

Wells, Act 215, Fall 2006, M250

COURSE:  
LECTURE SESSION:  
QUARTER:  
TEST:

Accounting 215  
E  
Winter 2006  
Second Midterm

1  
DATE: November 15, 2006  
INST.: Bill Wells

Version: 1 (2)

CIRCLE THE TIME YOUR QUIZ SECTION BEGINS 7:30 (8:30) 9:30

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. WE 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 and/or the narrative is close to the best answer.
- Multiple-choice questions are worth 4 points each unless indicated otherwise.

**EXTRA CREDIT** (12) Confine your answer to 1-2 sentences.

1. (4) In the article “Outside Audit: Big Oil’s Accounting Methods fuel Criticism; ...” what was the primary argument to do away with LIFO from the government’s perspective?
2. (4) In the article “Tech Companies Charge Now, May Profit Later ...” explain what they were talking about and how that leads to a profit later?
3. (4) In the Article “Death by Accounting? What was the accounting policy/procedure the author linked to potentially causing death?

## RECEIVABLES (24)

Ar 100 → 100 → Cash 9  
revenue 100 → 100 → Ar 10

3. Which statement about the "gross" method of recording cash receipts from charge customers is correct?
- "Cash Discount Not Taken" is debited when payment is received after the discount period
  - "Cash Discount Not Taken" is credited when payment is received after the discount period
  - ☒ "Cash Discounts Taken" is debited when payment is received within the discount period
  - Entry to a "discount-taken" or "...not-taken" account is inappropriate
4. After trying for many months to get Mr. Jones to pay the outstanding balance on his charge account, a local store decided to write off the total balance owing. Not long thereafter, Mr. Jones made a partial payment and gave indications he would pay off the balance. Which accounts should have been debited when his first payment was received?

- ☒ a. Accounts Receivable and Cash  
b. Allowance for Doubtful Accounts and Accounts Receivable -  
c. Bad Debts Expense and Cash  
☒ d. Cash and Allowance for Doubtful Accounts

- \*5. Use the following information to answer questions a and b below: Treat each question independently of the other.

	2006	2005
Accounts Receivable	32,000	27,000
Allowance for Doubtful Accounts	2,400	2,000

- \*a. (5PC) Assuming 2% of credit sales was used to estimate bad debts expense and that \$1500 in receivables had been written off in 2006, what were credit sales in year 2006?

ADA	A/R
1500	27000
2000	15000
1900	
2400	32000

$$BDE = \% \times \text{Credit Sales}$$

$$1,900 = .02 \times (?)$$

$$.02$$

$$? = 95,000$$

32,500  
-5

- \*b. (3) Assuming \$1700 in credit sales were written off in 2006 and an aging schedule had been used to estimate the amount of receivables expected to become uncollectible, what amount was recorded as Bad Debts Expense?

ADA
1700
2000
2100

-3 700

6. (24) During the lecture, "contingent situations" were introduced. To record a contingent situation such as provision for bad debts, what two criteria must be met?

- Be able to estimate amount
- probable assumption that bad debts will not be paid

\* 7. Regarding an "aging schedule" of receivables, which statement is correct?

- a. The total of all receivables expected to go bad as computed on that schedule is the amount that will be debited to Bad Debts Expense
- ☒ b. Completion of an aging schedule is a mandatory step when using the direct method of writing off receivables
- c. If completed correctly, an aging schedule will produce the same estimate of uncollectibles as the percent of sales method
- ☒ d. The amount estimated by that method should be the ending balance in the Allowance for Bad Debts account.

### LONG-LIVED ASSETS (26)

8. (7PC) Your firm bought a depreciable asset for \$50,000 and put it into use the first day of 2004, 2005. Depreciation was based on estimates of a \$5,000 salvage value and a nine-year life. At the beginning of 2006, you spent \$15,000 to improve the quality of the asset's output over its remaining life and \$4,000 on general maintenance and repair. Using straight-line depreciation, how much depreciation would be expensed in 2006? (answer is not a round number)

$$\begin{array}{r} 50,000 \\ - 5,000 \\ \hline 45,000 \\ \div 9 \\ \hline = 5,000 \times 2 \end{array}$$

beg 2006 → 40,000

$$\begin{array}{r} + 19,000 \\ \hline 59,000 \\ - 5,000 \\ \hline 54,000 \\ \div 7 \end{array}$$

(3)

$$= 7714.286$$

expensed in 2006

9. Using the same facts found in question 8, assume double declining balance method of depreciating the asset had been used.

