leaving the oldest costs in ending inventory. In a perpetual inventory system, the cost of the inventory is determined after each transaction. At the end November, there were 10 units from the Nov. 1 inventory (at \$20), 10 units from the Nov. 10 purchase (at \$21), and 10 units from the Nov. 30 purchase (at \$22). Therefore, the cost of the merchandise inventory on November 30 is: $(10 \times \$20) + (10 \times \$21) + (10 \times \$22) = \$200 + \$210 + \$220 = \$630$.

21. The correct answer is C. Under the FIFO method, the oldest inventory is assumed to be sold first, leaving the most recent purchases in ending inventory. In a periodic system, the cost of the inventory is determined at the end of the period. At the end of the year, there were 15 units from the third purchase (at \$60) and 5 units from the second purchase (at \$54). Therefore, the amount of inventory is: $(15 \times \$60) + (5 \times \$54) = \$900 + \$270 = \$1,170$.

22. The correct answer is B. Under the LIFO method, the newest inventory is assumed to be sold first. These costs become cost of merchandise sold. If prices are consistently rising, the newest inventory will always be the most expensive.

23. The correct answer is B. Before a company posts journal entries to the appropriate ledger accounts, it should record transactions in the journal. Recording transactions in the journal is the first step in the accounting cycle.

24. The correct answer is C. The cost basis of an asset is the amount paid. In this case, that includes the

cash used and the face value of the notes ($\$30,000 + \$40,000 + \$60,000 = \$130,000$).

25. The correct answer is B. The declining-balance method provides a declining periodic expense over the estimated useful life of the asset. The straight-line rate is doubled and then multiplied by the book value of the asset to determine the depreciation expense for the period.

26. The correct answer is A. Under the straight-line method, depreciation expense is determined by deducting the residual value from the cost, then dividing by the estimated life of the asset (in years). In this case the depreciation expense is: $(\$160,000 - \$10,000) \div 5 = \$150,000 \div 5 = \$30,000$.

27. The correct answer is C. The book value of the asset is: $\$40,000 - \$36,500 = \$3,500$. The trade-in allowance was less than the book value of the asset by \$500; therefore, there is a \$500 loss recorded on the transaction.

28. The correct answer is C. The maturity value of the note includes the face value (\$80,000) and the interest incurred (6% for 120 days, or \$1,600). Therefore, the maturity value is: $\$80,000 + \$1,600 = \$81,600$.

29. The correct answer is A. If a company grants a warranty on a product, an estimated warranty expense and liability should be recorded in the period of the sale.

30. The correct answer is B. The straight-line method of amortizing a bond discount provides for amortization in equal periodic amounts. This is added to the interest payments (which are also equal periodic amounts) to determine interest expense.

31. The correct answer is D. Temporary investments classified as trading are to be reported on the balance sheet at fair market value. Any difference between the fair market value and their cost is reported as a gain or loss in the income statement.

32. The correct answer is C. Under the equity method, the investor's share of the net income (loss) is an increase (decrease) to the investment account. The dividends received by the investor are an increase to cash and a decrease to the investment account.

33. The correct answer is B. When bonds are purchased as an investment, the cost of the bonds is recorded in a single account, not separate accounts for the face value and the premium or discount. The amortization of the premium or discount affects the investment account.

34. The correct answer is A. When stock is issued above par or stated value, Cash or other asset accounts are debited. Common Stock is credited for the amount of par or stated value and the excess is credited to Paid-in Capital in Excess of Par or Paid-in Capital in Excess of Stated Value. Therefore, the amount of credit to Common Stock is $\$10 \times 2,000$, or \$20,000.

35. The correct answer is C. When stock is issued above par or stated value, Cash or other asset accounts are debited. Common Stock is credited for the amount of par or stated value and the excess is credited to Paid-in Capital in Excess of Par or Paid-in Capital in Excess of Stated Value.

36. The correct answer is E. Only shares that are outstanding receive dividends. Shares that are reacquired by the issuing corporation do not receive dividends. Therefore, only the 45,000 outstanding shares receive the \$1 dividend.

