

Fundamental Managerial Accounting Concepts, 9e (Edmonds)
Chapter 1 Management Accounting and Corporate Governance

1) Ashley Bradshaw is the manager of one department in a large store. In this capacity, which of the following kinds of information would she be interested in?

- A) Economic data
- B) Financial data
- C) Nonfinancial data
- D) Financial, economic, and nonfinancial data

Answer: D

Explanation: Managers rely on financial, economic, and nonfinancial data to make decisions and evaluate performance.

Difficulty: 1 Easy

Topic: Users and Types of Information

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

2) All of the following are features of managerial accounting **except**:

- A) information is provided primarily to insiders such as managers.
- B) information includes economic and non-financial data as well as financial data.
- C) information is characterized by objectivity, reliability, consistency, and accuracy.
- D) information is reported continuously with a present or future orientation.

Answer: C

Explanation: Managerial accounting is concerned with unregulated financial, economic, and nonfinancial data, which pertains more to the sub-units of the organization, that is current and future oriented, and that is designed primarily to meet the information needs of insiders.

Financial accounting information is characterized by objectivity, reliability, consistency, and accuracy.

Difficulty: 1 Easy

Topic: Information Characteristics

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

3) Choose the answer that is **not** a distinguishing characteristic of financial accounting information.

- A) It is global information that reflects the performance of the whole company.
- B) It is focused primarily on the future.
- C) It is more concerned with financial data than physical or economic data.
- D) It is more highly regulated than managerial accounting information.

Answer: B

Explanation: Financial accounting deals with regulated, historical financial information that pertains to the whole company and is designed primarily to meet the information needs of outsiders.

Difficulty: 1 Easy

Topic: Information Characteristics

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

4) Managerial accounting information is limited or restricted by which of the following authorities or principles?

- A) Securities and Exchange Commission
- B) Generally Accepted Accounting Principles
- C) Managerial Accounting Standards Board
- D) Value-Added Principle

Answer: D

Explanation: The value-added principle means that management accountants are free to engage in any information gathering and reporting activity so long as the activity adds value in excess of its cost.

Difficulty: 1 Easy

Topic: Regulation

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

5) Select the **incorrect** statement regarding the relationship between type of user and type of information.

- A) Middle managers need more nonfinancial, or operational data than do senior executives.
- B) Assembly line supervisors need more immediate feedback on performance than do senior executives.
- C) Senior executives need less aggregated information than do lower-level managers.
- D) Senior executives use general economic information as well as financial information.

Answer: C

Explanation: Senior executives need more aggregated information than do lower-level managers.

Difficulty: 1 Easy

Topic: Users and Types of Information

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

6) Select the **correct** statement regarding managerial and financial accounting.

- A) Users of managerial accounting information desire greater aggregation than do users of financial accounting information.
- B) Both managerial and financial accounting use economic and physical data in addition to financial data.
- C) Financial accounting is more highly regulated than managerial accounting.
- D) Timeliness is more important in financial accounting than in managerial accounting.

Answer: C

Explanation: Financial accounting deals with regulated, historical, financial information that pertains to the whole company and is designed primarily to meet the information needs of outsiders. Managerial accounting is concerned with unregulated financial, economic, and nonfinancial data, which pertains more to the sub-units of the organization, that is current and future oriented, and that is designed primarily to meet the information needs of insiders.

Difficulty: 1 Easy

Topic: Regulation

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

- 7) Which of the following most exemplifies the value-added principle?
- A) An ongoing process where continuous improvement is the goal.
 - B) A competitive management program that emphasizes quality.
 - C) Information gathering and reporting activities should be restricted to those activities that add value in excess of their cost.
 - D) Managerial accounting information is measured in economic, physical, and financial terms.

Answer: C

Explanation: The value-added principle means that management accountants are free to engage in any information gathering and reporting activity so long as the activity adds value in excess of its cost.

Difficulty: 1 Easy

Topic: Regulation

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

- 8) Which of the following costs would be classified as a direct cost for a company that produces motorcycles?
- A) Rent of manufacturing facility that produces motorcycles.
 - B) Seats used in the motorcycles.
 - C) Wages of motorcycle assembly workers.
 - D) Both seats used in the motorcycles and wages of motorcycle assembly workers are correct.

Answer: D

Explanation: Direct costs can be traced to a specific product. The costs of the seats used in the motorcycles and wages of motorcycle assembly workers are direct costs. An indirect cost cannot be easily or economically traced to a specific product. The rent of the manufacturing facility that produces motorcycles is an indirect cost.

Difficulty: 2 Medium

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

9) Which of the following is a product cost for a construction company?

- A) Cost of transporting raw materials to the job site
- B) Wages paid to the company's payroll clerk
- C) Rent of the company's main office
- D) All of these.

Answer: A

Explanation: Product costs are all costs incurred to obtain a product or provide a service. Period costs are associated with the general, selling, and administrative functions of the business. Wages paid to the company's payroll clerk and rent of the company's main office would be categorized as period costs.

Difficulty: 2 Medium

Topic: Components of Product Cost

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry; FN Measurement; BB Resource Management

10) For a manufacturing company, product costs include all of the following **except**:

- A) indirect material costs.
- B) warehousing costs of finished goods.
- C) direct labor costs.
- D) All of these are product costs.

Answer: B

Explanation: Product costs are all costs incurred to obtain a product or provide a service. Period costs are associated with the general, selling, and administrative functions of the business. The cost of storing finished goods is considered a period cost.

Difficulty: 2 Medium

Topic: Components of Product Cost

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry; FN Measurement; BB Resource Management

11) During its first year of operations, Connor Company paid \$50,000 for direct materials and \$36,000 in wages for production workers. Lease payments and utilities on the production facilities amounted to \$14,000. General, selling, and administrative expenses were \$16,000. The company produced 5,000 units and sold 4,000 units for \$30.00 a unit. The average cost to produce one unit is which of the following amounts?

- A) \$20.00
- B) \$16.00
- C) \$18.40
- D) \$25.00

Answer: A

Explanation: $\text{Average cost per unit} = (\text{Materials cost} + \text{Labor costs} + \text{Overhead costs}) \div \text{Number of units produced}$

$\text{Average cost per unit} = (\$50,000 + \$36,000 + \$14,000) \div 5,000 \text{ units} = \20.00 per unit

Difficulty: 3 Hard

Topic: Components of Product Cost; Average Cost per Unit

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry; FN Measurement; BB Resource Management

12) During its first year of operations, Forrest Company paid \$30,000 for direct materials and \$50,000 in wages for production workers. Lease payments, utility costs, and depreciation on factory equipment totaled \$15,000. General, selling, and administrative expenses were \$20,000. The average cost to produce one unit was \$2.50. How many units were produced during the period?

- A) 40,000
- B) 46,000
- C) 38,000
- D) None of these.

Answer: C

Explanation: $\text{Average cost per unit} = (\text{Materials cost} + \text{Labor costs} + \text{Overhead costs}) \div \text{Number of units produced}$

$\$2.50 \text{ per unit} = (\$30,000 + \$50,000 + \$15,000) \div \text{Number of units produced}$

$\$2.50 \text{ per unit} = \$95,000 \div \text{Number of units produced}$

$\text{Number of units produced} = \$95,000 \div \$2.50 = 38,000 \text{ units}$

Difficulty: 3 Hard

Topic: Components of Product Cost; Average Cost per Unit

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry; FN Measurement; BB Resource Management

- 13) Why do accountants normally calculate cost per unit as an average?
- A) Determining the exact cost of a product is virtually impossible.
 - B) Some manufacturing-related costs cannot be accurately traced to specific units of product.
 - C) Even when producing multiple units of the same product, normal variations occur in the amount of materials and labor used.
 - D) All of these are justifications for computing average unit costs.

Answer: D

Difficulty: 2 Medium

Topic: Components of Product Cost; Average Cost per Unit

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry; FN Measurement; BB Resource Management

- 14) Which of the following costs is **not** considered a period cost?
- A) Warehousing costs
 - B) Depreciation of delivery vehicles
 - C) Salaries paid to company executives
 - D) Freight paid on a purchase of raw materials

Answer: D

Explanation: Period costs are associated with the general, selling, and administrative functions of the business. Product costs are all costs incurred to obtain a product or provide a service.

Freight paid on a purchase of raw materials is considered a product cost.

Difficulty: 2 Medium

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

15) Select the **incorrect** statement regarding costs and expenses.

- A) Some costs are initially recorded as expenses while others are initially recorded as assets.
- B) Expenses are incurred when assets are used to generate revenue.
- C) Manufacturing-related costs are initially recorded as expenses.
- D) Non-manufacturing costs should be expensed in the period in which they are incurred.

Answer: C

Explanation: Product costs (i.e. manufacturing costs) are all costs incurred to obtain a product or provide a service. These costs are treated as assets, recorded in inventory, and expensed when the associated products are sold. Period costs (i.e. non-manufacturing costs) are all costs not associated with a product. They are associated with the general, selling, and administrative functions of the business and most are expensed in the period in which the associated economic sacrifice is made.

Difficulty: 1 Easy

Topic: Costs Can Be Assets or Expenses

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry; FN Measurement

16) Which of the following costs should be recorded as an expense?

- A) Salary of administrative employee
- B) Depreciation of manufacturing equipment
- C) Insurance for the factory building
- D) All of these are expenses.

Answer: A

Explanation: Product costs (i.e. manufacturing costs) are all costs incurred to obtain a product or provide a service. These costs are treated as assets, recorded in inventory, and expensed when the associated products are sold. Period costs (i.e. non-manufacturing costs) are all costs not associated with a product. They are associated with the general, selling, and administrative functions of the business and most are expensed in the period in which the associated economic sacrifice is made.

Difficulty: 2 Medium

Topic: Costs Can Be Assets or Expenses

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry; FN Measurement

17) Which of the following costs should **not** be recorded as an expense?

- A) Insurance on factory building
- B) Sales commissions
- C) Product shipping costs
- D) Product advertising

Answer: A

Explanation: Product costs (i.e. manufacturing costs) are all costs incurred to obtain a product or provide a service. These costs are treated as assets, recorded in inventory, and expensed when the associated products are sold. Period costs (i.e. non-manufacturing costs) are all costs not associated with a product. They are associated with the general, selling, and administrative functions of the business and most are expensed in the period in which the associated economic sacrifice is made. The insurance on the factory building is a product cost and should be recorded in inventory.

Difficulty: 2 Medium

Topic: Costs Can Be Assets or Expenses

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry; FN Measurement

18) Which of the following transactions would cause net income for the period to decrease?

- A) Paid \$2,500 cash for raw material cost
- B) Purchased \$8,000 of merchandise inventory
- C) Recorded \$5,000 of depreciation on production equipment
- D) Used \$2,000 of office supplies

Answer: D

Explanation: Costs that are not classified as product costs are normally expensed in the period in which they are incurred and, as such, decrease net income. These costs include general operating costs, selling and administrative costs (such as the use of office supplies), interest costs, and the cost of income taxes.

Difficulty: 2 Medium

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

19) Which of the following statements is true with regard to product costs versus general, selling, and administrative costs?

- A) Product costs associated with unsold units appear on the income statement as general expenses.
- B) General, selling, and administrative costs appear on the balance sheet.
- C) Product costs associated with units sold appear on the income statement as cost of goods sold.
- D) None of these are true.

Answer: C

Explanation: Product costs are all costs incurred to obtain a product or provide a service. These costs are treated as assets, recorded in inventory, and expensed (as cost of goods sold) when the associated products are sold. Period costs are all costs not associated with a product. They are associated with the general, selling, and administrative functions of the business and most are expensed in the period in which the associated economic sacrifice is made. A product cost would be the cost of direct materials used in the production of a product. A period cost would be rent on administrative facilities.

Difficulty: 2 Medium

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

20) Which of the following statements concerning product costs versus general, selling, and administrative costs is **false**?

- A) Product costs incurred during the period will initially appear as inventory on the balance sheet.
- B) General, selling, and administrative costs are always expensed when paid.
- C) Product costs may be divided between the balance sheet and income statement.
- D) General, selling, and administrative costs never appear as inventory on the balance sheet.

Answer: B

Explanation: Product costs are all costs incurred to obtain a product or provide a service. These costs are treated as assets, recorded in inventory, and expensed (as cost of goods sold) when the associated products are sold. Period costs are all costs not associated with a product. They are associated with the general, selling, and administrative functions of the business and most are expensed in the period in which the associated economic sacrifice is made. The cost of purchasing a building to be used for administration would not be expensed when paid. The administration building would be considered an asset and depreciated over its useful life.