- a. (5PC) What would the asset's book value be at the end of 2005 after 2005 depreciation had been recorded?

$$50,000$$

$$30,246.914$$

$$\frac{1}{9} \times 2 \times (50,000) = 1111.1111$$

$$\frac{1}{9} \times 2 \times (50 - 1111.1111) = 8,641.975309$$

- b. (3) Over the life of the asset, what amount of accumulated depreciation will be recorded?

$$50,000 - 5,000 = 45,000$$

(3) ~~45,000~~

(6)

10. (2) After purchasing a \$50,000 machine, you incur \$1000 each for 1) transportation to its intended location, 2) installation, and 3) initial training. How much of those cash outflows should be capitalized?

3000 total

assuming total amount capitalized (em) 53,000

11. (2) True or False (circle one) In general, research and development costs are capitalized when incurred.

- \* 12. (7 PC) In journal entry form, record the sale of a depreciable asset for cash at a price greater than its book value at the time of sale. Make up whatever numbers you want to complete the journal entry.

Cash 10,000

Unrealized gain 2,000

equipment 8,000 (2) ~~acc~~ dep

### INVENTORY (26)

13. How many units should be included in ending inventory if, at year end, there were 1) 120 units of inventory on hand, 10 of which were on consignment from another firm, 2) 20 units were inbound to your firm under terms of FOB destination (they had not yet arrived), and 3) 40 units were outbound from your firm under terms of FOB shipping point (they also had not arrived)?

- a. 90  
b. 110  
c. 120  
d. 150

$$\begin{array}{r} - 120 - 10 = 110 \\ - 20 = 0 \\ - 40 = 0 \\ \hline 110 \end{array}$$

- \* 14. (2) True or false (circle one) If the perpetual inventory method is followed, any spoilage, theft, etc. will be included in the ending inventory balances unless an end-of-year physical count is taken.

- \* 15. Which statement regarding the averaging method of valuing inventory and cost of goods sold is correct?

assuming weighted average

- (4) a A new average is computed every time a sale is made under the perpetual method  
b A new average is computed every time a purchase is made under the perpetual method  
c A new average is computed every time a purchase is made under the periodic method  
d The periodic and perpetual methods produce the same valuations of ending inventory and cost of goods sold since they average the same figures

16. (2 points each) 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 than it would have been if the other method had been used.) If both flow assumptions would have the same impact on the amount/ratio, enter "same." Enter your answer in the blank provided.

	<u>AMOUNT/RATIO</u>	<u>CIRCUMSTANCES</u>
<u>FIFO</u>	Net income	Inventory prices had been steadily rising <span style="float: right;">A</span>
<u>LIFO</u>	Current ratio	Inventory prices had been steadily decreasing <span style="float: right;">B</span>

*sale value -*

- \*17. If inventory's replacement cost is more than its net realizable value, and its historical cost is greater than its replacement cost, at what value should inventory be reported in the financial statements?

- Historical cost
- ☒ Net realizable value
- Net realizable value minus a normal profit margin
- Replacement cost

- \*18. If the inventory turnover ratio in 2005 was 5 and in year 2006 it was 15, which conclusion is appropriate?

- Costs*  
*Inventory*
- ☒ If management's year 2006 goal was to sell inventory faster, they appear to have accomplished their goal
  - If management's goal was to sell inventory faster, they appear to have not accomplished their goal
  - If the accounts receivable turnover ratio remained unchanged over the same period, then the operating cycle has become longer
  - Accounts receivable are being collected over a shorter period of time in 2006 than they were in 2005

19. (4) At what value would cost of goods sold be shown given the following chronological facts and use of LIFO periodic flow assumption?

