

COURSE: Accounting 215  
 LECTURE SESSION: E  
 QUARTER: Fall, 2006  
 TEST: Final Examination

DATE: December 12, 2006  
 INST.: Bill Wells

Version: ① 2

113  
 1144

7:30  
 8:30  
 9:30

# 1. GENERAL INSTRUCTIONS:

- You will need access to a hand held calculator and pencil(s) only; all other materials should be out of sight. Scratch work should be done on the examination.
- You have approximately 110 minutes to complete the test.
- Select the best answer from the choices provided. Do not make any unnecessary or unsupported assumptions. All answers recorded by you must be the result of your own efforts. Record your answers on the cover sheet only. Turn in the entire examination material except the tables.
- 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.
- When the bell rings, the test has ended and you should **immediately stop your work**. Work after the test has ended is subject to point reduction at the instructor's discretion. Turn in the entire examination.

## 2. SPECIAL INSTRUCTIONS: Time-value-of-money tables are on the last page of this exam

3 POINTS EACH		4 POINTS EACH		6 POINTS EACH	
1. B	8. A	15. D	19. A	24. e	29. <del>B</del>
2. <del>A</del>	9. C	16. A	20. <del>A</del> B	25. A	30. D
3. <del>A</del>	10. A	17. C	21. A	26. D	31. <del>C</del>
4. B	11. C	18. D	22. C	27. B	32. B
5. C	12. B		23. <del>A</del> B	28. E	33. <del>C</del>
6. <del>A</del> B	13. C				34. A
7. B	14. A				35. D

9:40 2

## THE FOLLOWING QUESTIONS ARE WORTH 3 POINTS EACH.

### ERROR CORRECTION

1. Assume ending inventory is determined using a periodic method. If inventory is undercounted at the end of a reporting period, what will be the result on net income for that period?
- a. No effect
  - ☒ b. It will be lower than it would have been had the inventory been counted correctly
  - c. It will be higher than it would have been had the inventory been counted correctly

### CURRENT LIABILITIES

2. You collected \$200 as a damage deposit from the new renters of your basement apartment. Assuming you keep accounting records of all apartment transactions according to GAAP and that no damages occurred, which type of account will be debited upon returning the \$200?
- a. Liability
  - ☒ b. Asset
  - c. Revenue
3. Your firm is suing another firm at the time your 2006 accounting records are being closed. Your attorney believes your firm will probably win \$500,000 in the case. Assuming this is a material amount, what effect, if any, would this circumstance have on your 2006 financial statements?
- a. None
  - b. Liabilities would increase and net income would decrease after the appropriate journal entry
  - ☒ c. The situation would be revealed in the statement's footnotes and in the statements themselves

### TIME VALUE OF MONEY

4. You have two choices to invest \$1,000 now. Opportunity A pays a 12% annual return, compounded quarterly. Opportunity B pays a 12% annual return compounded annually. If both opportunities last for only two years, which statement is incorrect? Correct
- 1254
- a. A will return about \$1,254
  - ☒ b. A will increase your wealth about \$13 more than B.
  - c. Your wealth after two years will be the same, regardless of which opportunity you select
5. You are projecting net profits next year to be \$1,000 and the year after to be \$3,000. Assuming all profits are in cash and all arrive on the last day of the year, what is the present value of those future cash flows using a 9% annual interest rate?
- 917
- 917 - 1,000  
+ 2,752.29  
= 1,752.29
- a. \$3,593
  - b. \$3,751
  - ☒ c. \$3,442

6. You have been given several investment opportunities to analyze and are comfortable with the projected cash inflows and outflows but uncomfortable with the "opportunity rate" needed to complete your calculations. If you hold all other information constant except the opportunity rate, which rate, if any, will produce the most favorable net present value?

- ☒ a. The higher one
- b. The lower one
- c. Either rate will produce the same net present value

### LONG-TERM LIABILITIES

7. If 1) interest expense has remained constant over a number of reporting periods, 2) new debt has not been undertaken and 3) old debt has not been retired, the underlying debt was issued at a:

- a. Premium
- ☒ b. Par
- c. Discount

8. You hear that the Federal Reserve is going to raise an important interest rate and you translate that information as meaning the "riskless" portion of an investor's required interest rate will therefore increase. All other things constant, what would you expect to happen to bond prices in general?

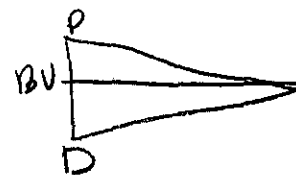
- ☒ a. Decrease
- b. Increase
- c. Remain unaffected

9. You read in The Wall Street Journal that a bond that has a 10% stated rate is selling at "103." Given that information, which statement is correct?