37. The correct answer is D. Stock dividends are distributed on outstanding shares. 800 shares will be distributed ($40,000 \text{ shares} \times 2\%$). The amount transferred from retained earnings will be equal to the market price of those shares ($800 \times \$11 = \$8,800$).

38. The correct answer is B. The balance in the treasury stock account is reported as a deduction from the total paid-in capital and retained earnings. This is because the stock is not considered to be outstanding but it is still considered to be issued.

39. The correct answer is E. When Treasury Stock is sold, account is decreased for the purchase price of each share. Any difference in the purchase price and selling price is recorded in the Paid-in Capital from Treasury Stock account.

40. The correct answer is B. When a customer returns merchandise, the seller must add the cost of the merchandise back to the merchandise inventory account since the merchandise has been returned.

41. The correct answer is C. When merchandise is sold and a discount for early payment is offered, the Sales account is credited for the full amount of the sale. Discounts taken by the customer are not recorded until the cash is received.

42. The correct answer is B. Sales is a revenue account and is increased with a credit. Therefore, its normal balance is a credit.

43. The correct answer is C. Extraordinary items result from events and transactions that (1) are significantly different (unusual) from the typical or the normal operating activities of the business and (2) occur infrequently.

44. The correct answer is B. Earnings per share is reported on the financial statements of corporations whose stock is publicly traded. Net income less any preferred dividends is divided by the number of common shares outstanding. If the number of common share outstanding has changed during the period, the weighted-average shares outstanding of common stock should be used as the denominator.

45. The correct answer is A. A signature card is used by a bank to verify the signature on checks that are submitted for payment. All persons authorized to write checks drawn on an account must sign a signature card.

46. The correct answer is C. Deposits recorded in the depositor's records but not appearing on the bank statement must be added to the bank statement balance during reconciliation to arrive at the adjusted bank balance.

47. The correct answer is D. Fred's beginning capital balance was \$42,000. Add his share of the net income of \$20,000 and deduct his withdrawals of \$12,000. This leaves an ending balance of \$50,000.

48. The correct answer is D. After interest on each partner's original investment and salary allowances are deducted from net income, \$30,000 is left from net income to be divided equally. Therefore, X will receive interest (\$5,000) plus salary allowance (\$27,000) plus his share of the remaining net income (\$15,000) for a total of \$47,000.

49. The correct answer is B. Bonds issued by a company provide a cash inflow used to finance the company. Therefore, cash received for the issuance of debt securities is in the financing activities section of the statement of cash flows.

50. The correct answer is A. The cash flow resulting from the sale of land is reported in the investing activities section of the statement of cash flows. The gain or loss is addressed in the operating activities section.

51. The correct answer is D. To determine the cash received from sales to customers, \$600,000 must be adjusted to convert the sales reported to the cash received from customers. The decrease in accounts receivable of \$20,000 indicates that the cash received on accounts exceeded the sales for the period; therefore, \$20,000 is added to the \$600,000 sales.

52. The correct answer is A. Net sales less cost of goods sold is gross profit. Therefore, the gross profit for the Software Division is: $\$95,000 - \$47,200 = \$47,800$.

53. The correct answer is C. Rate of return on investment is income from operations divided by invested assets. Therefore, the rate of return on investment for Stevenson Corporation is: $\$49,500 \div \$275,000 = 18\%$.

54. The correct answer is C. Quick assets are cash and those assets that can be quickly converted to cash. This would include marketable securities and accounts receivable. Therefore, the amount of quick assets is: $\$20,000 + \$36,000 + \$65,000 = \$121,000$.

55. The correct answer is B. The accounts receivable turnover ratio is computed by dividing net sales on account by the average net accounts receivable.

56. The correct answer is A. Rate of return on total assets is computed by adding interest expense to net income then dividing the sum by total assets: $(\$115,000 + \$30,000) \div (\$600,000 + \$60,000 + \$900,000) = 9.3\%$.

57. The correct answer is D. To close the Revenues account, the company should debit \$25,000 from Revenues and credit \$25,000 to Income Summary, which is a temporary account used in the closing process. The retained earnings account is adjusted only when income summary is closed.

