Bill Wells Accounting 215
FALL 2007 Midterm 2

COURSE:	Accounting 215	DATE: November 13, 2007
LCCTUE SESSION:	C	INST.: Bill Wells
QUARTER:	Fall 2007	
TEST:	Second Midterm	Version: 1 2

What time does your quiz session meet? 10:30

1. GENERAL INSTRUCTIONS:

- You will need access to a hand-held calculator and pencil(s) only to complete this examination; all other materials should be out of sight. Scratch work should be done on the examination.
- You have 80 minutes to complete the test. When the test is over, you should **immediately stop your work**. Work after the exam has ended is not fair to other students who complete the test on time and, therefore, is subject to point reduction at the instructor's discretion.
- If you need clarification (e.g. definition of words, an unclear problem) during the test, raise your hand. We will help you as best we can; we will not, however, reteach any point.
- Select the best answer from any choices provided. Do not make any unnecessary or unsupported assumptions.
- All answers recorded by you must be the result of your own efforts.
- Unless indicated otherwise, all situations are subject to U.S. rules and procedures.
- BUDGET YOUR TIME WISELY. I WISH YOU SUCCESS.

2. SPECIAL INSTRUCTIONS

- Partial credit may be given on certain questions marked "PC" if all mathematical work is shown immediately below the problem or the narrative is close to the best answer.

3. GRADING

Points Possible	~~150~~ 146	Extra Credit Earned 2
Points Lost	~~45~~ (41)	
Grade on Exam	~~101~~ 105	

EXTRA CREDIT (8)

1. (4) In the article "**Missed Signals: Stock Gurus Write Off Most Big Write-Offs, But They Shouldn't --- `Special' or `Unusual' Charges Often Hold Vital Clues To Companies' Prospects --- At Home's Future Foretold** ", Cisco was writing down the value of its inventory. Briefly describe why they were doing that.

~~They were using the LIFO method because prices were falling to average out there costs.~~

2
2. (4) In the article "**Blackstone Tests Fairness of Using 'Fair Value' Rule; Buyout Titan Will Book Projected Profit Upfront; Regulators Are Watching**", one person cited described what he thought to be the "biggest problem with fair value accounting." What was that problem?

It would give the wrong interpretation of accounts.

vague!

LONG-TERM ASSETS (30)

3. Which statement regarding depreciation methods used in financial and tax accounting is correct?

   a. Both the statement and tax preparer are permitted to use any methods/asset lives he/she wants to
   b. Methods and asset lives are prescribed by tax regulations whereas the financial statement preparer has greater flexibly
   c. Methods and asset lives are prescribed by FASB standards whereas the tax preparer has greater flexibly
   d. Neither the statement or tax preparer has any flexibility; the IRS and FASB both prescribe certain methods and asset lives which must be used

$65000 \times .4 = 26000$

(A) 26000

~~(B) 15600 = (65000 - 26000)(.4)~~

(B) 55000/5 = 11,000

(E) $65000 - 26000 = (39000)(.4)$

$= 15600$

$39000 - 15600 = 23400$

$65000 - (26000 + 15600) = 2340$

4. "Depletion expense" is a term most closely associated with which of the following:

   a. ~~Spreading the cost of a building over its useful life~~
   b. Spreading the cost of a patent over its useful life
   c. Spreading the cost of an oil well over its productive life
   d. Depletion is a term that may be used in any of the situations above (a-c)

-4

5. Which expenditure should not be capitalized as part of the cost of a long-term asset?

   a. Lawyer's fees incurred in successfully defending the rights inherent in a patent
   b. ~~Costs to install and test a new piece of equipment prior to usage~~
   c. Oil and grease servicing on a fleet of company trucks
   d. None of these costs (a through c) should be capitalized

OK -4 All

6. Use the following facts to answer only two of questions a to d below by placing your answer on the line. If more than two answers are provided, the third and fourth sequential answer will be ignored when grading. (In other words, you may select the two questions you wish to answer.) Also note the questions are weighted differently, giving you the choice of addressing easier or harder questions. To avoid confusion, use the back side of the prior page for your scratch work. All four questions are "all or nothing", that is no partial credit will be given.

