

COURSE: Accounting 215
 LECTURE SESSION: F
 QUARTER: Fall 2006
 TEST: First Midterm

DATE: Oct 23, 2006
 INST.: Bill Wells
 Version: 1 2

1:30 2:30 3:30

(CIRCLE THE TIME OF YOUR QUIZ SECTION)

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.

105 / 150

15 #7
 16 a, d

EXTRA CREDIT (4)

The two questions below are drawn from the article "Corporate Governance – Everything You Wanted to Know About Corporate Governance... But didn't know to ask."

1. (2) In lecture, I stressed that the Board set the strategic direction of the firm, implying that that was the most important function of the board. This article identified another "most important" job. What was that job?

creating financial statements

Hire, Fire Management CEO's and executives

2. What was the main criticism of boards (of directors)?

They may push auditors or people creating financial statements to make results that make the company look good even if it is slightly off as they have the best interest of company in mind

INTERNATIONAL (2)

3. (2) True or False (circle one) The FASB is presently taking steps to converge some of their accounting standards with those published by the International Accounting Standards Board.

CONTROL (21)

4. (2) Which body has the authority given to it by law to stop trading of a company's stock?

SEC securities Exchange Commission

5. (3) Which body licenses a person as a "Certified Public Accountant"?

AICPA

4

6. (3) Financial information, to be valuable, should not only be understandable, but also possess quality. In lecture I defined "quality" as consisting of four elements. Name one.

3 reliable, consistent, comparable

7. (3) Why would you not expect to find the Chief Executive Officer of a publicly traded company on the Audit Committee of the Board of Directors?

Members must be independent of management from that company

Because the CEO has the best interests of the company in mind and may be biased, and not conduct a fair or accurate audit.

8. (3) We briefly discussed what compilations, reviews and audits are. What distinguishes an audit from the other two types of engagements?

Independent verifications (of assertions made by managers in their statements)

Compilation is gathering of information, and a review is summarizing going over it. An audit is much more thorough analysis of financial statement done by audit committee's and CPA's

9. (3) Of the following annual report components, which one was not audited by the independent outside auditors?

- a. Statement of financial condition
- b. Statement of stockholders equity
- ☒ c. Summary of past financial highlights
- d. Footnotes to the financial statements

10. (2) Briefly describe one of the two conclusions independent outside auditors reach and report when rendering a "clean" or "unqualified" opinion.

In an unqualified opinion, auditors found few errors in the financial statements, but are errors that can be fixed easily, as opposed to "adverse" or "disclaimer" opinions.

11. (2) Which governmental organization writes the auditing standards followed by independent external auditors?

PCAOB

~~SEC~~

FINANCIAL REPORTING (44)

12. (3) Which of the following statements best describes what is included in a set of financial statements properly prepared using accrual accounting?

- a. Every event that happened to the firm during the reporting period
- b. Only those events that involved cash
- ☒ c. Limited to relevant events that are objectively measured

14

13. (2 EACH; 8 TOTAL) The statement of cash flows is supposed to explain the change that occurred between last year's and this year's cash (and equivalents) by reporting all cash flows in three categories. Listed below are four cash events. In the space to the right of each event, write the cash flow statement category under which each flow should be reported.

| Cash event | Category |
|--|------------------|
| A piece of land that had been held for many years is sold <i>land is long term</i> | <u>investing</u> |
| Dividends are paid out by the reporting firm <i>dividends + long term liabilities issuing stocks</i> | <u>Finance</u> |
| Rent is paid on the buildings used in the business <i>operating - all transactions related to purchasing and producing etc.</i> | <u>operating</u> |
| The reporting firm received the proceeds of a life insurance policy it held on its president (who recently died) <i>investing: non-current assets</i> | <u>operating</u> |

14. (3) Where, in an annual report, would investors find management's narrative perception about topics such as acquisitions, reclassifications and results of operations?

MD&A is footnote in 10-K
Management Discussion & Analysis MD&A

15. (1 EACH; 9 TOTAL) The following nine elements listed below have been defined by the FASB and appear on one of the four financial statements introduced in class. If an element appears on a financial statement, name that statement by recording in the blank space the number that corresponds to the statement. For example, if the first element below appeared on the income statement, then enter "1" in the space to the right. Do not confuse "elements" with accounts. There are many subsets of, say assets, e.g. cash. This question is only about the nine elements, not accounts.

