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Acctg 215 wells:

Midterm 1

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Quiz 1

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W Foster

School of Business

COURSE: Accounting 215D
INSTRUCTOR: Bill Wells
QUARTER: Autumn 2009

TEST: Second Examination
DATE: November 16, 2009
Version: 1(2)

At what time does your quiz section meet? (Circle one time) 10:30 11:30 12:30

Tyler Watson
(Print your name)

0539977
Print your student number

By signing below, you acknowledge that you are a part of a learning community at the Foster School of Business that is committed to the academic standards of honesty, respect, and integrity, and that you adhered to these standards while completing this examination.

[Signature]
(Sign your name)

- You will need access to a hand-held calculator and pencil(s)/pen only to complete this examination; all other materials should be out of sight. Scratch work should be done on the examination.
- 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.
- Do not make any unnecessary or unsupported assumptions. Select the best answer from the choices provided. You may omit explanations which otherwise should accompany journal entries. Unless indicated otherwise, multiple choice questions are worth 4 points.
- Unless indicated otherwise, all situations are subject to U.S. rules and procedures. 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. All answers recorded by you must be the result of only your own efforts.
- You have approximately 80 minutes to complete the test. When the end of the test is announced, you should **immediately stop your work**. Work after the exam has ended is not fair to other students who complete the test within the allotted time. If such work continues after the bell, it will be subject to point reduction at my discretion.
- BUDGET YOUR TIME WISELY. WE WISH YOU SUCCESS.

EXTRA CREDIT (8)

1. In the article "Big Oil's Accounting Methods Fuel Criticism..."

a. What inventory flow method were large oil companies reportedly using?

LIFO 2

b. Briefly describe (one sentence) why, according to the article, the oil companies believed the method they were using was justified?

The Lifo approach allowed the oil companies to match present costs to their corresponding benefits more accurately. 3

c. Briefly describe (one sentence) the argument put forth by critics of the policy being used by oil companies.

3 This Lifo approach the oil companies used allowed them to report low profits, thus allowing them to avoid paying some taxes.

⑧ E.C.

LONG-TERM ASSETS (23)

2. If the \$200,000 paving expenditures are amortized over a 10 year period with no salvage value envisioned, what will:
- a. (3PC) The book value of the parking surface be after four full years of usage using straight-line depreciation?

$$\frac{200,000 - 0}{10} = 20,000/\text{year}$$

3 120,000

- b. (4PC) Depreciation expense for the parking surface be at the end of the second full year of usage using the double declining balance method?

year 1: $2 \cdot \frac{1}{10} \cdot 200,000 = 40,000$

year 2: $2 \cdot \frac{1}{10} \cdot 160,000 = \boxed{32,000}$

4 32,000

- * c. (4PC) Suppose after using the lot for 5 years (five financial statements have been prepared), it was determined that used asphalt has alternative uses so the estimated salvage value of the lot changed from zero to \$20,000. What amount of depreciation expense should be recorded in the sixth year, assuming straight-line depreciation was and continues to be used?

$$20,000 \times 5 = 100,000$$

$$200,000 - 100,000 = 100,000$$

$$\frac{100,000 - 20,000}{5} = 16,000$$

4 8,000

or $\boxed{16,000}$?

- d. (2) Suppose a new asphalt coating was invented that, when applied, extends the asphalt's life for several years. If \$30,000 (a material amount) is invested in this new coating, should that amount be expensed or capitalized? (circle one)

2

3. (2) A developer bought some land for \$100,000; she intended to convert it to a parking lot. In addition to the purchase price, \$20,000 of clearing and leveling costs are incurred. With the land now ready, \$200,000 was spent on paving the area and \$200,000 on lighting and fencing the area. What amount should be charged to the land account?

$$\begin{array}{r}
 100,000 \\
 + 20,000 \\
 200,000 \\
 200,000 \\
 \hline
 520,000
 \end{array}$$

520,000

0

4. (2) Your firm normally spends \$500,000 per year on research and development. Due to a severe drop in business, it is forced to cut this year's R&D efforts and thus costs by half. What effect, if any, will the curtailment of R&D have on this year's expenses?