- a. Investors will receive more cash annually than 10% of the face value of the bond
- b. The bond is selling at a discount
- ☒ c. The bond's stated interest rate exceeds the rate investors want from similar investments

10. A five-year term bond (one whose principal is paid off in full at the end of the period; interest is paid periodically over the life of the bond) was issued on January 1, 2005 at a discount. The carrying amount (book value) of the bond at December 31, 2006 would be: (adapted from a CPA examination)

- ☒ a. Higher than the carrying amount at December 31, 2005
- b. Lower than the carrying amount at December 31, 2005
- c. The same as the carrying amount at January 1, 2005



### STOCKHOLDER'S EQUITY

11. A four for one common stock split should:

where par value is reduced

- a. Increase additional paid in capital by the difference between the market price and par value
- b. Cause retained earnings to decrease
- ☒ c. Have no effect on the debt to equity ratio

no journal entry

12. In the event a firm was forced to liquidate all of its assets, in which order would the providers of capital normally be paid?

- a. Holders of debt, common stock and then preferred stockholders
- ☒ b. Holders of debt, preferred stock and then common stock
- c. Holders of common stock, preferred stock and then debt holders

### STATEMENT OF CASH FLOWS

13. A statement of cash flows should:

- ☒ a. Include significant noncash flows within the statement itself, i.e., not in the related footnotes
- b. Only be prepared when management believes it will be of interest to stockholders
- ☒ c. Explain the change that occurred in the cash account between two reporting periods

14. Which of the following events represent operating, investing and financing cash flows respectively?

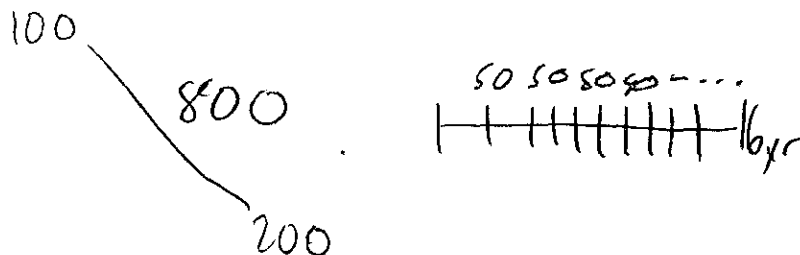
- ☒ a. Interest payments, purchase of a patent, treasury stock repurchases for cash
- b. Cash sales, sale of fully depreciated equipment for cash, inventory purchases
- c. Recognition of bad debt expense, purchase of a building for cash, sale of additional stock to owners for cash

## THE FOLLOWING QUESTIONS ARE WORTH 4 POINTS EACH.

### ERROR CORRECTION

15. A \$1,000 machine, with \$200 salvage value and 16-year life expectancy was accidentally expensed when purchased on January 1, 2005. The error was discovered and corrected during 2006. Assuming the firm uses straight-line depreciation, by what amount, if any, was 2005 net income misstated (ignore taxes)?

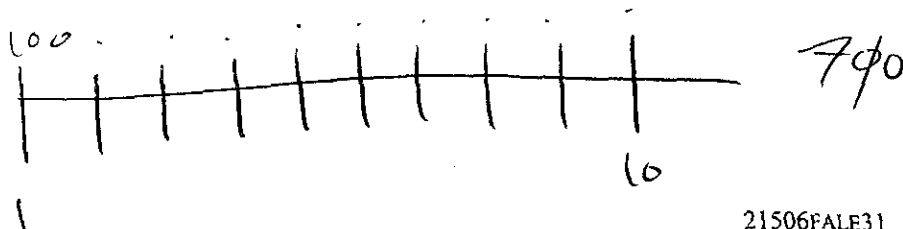
- a. 0
- b. \$50
- c. \$1000
- ☒ d. \$950



### TIME VALUE OF MONEY

16. \$100 deposited in the bank today, January 2, and each year thereafter on the same day for 10 straight years will grow to what amount by the end of the 10<sup>th</sup> year, assuming funds earned a 7% annual rate of interest?

- ☒ a. \$1478
- b. \$1382
- c. \$1514
- d. 1302



## CURRENT LIABILITIES

17. If a firm used straight-line depreciation to prepare its financial statements and an accelerated method for tax reporting purposes, which statement about their deferred tax liability account is correct, assuming no new items are purchased and depreciated?
- a. A debit balance over the depreciable assets' life will exist
  - b. Deferred tax liabilities have nothing to do with depreciation
  - ☒ c. Early entries will be credits; later entries will be debits; eventually the account will have a zero balance
  - d. Early entries will be debits; later entries will be credits; eventually the account will have a zero balance

