

Bill Wells Accounting 215
FALL 2007 Midterm 1

COURSE: Accounting 215
LECTURE SESSION: C
QUARTER: Fall 2007
TEST: First Midterm

DATE: October 18, 2007
INST.: Bill Wells
Version: 1/ 2

What time does your quiz session meet? 10:30

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 or the narrative is close to the best answer.

Multiple choice questions are worth 4 points a piece unless indicated otherwise.

3. GRADING	Points Possible	150	Extra Credit Earned	<u>0</u>
	Points Lost	<u>46</u>		
	Grade on Exam	<u>104</u>		

INTRODUCTION (3)

1. The role financial accountants fulfill is best described by which one of the following:

- ✓ a. Regulator
 b. Tax authority
 c. Information Specialist
 d. Client advisor

FINANCIAL REPORTING (53)

2. (13 PC) For the purposes of this question, assume this is the first year of operation of this mythical company. Complete the equations below by entering only one of the following words (or abbreviations shown in "()") in each blank. Note that the "+" or "-" signs may not be changed; if they are, the entire question will be graded as zero. Words/abbreviations may be used more than once.

- | | |
|-----------------------------------|--|
| Assets (A) | Dividends (D) |
| Expenses (E) | Operating (O) |
| Financing (F) | Gains (G) |
| Investing (I) | Liabilities (LIAB) |
| Losses (L) | Net Income (NI) |
| Owners' Equity (OE) | Investments by owners (Paid in Capital) (PIC) |
| Revenue (R) | Ending Balance in the Cash Account (EBCA) |
| Retained Earnings (RE) | |

a. (2) Retained Earnings = NI - D on a financial statement.

b. (4) NI = R + G - E - Losses on a financial statement.

c. (2) A = LIAB + Owners' Equity on a financial statement.

d. (2) OE = PIC + Retained Earnings

e. (3) EBCA = Operating + or -

Investing + or - Financing categories.

3. (2 Each – 16 total) Using the same word choices found in the prior question, enter the word(s) in the second column that most closely relate to the description in the first column. There could be more than one answer for each description.

Description	Most closely related word(s)
Peripheral or incidental transactions during the year	Gains or Losses
Distributions to owners	Dividends
Net Assets/Book Value/Residual Interests	Owners Equity
Preferred and/or Common Stock	Investments By Owners
Inflows and Outflows resulting from ongoing major or central operations	Revenues and Expenses
Probable future benefits	Assets

4. (3) Suppose 1) today you purchased a share of outstanding stock in Costco, then tomorrow you sold it. In which sets of capital markets, if any, did both events occur?

- a. Primary only
☒ b. Secondary only
☒ c. Both primary and secondary
d. Neither the primary or secondary.
5. (2 each, 4 total) The financial statements studied to date are all interrelated, that is, at least one number from one statement also appears on another statement. This question is about those relationships. What amount (describe in words since no amounts are given) would be found on both of the named statements?

- a. Statement of Retained Earnings and Income Statement

$$RE = P - E - L + NI$$

$$NI = REV - EXP + GAINS - LOSSES$$

Income Stat

NET INCOME

- b. Statement of Retained Earnings and the Balance Sheet

Owners Equity

6. (9 PC) In total, there are 9 correct answers to the sub questions below. If more than 9 answers are provided, they will be graded as incorrect. For each question, circle the subtotals/totals that would be affected, if any, by each of the following events.

a. Income from a division sold before the end of the fiscal year

- 1) Income from operations
- ~~2) Income from continuing operations~~
- 3) Net income
- ~~4) Gross profit margin~~
- 5) None of the above

b. Payment of advertising expense not previously capitalized

- 1) Net income
- 2) Income from operations
- 3) Income from continuing operations
- 4) Gross profit margin
- ~~5) None of the above~~

c. Sale of inventory at a profit.

- 1) Net income
- 2) Income from operations
- 3) Income from continuing operations
- 4) Gross profit margin
- 5) None of the above

d. Purchase of a building for cash

- ~~1) Net income~~
- ~~2) Income from operations~~
- 3) Income from continuing operations
- 4) Gross profit margin
- 5) None of the above

7. (2 PC) What criterion should be used to determine if an asset should be shown as current or long-term on the balance sheet?