1. Income Statement
2. Balance Sheet
3. Statement of Cash Flows
4. Statement of Retained Earnings

| | |
|-------------------------|-------------------|
| Net Assets | <u>1</u> <u>2</u> |
| Revenue | <u>1</u> |
| Liabilities | <u>2</u> |
| Distributions to Owners | <u>4</u> |
| Losses | <u>1</u> |
| Expenses | <u>1</u> |
| Contributions by owners | <u>3</u> <u>2</u> |
| Assets | <u>2</u> |
| Gains | <u>1</u> |

one answer

18

16. (12) The information below is found in the annual report of 215 Corporation. Division C was sold during the reporting period. Using this information, answer questions a – d below:

| | <u>Divisions A and B</u> | <u>Division C</u> | <u>Total</u> |
|--------------------------------------|--------------------------|-------------------|--------------|
| Revenue | 5,400 | 1,300 | 6,700 |
| Expenses (except Cost of Goods Sold) | 2,100 | 400 | 2,500 |
| Cost of Goods Sold | 2,200 | 800 | 3,000 |
| Loss on disposal of Division C | | 1,000 | 1,000 |

- a. (3) What gross profit margin (in dollars) would be reported by 215 in their financial statements?

Revenue - costs
 $6700 - 3000 = 3700$
 Gross Profit Margin = $\frac{3700}{6700} = 55\%$
 Gross Profit Margin = difference between revenue & cost of goods sold
 $1300(100\%) - 800(61\%) = 900 = 39\%$

- b. (3) In percentage terms, what was Division C's gross profit margin?

Gross Profit - Expenses
 $5400 - 2100 - 2200 = 1100$
 $3700 - 2500 = 1200$

- c. (3) What amount should be reported by 215 Corp. as "Income from Continuing Operations"?

Revenue - (Expenses + Losses)

$6700 - 2500 - 3000 - 1000 = 200$

- d. (3) What amount should be reported by 215 Corp. as "Net Income"?

17. (1 EACH, 9 TOTAL) Several accounts or descriptions of accounts are listed in column 1. Each of those accounts is a subset of one of the elements listed in column 2-9. Associate each account with each element by placing one check mark in the appropriate column.

| ACCOUNT | Revenue | Liabilities | Distributions to Owners | Losses | Expenses | Contributions by owners | Asset | Gains |
|--------------------------------|---------|-------------|-------------------------|--------|----------|-------------------------|-------|-------|
| Fees earned | X | | | | | | | |
| Preferred stock | | X | | | | ✓ | X | |
| Cash dividends declared | | X | ✓ | | | | | |
| Dividends owed to stockholders | | ✓ | X | | | | | |
| Accumulated depreciation | | | | | | | X | |
| Sales | X | | | | | | | |
| Patent | | | | | | | X | |
| Unearned revenue | | X | | | | | X | |

Preferred stock - contributions by owners
 - different type of stock
 - owners have priority when firm is liquidated

91

INVESTOR (16)

18. (16PC) Use the information below to answer questions a-e which follow.

2005 - \$1,200,000 in revenue
 2006 \$1,000,000 in revenue
 \$225,000 net income
 \$500,000 declared and distributed in dividends - common stock dividends
 3,000,000 weighted average number of common shares outstanding during 2006
 \$9 market price per share at the end of the year

a. (3) Earnings per share of common stock?

.08

Net income

225,000

Avg # of
common shares
outstanding

3,000,000

b. (3) By what percentage amount did revenue change from 2005?

~~20%~~

$$-200,000 / 1,200,000 = -16.77\%$$

c. (3) In percentage terms, how much was earned from every revenue dollar in 2006?

~~5%~~

$$225,000 / 1,000,000 = 22.5\%$$

Gross Profit
Sales

d. (4) What was the dividend yield as of the end of year 2006?

1.85%

$$\frac{500,000}{9}$$

$$\frac{500,000}{3,000,000}$$

1.85%

e. (3PC) How much more were investors willing to pay for a share of stock than it was earning?
 For this question, just set up the problem by completing the blanks below, i.e., you do not have to solve it.

Numerator 9 Market price per share

Denominator .08 EPS

BUSINESS ENTITY (8)

19. (2) If you formed your own business, what organizational form should it assume if you wanted to
 1) minimize the liability to its owners, and 2) were not concerned about the earnings distributed to its owner(s) being taxed twice?