Purchase price	$65,000
Expected salvage value at the time of purchase	$10,000
Expected life at the time of purchase	Five years
Date of purchase	January 2, 2004
Fiscal Year ends	December 31

a. (3) What amount of depreciation expense will be recorded for the first year of usage if double declining balance depreciation method is used?

$26000

65000 x .4 = 26000

3

b. (3) What amount of depreciation expense will be recorded for the second year of usage if the straight line depreciation method is used?

11,000

x2

c. (4) What will the asset's book value be on December 31, 2007 if straight line depreciation was used?

21,000

5

d. (5) What will the asset's book value be on December 31, 2005 if double declining balance depreciation was used?

$23400

65000 - 26000 = 39000 (.4)
= 15600

65000 - (26000 + 15600) = 23400

7. (2 Each; 4 total) A "betterment" is supposed to be capitalized if the amount is material and it meets any of four conditions. Name two of those conditions.

If it lowers operating costs or improves quality of production

8. (2) Assume a depreciable asset was sold for an amount of cash that was less than the asset's book (carrying) value. Which accounts should be credited when recording the sale?

Asset Account (to get it off the books)
Realized Loss Account

9. (2) True or False (Circle one) In general, research and development costs are expensed, not capitalized.

10. (2) True or False (Circle one) Once acquired, "goodwill" remains on the books of the acquiring firm forever.

11. (2) True or False (Circle one) A patent developed by a firm should be capitalized and subsequently amortized, just like a piece of equipment.

COGS - INVENTORY (22)

12. (2 points each; 4 total) Which inventory flow assumption (LIFO or FIFO) would improve the amount/ratio below under the given circumstances? (For the purposes of this question, "improve" means get larger.) If both flow assumptions would have the same impact on the amount/ratio, enter "same." Enter your answer in the blank provided.

	AMOUNT/RATIO	CIRCUMSTANCES
LIFO	Net income	Inventory prices had been steadily falling
FIFO	Current ratio	Inventory prices had been steadily increasing

13. (2) True or False (Circle one) Commissions paid to your sales persons for selling resalable merchandise should become part of inventory and eventually cost of goods sold rather than as a separately reported expense.

14. (2) True or False (Circle one) If the perpetual inventory method is followed, one must take an ending inventory count in order to determine Cost of Goods Sold.

15. (2) True or False (Circle one) Goods in transit at the end of a fiscal year should be included on the books of the recipient when the goods are shipped FOB Shipping Point

16. (2) True or False (Circle one) The "LIFO Conformity Rule" requires companies that use LIFO for tax purposes to also use that method for financial reporting purposes.

17. (3) If, over the past few years, the accounts receivable and inventory turnover ratios both had shown significant increases, which conclusion is correct?

Credit Sales / AVG A/R   COGS / AVG INV

a. The operating cycle is getting longer
b. The operating cycle is getting shorter
c. There is no change to the operating cycle since both changes off set each other

18. (2) If you purchased goods under terms of "1/10/n45," when does your payment have to be made in order to take advantage of the discount offered?

Has to be between 10 and 45 days

19. Use the following information which is in chronological order to answer questions a and b below:

	Units	Unit cost
Beginning Balance	8	$10
Sale # 1	2	
Purchase # 1	20	$6
Purchase # 2	30	$7
Sale # 2	28 − 6 = 22 − 20 = 2	

a. (3PC) What dollar amount of goods was sold if FIFO method had been used? $214

2(10) = 20 + 6(10) = 60 + 20(6) = 120 + 2(7) = 14

b. (2) What dollar amount of goods was sold if LIFO periodic method had been used? $210

30(7) = 210

REVENUE RECOGNITION - RECEIVABLES (21)

20. Suppose your firm ended its fiscal year with a debit balance in its Allowance for Doubtful Accounts account BEFORE the year-end adjustment was made. Which statement is correct?

    a. A mistake has been made, such a balance cannot exist in that account
    b. Your firm underestimated the amount of accounts to be written off
    c. Bad debts expense for the fiscal year will equal the debit balance in that account
    ~~d.~~ Your firm overestimated the amount of accounts to be written off

21. (8 PC) 2006 credit sales were $2,000,000, beginning and ending 2006 receivables were $500,000 and $700,000 respectively. This firm uses the indirect method (the method discussed at length in lecture) of accounting for bad debts. What journal entries are needed to:

    a. (2PC) Write off a $100 account (you may ignore the amount since it will be $100)

    Bad Debt Expense 100
    ← Allowance for Doubtful Accounts 100

    b. (4PC) Record the year-end adjusting journal entry given the following 2006 related events: (The affects of $100 write-off should be ignored in your answer.)