Reduce this year's expenses

2

- * 5. (4PC) Suppose a firm is considering the purchase of another firm. After all discovery has been completed, the deal breaks down to the following:

	<u>Book Value</u>	<u>Market Value</u>
Assets to be gained	100,000	123,000
Liabilities assumed	30,000	30,000

What amount of goodwill should be recorded if the other firm is purchased for \$110,000?

Goodwill = premium paid over value of company.

or 10,000?

4

17,000

6. (2) Suppose an existing patent may be purchased for \$100,000. Alternatively, a new patent, developed by your firm would cost \$100,000. In either case, the patent you eventually own is expected to provide exclusive benefit to you for 10 years, after which you believe another product will have been invented and patented. If the purchase or development could occur in one fiscal year, which method, development or purchase (circle one) will have the largest adverse impact on this year's income statement

Developing the patent

2

INVENTORY (26)

7. (3) In periods of falling inventory wholesale prices, which inventory method should minimize cash outflow for taxes?

- a. LIFO
 (b) FIFO
 c. Weighted Average

3

4

5

4

3

11

8. Circle the inventory method used by Costco in its national and international markets

a. (2) US operations

LIFO

~~FIFO~~

2

b. (2) Foreign Operations

LIFO

FIFO

↑

9. (2) True or False (circle one) Assuming wholesale inventory unit costs are rising, when less inventory is bought than sold and LIFO is used, then net income will be higher than it otherwise would have been had purchases equaled sales.

1
2
3
4

2

100 @ 1
100 @ 2
30 @ 2
30

100 @ 1
30 @ 2
30

100
30

100 @ 1
40
30 @ 2
20
10 @ 3

40 @ 1
40
20 @ 2
20

10. (10PC) Use the following information to answer the lettered questions which follow:

		Units	Cost per unit
1/1/09	Beginning Inventory	100	\$3
3/14/09	Sales	70	
4/12/09	Sales	20	
4/21/09	Purchases (additions)	50	\$4
5/16/09	Sales	40	

70 x 3 = 210
20 x 3 = 60
10 x 3 = 30
30 x 4 = 120
420

10 @ 3 = 30
10 @ 2 = 20
20 @ 2 = 40
20 @ 1 = 20

a. (4PC) If the firm assumes a LIFO flow and accounts for inventory periodically, what dollar amount of inventory was sold during the period?

70 + 20 + 40
130

70 x 3 = 210
20 x 3 = 60
40 x 4 = 160

50 x 4 = 200
30 x 3 = 90
290
4

b. (2PC) If the firm assumes a FIFO flow and perpetually accounts for inventory sales, what dollar amount of goods were still on hand at the end of the period?

20 x 4 = 80

2 80

c. (4PC) If the nature of the inventory permitted use of the specific identification method and your goal was to maximize net income, what would you report as the cost of goods sold, assuming you determined cost of goods sold periodically?

3 x 130 =

100 @ 3 = 300
30 @ 4 = 120

4 420

11. (4) Which statement best states the relationship between inventory flow assumptions used for financial reporting purposes versus that used for tax purposes?

- a. LIFO must be used for tax purposes if it is used for reporting purposes
 b. If LIFO is used for tax purposes, it must also be used for reporting purposes
 c. Any flow assumption can be used for reporting purposes but FIFO can not be used for tax purposes
 d. If FIFO is used for reporting purposes, it must also be used for tax purposes

12. (3) Given the following values of ending inventory, at what value should ending inventory be shown on the balance sheet?

	\$
Historical cost	101
Replacement cost	90
Net realizable value	118
Normal profit margin	20

RECEIVABLES (28)

13. (6PC) Credit sales are recorded at the gross selling price. On July 10, a \$100 credit sale occurred that offered the customer payment terms of 3/15/n45. On July 23, your firm received payment from this customer, bringing its balance owing to zero. Record the journal entry needed on July 23rd?