Difficulty: 1 Easy

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

21) During its first year of operations, Silverman Company paid \$14,000 for direct materials and \$19,000 for production workers' wages. Lease payments and utilities on the production facilities amounted to \$17,000 while general, selling, and administrative expenses totaled \$8,000. The company produced 5,000 units and sold 3,000 units at a price of \$15.00 a unit.

What is Silverman's cost of goods sold for the year?

- A) \$50,000
- B) \$24,600
- C) \$30,000
- D) \$41,000

Answer: C

Explanation: $\text{Average cost per unit} = (\text{Materials cost} + \text{Labor costs} + \text{Overhead costs}) \div \text{Number of units produced}$

$\text{Average cost per unit} = (\$14,000 + \$19,000 + \$17,000) \div 5,000 \text{ units} = \10.00 per unit

$\text{Cost of goods sold} = \text{Number of units sold} \times \text{Average cost per unit}$

$\text{Cost of goods sold} = 3,000 \text{ units sold} \times \$10.00 \text{ per unit} = \$30,000$

Difficulty: 3 Hard

Topic: Components of Product Cost; Average Cost per Unit; Costs Can Be Assets or Expenses

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

22) During its first year of operations, Silverman Company paid \$14,000 for direct materials and \$19,000 for production workers' wages. Lease payments and utilities on the production facilities amounted to \$17,000 while general, selling, and administrative expenses totaled \$8,000. The company produced 5,000 units and sold 3,000 units at a price of \$15.00 a unit.

What is the amount of gross margin for the first year?

- A) \$15,000
- B) \$24,000
- C) \$20,000
- D) \$45,000

Answer: A

Explanation: $\text{Average cost per unit} = (\text{Materials cost} + \text{Labor costs} + \text{Overhead costs}) \div \text{Number of units produced}$

$\text{Average cost per unit} = (\$14,000 + \$19,000 + \$17,000) \div 5,000 \text{ units} = \10.00 per unit

$\text{Cost of goods sold} = \text{Number of units sold} \times \text{Average cost per unit}$

$\text{Cost of goods sold} = 3,000 \text{ units sold} \times \$10.00 \text{ per unit} = \$30,000$

$\text{Gross margin} = \text{Revenue} - \text{Cost of goods sold}$

$\text{Gross margin} = (3,000 \text{ units} \times \$15.00 \text{ per unit}) - \$30,000 = \$15,000$

Difficulty: 3 Hard

Topic: Components of Product Cost; Average Cost per Unit; Costs Can Be Assets or Expenses

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

23) During its first year of operations, Silverman Company paid \$14,000 for direct materials and \$19,000 for production workers' wages. Lease payments and utilities on the production facilities amounted to \$17,000 while general, selling, and administrative expenses totaled \$8,000. The company produced 5,000 units and sold 3,000 units at a price of \$15.00 a unit.

What is the amount of finished goods inventory on the balance sheet at year-end?

- A) \$10,000
- B) \$20,000
- C) \$4,000
- D) \$15,000

Answer: B

Explanation: $\text{Average cost per unit} = (\text{Materials cost} + \text{Labor costs} + \text{Overhead costs}) \div \text{Number of units produced}$

$\text{Average cost per unit} = (\$14,000 + \$19,000 + \$17,000) \div 5,000 \text{ units} = \10.00 per unit

$\text{Finished goods inventory} = \text{Unsold units} \times \text{Average cost per unit}$

$\text{Finished goods inventory} = (5,000 \text{ units produced} - 3,000 \text{ units sold}) \times \$10.00 \text{ per unit} = \$20,000$

Difficulty: 3 Hard

Topic: Manufacturing Product Costs on Financial Statements; Components of Product Cost; Average Cost per Unit; Tabor Manufacturing Company

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.; 01-02 Identify the cost of manufacturing a product.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

24) During its first year of operations, Silverman Company paid \$14,000 for direct materials and \$19,000 for production workers' wages. Lease payments and utilities on the production facilities amounted to \$17,000 while general, selling, and administrative expenses totaled \$8,000. The company produced 5,000 units and sold 3,000 units at a price of \$15.00 a unit.

What was Silverman's net income for the first year in operation?

- A) \$7,000
- B) \$12,000
- C) \$28,000
- D) \$37,000

Answer: A

Explanation: $\text{Average cost per unit} = (\text{Materials cost} + \text{Labor costs} + \text{Overhead costs}) \div \text{Number of units produced}$

$\text{Average cost per unit} = (\$14,000 + \$19,000 + \$17,000) \div 5,000 \text{ units} = \10.00 per unit

$\text{Cost of goods sold} = \text{Number of units sold} \times \text{Average cost per unit}$

$\text{Cost of goods sold} = 3,000 \text{ units sold} \times \$10.00 \text{ per unit} = \$30,000$

$\text{Net income} = \text{Revenue} - \text{Cost of goods sold} - \text{Selling and administrative expenses}$

$\text{Net income} = (3,000 \text{ units} \times \$15 \text{ per unit}) - (3,000 \text{ units sold} \times \$10.00 \text{ per unit}) - \$8,000 = \$7,000$

Difficulty: 3 Hard

Topic: Manufacturing Product Costs on Financial Statements; Components of Product Cost;

Average Cost per Unit; Costs Can Be Assets or Expenses

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.;

01-02 Identify the cost of manufacturing a product.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

25) Manufacturing costs that **cannot** be traced to specific units of product in a cost-effective manner include:

- A) depreciation on production equipment.
- B) direct material.
- C) indirect labor.
- D) both depreciation on production equipment and indirect labor.

Answer: D

Explanation: An indirect product cost (i.e. indirect manufacturing cost) cannot be easily or economically traced to a specific product. Both depreciation on production equipment and indirect labor cannot be traced to specific units of product in a cost-effective manner.

Difficulty: 1 Easy

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

26) What is the effect on the balance sheet of recording a \$200 cash purchase of raw materials?

- A) Assets decrease by \$200 and stockholders' equity decreases by \$200.
- B) Assets and stockholders' equity do not change.
- C) Assets increase by \$200 and stockholders' equity increases by \$200.
- D) Assets increase by \$200 and stockholders' equity does not change.

Answer: B

Explanation: Purchasing raw materials for cash decreases Cash by \$200 and increases Raw Materials by \$200. This is an asset exchange transaction and does not affect total assets.

Difficulty: 3 Hard

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

27) What is the effect on the balance sheet of making cash sales of inventory to customers for profit?

- A) Assets and stockholders' equity increase.
- B) Assets and stockholders' equity decrease.
- C) Assets decrease and stockholders' equity increases.
- D) Assets increase and stockholders' equity decreases.

Answer: A

Explanation: The first part of the transaction is recording revenue from the sale. Recording cash revenue increases the asset account, Cash, and increases the stockholders' equity account, Retained Earnings. The second part of the transaction is removing the inventory that has been sold which decreases the asset account, Inventory, and decreases the stockholders' equity account, Retained Earnings. Overall, since the inventory was sold at a profit, the transaction will increase assets and stockholders' equity.

Difficulty: 2 Medium

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

28) Which of the following types of labor costs will **never** flow through the balance sheet?

- A) Plant supervision
- B) Sales commissions
- C) Material handling
- D) Assembly labor

Answer: B

Explanation: Product costs are all costs incurred to obtain a product or provide a service. These costs are treated as assets, recorded in inventory, and expensed when the associated products are sold. Period costs are all costs not associated with a product. They are associated with the general, selling, and administrative functions of the business and most are expensed in the period in which the associated economic sacrifice is made. Sales commissions are a period cost. Therefore, the sales commissions will be expensed when incurred and will never flow through the balance sheet.

Difficulty: 2 Medium

Topic: Costs Can Be Assets or Expenses

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry; FN Measurement; BB Resource Management

29) Which of the following is **not** classified as manufacturing overhead?

- A) Product delivery costs
- B) Salary of factory supervisor
- C) Factory insurance
- D) Production supplies

Answer: A

Explanation: Downstream costs are costs incurred after the manufacturing process including marketing, distribution, and customer services. Distribution costs include product delivery costs. Downstream costs are classified as general, selling, and administrative expenses and are expensed in the period they are incurred.

Difficulty: 2 Medium

Topic: Cost Classification in Manufacturing Companies

Learning Objective: 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

30) Kirsten believes her company's overhead costs are driven (affected) by the number of direct labor hours because the production process is very labor intensive. During the period, the company produced 5,000 units of Product A requiring a total of 1,600 labor hours and 2,500 units of Product B requiring a total of 400 labor hours. What allocation rate should be used if the company incurs overhead costs of \$20,000?

- A) \$10 per labor hour
- B) \$2.67 per unit
- C) \$12.50 per labor hour for Product A and \$50 per labor hour for Product B
- D) None of these

Answer: A

Explanation: The company's overhead costs are driven (affected) by the number of direct labor hours because the production process is very labor intensive. As a result, the allocation rate should be based on labor hours.

Allocation rate = Overhead cost ÷ Allocation base

Allocation rate = \$20,000 ÷ (1,600 labor hours + 400 labor hours) = \$10.00 per labor hour

Difficulty: 3 Hard

Topic: Overhead Costs: A Closer Look

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

31) Anton believes his company's overhead costs are driven (affected) by the number of machine hours because the production process is heavily automated. During the period, the company produced 3,000 units of Product A requiring a total of 100 machine hours and 2,000 units of Product B requiring a total of 25 machine hours. What allocation rate should be used if the company incurs overhead costs of \$10,000?

- A) \$2 per unit
- B) \$2 per machine hour
- C) \$80 per unit
- D) \$80 per machine hour

Answer: D

Explanation: The company's overhead costs are driven (affected) by the number of machine hours because the production process is heavily automated. As a result, the allocation rate should be based on machine hours.

Allocation rate = Overhead cost ÷ Allocation base

Allocation rate = \$10,000 ÷ (100 machine hours + 25 machine hours) = \$80 per machine hour

Difficulty: 3 Hard

Topic: Overhead Costs: A Closer Look

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

32) The following information relates to the operations of Cruz Manufacturing during the current year:

Raw materials used	\$ 20,000
Direct labor wages	60,000
Sales salaries and commissions	50,000
Depreciation on production equipment	4,000
Rent on manufacturing facilities	30,000
Packaging and shipping supplies	6,000
Sales revenue	190,000
Units produced and sold	10,000
Selling price per unit	\$ 20.00

Based on this information, what is the company's cost of goods sold?

- A) \$86,000
- B) \$120,000
- C) \$114,000
- D) \$170,000

Answer: C

Explanation: $\text{Average cost per unit} = (\text{Materials cost} + \text{Labor costs} + \text{Overhead costs}) \div \text{Number of units produced}$

$\text{Average cost per unit} = [\$20,000 + \$60,000 + (\$4,000 + \$30,000)] \div 10,000 \text{ units} = \11.40 per unit

$\text{Cost of goods sold} = \text{Number of units sold} \times \text{Average cost per unit}$

$\text{Cost of goods sold} = 10,000 \text{ units sold} \times \$11.40 \text{ per unit} = \$114,000$

Difficulty: 3 Hard

Topic: Components of Product Cost; Average Cost per Unit; Costs Can Be Assets or Expenses

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

33) The following information relates to Marshall Manufacturing's current accounting period:

Raw materials used	\$ 34,000
Direct labor wages	66,000
Sales salaries and commissions	50,000
Depreciation on production equipment	6,000
Rent on manufacturing facilities	4,000
Administrative supplies and utilities	10,000
Sales revenue	210,000
Units produced	10,000
Units sold	10,000

Based on this information, what is the company's net income?

- A) \$40,000
- B) \$70,000
- C) \$30,000
- D) \$42,000

Answer: A

Explanation: $\text{Average cost per unit} = (\text{Materials cost} + \text{Labor costs} + \text{Overhead costs}) \div \text{Number of units produced}$

$\text{Average cost per unit} = [\$34,000 + \$66,000 + (\$6,000 + \$4,000)] \div 10,000 \text{ units} = \11.00 per unit

$\text{Cost of goods sold} = \text{Number of units sold} \times \text{Average cost per unit}$

$\text{Cost of goods sold} = 10,000 \text{ units sold} \times \$11.00 \text{ per unit} = \$110,000$

$\text{Net income} = \text{Revenue} - \text{Cost of goods sold} - \text{Selling and administrative expenses}$

$\text{Net income} = \$210,000 - \$110,000 - (\$50,000 + \$10,000) = \$40,000$

Difficulty: 3 Hard

Topic: Manufacturing Product Costs on Financial Statements; Components of Product Cost; Average Cost per Unit; Costs Can Be Assets or Expenses

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.; 01-02 Identify the cost of manufacturing a product.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

34) Costs such as transportation-out, sales commissions, uncollectible accounts receivable, and advertising costs are sometimes called:

- A) upstream costs.
- B) downstream costs.
- C) direct costs.
- D) indirect costs.