Allowance for Bad Debts – ~~end~~ BEG of 2006	40,000
Net amount of accounts written off	50,000
Projected uncollectible accounts determined from an aging schedule	45,000

Bad Debt: 40000 |

Uncollec: | 40000 ; 45000

Bad Debt Expense 500~~0~~
Uncollectible Accounts 500~~0~~

    c. (2) How much cash was set aside to cover the bad debts? #40,~~000~~

22. (2) Using the information in question ~~16~~ 21 and your answer to question ~~16b~~ 21b above, at what net realizable value will outstanding receivables be shown on the 2006 balance sheet?

$700{,}000 - 45{,}000 = 655{,}000$ #655,000

23. If firm A had an accounts receivable turnover ratio of "5" and firm B reported its similar ratio as "8", which statement is true, all other things being equal?

   a. Firm A's receivables are being collected faster than Firm B's receivables
   b. It takes fewer days to collect Firm B's receivables than Firm A's
   c. Conclusions about a current ratio cannot be made from receivables turnover information
   d. Firm B's operating cycle must be longer

24. (3) A cash-payment discount of 3/15/n45 is offered to your firm. If it elects to forego that discount, what annual interest rate is inherent in that offering?

36%

$360/(45-15) \times .03 = .36$

INVESTMENTS (15)

25. Less than 20% of a publicly-traded stock in another company was purchased near the end of 2006 for \$14,000. By the end of 2006 it had declined in value to \$13,000. In 2007, the investment was sold for \$12,000. (Ignore any commissions/expenses related to the sale.)

   a. (3PC) What amount of gain or loss (circle one) should be reported on 2006's income statement if the investment was classified as trading securities?

   \$1000

   b. (2) Should a realized gain, realized loss, unrealized gain, unrealized loss or nothing (circle one) have been reported on 2006's income statement if the investment was classified as available for sale securities?

   c. (8PC) If the investment had been classified as available for sale, what journal entry should have been made at the time of the sale?

   Cash 12000
   Unrealized G/L 100~~0~~
   Realized Loss 1000
   Investment 14~~0~~00

26. (2) True or False (Circle one) If your firm owns 70% of Company B's publicly traded stock, the value of that investment on your firm's statements will change as the market price of Company B's stock changes,

  POINTS LOST -7

ASSETS (12)

27. Bill Company currently has a 0.5 to 1.0 current ratio. Which of the following will cause that ratio to remain unchanged?

    a. Sell new common stock to owners for cash
    b. Purchase inventory on credit
    c. Pay off a short-term debt
    d. Collect cash from outstanding receivables

28. (2 Each; 4 Total) Randy Inc. uses the two ratios named below to analyze its results. What amounts will appear in the denominator of each of those ratios? (Circle one choice below each ratio.)

SALES REV / AVG TOT ASSET

Total Asset Turnover Ratio	Acid-Test Ratio
Total Assets at the end of this year only	Total Assets at the end of this year
Revenue	Revenue
Current Assets	Current Assets
Working Capital	Working Capital
Net Income	Net Income
Average total assets over the past two years	Average total assets over the past two years
Current Liabilities	Current Liabilities
Cash, short term investments and receivables	Cash, short term investments and receivables

29. Which of the following transactions, if any, will cause working capital to change?

    a. Refinance a long-term note with a short-term note (no cash is exchanged)
    b. Purchase inventory on short-term credit
    c. Pay off a short-term debt with cash
    d. Collect cash from outstanding receivables
    e. None of the above will affect working capital

CA − CL

CASH (2)

30. (2) True or False (circle one). If a firm has any cash at all, the total amount of that cash should always appear on the first line of a balance sheet presented in liquidity order.