58. The correct answer is D. After constructing a trial balance, a company should prepare and post adjusting entries. An adjusted trial balance should be prepared only after adjusting entries are prepared and posted, and formal financial statements should be produced only after an adjusted trial balance is prepared.

59. The correct answer is E. Companies should change the costing method for inventory only for good cause, not just to improve income in a certain period. It is important to note that both FIFO and LIFO comply with GAAP. Depreciating an asset over its useful life is a necessary practice for long-lived assets. Goodwill should be declared as an asset when one business buys another business for more than fair value.

60. The correct answer is B. The principle of periodicity requires that business activity be divided into intervals. For this reason, companies must produce periodic reports. Public companies in the United States produce reports at quarterly intervals.

61. The correct answer is E. Financial statements are designed to provide information about the condition

of a company. A key financial statement, the income statement, summarizes the revenues generated and expenses incurred by a company over the reporting period.

62. The correct answer is E. Revenues are reported on the income statement, so an increase in revenues must affect the income statement. Since an increase in revenues not offset by an increase in expenses raises net income, retained earnings increase. Thus, the statement of retained earnings must also be affected. Since retained earnings increase and retained earnings are a component of the balance sheet, the balance sheet must also be affected.

63. The correct answer is A. Since land is an asset and a long-term bond is a liability, when a company purchases land while issuing a long-term bond, both assets and liabilities increase. Since the company does not have to pay interest on the bond for a year, net income is not affected. Going forward, it will be affected because interest expenses will increase.

64. The correct answer is B. According to the fundamental accounting equation, assets are equal to the sum of liabilities and owners' equity. Therefore, when assets increase, the sum of liabilities and owners' equity increases. In terms of financial statements, an increase in assets has to affect at least the balance sheet and can affect all financial statements.

65. The correct answer is C. When a company receives cash for an item that was purchased on credit, cash increases and accounts receivable fall. This changes the composition of the balance sheet, but it does not affect the total amount of company assets. Moreover, neither the statement of retained earnings nor the income statement is affected.

66. The correct answer is A. A corporation does not need to be publicly traded since the stock of a closely held (or private) corporate entity is not publicly traded.

67. The correct answer is C. Limited liability means that a shareholder cannot lose more money than he or she invested. It is important to note, however, that this does not mean that a shareholder is protected from all losses.

68. The correct answer is D. Changes in the value of available for sale securities are recorded under other comprehensive income, so when an available for sale security loses value, other comprehensive income adjustments from certain investments should be negative (making comprehensive income lower than net income).

69. The correct answer is E. Of the choices provided, net income is typically on the lowest line. Indeed, the phrase "bottom line," which refers to net income, is derived from the fact that net income tends to be located on the bottom line of the income statement.

70. The correct answer is A. The taxation of corporate income and dividends is seen as double taxation. When corporations pay tax, the dividends they distribute are after-tax amounts. When investors pay tax on the dividends they receive, they are thus paying tax on an asset that has already been taxed.

71. The correct answer is B. A company must report results from discontinued operations when it exits a separate business unit—that is, a unit that is readily distinguishable from the rest of the company's businesses.

72. The correct answer is C. If 10% of sales are estimated to be uncollectible, the company must credit

\$100,000 to Allowance for Uncollectible Accounts and debit \$100,000 from Uncollectible Accounts Expense. The company is treating \$100,000 of its sales as an expense because they represent bad debt.

73. The correct answer is C. Since a patent is an intangible asset, its cost is amortized over its useful life. With straight-line amortization, the company's annual amortization expense for the patent is \$10,000.

74. The correct answer is D. Net profit on sales is the ratio of net income (income after taxes) to net sales (sales after returns and allowances as well as discounts). Since income before taxes is equal to \$100,000 and the tax rate is equal to 35%, net income is equal to \$65,000. Since sales are equal to \$160,000 and sales returns and allowances are equal to \$30,000, net sales is equal to \$130,000. Thus, the company's net profit on sales is equal to 50%.

75. The correct answer is B. The depletion per barrel is equal to the depletable base (the initial cost minus the estimated residual value) divided by the estimated number of barrels of production. Since the depletable base is \$4,000,000 and 100,000 barrels of oil will be extracted, the depletion per barrel of oil is equal to \$40.