Answer: B

Explanation: Downstream costs are costs incurred after the manufacturing process including marketing, distribution, and customer services.

Difficulty: 1 Easy

Topic: Cost Classification in Manufacturing Companies

Learning Objective: 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

35) All of the following are downstream costs **except**:

- A) packaging costs.
- B) advertising.
- C) research and development.
- D) sales commissions.

Answer: C

Explanation: Downstream costs are costs incurred after the manufacturing process including marketing, distribution, and customer services. Research and development is considered an upstream cost because it is incurred before the manufacturing process.

Difficulty: 1 Easy

Topic: Cost Classification in Manufacturing Companies

Learning Objective: 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

- 36) Select the **incorrect** statement regarding upstream and downstream costs.
- A) Companies normally incur significant downstream costs.
 - B) To be profitable, companies must recover the total cost of developing, producing, and delivering products.
 - C) Pricing decisions must consider both upstream and downstream costs in addition to manufacturing costs.
 - D) Upstream and downstream costs are reported as product costs on the income statement.

Answer: D

Explanation: Upstream costs are costs that are incurred prior to manufacturing process including research and development costs and product design costs. Downstream costs are costs incurred after the manufacturing process including marketing, distribution, and customer services. Upstream and downstream cost are not reported as product costs on the income statement; instead, they are classified as general, selling, and administrative expenses and are expensed in the period they are incurred.

Difficulty: 2 Medium

Topic: Components of Product Cost; Cost Classification in Manufacturing Companies

Learning Objective: 01-02 Identify the cost of manufacturing a product.; 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

- 37) Select the **incorrect** statement regarding service companies.
- A) Because service companies do not carry inventory, it is impossible to determine product costs.
 - B) Because the products of service companies are consumed immediately, there is no finished goods inventory on their balance sheets.
 - C) Managers of service companies are expected to control costs, improve quality, and increase productivity just like managers of manufacturing companies.
 - D) Material, labor, and overhead costs of service companies are treated as period costs.

Answer: A

Explanation: The primary difference between manufacturing entities and service companies is that the finished products provided by service companies are consumed immediately.

Difficulty: 2 Medium

Topic: Cost Classification in Service and Merchandising Companies

Learning Objective: 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

38) Identify the **false** statement regarding how product costs in a manufacturing company differ from product costs in a service or merchandising company.

- A) Both manufacturing companies and service companies incur costs for supplies.
- B) Manufacturing companies accumulate product costs in inventory accounts, while service companies do not.
- C) Products of service companies such as restaurants are consumed immediately.
- D) Most labor costs for merchandising companies are treated as product costs.

Answer: D

Explanation: The primary difference between manufacturing entities and service companies is that the finished products provided by service companies are consumed immediately. Most labor costs incurred by service companies result from providing services to customers. These costs are treated as selling, general, and administrative expenses rather than being accumulated in inventory accounts as product costs. A merchandise company purchases goods and resales the goods to customers (i.e. Walmart). The labor cost for a merchandising company is not considered a product cost. Instead, it is considered a period cost.

Difficulty: 2 Medium

Topic: Cost Classification in Service and Merchandising Companies

Learning Objective: 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

39) Costs associated with holding inventory often include:

- A) theft, damage, and obsolescence.
- B) financing.
- C) warehouse space.
- D) supervision.
- E) All of these.

Answer: E

Explanation: Inventory holding costs include, but are not limited to, financing, warehouse space, supervision, theft, damage, and obsolescence.

Difficulty: 1 Easy

Topic: Just-in-Time Inventory

Learning Objective: 01-05 Show how just-in-time inventory can increase profitability.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

40) A company that uses a just-in-time inventory system:

- A) has finished goods inventory on hand at all times in order to speed up shipments of customer orders.
- B) may find that having less inventory actually leads to increased customer satisfaction.
- C) assesses its value chain to create new value-added activities.
- D) adopts a systematic, problem-solving attitude.

Answer: B

Explanation: Many businesses have been able to simultaneously reduce their inventory holding costs and increase customer satisfaction by making products available just in time (JIT) for customer consumption. Many fast-food restaurants have discovered that JIT systems lead not only to greater customer satisfaction but also to lower costs through reduced waste.

Difficulty: 1 Easy

Topic: Just-in-Time Inventory

Learning Objective: 01-05 Show how just-in-time inventory can increase profitability.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

41) Howard Lumber Company mistakenly classified a product cost as an expense that totaled \$20,000. The company produced 2,000 units of product and sold 1,000 of them during the year. Management is paid a bonus equal to 2% of net income. In the year in which the mistake was made:

- A) product costs were overstated.
- B) management bonuses were underpaid.
- C) the company's income statement portrayed a more favorable position than actually existed.
- D) the company's net income was overstated.

Answer: B

Explanation: Product costs were understated because a product cost in the amount of \$20,000 was mistakenly classified as an expense. The income statement is affected as follows:

(1) Understatement of cost of goods sold in the amount of \$10,000, computed as follows:

Average cost per unit = Product costs ÷ Number of units produced

Average cost per unit = \$20,000 ÷ 2,000 units = \$10.00 per unit

Cost of goods sold = Number of units sold × Average cost per unit

Cost of goods sold = 1,000 units sold × \$10.00 per unit = \$10,000

(2) Overstatement of selling and administrative expenses = \$20,000

The understatement of cost of goods sold of \$10,000 would be offset by the overstatement of selling and administrative expenses of \$20,000, resulting in an understatement of net income in the amount of \$10,000 (a less favorable result). Since management is paid a bonus equal to 2% of net income, the bonus was underpaid as a result.

Difficulty: 3 Hard

Topic: The Motive to Manipulate

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Apply

AACSB: Knowledge Application; Ethics

AICPA: BB Industry; FN Measurement

- 42) Assuming a company's inventory increased during the period, which of the following misclassifications may increase net income?
- A) Recording administrative salaries as a product cost
 - B) Recording depreciation on production equipment as an expense
 - C) Expensing raw material costs instead of including them in inventory
 - D) Recording depreciation on production equipment as an expense and Expensing raw material costs instead of including them in inventory

Answer: A

Explanation: Classifying administrative salaries as a product cost (rather than a period cost) means that these costs are first accumulated in the Inventory account and then expensed when the goods are sold. Given that inventory increased during the period, some of the administrative salaries have passed through the Inventory account into the Cost of Goods Sold account with the rest remaining in the Inventory account. As a result, net income would be overstated (that is, increased) because the understated expense would exceed the overstatement of cost of goods sold.

Difficulty: 3 Hard

Topic: The Motive to Manipulate

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Apply

AACSB: Knowledge Application; Ethics

AICPA: BB Industry; FN Measurement

- 43) During her first year with the company, Ann mistakenly accumulated some of the company's period costs in ending inventory. Which of the following indicates how this error affects the company's financial statements assuming number of units produced exceeded number of units sold during the period?

- A) Cash flows from operations are understated.
- B) Gross margin is unaffected.
- C) Net income is overstated.
- D) Inventory is understated.

Answer: C

Explanation: Classifying administrative salaries as a product cost (rather than a period cost) means that these costs are first accumulated in the Inventory account and then expensed when the goods are sold. Given that inventory increased during the period, some of the administrative salaries have passed through the Inventory account into the Cost of Goods Sold account with the rest remaining in the Inventory account. As a result, net income would be overstated because the understated expense would exceed the overstatement of cost of goods sold.

Difficulty: 3 Hard

Topic: The Motive to Manipulate

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Apply

AACSB: Knowledge Application; Ethics

AICPA: BB Industry; FN Measurement

44) If a company misclassifies a general, selling and administrative cost as a product cost in a period when production exceeds sales:

- A) net income will be overstated.
- B) total assets will be understated.
- C) gross margin will be understated.
- D) both net income will be overstated and gross margin will be understated

Answer: D

Explanation: Classifying administrative salaries as a product cost (rather than a period cost) means that these costs are first accumulated in the Inventory account and then expensed when the goods are sold. Production exceeded sales; as such, inventory increased during the period and some of the administrative salaries have passed through the Inventory account into the Cost of Goods Sold account with the rest remaining in the Inventory account. As a result, the gross margin will be understated. In addition, net income would be overstated because the understated expense would exceed the overstatement of cost of goods sold.

Difficulty: 3 Hard

Topic: The Motive to Manipulate

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Apply

AACSB: Knowledge Application; Ethics

AICPA: BB Industry; FN Measurement

45) Which of the following is **not** a reason management might be tempted to classify costs as product costs rather than expensing them during periods in which production exceeds sales?

- A) The company's bank may be more likely to extend financing to the firm.
- B) Income taxes will be lower.
- C) Net income will be higher.
- D) Management bonuses may be higher.

Answer: B

Explanation: Since income tax expense is calculated as a designated percentage of taxable income, managers seek to minimize taxes by reporting the minimum amount of taxable income. In other words, because taxes will be lower, managers prefer to classify costs as expenses rather than assets (rather than classify costs as product costs rather than expensing them as stated here).

Difficulty: 3 Hard

Topic: The Motive to Manipulate

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Apply

AACSB: Knowledge Application; Ethics

AICPA: BB Industry; FN Measurement

46) Certified Management Accountants (CMA) must complete a specified number of continuing professional education credits each reporting period. Which of the four standards of ethical conduct issued by the Institute of Management Accountants likely motivated this requirement?

- A) Confidentiality
- B) Competence
- C) Integrity
- D) Objectivity

Answer: B

Explanation: The Competence standard of the IMA Statement of Ethical Professional Practice states that each member has a responsibility to maintain an appropriate level of professional expertise by continually developing knowledge and skills. That standard may be met, in part, by completing continuing professional education classes.

Difficulty: 2 Medium

Topic: Statement of Ethical Professional Practice

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Understand

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

47) Which of the following is **not** one of the four Standards of Ethical Conduct for Management Accountants?

- A) Credibility
- B) Confidentiality
- C) Integrity
- D) Independence

Answer: D

Explanation: The four standards of ethical conduct for management accountants are competence, confidentiality, integrity, and credibility.

Difficulty: 1 Easy

Topic: Statement of Ethical Professional Practice

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

- 48) As a Certified Management Accountant, Suzanne is bound by the standards of ethical conduct issued by the Institute of Management Accountants. During the course of business, Suzanne learned that her company has decided to discontinue a major product line. If she mentions this fact to her brother, who is a stockbroker, Suzanne could be in violation of the:
- A) competence standard.
 - B) confidentiality standard.
 - C) integrity standard.
 - D) objectivity standard.

Answer: B

Explanation: The Confidentiality standard of the IMA Statement of Ethical Professional Practice states that each member has a responsibility to keep information confidential except when disclosure is authorized or legally required and also to refrain from using confidential information for unethical or illegal advantage.

Difficulty: 2 Medium

Topic: Statement of Ethical Professional Practice

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Understand

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

- 49) As a Certified Management Accountant, Derek is bound by the standards of ethical conduct issued by the Institute of Management Accountants. According to the standards, Derek has a responsibility to:
- A) inform subordinates that they should protect confidential information.
 - B) ensure that financial accounting records are maintained as per the governing guidelines.
 - C) monitor the activities of subordinates to assure that confidentiality is maintained.
 - D) inform subordinates that they should protect confidential information and monitor the activities of subordinates to assure that confidentiality is maintained.

Answer: D

Explanation: The Confidentiality standard of the IMA Statement of Ethical Professional Practice states that each member has a responsibility to inform all relevant parties regarding appropriate use of confidential information and also to monitor subordinates' activities to ensure compliance.

Difficulty: 1 Easy

Topic: Statement of Ethical Professional Practice

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

50) As a Certified Management Accountant, Grace is bound by the standards of ethical conduct issued by the Institute of Management Accountants. If she accepts an expensive gift from a vendor trying to win a contract with her firm, which of the following standards will she violate?

- A) Integrity
- B) Confidentiality
- C) Competence
- D) Objectivity

Answer: A

Explanation: The Integrity standard of the IMA Statement of Ethical Professional Practice states that each member has a responsibility to mitigate actual conflicts of interest and avoid apparent conflicts of interest and also to refrain from engaging in any conduct that would prejudice carrying out duties ethically.

Difficulty: 2 Medium

Topic: Statement of Ethical Professional Practice

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Understand

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

51) Which of the following is **not** a provision of the Sarbanes-Oxley Act of 2002?

