Financial Accounting

CREDIT HOURS 3
LEVEL LOWER

PUBLISHED NOVEMBER 2017

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Before You Choose This UExcel Exam

Uses for the Examination

• Excelsior College, the test developer, recommends granting three (3) semester hours of lower-level undergraduate credit to students who receive a letter grade of C or higher on this examination. The examination may be used to help fulfill a core requirement for Business degrees or as a free elective for all Excelsior College degree programs that allow for free electives.

• Other colleges and universities also recognize this exam as a basis for granting credit or advanced standing.

• Individual institutions set their own policies for the amount of credit awarded and the minimum acceptable score.

Exam-takers who have applied to Excelsior College should ask their academic advisor where this exam fits within their degree program.

Exam-takers not enrolled in an Excelsior College degree program should check with the institution from which they wish to receive credit to determine whether credit will be granted and/or to find out the minimum grade required for credit. Those who intend to enroll at Excelsior College should ask an admissions counselor where this exam fits within their intended degree program.

Examination Length and Scoring

The examination consists of approximately 120 questions, most of which are multiple choice; for samples of all the item types on this exam, see the sample items in the back of this guide. Some items are unscored, pretest items. The pretest items are embedded throughout the exam and are indistinguishable from the scored items. You will have two (2) hours to complete the examination. Your score will be reported as a letter grade.

UExcel Exam Resources

Excelsior College Bookstore

The Excelsior College Bookstore offers recommended textbooks and other resources to help you prepare for UExcel exams.

The bookstore is available online at:
www.excelsior.edu/bookstore

UExcel Practice Exams

The official UExcel practice exams are highly recommended as part of your study plan. Once you register for your UExcel exam, you are eligible to purchase the corresponding practice exam, which can be taken using any computer with a supported Web browser. Each practice exam includes two forms that you may take within a 180-day period.
Excelsior College Library

Enrolled Excelsior College students can access millions of authoritative resources online through the Excelsior College Library. Created through our partnership with the Sheridan Libraries of The Johns Hopkins University, the library provides access to journal articles, books, websites, databases, reference services, and many other resources. Special library pages relate to the nursing degree exams and other selected exams. To access it, visit www.excelsior.edu/library (login is required).

Our library provides:

- 24/7 availability
- The world’s most current authoritative resources
- Help and support from staff librarians

Online Tutoring

Excelsior College offers online tutoring through SMARTTHINKING™ to connect with tutors who have been trained in a variety of academic subjects. To access SMARTTHINKING, go to www.excelsior.edu/smarthinking. Once there, you may download a copy of the SMARTTHINKING Student Handbook as a PDF.

MyExcelsior Community

MyExcelsior Community enables Excelsior College students and alumni to interact with their peers online. As members, students can participate in real-time chat groups, join online study groups, buy and sell used textbooks, and share Internet resources. Enrolled students have automatic access from their MyExcelsior page. Visit www.excelsior.edu/myexcelsiorcommunity.

Preparing for UExcel Exams

How Long Will It Take Me to Study?

A UExcel exam enables you to show that you’ve learned material comparable to one or more 15-week college-level courses. As an independent learner, you should study and review as much as you would for a college course. For a 3-credit course in a subject they don’t know, most students would be expected to study nine hours per week for 15 weeks, for a total of 135 hours.

Study Tips

Become an active user of the resource materials. Become an active user of the resource materials. Aim for understanding rather than memorization. The more active you are when you study, the more likely you will be to retain, understand, and apply the information.

The following techniques are generally considered to be active learning:

- preview or survey each chapter
- highlight or underline text you believe is important
- write questions or comments in the margins
- practice re-stating content in your own words
- relate what you are reading to the chapter title, section headings, and other organizing elements of the textbook
- find ways to engage your eyes, your ears, and your muscles, as well as your brain, in your studies
- study with a partner or a small group (if you are an enrolled student, search for partners on MyExcelsior Community)
- prepare your review notes as flashcards or create recordings that you can use while commuting or exercising

When you feel confident that you understand a content area, review what you have learned. Take a second look at the material to evaluate your understanding. If you have a study partner, the two of you can review by explaining the content to each other or writing test questions for each other to answer. Review questions from textbook chapters may be helpful for partner or individual study, as well.
Using UExcel Practice Exams

We recommend taking the first form of the practice exam when you begin studying, to see how much you already know. After taking the first practice exam, check your performance on each question and find out why your answer was right or wrong. This feedback will help you improve your knowledge of the subject and identify areas of weakness that you should address before taking the exam. Take the second form of the practice exam after you have finished studying. Analyze your results to identify the areas that you still need to review.