A/R 100
 Rev 100

Cash 100
 CDT 3
 A/R 100

6

Bad Debt Expense
 Allowance

AM 100
 A/R

14. (6PC) Using letters corresponding to the accounts below, indicate in the appropriate columns the accounts that should be debited or credited when correctly recording each given circumstance. Each block may contain more than one letter and each letter may be used more than once.

- A. Accounts Receivable
 B. Sales Revenue
 C. Cash

- D. Allowance for Bad Debts
 E. Bad Debts Expense

Allowance
 A/R
 A/R
 Allowance
 Cash
 A/R

CIRCUMSTANCE	DEBIT	CREDIT
a. Owing to some very bad decisions, one of your customers notified you that he was unable to pay what he owes your firm. While you thought he was more unwilling than unable, you wrote him and his account off.	D	A
b. Sometime after his account was written off, he made a partial payment. You believe the prospect of future payments looks good so you want to keep his remaining balance on your books.	A C	D A

6

15. (4PC) In the spaces below, construct the accounts receivable turnover ratio by describing what information should be used in the numerator and denominator of that ratio.

- a. Numerator Net Credit Sales Rev
- b. Denominator Avg Acct Recievables

4

16. The information below is available to you just before making an adjusting entry relative to receivables:

Total credit sales	10,000,000
Accounts Receivable (end of year balance)	2,300,000
Allowance for Doubtful Accounts (<u>before</u> adjusting entry)	13,000 (debit balance)

- a. (4PC) Assuming 1% of credit sales were estimated to result in bad debts, at what net realizable value will receivables be reported on the balance sheet?

A/D
100,000
<u>90,000</u>
10,000

B/D
100,000

$$10,000,000 \times .01 = 100,000$$

$$2,300,000 - 100,000 = 2,200,000$$

- b. (6PC) Assuming an aging schedule estimated that \$57,000 of the outstanding receivables would not be collected, record the necessary adjusting entry.

13,000	70,000
	<u>57,000</u>

6

Bad Debt Expense 70,000
Allowance for Doubtful Accts 70,000

- c. (2PC) In the prior question, a debit balance existed in the Allowance for Doubtful Accounts account before the end-of-period adjustment was recorded. What would cause this?

30,000

Underestimating allowance for Doubtful Accounts. 2

CASH (6)

17. (2) Using the definition provided by me in my overheads and COSTCO re: "cash equivalents", would an investment in 60-day Treasury Bills (debt issued by the US Government) be included as a cash equivalent and thus be included on the first line of a balance sheet? Yes or No (circle one)

0

141

18. Senait Inc. was in the middle of some big deal that had required it to place \$50,000 of its funds in an "escrow" account some months ago. The funds are still your funds but you cannot access them until the deal is done or abandoned (which is expected to occur about 10 months from the beginning of next fiscal year). Should the \$50,000 be:

- a. Excluded from the balance sheet altogether
 b. Included on the balance sheet and shown as a long-term assets
 c. Included on the balance sheet and shown on the "cash and equivalent"
 d. Included on the balance sheet and shown as a current assets other than on the "cash and equivalent" line

INVESTMENTS (8)

19. Use the information below to answer the questions which follow:

56,000

2007 Purchased 1000 shares of stock in Andre Inc. for \$50 each
 2007 year end The market price per share of Andre Inc. had declined to \$40
 2008 year end The market price per share of Andre Inc. had increased to \$46
 2009 All shares in Andre Inc. were sold for \$48 per share

(1 EACH) What amount related to Andre investment would be included in ~~net~~ net income if the investment was considered to be trading (Col. 2) or available for sale (Col. 3) when purchased? (If the effect is negative, be sure to place a minus sign or parenthesis around the amount entered.) If the effect is zero, be sure to put a "0" in the cell; blank cells will be graded as incorrect.

<u>Column 1</u>	<u>TRADING</u>	<u>AVAILABLE FOR SALE</u>
2007 Net Income	(10,000)	0
2008 Net Income	6,000	0
2009 Net Income	2,000	(2000) 6
2009 Ending total of all Owners' Equity accounts	48,000	48,000

ASSETS (10)

20. (5PC) You read in a newspaper that a firm had negative working capital. What does this mean (what is being said?) Do not draw any conclusions about the firm as a whole or about the future. Just explain what constitutes negative working capital.