	<u>Units</u>	<u>Cost/Unit</u>
Beginning balance	10	\$5
Sale	<u>4</u>	
Purchase	6	\$6
Sale	<u>5</u>	

51

$$9 \rightarrow 6 @ 6 = 36 \\ 3 @ 5 = 15$$

### CASH (4)

20. Suppose your clothing store closes its books on Dec 31, 2005. On Dec 27 2005, it took \$20,000 of its available cash and put it into a 2-year Certificate of Deposit. Which statement is correct?

- The investment will have no effect on the firm's quick (acid test) ratio
- The firm's acid test ratio will increase as a result of the investment
- ☒ The firm's acid test ratio will decrease as a result of the investment
- Both the acid test and current ratios will increase as a result of the investment

$$CL = 20,000 \\ CA = 100,000 \\ S = \frac{100}{20} \rightarrow \frac{80}{20} = 4$$

## ASSETS (10)

21. Given the following information, answer the questions that follow:

	<u>2005</u>	<u>2006</u>
Current Assets	\$400,000	\$500,000
Current Liabilities	\$300,000	\$700,000
Owners Equity	\$2,100,000	\$2,500,000
Long-term liabilities	\$800,000	\$1,000,000
Net Income 2006		\$700,000 (includes interest expense of \$90,000)

- a. (2PC) The amount **working capital** as of the end of 2005?

$$= CA - CL$$
$$= 400,000 - 300,000$$
$$= 100,000$$

100,000

- b. (2PC) The **current ratio** as of the end of 2006

$$= \frac{CA}{CL} = \frac{400,000}{300,000} = A \quad \frac{500,000}{700,000}$$

714

- c. (6PC) Return on assets for the year 2006. (Round answer to one decimal place.)

$$ROA = \frac{\text{Net income} + \text{interest} (1 - \text{tax})}{\text{Avg total Assets}}$$

$$= \frac{700,000}{500,000}$$

place.)  $1.5 \rightarrow 1.6$

4

### REVERSE INTERPRETATION (6)

- \*22. (6PC) What amount of prepaid advertising was on hand at the beginning of 2006 given the information below?

Prepaid advertising - <del>end of 2006</del>	45,000
Advertising Expense during 2006	340,000
Advertising Payable beginning of 2006	13,000
Advertising Payable end of 2006	18,000
Cash payments on advertising payable in 2006	295,000

~~40,000~~

PPA

415	© William

Ad. P

295	13
	300 ✓
	18

2006

Ad. E
295
5'
340

INVESTMENTS (20)

\* 23. Your firm purchases some real estate for \$50,000 with the idea it will be held as an investment until it reaches \$90,000 market value at which time it will be sold. At the end of the first year, the appraised value of the land declined to \$45,000. Which statement is correct from your firm's perspective?

- 4 ☒ a. A \$5000 realized loss should be included in the income statement  
☐ b. A \$5000 unrealized loss for should be included in the income statement  
☐ c. A \$5000 unrealized loss should be included in the owners' equity section of the balance sheet  
☐ d. No loss/decline should be recognized in any financial statement

\* 24. Refer to the facts in the prior question. Suppose, instead of real estate, your firm purchased some privately held stock in a corporation for the same amount. At year-end, the owners gathered and concluded the value of their shares had fallen \$1 per share (to you that meant a \$5000 loss in value on paper). Which statement is correct from your firm's perspective?

- 4 ☒ a. A \$5000 realized loss should be included in the income statement  
☐ b. A \$5000 unrealized loss for should be included in the income statement  
☐ c. A \$5000 unrealized loss should be included in the owners' equity section of the balance sheet  
☐ d. No loss/decline should be recognized in any financial statement

25. In an unrelated investment, in 2005, your firm purchased \$100,000 of stock in a publicly traded company with the idea of holding it for a short period and then selling it at a profit. At year-end, the stock had risen to \$120,000 market value. Which statement is correct from your firm's perspective?

- 4 ☒ a. A \$20,000 realized gain of should be included in the income statement  
☐ b. A \$20,000 unrealized gain should be included in the income statement  
☐ c. A \$20,000 unrealized gain should be included in the owners' equity section of the balance sheet  
☐ d. No gain/increase should be recognized in any financial statement

26. Using the same facts in question <sup>27 below</sup> ~~12 above~~, suppose the investment was sold in 2006 for \$296,000. Which statement is correct from your firm's perspective?