## LONG-TERM LIABILITIES

18. The effective interest method of allocating discounts and premiums associated with notes and bonds:
- ☒ a. Computes the actual cash payment for interest as the face value times the effective interest rate
  - ☒ b. Computes Interest expense as the book value times the stated interest rate
  - c. Changes the face value up or down as those premiums or discounts are amortized
  - ☒ d. Causes the book value of the bond to move closer to its face value the closer it gets to its maturity date
19. Your firm issued a \$10,000,000 long-term bond several years ago. Including premiums or discounts, its current book value at the end of last year was \$10,189,000. If the effective interest rate was determined at the time of issue to be 8% and the bond's stated interest rate is 10%, what will this year's interest expense be? (Assume interest payments are payable annually.)
- ☒ a. \$815,120  
b. \$1,018,900  
c. \$800,000  
d. \$1,000,000
- $$\begin{aligned} E &= 8 \\ S &= 10\% \\ PV &= 10,000,000 \\ FV &= 10,189,000 \end{aligned}$$
$$\begin{aligned} &.10 \times \\ &10,189,000 \times .08 = \\ &BV \times E = IE \end{aligned}$$
20. You purchased a new piece of machinery by giving the supplier a \$10,000 note, payable in full five years from today. The note has no stated interest in its provisions. It is accounted for using the effective interest method. At the end of any of the first four years, what adjusting journal entry, if any, needs to be made?

<u>DEBIT</u>	<u>CREDIT</u>
<input checked="" type="radio"/> a. Interest payable	Discount
b. Interest expense	Discount
c. Discount	Interest Payable
d. Interest expense	Cash

## STOCKHOLDER'S EQUITY

OE - Div - APIC  
#C/S shares

- 1/2 ✱ 21. Book value per share would be affected by which transaction?
- ☒ a. Recording an adjusting entry
  - ☐ b. Paying off a current liability
  - ☐ c. Buying an asset by signing a note for the full purchase price
  - ☐ d. Selling an investment at the same value it was bought (ignore commissions)
22. If new common stock with a par value of \$5 was sold to the public for \$20 per share, which of the following choices accurately reflects that issuance on a per-share basis?
- | <u>Additional paid in capital</u>                  | <u>Common stock</u> |     |
|--|---------------------|-----|
| a. Increases \$20                                  | Increases \$5       |     |
| b. Not affected                                    | Increases \$20      |     |
| <input checked="" type="radio"/> c. Increases \$15 | Increases \$5       | +15 |
| d. Increases \$20                                  | Not affected        |     |
23. Which statement regarding treasury stock (T/S) is correct?
- ☐ a. Increasing treasury stock holdings will increase the total amount reported for owners' equity +
  - ☐ b. The resale of treasury stock for an amount equal to its cost will increase owners' equity +
  - ☒ c. The Additional-Paid in-Capital -T/S account increases when T/S is sold for less than what it was purchased for
  - ☒ d. The Additional-Paid in-Capital -T/S account decreases when T/S is sold for more than what it was purchased for

## THE FOLLOWING QUESTIONS ARE WORTH 6 PTS EACH

### LONG-TERM LIABILITIES

24. Your firm needed cash for expansion and decided to issue 1,000 five-year \$1000 bonds, each paying \$40 in interest semiannually. On 1/1/06, the day of issue, lenders were asking for a 10% annual effective return on similar investments. If issued at the rate lenders were asking, what credit entries should have been made by your firm at the time the bond was issued? (Answers rounded to nearest hundred.)
- a. Bond Payable \$1,000,000 and Discount - 77,200
  - b. Premium - \$324,000 and Bond Payable - \$676,000
  - c. Discount - 77,200 and Bond Payable - 922,800
  - d. Bond Payable - \$1,000,000 and Premium - \$24,400
  - ☒ e. Bond Payable - \$1,000,000 only

## CURRENT LIABILITIES

$\Delta$  inv.      cash  $\Delta$       7  
①      ②

25. Which of the following is a direct consequence of failing to record an inventory purchase on credit by the time the books are closed? Cost of goods is determined using a perpetual method.

- a. Working capital will be understated ✓
- b. There will be no affect on the quick ratio
- c. A higher reported net income may lead to more dividends being declared than there should have been
- d. Net assets will be overstated
- e. The debt to equity ratio will be understated

## STOCKHOLDER'S EQUITY

★ 26. Assuming that your Additional Paid-in Capital - Treasury Stock account had a \$100 balance in it and that you sold treasury stock for \$400 less than what you originally paid for it, which account (and amount) would be debited as part of the complete journal entry?