- A) The chief executive officer and the chief financial officer are jointly responsible for establishment and enforcement of internal controls.
- B) Companies are required to report on the effectiveness of their internal controls.
- C) The company's external auditor is charged with the ultimate responsibility for the accuracy of the company's financial statements and accompanying footnotes.
- D) The company's external auditors are required to attest to the accuracy of the internal controls report.

Answer: C

Explanation: SOX charges management, not the external auditor, with the ultimate responsibility for the accuracy of the company's financial statements and accompanying notes.

Difficulty: 1 Easy

Topic: Sarbanes-Oxley Act

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

52) Which of the following practices is **not** considered an effective means of reengineering business systems?

- A) Identifying the best practices used by world-class competitors
- B) Improving the accuracy of cost allocations
- C) Increasing non-value added activities
- D) All of these are effective means of reengineering business systems.

Answer: C

Explanation: A key ingredient of successful reengineering is benchmarking. Benchmarking involves identifying the best practices used by world-class competitors. Best practices employed by world-class companies include total quality management (TQM), activity-based management (ABM), and value-added assessment. Comprehensive value chain analysis can lead to identifying and eliminating (rather than increasing) nonvalue-added activities

Difficulty: 2 Medium

Topic: Using Total Quality Management and Activity Based Management to Reengineer Production and Delivery Systems

Learning Objective: 01-07 Identify the key features of total quality management (TQM) and activity based management (ABM). (Appendix).

Bloom's: Understand

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

53) Levenworth Company incurs unnecessary costs each period because of the excess quantities of inventory maintained to meet unexpected customer demand. The costs of inventory financing, storage, supervision, and obsolescence could most likely be reduced by which of the following practices?

- A) Activity-based costing
- B) Just-in-time inventory
- C) Total quality management
- D) Benchmarking

Answer: B

Explanation: Inventory holding costs include, but are not limited to, financing, warehouse space, supervision, theft, damage, and obsolescence. Many businesses have been able to reduce their inventory holding costs by making products available just in time (JIT) for customer consumption.

Difficulty: 1 Easy

Topic: Just-in-Time Inventory

Learning Objective: 01-05 Show how just-in-time inventory can increase profitability.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

54) Which of the following is **not** an element that is typically present when fraud occurs?

- A) Separating duties
- B) Opportunity
- C) Pressure
- D) Rationalize

Answer: A

Explanation: The auditing profession has determined that the following three elements are typically present when fraud occurs: (1) the availability of an opportunity, (2), the existence of some form of pressure leading to an incentive, and (3) the capacity to rationalize. Separating the duties necessary to complete a task and assigning the separated duties to two or more employees reduces the opportunity for either employee to defraud the company.

Difficulty: 1 Easy

Topic: The Fraud Triangle

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

55) Which of the following best represents a characteristic of managerial accounting?

- A) Information is historically based and reported annually.
- B) Information is based on estimates and is bounded by relevance and timeliness.
- C) Information is regulated by the Securities and Exchange Commission.
- D) Information is characterized by reliability and objectivity.

Answer: B

Explanation: While financial accounting is characterized by its objectivity, reliability, consistency, and historical nature, managerial accounting is more concerned with relevance and timeliness. Managerial accounting uses more estimates and fewer facts than financial accounting.

Difficulty: 1 Easy

Topic: Information Characteristics

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

56) Which of the following statements concerning manufacturing costs is **incorrect**?

- A) All salaries incurred by the sales department are expensed as incurred.
- B) Direct labor costs are recorded initially in an inventory account.
- C) Depreciation on manufacturing equipment is a period cost.
- D) The cost of direct materials can be readily traced to products.

Answer: C

Explanation: Product costs are all costs incurred to obtain a product or provide a service. These costs are treated as assets, recorded in inventory, and expensed when the associated products are sold. Depreciation on manufacturing equipment is a product cost. Period costs are all costs not associated with a product. They are associated with the general, selling, and administrative functions of the business and most are expensed in the period in which the associated economic sacrifice is made.

Difficulty: 1 Easy

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

57) Steuben Company produces dog houses. During the current year, Steuben Company incurred the following costs:

Rent on manufacturing facility	\$ 250,000
Office manager's salary	150,000
Wages of factory machine operators	110,000
Depreciation on manufacturing equipment	50,000
Insurance and taxes on selling and administrative offices	30,000
Direct materials purchased and used	170,000

Wages paid to factory machine operators in producing the dog houses should be categorized as:

- A) a product cost and recorded in the inventory account
- B) a period cost and recorded on the income statement
- C) a product cost and recorded on the income statement
- D) a period cost and recorded in the inventory account

Answer: A

Explanation: Product costs are all costs incurred to obtain a product or provide a service. These costs are treated as assets, recorded in inventory, and expensed when the associated products are sold. Wages of machine operators are related to production and therefore considered a product cost. Period costs are all costs not associated with a product. They are associated with the general, selling, and administrative functions of the business and most are expensed in the period in which the associated economic sacrifice is made.

Difficulty: 2 Medium

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

58) Steuben Company produces dog houses. During the current year, Steuben Company incurred the following costs:

Rent on manufacturing facility	\$ 250,000
Office manager's salary	150,000
Wages of factory machine operators	110,000
Depreciation on manufacturing equipment	50,000
Insurance and taxes on selling and administrative offices	30,000
Direct materials purchased and used	170,000

Based on the above information, the amount of period costs shown on Steuben's income statement is:

- A) \$430,000
- B) \$150,000
- C) \$30,000
- D) \$180,000

Answer: D

Explanation: Selling, general, and administrative costs (SG&A) are normally expensed in the period in which they are incurred. Because of this recognition pattern, nonproduct expenses are sometimes called period costs. In this case, the period costs of \$180,000 are comprised of the office manager's salary of \$150,000 and the insurance and taxes on selling and administrative offices of \$30,000.

Difficulty: 3 Hard

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

59) Steuben Company produces dog houses. During the current year, Steuben Company incurred the following costs:

Rent on manufacturing facility	\$ 250,000
Office manager's salary	150,000
Wages of factory machine operators	110,000
Depreciation on manufacturing equipment	50,000
Insurance and taxes on selling and administrative offices	30,000
Direct materials purchased and used	170,000

Based on the above information, which of the following would **not** be treated as a product cost:

- A) Office manager's salary
- B) Rent expense incurred on manufacturing facility
- C) Depreciation on manufacturing equipment
- D) Wages of factory machine operators

Answer: A

Explanation: Selling, general, and administrative costs (SG&A) are normally expensed in the period in which they are incurred. Because of this recognition pattern, nonproduct expenses are sometimes called period costs. In this case, the period costs are comprised of the office manager's salary and the insurance and taxes on selling and administrative offices.

Difficulty: 3 Hard

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

60) The benefits of a just-in-time system would include all of the following **except**:

- A) increased warehousing costs.
- B) reduced inventory holding costs.
- C) improved customer satisfaction.
- D) decrease in the number of suppliers.

Answer: A

Explanation: Just-in-time systems deliver the product to the supplier just in time for the customer to purchase. This type of system has the benefit of decreased warehousing costs.

Difficulty: 1 Easy

Topic: Just-in-Time Inventory

Learning Objective: 01-05 Show how just-in-time inventory can increase profitability.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

61) The Sarbanes Oxley Act of 2002:

- A) prohibits CPA's from becoming managerial accountants.
- B) created Generally Accepted Accounting principles (GAAP).
- C) requires the CEO and CFO to defer responsibility for internal controls to external auditors.
- D) requires management to establish a whistleblower policy.

Answer: D

Difficulty: 1 Easy

Topic: Sarbanes-Oxley Act

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

62) A systematic problem-solving philosophy that encourages front line workers to achieve zero defects is known as:

- A) just-in-time (JIT).
- B) total quality management (TQM).
- C) activity based management (ABM).
- D) None of these

Answer: B

Explanation: To promote effective and efficient operations, many companies practice total quality management (TQM). TQM is a two-dimensional management philosophy using (1) a systematic problem-solving philosophy that encourages frontline workers to achieve zero defects and (2) an organizational commitment to achieving customer satisfaction.

Difficulty: 1 Easy

Topic: Using Total Quality Management and Activity Based Management to Reengineer Production and Delivery Systems

Learning Objective: 01-07 Identify the key features of total quality management (TQM) and activity based management (ABM). (Appendix).

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

63) Randall Company manufactures chocolate bars. The following were among Randall's manufacturing costs during the current year:

Wages

Machine operators	\$ 300,000
Selling and administrative personnel	\$ 75,000

Materials used

Lubricant for oiling machinery	\$ 25,000
Cocoa, sugar, and other raw materials	\$ 225,000
Packaging materials	\$ 190,000

Randall's direct labor costs amounted to:

- A) \$400,000.
- B) \$300,000.
- C) \$175,000.
- D) \$375,000.

Answer: B

Explanation: Direct labor costs include labor costs that can be easily and conveniently traced to products, such as the \$300,000 of wages paid to machine operators. The wages of \$75,000 paid to selling and administrative personnel would be classified as period costs.

Difficulty: 3 Hard

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

64) Randall Company manufactures chocolate bars. The following were among Randall's manufacturing costs during the current year:

Wages

Machine operators	\$ 300,000
Selling and administrative personnel	\$ 75,000

Materials used

Lubricant for oiling machinery	\$ 25,000
Cocoa, sugar, and other raw materials	\$ 225,000
Packaging materials	\$ 190,000

Randall's direct materials amounted to:

- A) \$25,000.
- B) \$225,000.
- C) \$250,000.
- D) \$475,000.

Answer: B

Explanation: Direct materials costs include the costs of materials that can be easily and conveniently traced to products, such as the \$225,000 of cocoa, sugar, and other raw materials. The lubricant for oiling machinery in the amount of \$25,000 and the packaging materials in the amount of \$190,000 would be classified as indirect materials because they are not easily and conveniently traced to products.

Difficulty: 3 Hard

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

65) Which of the following items would be reported directly on the income statement as a period cost?

- A) Selling and administrative salaries
- B) Cost of lubricant for oiling machinery
- C) Wages paid to machine operators
- D) All of these

Answer: A

Explanation: Selling and administrative salaries are reported directly on the income statement as a period cost. The cost of lubricant for oiling machinery and the wages paid to machine operators would be accumulated in inventory accounts as product costs.

Difficulty: 1 Easy

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

66) Managerial accounting systems consider economic and non-financial data as well as financial statement data.

Answer: TRUE

Difficulty: 1 Easy

Topic: Users and Types of Information

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

67) Most internal users of accounting information need primarily global information that reflects the performance of the company as a whole.

Answer: FALSE

Explanation: Internal users primarily need information about the sub-units of the company. External users primarily need global information that reflects the performance of the company as a whole.

Difficulty: 1 Easy

Topic: Level of Aggregation

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

68) Senior executives focus on financial data when comparing the performance of their companies to that of competitors.

Answer: TRUE

Difficulty: 1 Easy

Topic: Users and Types of Information

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

69) Managerial accounting is designed to satisfy needs of external users including creditors, investors, and governmental agencies.

Answer: FALSE

Explanation: Financial accounting is designed for external users, whereas managerial accounting is designed for internal users.

Difficulty: 1 Easy

Topic: Users and Types of Information

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

70) Managerial accounting focuses primarily on the performance of the company as a whole.

Answer: FALSE

Explanation: Financial accounting focuses primarily on the performance of the company as a whole. Managerial accounting focuses on the performance of sub-units within the company.

Difficulty: 1 Easy

Topic: Level of Aggregation

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

71) Product costs include materials, labor, and selling and administrative costs.

Answer: FALSE

Explanation: Product costs include materials, labor and overhead. Period costs include general, selling and administrative costs.

Difficulty: 1 Easy

Topic: Costs Can Be Assets or Expenses

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

72) Average costs are used for internal decision-making, but actual costs are required for calculating cost of goods sold.

Answer: FALSE

Explanation: Average costs are used to calculate cost of goods sold.

Difficulty: 2 Medium

Topic: Average Cost per Unit

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

73) The biggest challenge in computing the total cost per unit of a product is determining the amount of overhead cost that should be assigned to each unit.

Answer: TRUE

Difficulty: 1 Easy

Topic: Overhead Costs: A Closer Look

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

74) Distinguishing between product and period costs is sometimes guided by the value-added principle.

Answer: FALSE

Explanation: Product costs are comprised of the materials used to make the products, the labor used to transform the materials into products, and the overhead (other resources consumed in the process of making the products). Selling, general, and administrative costs are normally expensed in the period in which they are incurred. Because of this recognition pattern, nonproduct expenses are sometimes called period costs.