Although there is no guarantee, our research suggests that students who do well on the practice exams are more likely to pass the actual exam than those who do not do well (or do not take advantage of this opportunity).

About Test Preparation Services

Preparation for UExcel® exams and Excelsior College® Examinations, though based on independent study, is supported by Excelsior College with a comprehensive set of exam learning resources and services designed to help you succeed. These learning resources are prepared by Excelsior College so you can be assured that they are current and cover the content you are expected to master for the exams. These resources, and your desire to learn, are usually all that you will need to succeed.

There are test-preparation companies that will offer to help you study for our examinations. Some may imply a relationship with Excelsior College and/or make claims that their products and services are all that you need to prepare for our examinations.

Excelsior College is not affiliated with any test preparation firm and does not endorse the products or services of these companies. No test preparation vendor is authorized to provide admissions counseling or academic advising services, or to collect any payments, on behalf of Excelsior College. Excelsior College does not send authorized representatives to a student’s home nor does it review the materials provided by test preparation companies for content or compatibility with Excelsior College examinations.

To help you become a well-informed consumer, we suggest that before you make any purchase decision regarding study materials provided by organizations other than Excelsior College, you consider the points outlined on our website at www.excelsior.edu/testprep.

Preparing for This Exam

Prior Knowledge

No prior knowledge of financial accounting is required before you study for this exam.

Using the Content Outline

Each content area in the outline includes (1) the recommended minimum hours of study to devote to that content area and (2) the most important sections of the recommended resources for that area. These annotations are not intended to be comprehensive. You may need to refer to other chapters in the recommended textbooks. Chapter numbers and titles may differ in other editions.

This content outline contains examples of the types of information you should study. Although these examples are numerous, do not assume that everything on the exam will come from these examples. Conversely, do not expect that every detail you study will appear on the exam. Any exam is only a broad sample of all the questions that could be asked about the subject matter.

Using the Sample Questions and Rationales

Each content guide provides sample questions to illustrate those typically found on the exam. These questions are intended to give you an idea of the level of knowledge expected and the way questions are typically phrased. The sample questions do not sample the entire content of the exam and are not intended to serve as an entire practice test.
Recommended Resources for the UExcel Exam in Financial Accounting

The study materials listed below are recommended by Excelsior College as the most appropriate resources to help you study for the examination. For information on ordering from the Excelsior College Bookstore, see page 1 of this guide. You may also find resource materials in college libraries. Public libraries may have some of the textbooks or may be able to obtain them through an interlibrary loan program.

You should allow sufficient time to obtain resources and to study before taking the exam.

Textbook
This textbook was used by the exam development committee to verify all questions on the exam. It is available at the Excelsior College Bookstore.

www.excelsior.edu/bookstore


Recommended Supplemental Online Resources
The following topics may appear on the exam, but are not covered in the recommended textbook. These are free online resources to complete your study for the exam.

The separate entity concept
https://www.accountingtools.com/articles/2017/5/16/separate-entity
http://www.businessdictionary.com/definition/separate-entity.html

Arm's length transaction
https://www.investopedia.com/terms/a/armslength.asp
http://www.businessdictionary.com/definition/arm-s-length-transaction.html

Adjusting entries
Unrecorded receivables
Unrecorded liabilities
Prepaid expenses
Unearned revenues
https://www.accountingcoach.com/blog/appreciating-adjusting-entries

Typical problems with financial information
Errors in the reporting process
Disagreements in judgement
Fraudulent financial reporting

Cash collection
Control of cash
https://courses.lumenlearning.com/sac-finaccounting/chapter/cash-receipts-and-disbursements/

Inventory errors

Employee compensation
Compensated absences

Contingencies

Summarizing operations on an income statement
Other revenues and expenses
https://courses.lumenlearning.com/boundless-finance/chapter/the-income-statement/
https://www.accountingcoach.com/income-statement/explanation/4

Investments: Property, plant, and equipment and intangible assets
Repairs and improvements
https://www.accountingtools.com/articles/how-do-i-account-for-land-improvements.html
Reducing Textbook Costs

Many students know it is less expensive to buy a used textbook, and buying a previous edition is also an option. The Excelsior College bookstore includes a buyback feature and a used book marketplace, as well as the ability to rent digital versions of textbooks for as long as students need them. Students are encouraged to explore these and the many other opportunities available online to help defray textbook costs.
General Description of the Examination

The UExcel Financial Accounting examination is based on material typically taught in a one-semester, three-credit, lower-level course in Financial Accounting.