CA < CL

This is saying CL > CA.

5

The firm's current liabilities exceed its current assets

$$CA = 1$$

$$CL = 2$$

21. (2) Given a negative working capital, is it possible for a firm to have a current and quick ratio greater than 1.0? Yes or No, (circle one)

$\frac{1}{2}$ $\frac{1}{2}$ 2

22. (3) Charlie Inc. A has a higher Total Assets Turnover ratio than Isabel Inc. Both firms had the same amount of average assets over the past two years. Therefore, Charlie has more Sales revenue than Isabel. Complete the sentence with one to two word(s) that fit the context of this question.

$$\frac{\text{Sales rev}}{\text{Avg total assets}}$$

3

REVERSE INTERPRETATION (5)

23. (5PC) Given the following information extracted from two years of financial statements from the same business entity, how much cash was received from the sale of equipment in 2009? (During 2009, \$14,000 of equipment was bought for cash.)

	2008	2009
Equipment	75,000	82,000
Accumulated Depreciation	35,000	38,000
Gain Sale of equipment		3,000
Depreciation Expense		5,000

7,000

9

14

11,000

89

-82

7,000

-2 +3

2 51,000

75
14
82

A/D
35 38
3,000

Depreciation
5,000 3,000

ADJUSTMENTS (18)

24. (6PC) As a matter of policy, Nicole Inc. capitalizes all rent prepayments it receives, making any adjusting entries at the end of the fiscal year which occurs on December 31. On November 1, 2009, \$4,500 - three months rent - was received in advance of it being earned. What adjusting journal entry is needed on December 31, 2009?

Asset
Cash

~~Prepaid rent~~
Rent

Cash
Unearned Rev

Cash 4,500
Unearned Rev 4,500

UR 1,500
Rev 1,500
UR 3,000
Rev 3,000

- 24
25. (6PC) Using the same facts as in question 3 above, what journal entry should have been made on December 31, 2009 assuming the receipt was originally "expensed" (put on the income statement.)

Cash 4500
Rev 4500

Rev. 1500
U/R 1500

26. (2) True or False (circle one). Since the starting point and adjustments required in the two previous questions (3 and 4) are different, the ending balances at year-end in the affected accounts must therefore also be different.

2

27. (4) Adjustments (other than those made to revalue something such as cash) are made because the preparer of the statements is trying to apply certain principles correctly. Circle the letters that correspond to those two principles.

- a. Matching
b. Conservatism
c. Revenue Recognition
d. Going concern

4

12

FINANCIAL ACCOUNTING II (26)

28. (22 – 1 POINT EACH) For each of the accounts listed below, indicate whether they would 1) not be closed at year-end, or 2) closed by debiting the account, or 3) closed by crediting the account. Enter only one check mark for each listed account/total/category (one check per line).

ACCOUNT, TOTAL, CATEGORY	Not Closed	Closed by crediting the account	Closed by debiting the account
Accumulated depreciation	✓		
Retained earnings at the end of fiscal year 2009	✓		
Dividends declared		✓	
Supplies inventory	✓		
Merchandise inventory	✓		
Realized gain on selling a building			✓
Unearned revenue	✓		
Prepaid advertising	✓		
Depreciation expense		✓	
Long-term liabilities	✓		
Buildings	✓		
Cost of goods sold		✓	
Accounts receivable	✓		
Paid in capital	✓		
Dividends payable	✓		
Supply expense		✓	
Accounts payable	✓		
Sales Revenue			✓
Loss on sale of equipment		✓	
Extraordinary gain on insurance settlement			✓
Unrealized price increase/decrease on available-for-sale investments	✓		
Unrealized gain on Trading securities			✓

29. Suppose, during the closing process using an Income Summary account (as you did in Team Assignment 2), you determined that the Income Summary account had a debit balance. What does that mean?

- a. A mistake was made
 b. Net income will be reported as a positive number
 c. A net loss will be reported
 d. After the closing process is complete, retained earnings should increase by that amount

Debits Credits

~~Expenses~~

gains

expenses

4