

University of Washington
Accounting 301 – Section A
Winter Quarter 2006

Midterm #1

Acct. 301
Shores
Winter 06

	<u>Total Points</u>	<u>Points Earned</u>
I. ASSORTED MULTIPLE CHOICE	20	<u>18</u>
II. FINANCIAL ACCOUNTING ESSAY	15	<u>14</u>
III. ACCOUNTING PROCESS PROBLEM	20	<u>20</u>
IV. CONCEPTUAL FRAMEWORK ESSAY	20	<u>20</u>
	75	<u>72</u>

NOTES:

This examination consists of 8 pages, not including this cover page. Please check immediately to be certain that all pages are included.

Show the set up for all calculations.

Answer the essay questions in good form and in the spaces specified. You do not necessarily need to fill the entire space provided.

I. ASSORTED MULTIPLE CHOICE (20 points)

Circle the letter of the best answer for each of the following.

1. Generally accepted accounting principles
 - a. are fundamental truths or axioms that can be derived from laws of nature.
 - b. derive their authority from legal court proceedings.
 - c. derive their credibility and authority from general acceptance by the accounting profession.
 - ☒ d. have been specified in detail in the FASB's Conceptual Framework.
2. The two primary qualities that make accounting information useful for decision making are :
 - a. comparability and consistency.
 - b. materiality and timeliness.
 - ☒ c. relevance and reliability.
 - d. reliability and comparability.
3. Accounting information is considered to be relevant when it
 - a. can be depended on to represent the economic conditions and events that it is intended to represent.
 - ☒ b. is capable of making a difference in a decision.
 - c. is understandable by reasonably informed users of accounting information.
 - d. is verifiable and neutral.
4. Information is neutral if it
 - a. provides benefits which are at least equal to the costs of its preparation.
 - b. can be compared with similar information about an enterprise at other points in time.
 - c. would have no impact on a decision maker.
 - ☒ d. is free from bias toward a predetermined result.
5. The characteristic that is demonstrated when a high degree of consensus can be secured among independent measurers using the same measurement methods is
 - a. relevance.
 - b. reliability.
 - ☒ c. verifiability.
 - d. neutrality.
6. When information about ~~two~~ different enterprises has been prepared and presented in a similar manner, the information exhibits the characteristic of
 - a. relevance.
 - b. reliability.
 - c. consistency.
 - ☒ d. comparability.
7. A decrease in net assets arising from peripheral transactions is called a(n)
 - a. capital expenditure.
 - b. cost.
 - ☒ c. loss.
 - d. expense.

8. Changes in equity except from transactions with owners is

- ☒ a. comprehensive income.
- b. revenue.
- c. expense.
- d. retained earnings.

9. Which of the following is not a temporary account?

- a. Supplies expense.
- b. Cost of goods sold.
- c. Dividends.
- ☒ d. Accumulated depreciation.

10. One purpose of closing entries is to transfer

- a. accounts receivable to cash when an account is fully paid.
- ☒ b. balances of temporary accounts to a permanent account.
- c. inventory to cost of goods sold when merchandise is sold.
- d. balances of permanent accounts to a temporary account.

II. FINANCIAL ACCOUNTING ESSAY (15 points)

1. Many companies provided financial information to external parties before there was any requirement to do so. Discuss why the U.S. government decided to intervene in the financial reporting process.

4 The Stock Market Crash of 1929⁹ was blamed partly on the failure of financial statements. There was no credibility or comparability, because companies in the same industry were accounting for things differently. Therefore, the government decided that they needed to develop some accounting standards. They delegated this responsibility to the SEC, who delegated the responsibility to the CAP (then APB, now the FASB).

2. The Financial Accounting Standards Board (FASB) currently has the responsibility for setting accounting standards in the U.S. Discuss why the government delegated this responsibility to a private sector body.

2 The government delegated the responsibility of setting accounting standards to a private sector, because they didn't want any bias in the accounting standards. All 7 members of the FASB must sever all ties and be completely independent of a business, an industry, or the government to ensure that there is no bias in the way the accounting standards are set.

A: Current Issues
D: Long Process
Acceptance of Stockholders
Squeaky wheel

3. The standard setting process that the FASB employs has been labeled political because of its procedures that give interested parties opportunities to influence the process at various stages (e.g., by attending public meetings, writing comment letters). In particular, the FASB considers the diverse interests of preparers, users, and auditors in reaching a consensus on accounting standards. Discuss two potential advantages and two potential disadvantages of the FASB allowing interested parties the opportunity to influence its standard setting process.

Allowing other parties the opportunity to voice their opinions has its advantages and disadvantages.

Advantages: First, current issues are brought to the table. If these outside parties think that a standard needs to be created or revised due to a new development or just a change in the market, the FASB can move it to the front of the agenda. Also, by allowing input from users of financial statements, the FASB can assess the costs and the benefits of new or revised standard has to all 3 parties: users, preparers, and auditors.

Disadvantages: Because the process is so political, it may take a very long time to revise or create a new standard. Therefore, some issues may sit on the shelf for years. In addition, because of the input from outsiders, "the squeaky wheel gets the grease". If an issue really needs to be dealt with, the FASB may drop what they're doing to deal with it, and other issues will just have to sit on the shelf.