The examination measures comprehension and understanding of basic financial accounting in pursuit of organizational goals and strategies, familiarity with the technical skills of financial statements, accounting information systems, operating decisions, and financing decisions, and the ability to identify relevant information and the appropriate methods for analyzing information, working in a financial, global, and ethical environment.

No prior knowledge of accounting is required before beginning study for this exam.

Learning Outcomes

After you have successfully worked your way through the recommended study materials, you should be able to demonstrate the following learning outcomes:

1. Explain the role of financial accounting in reporting to the stakeholders of an organization, including investors, creditors, and management.
2. Explain and use the basic concepts and elements of financial statements.
3. Describe a typical accounting information system.
4. Analyze business transactions and understand their effects on financial statements.
5. Recognize and understand the role of ethics in preparing and communicating financial information.
Content Outline

The content outline describes the various areas of the test, similar to the way a syllabus outlines a course. To fully prepare requires self-direction and discipline. Study involves careful reading, reflection, and systematic review.

The major content areas on the Financial Accounting examination, the percent of the examination, and the hours to devote to each content area are listed below.

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<th>Content Area</th>
<th>Percent of the Examination</th>
<th>Hours of Study</th>
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<td>I. Financial Accounting and Reporting</td>
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<td>II. Accounting Information Systems and Internal Controls</td>
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<td>34</td>
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<td>III. Operating Activities</td>
<td>25%</td>
<td>34</td>
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<tr>
<td>IV. Investing and Financing Activities</td>
<td>25%</td>
<td>34</td>
</tr>
<tr>
<td>V. Other Dimensions of Financial Reporting</td>
<td>10%</td>
<td>14</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
<td></td>
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</tbody>
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**Note:** Occasionally, examples will be listed for a content topic to help clarify that topic. However, the content of the examination is not limited to the specific examples given.

I. Financial Accounting and Reporting

15 PERCENT OF EXAM  | 20 HOURS OF STUDY

Ch. 1, Accounting Information: Users and Uses

Ch. 2, Financial Statements: An Overview

A. Accounting information

1. Purpose of accounting
   a. Relationship of accounting to business
   b. Users of accounting information
2. The accounting environment

B. Financial statements

1. Types of financial statements
   a. Balance sheet
   b. Income statement
   c. Statement of cash flows
2. Notes to the financial statements
3. External audit
4. Fundamental concepts and assumptions
   a. The separate entity concept
b. The assumption of arm’s length transactions
c. The cost principle
d. The monetary measurement concept
e. The going concern assumption

II. Accounting Information Systems and Internal Controls

25 PERCENT OF EXAM | 34 HOURS OF STUDY

Ch. 3, The Accounting Cycle: The Mechanics of Accounting
Ch. 4, Completing the Accounting Cycle
Ch. 5, Internal Controls: Ensuring the Integrity of Financial Information

A. The accounting cycle: The mechanics of accounting
   1. Information collection
   2. Transactions and the accounting equation
      a. The accounting equation
      b. Using accounts to categorize transactions
      c. Expanding the accounting equation to include revenues, expenses, and dividends
   3. Recording the effects of transactions
      a. Acquiring cash
      b. Acquiring other assets
      c. Selling goods or providing services
      d. Collecting cash and paying obligations
   4. Posting journal entries and preparing a trial balance
      a. Determining account balances

B. Completing the accounting cycle
   1. Accrual accounting
      a. Periodic reporting
      b. Accrual versus cash-basis accounting
   2. Adjusting entries
      a. Unrecorded receivables
      b. Unrecorded liabilities
      c. Prepaid expenses
      d. Unearned revenues
   3. Preparing financial statements
      a. The notes
      b. The audit
   4. Closing the books
      a. Real and nominal accounts
      b. Closing entries
      c. Preparing a post-closing trial balance

C. Internal controls
   1. Typical problems with financial information
      a. Errors in the reporting process
      b. Disagreements in judgment
      c. Fraudulent financial reporting
   2. Safeguards
      a. The control environment
      b. Control activities (procedures)
   3. Reasons for earnings management
   4. The Sarbanes-Oxley Act
      a. Public Company Accounting Oversight Board
      b. Constraints on auditors
      c. Constraints on management
   5. The role of auditors in the accounting process
      a. Internal auditors
      b. External auditors
      c. Audit procedures
      d. The assumption of independence
   6. The Securities and Exchange Commission
III. Operating Activities

25 PERCENT OF EXAM | 34 HOURS OF STUDY

Ch. 6, Receivables: Selling a Product or Service
Ch. 7, Inventory and the Cost of Sales
Ch. 8, Completing the Operating Cycle