Difficulty: 2 Medium

Topic: Manufacturing Product Costs on Financial Statements; Components of Product Cost

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.; 01-02 Identify the cost of manufacturing a product.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

75) Period costs are initially recorded in asset accounts and are later expensed in the period when the related units are sold.

Answer: FALSE

Explanation: Selling, general, and administrative costs are normally expensed in the period in which they are incurred.

Difficulty: 1 Easy

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

76) Product costs are immediately recorded in expense accounts when the products are manufactured.

Answer: FALSE

Explanation: Product costs are initially recorded in inventory accounts and are later expensed in the period when the related units are sold.

Difficulty: 1 Easy

Topic: Components of Product Cost

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

77) Costs that are not classified as product costs are normally expensed in the period incurred.

Answer: TRUE

Explanation: Selling, general, and administrative costs are normally expensed in the period in which they are incurred. Because of this recognition pattern, nonproduct expenses are sometimes called period costs.

Difficulty: 1 Easy

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

78) During its first year of operations, a company that incurred \$1,000 in production costs reported cost of goods sold of \$800 and selling costs of \$100. The company's ending finished goods inventory was \$300.

Answer: FALSE

Explanation: Finished goods inventory = Production costs of \$1,000 – Cost of goods sold of \$800 = \$200

Difficulty: 3 Hard

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

79) A company uses sandpaper to prepare its product for finishing. Most manufacturers would classify the sandpaper as direct material because it is physically consumed in the production process.

Answer: FALSE

Explanation: Materials costs that cannot be traced to products and services in a cost-effective manner, such as sandpaper, are considered indirect (rather than direct) materials.

Difficulty: 2 Medium

Topic: Overhead Costs: A Closer Look

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

80) Cash paid to production workers should be recorded as Wages Expense in the income statement for the period incurred.

Answer: FALSE

Explanation: Production wages are expensed as part of cost of goods sold at the time the inventory is sold. Labor costs that can be easily and conveniently traced to products are called direct labor costs.

Difficulty: 1 Easy

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

81) For a manufacturing company, both direct labor costs and indirect labor costs are classified as product costs.

Answer: TRUE

Explanation: Product costs are all costs incurred to obtain a product or provide a service. Product costs can be direct or indirect.

Difficulty: 2 Medium

Topic: Manufacturing Product Costs on Financial Statements; Overhead Costs: A Closer Look

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

82) Product costs flow from the balance sheet to the income statement.

Answer: TRUE

Explanation: Product costs are first accumulated in an asset account (Inventory). They are expensed as cost of goods sold in the period the inventory is sold.

Difficulty: 2 Medium

Topic: Manufacturing Product Costs on Financial Statements; Tabor Manufacturing Company

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.; 01-02 Identify the cost of manufacturing a product.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

83) Unlike direct material and direct labor costs, overhead costs must be allocated to products.

Answer: TRUE

Explanation: An indirect product cost cannot be easily or economically traced to a specific product. In traditional costing systems, indirect costs are assigned to products using some allocation base measured in volume such as direct labor hours.

Difficulty: 1 Easy

Topic: Overhead Costs: A Closer Look

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

84) Depreciation on manufacturing equipment is an indirect product cost, while depreciation on office equipment is a period cost.

Answer: TRUE

Explanation: Product costs are comprised of the materials used to make the products, the labor used to transform the materials into products, and the overhead (other resources consumed in the process of making the products). Selling, general, and administrative costs are normally expensed in the period in which they are incurred. Because of this recognition pattern, nonproduct expenses are sometimes called period costs.

Difficulty: 2 Medium

Topic: Manufacturing Product Costs on Financial Statements; Components of Product Cost

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.; 01-02 Identify the cost of manufacturing a product.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

85) Upstream costs are classified as product costs and downstream costs are classified as period costs for financial reporting purposes.

Answer: FALSE

Explanation: Upstream costs are costs that are incurred prior to manufacturing process including research and development costs and product design costs. Downstream costs are costs incurred after the manufacturing process including marketing, distribution, and customer services. Upstream and downstream cost are not reported as product costs on the income statement; instead, they are classified as general, selling, and administrative expenses and are expensed in the period they are incurred.

Difficulty: 2 Medium

Topic: Components of Product Cost; Cost Classification in Manufacturing Companies

Learning Objective: 01-02 Identify the cost of manufacturing a product.; 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

86) All costs incurred prior to delivery of the product to the customer are referred to as upstream costs.

Answer: FALSE

Explanation: Upstream costs are costs that are incurred prior to manufacturing process including research and development costs and product design costs.

Difficulty: 1 Easy

Topic: Cost Classification in Manufacturing Companies

Learning Objective: 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

87) Transportation costs incurred to transfer products to customers are downstream costs.

Answer: TRUE

Explanation: Downstream costs are costs incurred after the manufacturing process including marketing, distribution, and customer services.

Difficulty: 1 Easy

Topic: Cost Classification in Manufacturing Companies

Learning Objective: 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

88) Unlike manufacturers, service companies do not have an inventory of products.

Answer: TRUE

Explanation: Service companies do not sell a product and therefore do not have an inventory account listed on their balance sheet.

Difficulty: 1 Easy

Topic: Cost Classification in Service and Merchandising Companies

Learning Objective: 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

89) The primary difference between manufacturing companies and service companies is that the products provided by service companies are consumed immediately.

Answer: TRUE

Difficulty: 1 Easy

Topic: Cost Classification in Service and Merchandising Companies

Learning Objective: 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

90) A merchandising business paid \$2,500 to purchase inventory and \$50 to have the inventory delivered to its customers. Its product costs were \$2,550.

Answer: FALSE

Explanation: The \$2,500 paid to purchase inventory would be considered a midstream costs in a merchandising company and, as such, it would be classified as a product cost. Downstream costs are costs incurred after the manufacturing process including marketing, distribution, and customer services. Distribution costs, which include the product delivery costs of \$50 in this situation, are classified as general, selling, and administrative expenses and are expensed in the period they are incurred.

Difficulty: 3 Hard

Topic: Cost Classification in Manufacturing Companies; Cost Classification in Service and Merchandising Companies

Learning Objective: 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

91) A manufacturing business paid \$3,000 to purchase inventory. As a result, assets would increase by \$3,000.

Answer: FALSE

Explanation: The decrease in Cash, an asset, would offset the increase in Inventory, another asset. As such, total assets would not change.

Difficulty: 3 Hard

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

92) A just-in-time system can lower inventory holding costs and increase customer satisfaction.

Answer: TRUE

Explanation: JIT systems allow companies to receive products just in time to sell them. JIT systems decrease holding costs.

Difficulty: 1 Easy

Topic: Just-in-Time Inventory

Learning Objective: 01-05 Show how just-in-time inventory can increase profitability.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

93) The objective of a just-in-time inventory system is to totally eliminate all inventories.

Answer: FALSE

Explanation: The objective is to minimize the amount of inventory because of the high cost of holding it.

Difficulty: 1 Easy

Topic: Just-in-Time Inventory

Learning Objective: 01-05 Show how just-in-time inventory can increase profitability.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

94) Just-in-time systems can be used by both manufacturing and merchandising companies.

Answer: TRUE

Difficulty: 1 Easy

Topic: Just-in-Time Inventory

Learning Objective: 01-05 Show how just-in-time inventory can increase profitability.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

95) A potential negative effect of using a just-in-time inventory system is the immediate impact of labor strikes on the transportation system such as railroad.

Answer: TRUE

Explanation: JIT systems allow companies to receive products just in time to sell them. Labor strikes related to the transportation system could make it difficult to obtain the needed inventory just in time.

Difficulty: 1 Easy

Topic: Just-in-Time Illustration

Learning Objective: 01-05 Show how just-in-time inventory can increase profitability.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

96) Costs associated with holding inventory include hidden costs, such as low employee motivation.

Answer: TRUE

Explanation: Many costs of holding inventory are obvious such as financing, warehouse space, security and maintenance, theft, damage and obsolescence. Other costs are hidden such as diminished motivation, sloppy work, inattentive attitudes, and increased production times.

Difficulty: 1 Easy

Topic: Just-in-Time Inventory

Learning Objective: 01-05 Show how just-in-time inventory can increase profitability.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

97) Because management accountants prepare and analyze financial information used by company decision-makers, they are considered to be at the forefront of corporate governance.

Answer: TRUE

Difficulty: 1 Easy

Topic: Corporate Governance

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

98) Assuming that the number of units produced exceeds the number of units sold, misclassifying period costs as product costs will overstate net income relative to what net income would be without this error.

Answer: TRUE

Explanation: Misclassifying period costs as product costs means that these costs are first accumulated in the Inventory account and then expensed when the goods are sold. Production exceeded sales; as such, inventory increased during the period and some of the misclassified period costs have passed through the Inventory account into the Cost of Goods Sold account with the rest remaining in the Inventory account. As a result, net income would be overstated because the understated expense would exceed the overstatement of cost of goods sold.

Difficulty: 1 Easy

Topic: The Motive to Manipulate

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Understand

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

99) Misclassifying a product cost as a period cost will usually cause the income statement to be incorrect, but the balance sheet will not be affected.

Answer: FALSE

Explanation: Misclassifying period costs as product costs means that these costs are first accumulated in the Inventory account and then expensed when the goods are sold. As a result, some of the misclassified period costs have passed through the Inventory account into the Cost of Goods Sold account with the rest remaining in the Inventory account. Net income would be misstated by the difference between the understated expense and the misstatement of cost of goods sold. Because some of the misclassified period costs remain in the Inventory account, the balance sheet may also be affected.

Difficulty: 2 Medium

Topic: The Motive to Manipulate

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Understand

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

100) Assuming that the inventory on hand at the end of the period is sold during the following period, misclassifying a period cost as a product cost during a period will usually correct itself in the following period.

Answer: TRUE

Explanation: Misclassifying period costs as product costs means that these costs are first accumulated in the Inventory account and then expensed when the goods are sold. Production exceeded sales; as such, inventory increased during the period and some of the misclassified period costs have passed through the Inventory account into the Cost of Goods Sold account with the rest remaining in the Inventory account. As a result, net income would be overstated because the understated expense would exceed the overstatement of cost of goods sold. Assuming that the remaining inventory is sold during the following period, the misclassified period costs that were in the Inventory account at the end of the current period will be expensed as cost of goods sold during the following period. As a result, net income would be understated because of the overstatement of cost of goods sold.

Difficulty: 3 Hard

Topic: The Motive to Manipulate

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Apply

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

101) If product costs are misclassified as selling costs, the average cost per unit will be understated.

Answer: TRUE

Explanation: Recall that average cost per unit equals the product costs divided by the number of units produced. If the product costs are understated, the average cost per unit will be understated.

Difficulty: 3 Hard

Topic: The Motive to Manipulate

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Apply

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

102) With respect to income taxes, managers would prefer to classify costs as assets rather than expenses.

Answer: FALSE

Explanation: Since income tax expense is calculated as a designated percentage of taxable income, managers seek to minimize taxes by reporting the minimum amount of taxable income. In other words, with respect to taxes, managers prefer to classify costs as expenses rather than assets.

Difficulty: 1 Easy

Topic: The Motive to Manipulate; Statement of Ethical Professional Practice

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

103) The four Standards of Ethical Conduct for Management Accountants relate to competence, confidentiality, integrity, and objectivity.

Answer: TRUE

Difficulty: 1 Easy

Topic: Statement of Ethical Professional Practice

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

104) Karen is a Certified Management Accountant and is bound by the IMA's Standards of Ethical Conduct. Her superior has asked her to try to influence the firm's outside auditors with expensive gifts and favors. If Karen complies, she will violate the competence standard.

Answer: FALSE

Explanation: The Integrity standard of the IMA Statement of Ethical Professional Practice states that each member has a responsibility to mitigate actual conflicts of interest and avoid apparent conflicts of interest and also to refrain from engaging in any conduct that would prejudice carrying out duties ethically.

Difficulty: 2 Medium

Topic: Statement of Ethical Professional Practice

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Understand

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

105) Opportunity, pressure and rationalization are the three elements of the fraud triangle.

Answer: TRUE

Difficulty: 1 Easy

Topic: The Fraud Triangle

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

106) Under the terms of the Sarbanes-Oxley Act, a company and its external auditor are required to report on the effectiveness of the company's system of internal controls.

Answer: TRUE

Explanation: SOX holds the chief executive officer (CEO) and the chief financial officer (CFO) responsible for the establishment and enforcement of a strong set of internal controls. Along with its annual report, companies are required to report on the effectiveness of their internal controls.