APIC      RE  
100      1

- a. Additional Paid-in Capital for \$400
- b. Treasury Stock for \$400
- c. Retained Earnings for \$100
- d. Retained Earnings for \$300
- e. Contributed Capital for \$400

27. If the net income to sales ratio is 40% and the owners investment turnover ratio is \$10:\$1, then the return on equity must be:

$$.4 \times 10 =$$

- a. Unknown since it can not be determined from the information
- b. 400% ✓
- c. 40%
- d. 25%
- e. 4%

40

28. You bought 200 shares of \$50 par value preferred stock in 2005, believing that you were guaranteed to receive a 7% dividend each year per share of stock. When you failed to receive your check in 2005, you read the fine print and found out that the stock was classified as cumulative and participating preferred stock. If the firm was profitable in 2006 and paid all dividend obligations in cash at the end of 2006, what is the most you could receive at the end of 2006, assuming you still own the same number of shares?

- a. \$0
- b. \$700
- c. Between \$700 and \$1400
- d. \$1400
- e. More than \$1400 ✓

$$200 \times 50 = 10,000$$

2005  
700 div

2006  
700 div

★ 29. When debt is not being used advantageously, the average cost of debt will be:

- a. Less than the return on assets
- b. More than the return on assets
- c. Less than the return on equity
- d. Equal to the return on assets
- e. Equal to the return on equity

30. Of the four results below, three could be caused by a 100% stock split. Which one would not occur after recording that split?

- a. Par value could decrease
- b. Par value could remain the same
- c. Total owners' equity would not change
- d. The amount reported for common stock would decrease

### STATEMENT OF CASH FLOWS

31. If both inventory and accounts payable increased between last year and this year, should those changes be added to and/or subtracted from net income when preparing a statement of cash flows using the indirect method.

- | <u>Increase in Inventory</u>  | <u>Increase in Accounts Payable</u> |
|-------------------------------|-------------------------------------|
| a. Added to net income        | Added to net income                 |
| b. Added to net income        | Subtracted from net income          |
| c. Subtracted from net income | Added to net income                 |
| d. Subtracted from net income | Subtracted from net income          |
| e. Subtracted from net income | Ignored                             |

32. From the partial information below, how much cash was received from sales and collections from charge customers?

	End <u>2005</u>	During <u>2006</u>	End <u>2006</u>
Allowance for Bad Debts	7,000		6,000
Accounts Receivable	50,000		40,000
Sales (assume all on credit)		100,000	
Bad debts expense (% of sales method)		5,000	

- a. \$110,000
- b. \$104,000
- c. \$94,000
- d. \$106,000
- e. \$90,000

AR	ADA	BDE	Rev
50,000	7,000	5,000	100,000
100,000	6,000		
40,000	6,000		
104,000			



33. From the partial information below, how much cash was spent on interest?

	End 2005	During 2006	End 2006
Bonds Payable	90,000		80,000
Interest Payable	300		200
Premium on Bonds	1,500		1,400
Interest Expense on Bonds		800	

- a. \$800
- b. \$900**
- c. \$1000
- d. \$1100
- e. \$1200

Int P	
	200
900	800
	200

BD Pay	
	90,000
	80,000

Premium B	
	1500
	1400

Int exp	
	800

34. From the partial information below, how much cash was spent on dividends?

	End 2005	During 2006	End 2006
Retained Earnings	12,400		15,000
Net income		4,000	
Dividends Payable	1,000		1,400

- a. \$1,000**
- b. \$1,100
- c. \$300
- d. \$1,700
- e. \$2,200

$$12,400 + 4,000 - 15,000 = \text{Div}$$

$$\text{BIE} + \text{NI} - \text{Ere} = \text{Div}$$

Div	
1000	1000
400	
	1400

$$\text{Div} = 1400 - 400$$

1000

35. From the partial information below, how much cash was spent on the acquisition of equipment?  
Assume all depreciable asset additions were paid for in cash.

	End 2005	During 2006	End 2006
Accumulated Depreciation (A D)	1,000		1,000
Depreciation Expense		300	
Equipment	20,000		22,000
Loss on disposition of equipment		5,000 (Note: These assets brought in no cash when disposed of)	

- a. \$2,000
- b. \$4,700
- c. \$5,300
- d. \$7,300**
- e. \$3,000

Equip	
20,000	5000
7300	300
	22,000

A D	
1000	1000
300	300
	1000

DE	
	300

Loss	
	5000

EXTRA CREDIT

36. (4) In the article "Cash Flow Never Lies - Or Does It?", what was the 1) underlying cash event that was being used as the example, and 2) the point being made/cited author and those who he quoted?

that cash flows do a good job of giving an overview of the transactions that occurred throughout the financial period, but certain areas can be window dressed, especially in the direct method

37. In the article "Cookie Jar" Trick Sweetens Earnings" describe in one or two sentences, 1) how the the "cookie jar" is created, and 2) how dipping into it "sweetens earnings."

1) Cookie jar is a higher net income

2) Sweeter earnings can be earned by reporting a higher net income