A. Receivables: Selling a product or service
1. Major business activities
2. Recognizing revenue
   a. Timing
   b. Revenue recognition criteria
3. Cash collection
   a. Sales discounts
   b. Sales returns and allowances
   c. Control of cash
4. Accounting for non-payment by credit customers
   a. The allowance method
   b. Bad debt accounting examples
5. Evaluating receivables management
6. Recording warranty and service costs associated with a sale
7. Reconciling the bank account

B. Inventory and the cost of sales
1. Inventory and cost of goods sold
   a. Definition of inventory
   b. Costs included in inventory cost
   c. Ownership of inventory
   d. Ending inventory and costs of goods sold
2. Accounting for inventory purchases and sales
   a. Overview of perpetual and periodic systems
   b. Perpetual and periodic journal entries
3. Counting inventory and calculating cost of goods sold
   a. Taking a physical count of inventory

b. The income effect of an error in ending inventory
4. Inventory cost flow assumptions
   a. Specific identification
   b. First in, first out (FIFO)
   c. Last in, first out (LIFO)
   d. Averaging
5. Evaluating investment management
   a. Evaluating the level of inventory
   b. Number of days’ purchases in accounts payable
6. Inventory errors
7. Complications of the perpetual method with LIFO and average cost
8. Reporting inventory at amounts below cost
   a. Inventory valued at net realizable value
   b. Inventory valued at lower of cost or market

C. Completing the operating cycle
1. Employee compensation
   a. Payroll
   b. Compensated absences (for example: sick leave)
   c. Bonuses
2. Taxes
   a. Sales taxes
   b. Property taxes
   c. Income taxes
3. Contingencies
4. Capitalize vs. expense
   a. Research and development
   b. Advertising
5. Summarizing operations on an income statement
   a. Other revenues and expenses
   b. Extraordinary items
   c. Earnings per share
d. Differing income statement formats

IV. Investing and Financing Activities

25 PERCENT OF EXAM | 34 HOURS OF STUDY

Ch. 9, Investments: Property, Plant, and Equipment and Intangible Assets
Ch. 10, Financing: Long-Term Liabilities
Ch. 11, Financing: Equity

A. Investments: Property, plant, and equipment and intangible assets
1. Long-term operating assets
2. Deciding whether to acquire a long-term operating asset
3. Accounting for acquisition of property, plant, and equipment
   a. Assets acquired by purchase
   b. Acquisition of several assets at once
4. Calculating and recording depreciation expense
   a. Straight-line method
   b. Units-of-production method
   c. Partial-year depreciation calculations
   d. Units-of-production method with natural resources
5. Repairs and improvements
6. Disposal
   a. Discarding
   b. Selling
7. Accounting for intangible assets
   a. Amortization
   b. Impairment
8. Measuring property, plant, and equipment efficiency
   a. Evaluating the level of property, plant, and equipment
   b. Industry differences in fixed asset turnover
9. Accelerated depreciation methods
   a. Declining-balance method
   b. Sum-of-the-years’-digits method
10. Changes in depreciation estimates and methods

B. Financing: Long-term liabilities
1. Measuring long-term liabilities
   a. Present value and future value concepts
   b. Computing the present value of an annuity
2. Accounting for long-term liabilities
   a. Interest-bearing notes
   b. Mortgages payable
3. The nature of bonds
   a. Types
   b. Characteristics
   c. Determining a bond’s issuance price
   d. Accounting for bonds payable issued at face value
   e. Bond retirement before maturity
4. Using debt-related financial ratios
   a. Debt ratio and debt-to-equity ratio
   b. Interest earned ratio
5. Bonds issued at a discount or at a premium (straight-line amortization)
   a. Accounting for bonds issued at a discount
   b. Accounting for bonds issued at a premium

C. Financing equity
1. Raising equity financing
   a. Difference between a loan and an investment
   b. Proprietorships and partnerships
2. Corporations and corporate stock
   a. Starting a corporation
   b. Common stock
   c. Preferred stock
3. Accounting for stock
   a. Issuance of stock
   b. Accounting for stock repurchases
   c. Balance sheet presentation
4. Retained earnings
   a. Cash dividends
   b. Dividend payout ratio

V. Other Dimensions of Financial Reporting

10 PERCENT OF EXAM | 14 HOURS OF STUDY

Ch. 13, Statement of Cash Flows
Ch. 14, Analyzing Financial Statements

A. The statement of cash flows
   1. Purpose of the statement
   2. Information included
      a. Major classifications of cash flows
      b. Noncash investing and financing activities
      c. Cash flow patterns
   3. Preparing a statement of cash flows
   4. Analyzing the other primary financial statements to prepare a statement of cash flows
      a. The six-step process for preparing a statement of cash flows
   5. Using information from the statement of cash flows to make decisions