✓ If the asset is expected to be used up during the current fiscal period it should be a current asset, if not long-term.

5.
8. (3 each - 6 total) In once sentence, describe what is meant by the following assumptions that underlay all financial statements.

a. Economic entity - activities can be separated from those of the owners and can be separately measured and reported

b. Stable Dollar - The assumption that the dollar will stay relatively unchanged.

BUSINESS ENTITY (14)

9. Suppose you are forming a business and you now need to decide which form it must take. Which of the following business forms will not directly pay any income taxes but rather pass the income tax liability to the business's owner(s).

- a. Sole Proprietorship
- b. Partnership
- c. Corporation
- ☒ d. Two of the above

10. Which of the following functions is/are performed by senior management (as opposed to the board of directors)?

- a. Declare dividends
- b. Run the daily affairs of the company
- c. Prepare the financial statements
- d. Certify that it is responsible for internal controls
- e. Two of the above (a-d) are performed
- ☒ f. Three of the above (a-d) are performed
- g. Four of the above (a-d) are performed

11. (2) True or False (circle one) Selecting an acceptable accounting technique because it will have a more favorable impact on one's financial statements is an example of "Window Dressing."

TRUE

12. (4PC) To prepare the balance sheet conservatively, I named three things the financial accountant should do when in doubt. Name two of them.

~~Conservatism~~ - error on the side of caution

~~Materiality~~ - if not sure of importance you should include it

FINANCIAL ACCOUNTING - I (49)

6

13. (15PC) The following events occurred over a one week period: \$100 retail price

- Monday - a customer came into your store wanting to purchase a red sweater. Since none were in stock, you accepted her \$20 cash down payment and ordered the sweater
- Tuesday - the sweater arrived and was billed to your firm; cost to your firm was \$50
- Wed - the customer was notified the sweater had arrived
- Thursday - the customer arrived, paying the balance owing to your firm and taking the item home \$80
- Friday - Your firm sent a check to the sweater supplier

Assuming your financial statements are at the end of each day, answer the following questions:

- a. (2) On which day was the week's net performance realized using cash accounting? Thursday
Friday
- b. (2) On which day should Cost of Goods Sold (COGS) have been recorded using accrual accounting? Monday
Thursday
- c. (3) What is the short name of the principal that underlies recording COGS when you did in question b above? Matching
- d. (2) On which day should Revenue have been recorded using accrual accounting? Monday
Tuesday
- e. (2) By what amount did equity change on Friday using accrual accounting? \$0
WENT FROM \$100 - 50 = \$50
- f. (2) What was the week's net change in equity measured using cash accounting? \$50
- g. (2) What was the week's net change in equity measured using accrual accounting? \$50

14. Suppose this year's earnings statement reflected supplies expense of \$200,000 and this year's balance sheet showed you ended the year with \$15,000 of prepaid supplies. Which of the following combinations is possible given these facts?

<u>Supply Purchases</u>	<u>Beginning Prepaid Supplies</u>
a. 200,000	20,000
b. 195,000	15,000
c. 205,000	25,000
<u>d. 205,000</u>	10,000

15. (6PC) Although accounting and reporting rules, standards, procedures, etc. exist, sometimes a financial statement preparer can deviate from them without further consequences. I named three such justifications. Name or briefly describe all three of them.

✓ Materiality - material is important enough to change investors opinion so leave it out

✓ Industry Practice - some techniques may vary due to the industry practice

✓ Cost-Benefit - the cost of complying GAAP out weighs the Benefit

16. (3 Each, 6 Total) Suppose your firm purchases \$10,000 supplies "on account" and "expensed" them at the time of purchase. At the end of the fiscal year, it was determined that only \$6000 had been actually used. What two accounts would require adjustment? After naming those accounts, put a "+" or "-" after each account to indicate whether that specific account would have increased or decreased after making the needed adjustment. (Do not use "retained earnings" in your answer.)