III. ACCOUNTING PROCESS PROBLEM (20 points)

The unadjusted trial balance for Bonferroni Company is as follows:

Bonferroni Company
Unadjusted Trial Balance
As of December 31, 2005

	<u>Debit</u>	<u>Credit</u>
Cash	\$15,400	
Marketable securities	4,050	
Accounts receivable	50,000	
Allowance for uncollectibles		420
Inventory	16,800	
Supplies on hand	1,040	
Equipment	39,000	
Accumulated depreciation		9,500
Accounts payable		4,400
Notes payable		5,000
Common stock		40,000
Retained earnings		24,590
Cost of goods sold	228,520	
Office salaries expense	20,800	
Sales commission expense	29,000	
Rent expense	7,200	
Miscellaneous expense	2,200	
Sales revenue		330,100
	<u>\$414,010</u>	<u>\$414,010</u>

- BPE
- Deprec
Sales Ex
Int. Exp.
Supplies

In addition, the information below is relevant to the preparation of the necessary adjusting entries to be recorded on December 31, 2005:

- Bonferroni estimates that one percent of total sales will be uncollectible.
- Bonferroni computes depreciation for the equipment using the straight-line method assuming an eight year useful life and a \$3,000 salvage value.
- Bonferroni pays its sales force 10 percent commissions on total sales. Commissions on sales for the last week of December have not been recorded or paid.
- Bonferroni issued the note payable on October 1, 2005. It bears an eight percent interest rate and interest is paid at maturity on February 1, 2006.
- Bonferroni's physical count indicated that \$340 of supplies are on hand as of December 31, 2005.
- Bonferroni's rental agreement specifies that monthly payments of \$900 must be made one month in advance. All rental payments due in fiscal 2005 have been paid and recorded.

1. Prepare in good form all adjusting journal entries necessary at December 31, 2005 (no explanations or dates are required).

- a. Bad Debt Expense 3301 $330,100 \times .01$
 Allowance for Uncollectibles 3301
- b. Depreciation Expense 4,500 $\frac{39,000 - 3,000}{8}$
 Accumulated Depreciation - Equipment 4,500
- c. Sales Commissions Expense 4,010 $\frac{330,100 - 290,000}{10}$
 Sales Commissions Payable 4,010
- d. Interest Expense 100 $5000 \times .08 \times (3/12)$
 Interest Payable 100
- e. Supply Expense 700 $1040 - 340$
 Supplies on hand 700
- f. Prepaid Rent 900 12
 Rent Expense 900

2. Prepare in good form all closing journal entries necessary at December 31, 2005 (no explanations or dates are required).

Sales Revenue	330,100	
Cost of Goods Sold	228,520	
Office Salaries Expense	20,800	
Sales Commissions Expense	33,010	
Rent Expense	6,300	
Misc. Expense	2,200	
Bad Debt Expense	3,301	
Depreciation Expense	4,500	
Interest Expense	100	
Supply Expense	700	
Retained Earnings	30,669	

IV. CONCEPTUAL FRAMEWORK ESSAY (20 points)

An important part of Nike's advertising involves celebrity endorsements of its products (e.g., Michael Jordan's endorsement of shoes, Tiger Wood's endorsement of golf balls). In some cases, such endorsement contracts require prepayments by Nike.

1. In the space below, evaluate whether these prepayments meet the definition of an asset. Be sure to make explicit any assumptions you make and to support your conclusions.

1. Prob future economic benefit
2. owned by company
3. past transaction

An asset is a probable future economic benefit controlled or owned by an entity as a result of past transactions. These prepayments, assuming that Michael Jordan or Tiger Wood's image increases sales, do have a future economic benefit. Also, because they are under contract with Nike, the prepayments are controlled by Nike. Furthermore, the prepayments are controlled by Nike as a result of a past transaction (offer and acceptance of the contract). Therefore, these prepayments do meet the definition of an asset.

Relevance

Reliability

· T

· RF

· PV

· V

· FV

· W-M

· I

2. Regardless of your answer in part 1, assume now that the FASB has decided to require Nike to recognize these prepayments as an asset. In the space below, identify which one of the five possible attributes (i.e., historical cost, current cost, market value, net realizable value, or present value of future cash flows) you would recommend they adopt for the measurement of this particular asset. Explain the strengths and weaknesses of measuring the asset with the attribute you recommend in terms of relevance and reliability (it is not necessary to do a comparative analysis of all five attributes). Be sure to make explicit any assumptions you make and to support your conclusions.

I would recommend to measure the asset in terms of Present Value of Future Cash Flows. The timeliness of PV is not really an issue, because all of the 5 attributes could be made available before a decision is made. However, the Present Value of these prepayments can be updated each accounting period, which will allow for a high predictive and feedback value. In terms of reliability, the prepayment faithfully represents an asset, a probable future economic benefit, and the PV does exactly that. It represents the present value of the future cash flows that the prepayments are expected to be converted in to. One of the only weaknesses of using PV is the verifiability. Because there is no concrete way to measure the PV of the prepayments, the PV will be very subjective and the verifiability very low. As far as neutrality goes, the PV represents an asset well and therefore the method is subject to very little bias. Conversely, because measuring the prepayments in PV is so subjective, the implementation of it may be subject to bias.