B. Analyzing financial statements
   1. Purpose of financial statement analysis
   2. Widely used financial ratios
      a. Debt ratio
      b. Current ratio
      c. Return on sales
      d. Asset turnover
      e. Return on equity
      f. Price-earnings ratio
   3. Common-size financial statements

4. Efficiency ratios
   a. Accounts receivable efficiency
   b. Inventory efficiency
   c. Property, plant, and equipment efficiency

5. Leverage ratios
   a. Debt-to-equity ratio
   b. Times interest earned ratio

6. Potential pitfalls in financial statement analysis
   a. Incomplete information
   b. Lack of comparability
   c. Search for the smoking gun
   d. Anchoring, adjustment, and timelines
Sample Questions

The sample questions give you an idea of the level of knowledge expected in the exam and how questions are typically phrased. They are not representative of the entire content of the exam and are not intended to serve as a practice test.

Rationales for the questions can be found on pages 16–19 of this guide. In that section, the correct answer is identified and each answer is explained. The number in parentheses at the beginning of each rationale refers to the corresponding section of the content outline. For any questions you answer incorrectly, return to that section of the content outline for further study. You will be provided with an erasable white board to use during your exam, and you will have access to a basic 8-function calculator on the computer. The calculator button is in the top left hand corner of the page as each question is presented. A picture of a typical 8-function calculator is printed at the back of this content guide.

1. Which information is most likely to be included in the notes to financial statements?
   1) statement of cash flow
   2) supplementary information required by the FASB
   3) explanation of the various methods used in depreciation
   4) total number of all long-term debentures with specific debt issues in the balance sheet

2. Company O has completed a sale for 1,000 of its top quality pogo sticks to a large retailer. The retailer paid $500 as a down payment on the day of the sale, and will be billed for the remainder during the next billing cycle. The pogo sticks normally sell for $12 each, but Company O allowed for a 10% bulk discount. Cost of goods sold is 40% of the normal sales price. What would be the correct entry for the sale?

   1) Debit Credit
   Cash $500
   Accounts Receivable $11,500
   Cost of Goods Sold $4,800
   Revenue $12,000
   Inventory $4,800

   2) Debit Credit
   Cash $500
   Accounts Receivable $11,500
   Cost of Goods Sold $4,320
   Revenue $12,000
   Inventory $4,320

   3) Debit Credit
   Cash $500
   Accounts Receivable $10,300
   Cost of Goods Sold $4,800
   Revenue $10,800
   Inventory $4,800

   4) Debit Credit
   Cash $500
   Accounts Receivable $11,300
   Cost of Goods Sold $4,320
   Revenue $10,800
   Inventory $4,320
3. What is the primary purpose of auditing financial statements?
   1) to ensure that the statements have been prepared in conformity with generally accepted accounting principles
   2) to compute the ending balance of retained earnings used to prepare the balance sheet
   3) to compile summarized numerical data contained in the notes to the financial statements
   4) to determine revenues, expenses, assets, and liability balances used to prepare the financial statements

4. What type of account adjustment is the auditor most concerned with when conducting a financial statement audit?
   An adjustment that
   1) understates revenue and overstates expense
   2) overstates assets and understates liabilities
   3) overstates expense and understates assets
   4) understates revenue and overstates liabilities

5. During the fiscal year, Company F had an average accounts payable balance of $5,000, their sales totaled $100,000, and their purchases totaled $35,000. On average, how long did it take Company F to pay its vendors?
   1) 2.9 days
   2) 7 days
   3) 20 days
   4) 52 days

6. If inventory available for sale totals $60,000 and beginning and ending inventory are both $15,000, what would be the cost of goods sold and purchase total for the fiscal year?
   1) $45,000 and $45,000
   2) $45,000 and $60,000
   3) $75,000 and $45,000
   4) $75,000 and $60,000

7. Which organization would expect bad debt expense as a percentage of sales to vary significantly from year to year?
   1) a volatile internet service company
   2) a restaurant that accepts cash only sales
   3) a government administrative department
   4) a well established automobile manufacturer

8. Revenue of goods is recognized when which combination of events occurs?
   When an order of goods
   1) has been shipped and a promise of future payment has been made by the customer
   2) has been placed and a promise of future payment has been made by the customer
   3) has been placed and the goods have been shipped to the customer
   4) has been placed and cash has been received from the customer