Difficulty: 1 Easy

Topic: Sarbanes-Oxley Act

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

107) According to the Sarbanes-Oxley Act, a company's audit committee is responsible for its system of internal controls.

Answer: FALSE

Explanation: SOX holds the chief executive officer (CEO) and the chief financial officer (CFO) responsible for the establishment and enforcement of a strong set of internal controls. Along with its annual report, companies are required to report on the effectiveness of their internal controls.

Difficulty: 1 Easy

Topic: Sarbanes-Oxley Act

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

108) The Sarbanes-Oxley Act allows, but does not require, a corporation to establish a whistleblower policy.

Answer: FALSE

Explanation: SOX demands that management establish a hotline and other mechanisms for the anonymous reporting of fraudulent activities. Further, SOX prohibits companies from punishing whistleblowers, employees who legally report corporate misconduct.

Difficulty: 1 Easy

Topic: Sarbanes-Oxley Act

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

109) The philosophy of encouraging workers to achieve zero defects and high customer satisfaction is known as total quality management.

Answer: TRUE

Difficulty: 1 Easy

Topic: Sarbanes-Oxley Act

Learning Objective: 01-07 Identify the key features of total quality management (TQM) and activity based management (ABM). (Appendix).

Bloom's: Remember

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

110) The sequence of activities through which an organization provides products to its customers is called a supply chain.

Answer: FALSE

Explanation: The sequence of activities used to provide products is called a value chain (rather than the supply chain).

Difficulty: 1 Easy

Topic: Using Total Quality Management and Activity Based Management to Reengineer Production and Delivery Systems

Learning Objective: 01-07 Identify the key features of total quality management (TQM) and activity based management (ABM). (Appendix).

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

111) The time spent moving a product from one processing department to the next processing department is an example of a value-added activity.

Answer: FALSE

Explanation: A value-added activity is any unit of work that contributes to a product's ability to satisfy customer needs. Nonvalue-added activities are tasks undertaken that do not contribute to a product's ability to satisfy customer needs. Moving a product from one processing department to the next processing department is an example of a nonvalue-added activity.

Difficulty: 1 Easy

Topic: Using Total Quality Management and Activity Based Management to Reengineer Production and Delivery Systems; Value Chain Analysis Across Companies

Learning Objective: 01-07 Identify the key features of total quality management (TQM) and activity based management (ABM). (Appendix).

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

112) Who are the primary users of financial accounting information? Who are the primary users of managerial accounting information?

Answer: Answers will vary.

Financial accounting information is used primarily by investors, creditors, and others who are outside a business. Managerial accounting information focuses on information users who are inside the business, including its managers and other employees.

Difficulty: 1 Easy

Topic: Users and Types of Information

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application; Communication

AICPA: FN Decision Making; BB Industry

113) For what activities do an organization's managers need accounting information?

Answer: Answers will vary.

Managers of an organization use accounting and other information to plan, direct, and control business operations.

Difficulty: 1 Easy

Topic: Users and Types of Information

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application; Communication

AICPA: FN Decision Making; BB Industry

114) How does the level of aggregation differ between financial accounting information and managerial accounting information?

Answer: Answers will vary.

Most financial accounting information is prepared for the organization as a whole, so the level of aggregation is high. Most managerial accounting information is prepared for subunits of the company (departments, sales territories, etc.), so the level of aggregation is lower than for financial accounting.

Difficulty: 1 Easy

Topic: Level of Aggregation

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application; Communication

AICPA: FN Decision Making; BB Industry

115) How do information needs of employees change moving up the organization chart?

Answer: Answers will vary.

Lower-level employees use primarily nonfinancial information, such as schedules and company policies. Moving up the organization, there is an increasing need for and use of financial information about the company or segments of the company. The top-level managers also use more information from outside the company, such as information about general economic conditions.

Difficulty: 1 Easy

Topic: Users and Types of Information

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application; Communication

AICPA: FN Decision Making; BB Industry

116) Financial accounting information is reported periodically, primarily at the end of each fiscal year. When is managerial accounting information reported to managers of an organization?

Answer: Answers will vary.

Managerial accounting information is reported as needed, much more often than financial accounting. Managerial accounting information is delivered on a continuous basis.

Difficulty: 1 Easy

Topic: Time Horizon and Reporting Frequency

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application; Communication

AICPA: FN Decision Making; BB Industry

117) What costs are treated as product costs for a manufacturing company?

Answer: Answers will vary.

Product costs for a manufacturing company include the costs associated with making the products, specifically, materials, labor and overhead.

Difficulty: 1 Easy

Topic: Product Costing in Manufacturing Companies

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Remember

AACSB: Knowledge Application; Communication

AICPA: BB Industry; FN Measurement

118) Discuss the regulation of financial accounting, and compare to the level of regulation of managerial accounting information.

Answer: Answers will vary.

The financial accounting information prepared by a company is governed by accounting standards (generally accepted accounting principles), most of which have been established by the Financial Accounting Standards Board (FASB). The Securities and Exchange Commission has authority to set these standards, but it has generally deferred to FASB. In comparison, the practice of managerial accounting is unregulated. The information is not made available to the public, so managerial accounting is limited only by the value-added principle: the cost of preparing the information should not exceed the benefits to be received from using the information.

Difficulty: 1 Easy

Topic: Regulation

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application; Communication

AICPA: FN Decision Making; BB Industry

119) Does the term "cost" mean the same thing as the term "expense?" Explain your answer.

Answer: Answers will vary.

The term "cost" can be used to refer to an expense or an asset. For example, wages paid to production workers are recorded in an inventory account, so they are treated as an asset and part of the cost of goods that the company has produced. The cost of the goods (including the amount spent for wages) becomes an expense when the related goods are sold.

Difficulty: 1 Easy

Topic: Costs Can Be Assets or Expenses

Learning Objective: 01-02 Identify the cost of manufacturing a product.

Bloom's: Remember

AACSB: Knowledge Application; Communication

AICPA: BB Industry; FN Measurement

120) What are period costs? How does the accounting for period costs differ from the accounting for product costs?

Answer: Answers will vary.

Period costs include general, selling, and administrative costs. Period costs are expensed in the period they are incurred. In contrast, product costs are initially recorded as assets, and become expenses in the period that the related goods are sold.

Difficulty: 2 Medium

Topic: Manufacturing Product Costs on Financial Statements; Components of Product Cost

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.;
01-02 Identify the cost of manufacturing a product.

Bloom's: Understand

AACSB: Knowledge Application; Communication

AICPA: BB Industry; FN Measurement

121) Is depreciation on manufacturing equipment expensed in the period incurred? Explain why or why not.

Answer: Answers will vary.

Depreciation on manufacturing equipment is a product cost. Therefore, it is expensed when the products are sold. Depreciation on manufacturing equipment is initially recorded in an asset account.

Difficulty: 2 Medium

Topic: Manufacturing Product Costs on Financial Statements; Components of Product Cost

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.;
01-02 Identify the cost of manufacturing a product.

Bloom's: Understand

AACSB: Knowledge Application; Communication

AICPA: BB Industry; FN Measurement

122) What are indirect costs, and how are the indirect costs incurred to make products accounted for?

Answer: Answers will vary.

Indirect costs are costs that cannot be traced to products and services in a cost-effective manner. These costs are initially recorded in a Manufacturing Overhead account, then they are allocated to the products that the company has produced.

Difficulty: 1 Easy

Topic: Overhead Costs: A Closer Look

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Remember

AACSB: Knowledge Application; Communication

AICPA: BB Industry; FN Measurement

123) What are upstream costs? What upstream costs would be incurred by a company that produces and sells computer software programs?

Answer: Answers will vary.

Upstream costs are incurred before a company begins manufacturing a product. For a company producing computer software, upstream costs would include research and development for the product itself and market research.

Difficulty: 2 Medium

Topic: Cost Classification in Manufacturing Companies

Learning Objective: 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.

Bloom's: Understand

AACSB: Knowledge Application; Communication

AICPA: BB Industry; FN Measurement

124) Is McDonald's a manufacturing company or a service company? How do they record the cost of materials, labor, and overhead?

Answer: Answers will vary.

McDonald's and other restaurants are considered to be service companies because their product is consumed immediately. Even though McDonald's has costs related to materials, labor, and overhead, these costs are recorded as expenses.

Difficulty: 2 Medium

Topic: Cost Classification in Service and Merchandising Companies

Learning Objective: 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.

Bloom's: Understand

AACSB: Knowledge Application; Communication

AICPA: BB Industry; FN Measurement

125) What inventory holding costs would be incurred by a business that holds a large amount of inventory?

Answer: Answers will vary

Inventory holding costs include storage costs, theft, damage, obsolescence, and financing costs. In addition, a company with a large amount of inventory may experience diminished motivation and sloppy work by its employees and increased production time.

Difficulty: 1 Easy

Topic: Just-in-Time Inventory

Learning Objective: 01-05 Show how just-in-time inventory can increase profitability.

Bloom's: Remember

AACSB: Knowledge Application; Communication

AICPA: FN Decision Making; BB Industry

126) What benefits may result from use of a just-in-time system?

Answer: Answers will vary.

A just-in-time system reduces the amount of inventory that a business holds. Therefore, the inventory holding costs (theft, obsolescence, damage, financing costs, warehousing costs, and others) will be reduced. Inventory holding costs are non-value-added costs that a business should seek to reduce. Additionally, a just-in-time system may improve the flow of products to customers and may actually improve customer satisfaction.

Difficulty: 1 Easy

Topic: Just-in-Time Inventory

Learning Objective: 01-05 Show how just-in-time inventory can increase profitability.

Bloom's: Remember

AACSB: Knowledge Application; Communication

AICPA: FN Decision Making; BB Industry

127) What part do management accountants play in corporate governance?

Answer: Answers will vary.

Management accountants are the guardians of the information used to report on the financial condition of their companies. They prepare and analyze the information used by the board of directors and management to formulate the company's strategy. As such, they constitute the "intelligence" function of corporate governance.

Difficulty: 1 Easy

Topic: Corporate Governance

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Communication

AICPA: FN Decision Making; BB Industry

128) Discuss three practical implications of misclassifying product and/or period costs.

Answer: Answers will vary.

The temporary effects on the financial statements can have important implications with respect to the (1) availability of financing, (2) motivations of management, and (3) payment of income taxes. When period costs are misclassified as product costs, net income of the period will be higher than it should be, assuming that production exceeds sales. This might influence a lender's decision to extend credit to the firm. If managers are paid a bonus based on some measure of income, managers may be tempted to misclassify period costs as product costs in those periods when production exceeds sales. Finally, if a firm misclassifies product costs as period costs in a period of increasing inventory levels, net income will be lower than it should be, resulting in lower income taxes than should be the case.

Difficulty: 1 Easy

Topic: The Motive to Manipulate

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics; Communication

AICPA: FN Decision Making; BB Industry

129) As a Certified Management Accountant, Steven is bound by the Institute of Management Accountant's Standards of Ethical Conduct. Describe the actions Steven should take when faced with an ethical dilemma at work.

Answer: Answers will vary.

Steven should first identify the ethical issues involved. He should consider the consequences of not pursuing the issue (i.e., the consequences of possible violations of the code of ethics). If he decides to pursue the issue, he should discuss the matter with his immediate superior unless he believes that the superior is involved. In that case, he should discuss the matter at the next higher level. He should continue in this way until the matter is resolved. If the matter goes all the way to the company's board of directors and is still not resolved, Steven may have to consider resigning. It would not be appropriate for Steven to contact outside parties unless required by law.

Difficulty: 1 Easy

Topic: Statement of Ethical Professional Practice

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics; Communication

AICPA: FN Decision Making; BB Industry

130) Management accountants have a responsibility to demonstrate integrity. What does this ethical standard require of management accountants?

Answer: Answers will vary.

The integrity standard requires management accountants to avoid conflicts of interest; refrain from any activity that would limit their ability to carry out their duties ethically; refuse any gift or favor that would appear to influence their actions; avoid subverting the attainment of the organization's legitimate objectives; communicate professional limitations that would prevent successful performance of an activity; communicate both favorable and unfavorable information and professional judgments; and avoid any activity that would discredit the profession.

Difficulty: 1 Easy

Topic: Statement of Ethical Professional Practice

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics; Communication

AICPA: FN Decision Making; BB Industry

131) Management accountants have a responsibility to be objective. What does this ethical standard require of management accountants?

Answer: Answers will vary.

This standard requires accountants to communicate information fairly and objectively and to disclose fully all relevant information that could influence a user's understanding of reports and recommendations.