- ☐ a. A \$16,000 realized gain of should be included in the income statement  
☐ b. A \$16,000 unrealized gain for should be included in the income statement  
☒ c. A \$4000 realized loss should be included in the income statement  
☐ d. A \$4000 unrealized loss should be should be included in the owners' equity section of the balance sheet

27. In yet another unrelated investment, your firm purchased in year 2005 \$300,000 of stock in a publicly traded company with the idea of holding it indefinitely. At year-end, the stock had fallen to a \$280,000 market value. Which statement is correct from your firm's perspective?

- ☐ a. A \$20,000 realized loss should be included in the income statement  
☐ b. A \$20,000 unrealized loss should be included in the income statement  
☒ c. A \$20,000 unrealized loss should be included in the owners' equity section of the balance sheet  
☐ d. No loss/decrease should be recognized in any financial statement



**ADJUSTMENTS (12)**

- \* 28. Given the following, record, in journal entry form, the appropriate year-end adjusting entry (your firm is paying/consuming, not receiving the rent).

- a. (5PC) Prepaid rent -Beginning of fiscal year \$3,000  
 Capitalized payments in advance not immediately consumed \$9,000  
 Amounts consumed by year-end relative to the above \$7,000  
 (No prior entries were made to reflect using this amount)

~~Prepaid rent 2000~~  
~~rent expense 2000~~ (5)

- \* b. (5PC) Using the same set of facts as in a above, what year-end adjusting entry would have been necessary if this firm recorded the \$9000 as an expense when it was paid?

~~Prepaid rent 2000~~  
~~rent expense 2000~~

- c. (2) Regardless of how the receipt was accounted for, what was the ending balance in the asset account?

\$000

**FINANCIAL ACCOUNTING II (22)**

29. Suppose your firm had correctly closed its temporary accounts into the income summary account and the balance in that account showed a \$45,000 debit balance. Which statement is correct?

- (4) a. A mistake has been made; that account can only show a credit balance  
 b. Dividends must have been \$45,000  
 c. The company earned \$45,000 during the reporting period  
 d. None of the above

30. Which conclusion regarding an adjusted trial balance is incorrect?

- (4) a. The closing entries should be included in the debit and credit balances  
 b. If the debits equal the credits, errors could still exist  
 c. If the debits do not equal the credits, errors have been made  
 d. If the debits do not equal the credits, the discrepancy could be due to an addition error rather than an error in recording events

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

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

(17)

32. There are three types of accounts listed below: 1) those that should not be closed, 2) those that should be closed by crediting that account, and 3) those that should be closed by debiting that account. Circle the letters that corresponds to the accounts that should be closed at year-end by crediting that account. (2 points for each correct answer; minus 2 points for each incorrect answer down to zero points.)

- A Unearned-Revenue
- ☒ B Loss on merchandise inventory
- C ~~Paid-in-Capital~~
- D Retained earnings —
- ☒ E Bad debts expense
- F Sales-Revenue
- G Copyright
- H Merchandise-Inventory
- I Buildings—
- J Accumulated-Depreciation – Buildings
- K Unrealized-price-increase-on-available-for-sale-securities
- L Accounts-receivable—
- ☒ M Depreciation expense - buildings
- N Allowance-for-Doubtful Accounts—
- O Patent
- P Investments—
- Q Realized-gain-on-sale-of-investments
- R Trademark
- S Accounts-Payable—
- T Cash—
- U Fees-Earned

33. Which of the following entries correctly records the sale of inventory at a profit?

	<u>DEBIT</u>		<u>CREDIT</u>
a.	Inventory 10 Cash 15		Cost of Goods Sold 10 Gain on Sale 15
<input checked="" type="radio"/> b.	Cash 20 Cost of Goods Sold 10		Inventory 20 Revenue 10
-4 <input checked="" type="radio"/> c.	Cost of Goods Sold 17 Accounts Receivable 22		Revenue 22 Inventory 17
d.	Revenue 33		Cost of Goods Sold 26 Profit 7