9. Physical inventory cost must be compared to which calculated amounts to determine inventory shrinkage for a period?
   1) beginning inventory + net purchases - cost of goods sold
   2) beginning inventory + net purchases + ending inventory
   3) beginning inventory + ending inventory - net purchases
   4) ending inventory + net purchases - cost of goods sold

10. Company B had year-end accounts payable balances in Year 1 and Year 2 of $38,000 and $42,000 respectively. The total cost of goods sold in Year 2 was $358,000 and inventory increased by $7,000 from Year 1 to Year 2. What would be the number of days purchases in accounts payable?
    1) 38 days
    2) 40 days
    3) 42 days
    4) 80 days
11. During a year, a company engaged in the following transactions relative to patents.

Patent A: the company internally generated patent A by incurring research and development costs of $40,000. The estimated value of the patent is $85,000. The patent has an estimated life of 10 years.

Patent B: The company purchased patent B for $25,000 on January 1. The company incurred registration and filing fees of $2,000 relative to this patent. Patent B has an estimated life of 8 years.

Relative to the two patents, what balances will the company have in the asset section of the balance sheet at year end and what amount of expense will be on its income statement for the year?

1) Balance Sheet Income Statement
   | $36,000  | $23,625  | $4,000   | $3,375   |

2) Balance Sheet Income Statement
   | $ -      | $23,625  | $40,000  | $3,375   |

3) Balance Sheet Income Statement
   | $ -      | $21,875  | $40,000  | $5,125   |

4) Balance Sheet Income Statement
   | $76,500  | $23,625  | $8,500   | $3,375   |

12. If an investor acquires $10,000 of callable, convertible debentures, what does this mean to the investor?

Callable, convertible debentures are bonds
1) backed only by the earnings of a company, which can be redeemed early by the company and exchanged for stock at the discretion of the investor.
2) guaranteed or backed by the company’s assets, which can be redeemed early by the company and converted to stock at the discretion of the company.
3) backed only by the earnings of the company, which can be redeemed early or exchanged for stock both at the discretion of the company and the investor.
4) guaranteed by the company’s assets, which can be redeemed early by the company or exchanged for stock at the discretion of the investor.

13. Which type of activity on the statement of cash flows shows the replacement of long-term assets by trading in the old assets and making additional payments?

1) financing transactions
2) investing transactions
3) noncash transactions
4) operating transactions

14. How should a gain on the sale of a long-term asset in the statement of cash flows be treated?

1) Include the gain as an operating activity.
2) Classify the gain as an investing activity.
3) Eliminate the effect of the gain from the income statement.
4) Prepare a revised income statement without the gain included.
15. How should a financial accountant treat depreciation expense when preparing the statement of cash flows?

1) Include depreciation expense as a deduction on the statement.
2) Eliminate the expense since depreciation does not involve cash.
3) Include depreciation expense in the financing section of the statement of cash flows.
4) Eliminate depreciation expense from operating and include it in the investing section.

16. What does a financial statement analyze?

1) evaluation by investors and creditors of information in the financial statements in order to make operating decisions
2) examination of both the relationships among financial statement numbers and trends in those numbers over time
3) investment by the entity in companies that employ and utilize the services of financial analysts
4) recording transactions, development of the financial statements, and issuance of the annual report

17. To what should the results of computing financial ratios for a company for the current period be compared?

1) common-size financial statements for the company for the current period
2) the financial statements of the leading company in the same industry
3) the results of the same ratios for prior periods for the same company
4) the adjusting journal entries made around the year-end date

18. What are the financial implications when a company prepays $5,000 of a mortgage, which is not due for three years, on the last day of the fiscal year?

The transaction

1) exemplifies the going-concern assumptions.
2) is based on the monetary measurement.
3) leaves current ratio unchanged.
4) decreases current ratio.

19. What does the ratio of net income to stockholder’s equity measure?

1) asset turnover
2) return on sales
3) price-earnings ratio
4) return on investment

20. How are common-size financial statements computed?

By dividing

1) all financial statement amounts for a given year by sales for that year
2) only income statement amounts for a given year by sales for that year only
3) only balance sheet amounts for a given year by total assets for that year
4) all financial statement amounts for a given year by total assets for that year
Rationales

1. (IB5)
   1) The statement of cash flows is a basic financial statement itself, and is presented before the notes to the financial statement.

   *2) The FASB (and the SEC) require certain supplementary information to be reported in the financial statement notes.

3) The financial statements (i.e., the balance sheet) contain the summary number of all long-term debentures; the details of the debt are presented in the notes.