Difficulty: 1 Easy

Topic: Statement of Ethical Professional Practice

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics; Communication

AICPA: FN Decision Making; BB Industry

132) What is the fraud triangle? Which element of the fraud triangle is most closely connected with internal controls?

Answer: Answers will vary.

The fraud triangle describes the three elements typically present when fraud occurs. They are: the availability of an opportunity, the existence of some form of pressure leading to an incentive, and the capacity to rationalize. Opportunity is the one element of the fraud triangle most easily controlled by the company through a system of internal controls.

Difficulty: 1 Easy

Topic: The Fraud Triangle

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics; Communication

AICPA: FN Decision Making; BB Industry

133) How does the Sarbanes-Oxley Act of 2002 affect the responsibilities of the managers of publicly held US corporations?

Answer: Answers will vary.

Under the terms of the Act, the chief executive officer and chief financial officer are responsible for development and enforcement of a strong set of internal controls. The company must report on the effectiveness of its internal controls. The CEO and CFO have ultimate responsibility for the accuracy of the company's financial statements. They must certify that, to their knowledge, the financial statements do not include False information or omit information that would be material. The managers of the company are required to establish a code of ethics and to report on the code of ethics in the 10K annual report filed with the Securities and Exchange Commission. Managers are also required to provide mechanisms for anonymous reporting of fraud within the company (to protect a potential whistleblower).

Difficulty: 1 Easy

Topic: Sarbanes-Oxley Act

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Remember

AACSB: Knowledge Application; Ethics; Communication

AICPA: FN Decision Making; BB Industry

134) What is a value chain? And what relationship is there between the value chain and activity-based management?

Answer: Answers will vary.

The value chain is the sequence of activities a company uses to provide products or services to its customers. Under activity-based management, a company examines its value chain, seeking to create and maintain value-added activities and to eliminate non-value-added activities.

Difficulty: 1 Easy

Topic: Using Total Quality Management and Activity Based Management to Reengineer Production and Delivery Systems

Learning Objective: 01-07 Identify the key features of total quality management (TQM) and activity based management (ABM). (Appendix).

Bloom's: Remember

AACSB: Knowledge Application; Communication

AICPA: FN Decision Making; BB Industry

135) Benchmarking involves the identification of the best practices used by world-class competitors. Discuss the following widely recognized best practices: activity-based management and just-in-time inventory.

Answer: Answers will vary.

Many companies have come to the conclusion that activities drive costs. To control or lower costs, companies must focus on activities. Activity-based management seeks to manage the value chain in order to create new or refine existing value-added activities. A value chain is the sequence of activities through which an organization provides products and services to its customers. A value-added activity is an activity that customers are willing to pay for. Companies should try to reduce or eliminate non-value-added activities. Just-in-time inventory seeks to reduce inventory holding costs and other hidden inventory-related costs such as diminished motivation, sloppy work, and increased production time. In a JIT manufacturer, no units are produced until customer orders are received.

Difficulty: 1 Easy

Topic: Using Total Quality Management and Activity Based Management to Reengineer Production and Delivery Systems

Learning Objective: 01-07 Identify the key features of total quality management (TQM) and activity based management (ABM). (Appendix).

Bloom's: Remember

AACSB: Knowledge Application; Communication

AICPA: FN Decision Making; BB Industry

136) Select the term from the list provided that best matches each of the following descriptions. The first is done for you.

Answer	Description	List of terms
4	A. Costs that are incurred after the manufacturing process is complete	1. Benchmarking
	B. The identification of the best practices used by world-class competitors	2. Cost allocation
	C. The linked sequence of activities that create value for the customer	3. Direct costs
	D. Costs that cannot be easily traced to specific products	4. Downstream costs
	E. All costs related to obtaining or manufacturing a product intended for sale to customers	5. Financial accounting
	F. Work that contributes to a product's ability to satisfy customer needs	6. Indirect costs
	G. The process of dividing a total cost into parts and assigning the parts to relevant cost objects	7. Period costs
	H. The field of accounting that is designed to meet the information needs of external users	8. Product costs
	I. General, selling, and administrative costs that are expensed in the period in which the economic sacrifice is made	9. Value-added activity
	J. Costs that can easily and conveniently be traced to products	10. Value chain

Answer:

Answer	Description	List of terms
4	A. Costs that are incurred after the manufacturing process is complete	1. Benchmarking
1	B. The identification of the best practices used by world-class competitors	2. Cost allocation
10	C. The linked sequence of activities that create value for the customer	3. Direct costs
6	D. Costs that cannot be easily traced to specific products	4. Downstream costs
8	E. All costs related to obtaining or manufacturing a product intended for sale to customers	5. Financial accounting
9	F. Work that contributes to a product's ability to satisfy customer needs	6. Indirect costs
2	G. The process of dividing a total cost into parts and assigning the parts to relevant cost objects	7. Period costs
5	H. The field of accounting that is designed to meet the information needs of external users	8. Product costs
7	I. General, selling, and administrative costs that are expensed in the period in which the economic sacrifice is made	9. Value-added activity
3	J. Costs that can easily and conveniently be traced to products	10. Value chain

Difficulty: 1 Easy

Topic: Users and Types of Information; Components of Product Cost; Manufacturing Product Costs on Financial Statements; Overhead Costs: A Closer Look; Cost Classification in Manufacturing Companies; Using Total Quality Management (TQM) and Activity Based Management (ABM) to Reengineer Production and Delivery

Learning Objective: 01-01 Distinguish between managerial and financial accounting.; 01-02 Identify the cost of manufacturing a product.; 01-03 Show how manufacturing product costs affect financial statements.; 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.; 01-07 Identify the key features of total quality management (TQM) and activity based management (ABM). (Appendix).

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Decision Making

137) Select the term from the list provided that best matches each of the following descriptions. The first is done for you.

Answer	Description	List of terms
4	A. An inventory flow system that minimizes the amount of inventory on hand	1. Continuous improvement
	B. The organization established by the accounting profession to develop accounting standards	2. Cost of goods sold
	C. The area of accounting designed to meet information needs of internal users	3. Financial Accounting Standards Board
	D. The government agency authorized to establish and regulate public company reporting practices	4. Just in time
	E. Assessing the value chain to create new value-added activities	5. Managerial accounting
	F. Tasks that do not contribute to a product's ability to satisfy customer needs	6. Nonvalue-added activities
	G. Costs incurred before the manufacturing process begins	7. Re-engineering
	H. The process of changing an organization's production and delivery systems to make the organization more competitive	8. Upstream costs
	I. The ongoing process through which employees become more effective and learn to work more efficiently	9. Securities and Exchange Commission
	J. The term used for the amount of product costs expensed in the current period	10. Activity-based management

Answer:

Answer	Description	List of terms
4	A. An inventory flow system that minimizes the amount of inventory on hand	1. Continuous improvement
3	B. The organization established by the accounting profession to develop accounting standards	2. Cost of goods sold
5	C. The area of accounting designed to meet information needs of internal users	3. Financial Accounting Standards Board
9	D. The government agency authorized to establish and regulate public company reporting practices	4. Just in time
10	E. Assessing the value chain to create new value-added activities	5. Managerial accounting
6	F. Tasks that do not contribute to a product's ability to satisfy customer needs	6. Nonvalue-added activities
8	G. Costs incurred before the manufacturing process begins	7. Re-engineering
7	H. The process of changing an organization's production and delivery systems to make the organization more competitive	8. Upstream costs
1	I. The ongoing process through which employees become more effective and learn to work more efficiently	9. Securities and Exchange Commission
2	J. The term used for the amount of product costs expensed in the current period	10. Activity-based management

Difficulty: 1 Easy

Topic: Users and Types of Information; Regulation; Costs Can Be Assets or Expenses; Cost Classification in Manufacturing Companies; Just-In-Time Inventory; Using Total Quality Management (TQM) and Activity Based Management (ABM) to Reengineer Production and Delivery

Learning Objective: 01-01 Distinguish between managerial and financial accounting.; 01-02 Identify the cost of manufacturing a product.; 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.; 01-05 Show how just-in-time inventory can increase profitability.; 01-07 Identify the key features of total quality management (TQM) and activity based management (ABM). (Appendix).

Bloom's: Remember

AACSB: Knowledge Application

AICPA: BB Industry; FN Decision Making

138) Complete the following table to compare and contrast financial and managerial accounting.

Characteristic	Financial Accounting	Managerial Accounting
Users		
Level of aggregation		
Regulation		
Characteristic of information		
Time horizon		
Reporting frequency		

Answer:

Characteristic	Financial Accounting	Managerial Accounting
Users	External (including investors and creditors)	Internal (managers of the organization)
Level of aggregation	Highly aggregated (looks at the organization as a whole)	Disaggregated (focuses on the entity's parts)
Regulation	Regulated by SEC and FASB	Unregulated
Characteristic of information	Financial information, characterized by objectivity and reliability	Financial and nonfinancial information; characterized by relevance and timeliness
Time horizon	Historically based	Oriented to the present and future
Reporting frequency	Periodically, with emphasis on annual and quarterly reports	Continuous reporting

Difficulty: 1 Easy

Topic: Users and Types of Information; Information Characteristics; Regulation; Level of Aggregation; Time Horizon and Reporting Frequency

Learning Objective: 01-01 Distinguish between managerial and financial accounting.

Bloom's: Remember

AACSB: Knowledge Application

AICPA: FN Decision Making; BB Industry

139) Classify each of the following costs for Harrison Company as a selling or general and administrative period cost or as a direct or indirect product cost by entering the dollar amount(s) in the appropriate column(s):

- A. Paid \$75,000 in wages for employees who assemble the company's products.
- B. Paid sales commissions of \$58,000.
- C. Paid \$38,000 in salaries for factory supervisors.
- D. Paid \$88,000 in salaries for executives (president and vice presidents).
- E. Recorded depreciation cost of \$25,000. \$13,000 was depreciation on factory equipment and \$12,000 was depreciation on the company headquarters building.
- F. Paid \$4,000 for various supplies that it used in the factory (oil and materials used in machine maintenance).
- G. Used \$10,000 in prepaid corporate liability insurance.

	Period Cost		Product Cost	
Item	Selling expense	General and administrative expense	Direct cost	Indirect cost
A				
B				
C				
D				
E				
F				
G				

Answer:

Item	Period Cost		Product Cost	
	Selling expenses	General and administrative expenses	Direct cost	Indirect cost
A			\$ 75,000	
B	\$ 58,000			
C				\$ 38,000
D		\$ 88,000		
E		\$ 12,000		\$ 13,000
F				\$ 4,000
G		\$ 10,000		

Product costs are all costs incurred to obtain a product or provide a service. Period costs are all costs not associated with a product. They are associated with the general, selling, and administrative functions of the business. Wages of workers that assemble the products are a direct, product cost. Sales commissions are a period cost (selling cost). Salaries for factory supervisors are an indirect, product cost. Salaries for executives (president and vice presidents) are a period cost (general and administrative). Depreciation on factory equipment is an indirect, product cost. Depreciation on the company headquarters building is a period cost (general and administrative). Supplies used in the factory (oil and materials used in the machine maintenance) is an indirect, product cost. Corporate liability insurance is a period cost (general and administrative).

Difficulty: 3 Hard

Topic: Manufacturing Product Costs on Financial Statements; Components of Product Cost; Overhead Costs: A Closer Look; Manufacturing Product Cost Summary

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.; 01-02 Identify the cost of manufacturing a product.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

140) The Giga Company produces tablet computers. The following information is provided:

a) Materials used	\$ 216,000
b) Advertising	\$ 40,000
c) Insurance, factory	\$ 20,000
d) Administrative salaries	\$ 50,000
e) Property taxes, factory	\$ 12,000
f) Utilities, administrative building	\$ 22,000
g) Factory labor	\$ 80,000
h) Sales commissions	\$ 56,000
i) Factory supervisor's salary	\$ 60,000
j) Research and development	\$ 18,000
k) Depreciation, factory	\$ 12,000
l) Depreciation, office	\$ 8,000
m) Indirect materials	\$ 14,000

Required:

Classify each of the company's costs as a period cost (general, selling, and administrative cost) or as a direct or indirect product cost. Enter the dollar amount of the cost in the appropriate column. After entering all amounts, calculate the total general, selling, and administrative cost, the total direct product cost, and the total indirect product cost.