REVERSE INTERPRETATION (5)

31. (5PC) What amount of cash was paid to suppliers of inventory given the following balance sheet and income statement information?

$306,000

	2006	2007
Accounts Payable	$12,000	$13,000
Inventory	34,000	$41,000
Cost of Goods Sold in 2007		$300,000

34000 + purchases − 300000 = 41000
Purchases = 307,000

12000 + 307,000 − Cash = 13,000
CASH = 306,000

ADJUSTMENTS (16)

32. You began the year with $300 in your supply inventory account. During the year you purchased and capitalized $500 of supply purchases. By year-end, it was determined that $100 of supplies were still on hand. What is the appropriate adjusting journal entry?

Supply
300
500
700
100

a. Credit supply expense for $700
b. Debit supply expense for $100
c. Debit supply inventory for $400
d. Credit supply inventory for $700

33. (2 Each; 4 total) In the answers below, there are two incorrect statements regarding adjusting entries. Circle the two incorrect statements.

a. Recording depreciation expense is an example of an accrual adjusting entry
b. Adjusting entries can result in debits or credits to a revenue account
c. Adjusting entries can result in debits or credits to an expense account
d. Adjusting entries are an effort to record the sacrifices made by the firm in the period in which they contributed to that period's accomplishments
e. An example of a cost expiration adjusting entry would be to debit Accumulated Depreciation and credit Depreciation Expense
f. Adjusting entries can be made to liability, revenue/gain or expense/loss accounts
g. Entries may be required to adjust prepaid asset accounts to their correct end-of-period balance
h. The Income Summary account should not be debited or credited when recording an adjusting entry

34. (8PC) On October 1, 2006, Nakamoto Electronics borrowed $2,000 from their bank at 12% annual interest The interest and principal are payable on September 30, 2007. Nakamoto closes its books on December 31 each year and made all the appropriate entries at the end of 2006. Assuming Nakamoto meets its loan commitments, what journal entry should be made on Sept. 30, 2007?

Dec 31 Interest Expense 60
Interest Payable 60

2000 × .12 = 240/12 = 20
20 × 3 = 60

-2

Sep30 Note Payable 2000
Interest Payable 240 — Separate
Cash 2240

FINANCIAL ACCOUNTING II (27)

35. Of the following sets of accounts, which set would normally appear on a post-closing trial balance with amounts equal to zero?

a. Accumulated Depreciation, Depreciation Expense, Inventory
b. Accounts Payable, Paid-in-capital, Retained Earnings
c. Gain on Sale of Land, Sales Revenue, Bad Debts Expense
d. Cash from Operations, Current assets, Net Income

POINTS LOST -4

36. (1 EACH-8 TOTAL) Assume a normal balance exists in each of the accounts listed in column 1. Place a check mark in either column 2 or 3 to indicate whether that balance would be a credit or debit balance prior to closing the accounts.

Account	Debit	Credit
Fees Earned		✓
Wage expense	✓	
Loss from discontinued operation	✓	
Unearned revenue		✓
Patent	✓	
Goodwill	✗	~~✓~~
Dividends	✓	

37. (1 EACH-7 TOTAL) For each of the following accounts, indicate whether that account would be closed or not closed by placing a check mark in the appropriate column.

Account	NOT CLOSED	CLOSED
Accumulated Depreciation	X	
Realized loss on available for sale securities		X
Accounts receivable	X	
Interest Income		X
Investment in trading securities	X	
Dividends payable	X	~~X~~
Common stock	X	
Depreciation Expense		X

38. (1 EACH-8 TOTAL) For each of the following accounts, place a check mark in the appropriate column to indicate whether the account should be closed by debiting or crediting that account. If the account should not be closed, make no entry in either column.

	CLOSED BY A	ENTRY
Account	DEBIT	CREDIT
Sales Revenue	X	
Cash		
Inventory		
Cost of goods sold		X
Equipment		
Accounts payable		
Retained earnings		
Unrealized gain on trading securities	X	