4) The summary of significant accounting policies note in the financial statements includes an explanation of (only) the method(s) of depreciation used by the business (not all of the various methods of depreciation).

2. (IIA3c)
   1) The cash amount is accurate, but the receivable amount of $11,500 does not take into consideration the 10% sales discount. The discount would lead to total revenues of $10,800.

2) The cash amount is accurate, but the receivable amount of $11,500 does not take into consideration the 10% sales discount. The discount would lead to total revenues of $10,800. In addition, cost of goods sold should be debited and inventory credited. The COGS amount should be 40% of the normal sales price of $12/unit.

*3) Revenue has been accurately calculated at 1,000 units times the discounted price of $10.80/unit. Cost of goods sold was accurately calculated as 40% of the normal sales price or $4.80/unit.

4) Revenue has been accurately calculated at 1,000 units times the discounted price of $10.80/unit. Cost of goods sold should be 40% of the normal sales price rather than the discounted price.

3. (IIB3c)
   *1) The primary purpose of the audit of the financial statements is to ensure that the financial statements have been prepared in conformity with generally accepted accounting principles.

   2) See 1).

   3) See 1).

   4) See 1).

4. (IIB3c)
   1) Understating revenue and overstating expenses would be a more conservative presentation of financial statement numbers.

   *2) When assets are overstated and liabilities are understated, the investor may be misled to believe that the company has greater equity and perhaps is worth more than it truly is.

   3) Overstating revenue and understating assets would be a more conservative presentation of financial statement numbers.

   4) An understatement of revenue and/or an overstatement of liabilities would be a more conservative presentation of financial statement numbers.
5. (IIIB5b)
1) This results from dividing the Sales of $100,000 by the Purchases of $35,000.
2) This results from dividing the Purchases of $35,000 by the average Accounts Payable of $5,000.
3) This results from dividing the Sales of $100,000 by the average Accounts Payable of $5,000.
4) Divide Purchases of $35,000 by the average Accounts Payable of $5,000 to get a factor of 7. Divide 365 days by 7 to produce 52 days.

6. (IIIB3)
1) Beginning Inventory of $15,000 and Goods Available for Sale of $60,000 suggests that Purchases were $45,000. If Ending Inventory is $15,000, the Cost of Goods Sold has to be $45,000. The formula used is BI + P + Goods Available - EI = COGS.
2) The $60,000 Cost of Goods Sold does not consider the amount of the beginning inventory.
3) See 1).
4) See 1).

7. (IIIA4b)
1) A volatile internet service company would likely experience swings in estimated bad debt expense from year to year, due to the volatile nature of the business.
2) If cash only sales are accepted, there would be no bad debt expense.
3) A government administrative department would not be likely to have any sales, and therefore would have no allowance for bad debts.
4) A well established automobile manufacturer would likely have predictable estimates of bad debt expense each year based on historic records.

8. (IIIA2a)
1) Revenue is recognized when both a promise of payment has been made by the customer and the work of the supplier is substantially complete. This is usually determined by shipment of the goods.
2) Revenue is not recorded until the work of the supplier is substantially complete. This has not occurred if only an order has been placed by the customer.
3) Even though shipment has been made to the customer, no promise has been made by the customer for payment. It is required that payment be “reasonably assured” before revenue is recorded. This is usually indicated by a promise to pay from the customer.
4) Revenue is not recorded until the work of the supplier is substantially complete, which has not occurred if only an order has been placed by the customer.

9. (IIIB3)
1) Beginning Inventory + Net Purchases - Cost of Goods Sold will determine what the ending inventory balance should be. The difference between what it is, based on the physical count, and what it should be is the shrinkage.
2) This formula will produce the cost of goods sold for the period. Also, ending inventory amount is not known, so it can’t be used in the calculation.
3) Ending inventory amount is not known, so it can’t be used in the calculation.
4) See 3).

10. (IIIB5b)
1) This is the result of a calculation that only used accounts payable from Year 1.
2) The correct calculation is $38,000 + 42,000 / 2 over $358,000 + 7000 / 365
3) This is the result of a calculation that only used accounts payable from Year 2.
4) This results from adding accounts payable values from Year 1 and Year 2 but then not dividing by 2 to obtain the average.

*correct answer
11. (IVA7a)

1) The research and development costs of internally generated intangibles should not be capitalized.

2) The research and development costs of internally generated intangibles should not be capitalized, but rather expensed as incurred (Patent A’s costs of $40,000 should be expensed immediately). The cost of intangibles that were purchased from third parties may be capitalized. In addition, costs to successfully defend a patent should also be capitalized. Intangible assets with a determinable life should be amortized. The total capitalized amount for Patent B is $27,000 (purchase price of $25,000 + successful litigation of $2,000). Patent B has an estimated life of 8 years, so the total capitalized amount is amortized, using straight-line, over this 8-year period, or $3,375/year.