Item	Period cost	Direct product cost	Indirect product cost
a)			
b)			
c)			
d)			
e)			
f)			
g)			
h)			
i)			
j)			
k)			
l)			
m)			
Total			

Answer:

Item	Period Cost	Direct product cost	Indirect product cost
a)		\$216,000	
b)	40,000		
c)			20,000
d)	50,000		
e)			12,000
f)	22,000		
g)		80,000	
h)	56,000		
i)			60,000
j)	18,000		
k)			12,000
l)	8,000		
m)			14,000
Total	\$194,000	\$296,000	\$118,000

Product costs are all costs incurred to obtain a product or provide a service. An indirect product cost cannot be easily or economically traced to a specific product. Period costs are all costs not associated with a product. They are associated with the general, selling, and administrative functions of the business. Materials used and factory labor are direct, product cost. Insurance factory, property taxes factory, factory supervisory salary, depreciation factory, and indirect materials are indirect, product costs. Advertising, administrative salaries, utilities administrative building, sales commissions, research and development, and depreciation office are period costs. Difficulty: 3 Hard

Topic: Manufacturing Product Costs on Financial Statements; Components of Product Cost; Overhead Costs: A Closer Look; Manufacturing Product Cost Summary

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.; 01-02 Identify the cost of manufacturing a product.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

141) Jarvis Company provided the following information regarding its first year of operations:

Administrative salaries	\$ 60,000
Depreciation on factory equipment	16,000
Indirect materials	4,000
Marketing costs	40,000
Salaries for factory supervisors	28,000
Wages for production workers	80,000
Raw materials used	100,000
Research and development	32,000
Rent on factory building	18,000
Sales revenues	432,000
Sales salaries and other selling costs	56,000
Beginning inventory	0 units
Number of units produced	20,000
Number of units sold	18,000

Required:

Determine the following amounts:

- (a) Total overhead costs.
- (b) Total product costs.
- (c) Product cost per unit.
- (d) Total cost of ending finished goods inventory.
- (e) Total cost of goods sold.

Answer:

(a) Overhead costs:

Depreciation on factory equipment	\$16,000
Indirect materials	4,000
Salaries for factory supervisors	28,000
Rent on factory building	<u>18,000</u>
Total overhead	\$66,000

(b) Product costs:

Raw materials used	\$100,000
Wages for production workers	80,000
Overhead costs	<u>66,000</u>
Total product costs	\$246,000

(c) Product cost per unit:

Total product costs/units produced = $\$246,000 / 20,000 = \12.30 per unit

(d) Total cost of ending finished goods inventory:

2,000 units in ending inventory (20,000 units produced – 18,000 units sold) times \$12.30 cost per unit = \$24,600

(e) Cost of goods sold:

18,000 units sold times \$12.30 cost per unit = \$221,400

Difficulty: 3 Hard

Topic: Manufacturing Product Costs on Financial Statements; Components of Product Cost; Average Cost per Unit; Costs Can Be Assets or Expenses; Overhead Costs: A Closer Look

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.; 01-02 Identify the cost of manufacturing a product.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

142) Arizona Company provided the following information regarding its most recent year of operations:

Administrative salaries	\$ 24,000
Direct labor	48,000
Direct raw material	80,000
Marketing and distribution costs	60,000
Overheads costs	36,000
Product design and testing	30,000
Research and development	40,000
Sales revenues	410,000
Sales salaries and commissions	54,000
Warranty costs	4,000
Number of units produced	20,000
Number of units sold	20,000

Required:

Determine the following amounts:

- (a) Total product costs
- (b) Total upstream costs
- (c) Total downstream costs
- (d) Product cost per unit
- (e) Total cost per unit, including product costs and upstream and downstream costs
- (f) The selling price per unit that would be required if the company wishes to earn a profit margin equal to 25% of total cost
- (g) Comment on the company's profitability at its current selling price

Answer:

(a) Total product costs:

Direct raw material	\$80,000
Direct labor	48,000
Overhead costs	<u>36,000</u>
Total product costs	\$164,000

(b) Total upstream costs:

Product testing	\$30,000
Research and development	<u>40,000</u>
Total upstream costs	\$70,000

(c) Total downstream costs:

Administrative salaries	\$24,000
Marketing and distribution costs	60,000
Sales salaries and commissions	54,000
Warranty costs	<u>4,000</u>
Total downstream costs	\$142,000

(d) Total product cost per unit:

Total product costs/units produced = $\$164,000/20,000 = \8.20 per unit

(e) Total cost per unit:

Total costs/units produced = $\$376,000/20,000 = \18.80 per unit

(f) Selling price to earn a profit margin equal to 25% of total cost:

Total unit cost + (total unit cost times profit margin) = $\$18.80 + (\$18.80 \times 25\%) = \$23.50$ per unit

(g) Current profitability:

The company's current selling price of \$20.50 ($\$410,000/20,000$ units) covers the product costs and the upstream and downstream costs, but it does not provide the amount of profit that the company would like to earn. Instead of generating a profit margin of 25% of total costs, it is earning a profit margin of approximately 9% of total costs.

Difficulty: 3 Hard

Topic: Manufacturing Product Costs on Financial Statements; Components of Product Cost; Average Cost per Unit; Costs Can Be Assets or Expenses; Cost Classification in Manufacturing Companies; Overhead Costs: A Closer Look

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.; 01-02 Identify the cost of manufacturing a product.; 01-04 Compare the treatment of upstream, midstream, and downstream costs in manufacturing, service, and merchandising companies.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

143) Reno Company provided the following information regarding its operations for the month ending September 30:

Administrative costs	\$ 30,000
Depreciation on factory equipment	12,000
Indirect materials	2,000
Marketing and distribution costs	24,000
Salaries for factory supervisors	20,000
Wages for production workers	26,000
Raw materials used	38,000
Sales revenue	196,000
Selling costs	18,000
Utilities for production facilities	8,000
Number of units produced	20,000
Number of units sold	15,000

Required:

- 1) Compute the firm's total manufacturing overhead cost.
- 2) Prepare a schedule of inventory costs that shows total product costs, ending inventory, and cost of goods sold; and
- 3) Prepare an income statement for the month ending September 30.

Answer:

1) Total manufacturing overhead cost:

Depreciation on factory equipment	\$12,000
Indirect materials	2,000
Salaries for factory supervisors	20,000
Utilities for production facilities	<u>8,000</u>
Total overhead cost	\$42,000

2) Schedule of inventory costs:

Raw materials used	\$38,000
Wages for production workers	26,000
Manufacturing overhead cost	<u>42,000</u>
Total product costs	\$106,000
Less: Cost of goods sold	
15,000 units x \$106,000/20,000	<u>79,500</u>
Ending inventory balance	\$26,500

3) Income statement:

Reno Company

Income Statement

For the Month Ended September 30

Sales		\$ 196,000
Less: Cost of goods sold		<u>79,500</u>
Gross margin		116,500
Less: General, selling and administrative expenses		
Administrative expenses	\$ 30,000	
Marketing and distribution expenses	24,000	
Selling expenses	<u>18,000</u>	<u>72,000</u>
Operating income		<u>\$ 44,500</u>

Difficulty: 3 Hard

Topic: Components of Product Cost; Average Cost per Unit; Costs Can Be Assets or Expenses;

Effect of Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.;

01-02 Identify the cost of manufacturing a product.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

144) The Szakos Company engaged in the following transactions during the current year:

- a) Acquired \$50,000 of cash by issuing common stock to owners
- b) Paid \$10,000 to acquire manufacturing equipment
- c) Paid \$5,000 cash for materials used in production
- d) Paid \$2,000 for wages of production workers
- e) Paid \$8,000 in general, selling, and administrative costs
- f) Recognized \$1,000 of depreciation on the manufacturing equipment
- g) Sold inventory for \$18,000 cash
- h) The cost of the inventory sold was \$6,500

Required:

Show the balance sheet and income statement effects of the transactions by completing the financial statement model provided.

	Balance Sheet								Income Statement				
	Cash	+	Invent.	+	Equip.	=	Comm. Stk.	+	Ret. Earn.	Rev.	-	Exp.	= NI
a)													
b)													
c)													
d)													
e)													
f)													
g)													
h)													
Total													

Answer:

	Balance Sheet								Income Statement					
	Cash	+	Invent.	+	Equip.	=	Comm. Stk.	+	Ret. Earn.	Rev.	-	Exp.	=	NI
a)	50,000						50,000							
b)	(10,000)				10,000									
c)	(5,000)		5,000											
d)	(2,000)		2,000											
e)	(8,000)								(8,000)			8,000		(8,000)
f)			1,000		(1,000)									
g)	18,000								18,000	18,000				18,000
h)			(6,500)						(6,500)			6,500		(6,500)
Total	43,000		1,500		9,000		50,000		3,500	18,000		14,500		3,500

Difficulty: 3 Hard

Topic: Manufacturing Product Costs on Financial Statements

Learning Objective: 01-03 Show how manufacturing product costs affect financial statements.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Industry; FN Measurement

145) The Carson Company was started at the beginning of the current year when it acquired \$20,000 by issuing common stock to its owners. During the year, the company incurred the following cash costs:

Direct material costs	\$ 10,000
Direct labor costs	8,000
Overhead costs	4,000
Selling and administrative costs	2,000

The company produced 5,000 units of product and sold 4,500 units. The average selling price was \$7.00 per unit. The accountant who prepared the firm's financial statements misclassified the selling and administrative costs as product costs.

Required:

Demonstrate the impact of the error on the company's financial statements by completing the following schedule.

	Scenario 1: With the error	Scenario 2: Without the error
Income Statement:		
Revenue		
Less: Cost of goods sold		
Gross margin		
Less: Selling, general, and administrative expenses		
Net income		
Balance sheet:		
Assets		
Cash		
Inventory		
Total assets		
Equity		
Common stock		
Retained earnings		
Total Equity		

Answer:

	Scenario 1: With the error	Scenario 2: Without the error
Income Statement:		
Revenue	\$ 31,500	\$ 31,500
Less: Cost of goods sold	<u>21,600</u>	<u>19,800</u>
Gross margin	<u>9,900</u>	<u>11,700</u>
Less: Selling, general, and administrative expenses	0	2,000
Net income	<u>\$ 9,900</u>	<u>\$ 9,700</u>

Balance sheet:

Assets		
Cash	\$ 27,500	\$ 27,500
Inventory	<u>2,400</u>	<u>2,200</u>
Total assets	<u>\$ 29,900</u>	<u>\$ 29,700</u>
Equity		
Common stock	\$ 20,000	\$ 20,000
Retained earnings	<u>9,900</u>	<u>9,700</u>
Total Equity	<u>\$ 29,900</u>	<u>\$ 29,700</u>

Difficulty: 3 Hard

Topic: The Motive to Manipulate

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Apply

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry

146) The Jacobson Manufacturing Company was started at the beginning of the current year when it acquired \$200,000 from its owners. During the year, the company incurred the following costs, all for cash:

Direct material costs	\$ 80,000
Direct labor costs	100,000
Overhead costs	40,000
Selling and administrative costs	60,000

The company produced 10,000 units of product and sold 8,000 units. The average selling price was \$34.00 per unit; all sales were for cash. The accountant who prepared the firm's financial statements misclassified the selling and administrative costs as product costs.

Required:

Demonstrate the impact of the error on the company's income statement and balance sheet by completing the following schedule:

	Scenario 1: With the error	Scenario 2: Without the error
Income Statement:		
Revenue		
Less: Cost of goods sold		
Gross margin		
Less: Selling, general, and administrative expenses		
Net income		
Balance sheet:		
Assets		
Cash		
Inventory		
Total assets		
Equity		
Common stock		
Retained earnings		
Total Equity		

Answer:

	Scenario 1: With the error	Scenario 2: Without the error
Income Statement:		
Revenue	\$ 272,000	\$ 272,000
Less: Cost of goods sold	<u>224,000</u>	<u>176,000</u>
Gross margin	48,000	96,000
Less: Selling, general, and administrative expenses	<u>0</u>	<u>60,000</u>
Net income	<u>\$ 48,000</u>	<u>\$ 36,000</u>
Balance sheet:		
Assets		
Cash	\$ 192,000	\$ 192,000
Inventory	<u>56,000</u>	<u>44,000</u>
Total assets	<u>\$ 248,000</u>	<u>\$ 236,000</u>
Equity		
Common stock	\$ 200,000	\$ 200,000
Retained earnings	<u>48,000</u>	<u>36,000</u>
Total Equity	<u>\$ 248,000</u>	<u>\$ 236,000</u>

Difficulty: 3 Hard

Topic: The Motive to Manipulate

Learning Objective: 01-06 Identify the key components of corporate governance.

Bloom's: Apply

AACSB: Knowledge Application; Ethics

AICPA: FN Decision Making; BB Industry