-6
~~+ EQUIPMENT~~

~~- EXPENSE (Equipment Expense)~~

17. (12PC) Your firm purchased equipment for \$29,000. When purchased, it was believed the equipment would last for 5 years and have a salvage value of \$4000 at the end of its life. Straight line depreciation was used for the first two years of its life. In the middle of the third year, the machine was disposed of for \$7,000 in cash. Using this information, answer the following questions.

- a. (4) What was the equipment's book value at the end of the second year? ^{29 - 4/5 = 5K}

Book Value $\rightarrow 29,000 - 11,600$

$$29 - (5 \times 2) = 19,000$$

~~\$17,400~~

- b. (3) What total amount of accumulated depreciation should have been recorded just before the sale was recorded?

$$5800 (2.5) = 14500$$

$$5000 + 5000 + 2500 = 12500$$

- c. (5PC) What amount of gain or loss (circle one) should have been recorded at the time of sale?

$$29,000 - 14,500 = 14,500 - 7,000 = 7500$$

loss
~~\$7,500~~

18. (2) Assume dividends were declared and then were paid five weeks later. Which component of the basic accounting equation increases, if any, at the time of payment?

$$A = L + OE$$

~~Liabilities~~

NONE

19. (4PC) Suppose your firm 1) received \$10,000 in cash that was a down payment on a special order item, and 2) "capitalized" that receipt. What two accounts would be affected when recording that transaction? (Do not use "retained earnings" in your answer.)

+10,000 CASH -10,000 UNEARNED REVENUE

CONTROL (7)

20. (2) Which body issues the majority of generally accepted accounting principles used by companies whose stock is publicly traded?

FASB → Financial Accounting Standards Board

21. (2) The first paragraph found in a typical financial audit opinion is referred to as the introductory paragraph. According to a standard introductory paragraph, what was audited:

Intro Paragraph says who did what to what

Financial Statements were audited

22. (3) Briefly describe one potential sanction auditors face from the State Board of Accountancy in the state(s) in which they are licensed.

State Board of Accountancy have authority of CPAs within there state and license them. They can be sanctioned and investigated for not following GAAP.

Licensed revoked
by SBA

USER - FINANCIAL ANALYSIS (22)

9

23. (2 EACH-22 total) I introduced six ratios, some of which are named in column 1 below. Each had one or more amounts in the numerator and denominator. Listed below the ratios are narrative descriptions of the amounts that appear in all six of those ratios; each is preceded by a letter. Place the appropriate letter(s) on the numerator and denominator lines that would be used to correctly compute the ratio. Note that a few of the ratios may require two amounts in either the numerator or denominator. If such is the case, be sure to indicate with a "+" or "-" sign whether the second amount should be added or subtracted from the first amount. For example, a correct answer for such a situation might appear as "X - Y" or "Z + A."

	<u>Numerator</u>	<u>Denominator</u>
Dividend yield	<u>D</u>	<u>b</u>
Dividend payout	<u>B</u>	<u>E</u>
Annual Return on Investment	<u>A + J A + D</u>	<u>H</u>
Net income to sales	<u>F</u>	<u>K</u>
Price Earnings	<u>G</u>	<u>I E</u>

- a. Change in market price of a share of stock
- b. Dividends paid per share of stock
- c. Dividends paid last year (total or on a per share basis)
- d. Dividends received per share of stock
- e. Earnings per share of stock
- f. Net income
- g. Market price of one share of stock at the present time
- h. Market price of a share of stock at the time of original purchase
- i. Number of shares of common stock outstanding
- j. Preferred dividends
- k. Sales Revenue

INTERNATIONAL (2)

24. (2) True or False (circle one) International accounting standards may be used by companies in the United States to file financial reports instead of U.S. GAAP.

FALSE

EXTRA CREDIT (8)

25. (4 PC) In the article "Boss Talk: Turning Shopping Trips Into Treasure Hunts; Surprises, Bargains Keep Sinegal's Costco Humming ...?" what was Mr. Sinegal willing to sacrifice in order to increase sales?

Ethics

26. (4 PC) In the article "Getting a lesson in retail inside world's busiest Costco"

- a. (2) In what state is that store located?

WASHINGTON

- b. (2) Costco states it carries approximately 4000 different items at a typical store. Of those, what percentage was described as "stable items that never change?"

30%