3) The research and development costs of internally generated intangibles should not be capitalized, but rather expensed as incurred (Patent A’s costs of $40,000 should be expensed immediately). The cost of intangibles that were purchased from third parties may be capitalized. In addition, costs to successfully defend a patent should also be capitalized. In this choice, only the costs to purchase Patent B of $25,000 were capitalized. This $25,000 cost was then amortized over the 8-year life, $3,125/year. The legal costs were erroneously expensed. So, the total amount expensed for Patent B in this choice was $5,125 (Amortization of $3,125 + legal costs to successfully defend of $2,000).

4) The estimated value of internally generated intangibles should not be capitalized.

13. (VA2c)

1) Financing activities include transactions and events whereby resources are obtained from or paid to owners and creditors.

2) Replacing assets by trading in and paying cash is an investing activity.

3) Replacing assets by trading in and paying cash involves cash and thus, cannot be classified as a noncash transaction.

4) Operating activities include those transactions and events that enter into the calculation of net income and do not encompass the replacement of long-term assets.

14. (VA4a)

1) Operating activities include those cash transactions and events that enter into the calculation of net income; a gain or loss on the sale of long-term assets is not a cash transaction.

2) Investing activities include cash transactions and events that involve the purchase and sale of securities, property, buildings, and equipment; other assets; and the making and collecting of loans. A gain is not a cash activity.

3) Nonoperating activity items, such as gains and losses on the sale of long-term assets, are eliminated from the income statement in converting the statement from an accrual-basis to a cash-basis summary of operations; this conversion is a part of the process of developing the statement of cash flows.

4) To develop the statement of cash flows, the effects of nonoperating activity items on the income statement, such as gains or losses on the sale of long-term assets, are eliminated; a revised income statement is not issued.

12. (IVB3a)

1) All three provisions or terms are correctly defined.

2) Debentures are backed only by earnings of corporation and conversion is at discretion of investor.

3) The callable provision is at discretion of corporation, not investors.

4) Debentures are backed only by earnings of the business and not secured by specific assets.

*correct answer
15. (VA4b)
1) Depreciation is a noncash transaction and thus, is not deducted on the statement of cash flows.
*2) Depreciation does not involve any cash flow; expenses not involving cash are eliminated.
3) Since depreciation is not a cash flow transaction, it is not included in the financing section (or either of the other two sections).
4) Depreciation expense is a non-cash transaction that is reported in the opening section. It is not proper to show it in the investing section.

16. (VB1)
1) Investors and creditors use the financial statements and analysis information in deciding whether to invest in, or loan money to, a company; they are not involved in operating decisions.
*2) Financial statement analysis involves the examination of both the relationships among financial statement numbers and trends in those numbers over time.
3) The performance of financial statement analysis includes the examination of relationships among financial statement numbers and trends in those numbers; making investment decisions is not part of financial statement analysis.
4) Development of the financial statements must be complete prior to commencing the performance of a financial statement analysis.

17. (VB1)
1) Common-size financial statements are used to compare the results of two companies of different sizes in different years; ratios are not compared to common-size financial statements.
2) Financial ratios may be compared to the same financial ratios of other companies in the same industry; ratios of one company are not compared to the financial statements of another.
*3) Information provided by financial ratios is greatly enhanced when it is compared with the results of the same ratios for prior periods for the same company.

18. (VB2b)
1) The going-concern concept relates to the future viability of a company. If a company is able to prepay its long-term debts, the going-concern is not an issue.
2) The monetary measurement concept relates to events that can be recorded in a monetary unit.
*4) When cash is used to pay a long-term liability, current assets are decreased, but current liabilities remain the same. This decreases the current ratio.

19. (VB2e)
1) Asset turnover measures company efficiency, which is equal to sales divided by total assets.
2) Return on sales measures the amount of profit earned per dollars of sales.
3) Price-earnings ratio measures growth potential, earnings stability, and management capabilities.
*4) Return on investment or return on equity measures the amount of profit earned per dollar of investment.

20. (VB3)
*1) Common-size financial statements are computed by dividing all financial statement amounts for a given year by sales for that year.
2) Common-size financial statements include both the balance sheet and the income statement.
3) Common-size financial statements include both the balance sheet and the income statement and use sales rather than total assets as the denominator.
4) Common-size financial statements use sales rather than total assets as the denominator.

*correct answer
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