Corporation

In partnership, one
 partner is still liable,

12

20. Which person/group usually sets the strategic direction of a corporation such as COSTCO?

- 4
- a. Owners
 - b. Senior management
 - ☒ c. Board of Directors
 - d. Auditors

21. (2) When a firm wants to issue new stock to the public, it has to prepare and file a document with the SEC that provides information about the offering, the risks, etc. What is the popular name of that document?

~~Financial Statement~~
Prospectus

FINANCIAL ACCOUNTING (59)

22. (2) Circle the date on which revenue should be recognized when using accrual accounting

- | | |
|---------------|---|
| Jan 24 | Customer orders goods from your store – they are not in stock |
| Jan 25 | You order the goods |
| Jan 26 | The goods arrive; you notify the customer that they are available |
| <u>Jan 27</u> | Customer picks up goods, charging them to her account <i>earned</i> |
| Jan 28 | Customer pays for goods bought yesterday |

23. (24PC) Suppose your very small firm purchased equipment for \$100,000 on January 1, 2004. When purchased, it was believed to have a useful life of 10 years at which time it would be sold for \$10,000.

- a. (2) Should the equipment purchased by capitalized or expensed when recorded? (Circle one)

Capitalize - put as an asset on the balance sheet

- b. (2) Explain what your answer to question a above means from an accounting perspective.

It is capitalized because you will be getting use of the equipment for 10 years,

- c. (1 each) Assume the equipment was capitalized. By what net amount did the following change on the date of purchase?

ASSETS

+ 0 100,000 from cash to equipment **(13)**

LIABILITIES

0

OWNERS EQUITY

- 0

- d. (6PC) What adjusting entry should be made at the end of the first year, assuming the item was capitalized? Be sure to put the amounts, account and direction under the appropriate caption. Direction means did the element, e.g., assets, increase (+) or decrease (-)

2

| <u>ASSETS</u> | <u>LIABILITIES</u> | <u>OWNERS EQUITY</u> |
|---------------|--------------------|----------------------|
| -10,000 | + | -10,000 |

- e. (2) What is the underlying principal that caused you to make the above entry?

DEPRECIATION

watching

- f. (4PC) Suppose the machine's cost continued to be amortized. What would its book value be at the end of 2006 after the appropriate adjusting entry had been made?

80,000

- g. (3) If the machine were sold at the end of 2006 for \$60,000, by what amount would retained earnings be affected?

loss of 20,000

20,000

- h. (2) Would that amount (question g) be reported as a gain, loss, or something else (circle one)?

loss

24. (3) Suppose you began the fiscal year with \$430,000 of merchandise (resalable) inventory and ended the year with \$20,000 more than that. Further suppose you purchased \$3,000,000 of merchandise inventory. What amount was sold and/or stolen, spoiled, or just disappeared?

2,980,000

10

25. (18PC) Suppose your firm sold some goods with a \$130 original cost to a customer for \$210 "on account."

- a. First record the sale (like you did in Team Assignment # 1), i.e., use amounts, accounts and direction properly placed under the appropriate caption.

| <u>ASSETS</u> | <u>LIABILITIES</u> | <u>OWNERS EQUITY</u> |
|--------------------------|--------------------|----------------------|
| +8 | | |
| Accounts receivable +210 | | Revenue +210 |
| Inventory +130 | | RE -130 |
| | | 210 |

- b. Then record the customer's payment to you

| <u>ASSETS</u> | <u>LIABILITIES</u> | <u>OWNERS EQUITY</u> |
|--------------------------|--------------------|----------------------|
| 96 | | |
| Accounts Receivable -210 | | |
| Cash +210 | | RE +210 |

I thought you could not record revenue until it was earned.

26. (12PC) Suppose you are a professional person that sells services, not goods, to clients. Further suppose that a customer **prepays** \$100 for that service. Under the appropriate column, record both the receipt and then the subsequent performance of the service using the appropriate amounts, accounts and direction.

| <u>ASSETS</u> | <u>LIABILITIES</u> | <u>OWNERS EQUITY</u> |
|---------------|--------------------|----------------------|
| Cash +100 | services owed +100 | |
| | Services owed -100 | RE +100 |
| | | Rev |

25