

Wells, Bill Fall 2004 ACCT 215 FINAL EXAM
 COURSE: Accounting 215 DATE: December 13, 2004
 LECTURE SESSION: A INST.: Bill Wells
 QUARTER: Autumn 2004
 TEST: Final Examination Version: 12

(8:30) 9:30 10:30

(CIRCLE THE TIME OF YOUR QUIZ SECTION)

3.7

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. 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 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.
- 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: Present value tables are on the last page of this exam

3 POINTS EACH		4 POINTS EACH		5 POINTS EACH	
1. A	8. C	15. B	22. D	27. e	34. F
2. B	9. C	16. B	23. C	28. D	35. e
3. B	10. A	17. B	24. e	29. B	36. C
4. A	11. A	18. D	25. B	30. D	37. C
5. e	12. e	19. A	26. B	31. B	38. a
6. A	13. B	20. C		32. e	
7. C	14. B	21. C		33. A	

-12

-12

-5

-29

118

THE FOLLOWING QUESTIONS ARE WORTH 3 POINTS EACH.

OWNERS' EQUITY

1. If the return on equity ratio exceeds the return on assets, then:

- ☐ a. Debt is being used to the firm's advantage
- ☐ b. Debt is not being used to the firm's advantage
- ☐ c. The firm must not have any interest expense or debt

$$ROE = \frac{\boxed{\text{Net Sales Rev}}}{\boxed{\frac{\text{Avg c/s equity}}{\text{Net Sales}}}}$$

2. Which of the following will not cause the debt-to-equity ratio to decline?

- a. Reissuing treasury stock at a price equal to its cost
- ☒ b. Purchasing assets by signing a long-term note
- c. Selling selected goods for cash at a price lower than their cost, i.e., at a loss

$$\frac{\text{debt} \uparrow}{\text{equity} \uparrow}$$

CURRENT LIABILITIES

3. In 2004, some advertising expenses were never recorded as owed by the end of the year. What effect would that omission have on the 2004 return on equity ratio? (Assume that ratio was 40% before discovery of the omission.)

- a. It would have no affect on the ratio
- ☒ b. The ratio would increase to more than 40%
- c. The ratio would decrease below 40%

- ☒ 4. In March 2004, your firm issued 10 \$1,000 bonds, receiving \$10,000 in cash. One bond matures (must be paid back) each year for the next ten years. If it is December 31 2004 (the end of your fiscal year) and all adjusting entries have been made, which statement is correct?

- ☒ a. Long-term bonds will show a balance of \$10,000 this year
- ~~b. Current liabilities will include a \$10,000 balance for the next ten years~~
- ~~c. Current liabilities will include a \$1,000 debt-related to the long-term bonds for the next 10-years~~

- ☒ 5. Your firm made quarterly cash payments to the IRS based on what it thought it would owe as of the year-end. By year-end, there were no tax payments due to the IRS. At year-end after determining taxable income, it was determined that too much cash had been sent to the IRS. What adjusting entry should be made before the 2004 books are closed?

- a. Debit Cash and credit tax expense
- b. Debit taxes receivable and credit tax expense
- ☒ c. Credit tax expense and debit tax payable

tax payable
tax expense

ERROR CORRECTION

- ~~6.~~ If interest receivable had not been accrued at the end of the reporting period as it should have been, which statement is accurate?
- Current assets will be overstated
 - Owners' equity will be understated
 - Net income will be overstated
7. If 2003 ending inventory was understated by \$100 and the firm used the "periodic method," which statement(s) is/are correct? (Ignore the impact of taxes on your answer.)
- 2003 net income will be understated by \$100.
 - 2004 net income will be overstated by \$100, assuming the 2004 ending inventory is correctly counted
 - Both of the above are correct.

TIME VALUE OF MONEY

8. How many years will it take to accumulate \$50,000 if you are able to put \$20,000 in the bank today, left it untouched for the duration, and the bank paid 8% annual interest rate?
- Between 9 and 10 years
 - Between 10 and 11 years
 - Between 11 and 12 years
9. If \$1000 deposited in a bank will grow to \$1159 in three years, what annual interest is the bank paying?
- About 3%
 - About 4%
 - About 5%
10. What is the maximum amount an investor with a 9% annual time preference rate would be willing to pay for an opportunity that guaranteed a \$500 per year future cash inflow for ten years, the first receipt occurring on the date of the agreement? (Answer rounded to nearest \$10)
- \$3,500
 - \$3,210
 - \$3,380
11. What is the net present value of a cash inflow of \$100 at the end of year one and a \$200 cash outflow at the end of year two, assuming your annual time preference rate is 8%?

- 78.88
- 117.0
- +264.06

$$\frac{-92.59}{1.08} = -171.47$$

$$\frac{1}{1.08} = 0.9259$$

$$\frac{2}{1.08^2} = 1.68$$

$$i = 8\%$$

$$-100 + 309.13$$

$$-92.59$$

$$356.65$$

$$\begin{aligned} n &= 1 \\ i &= 8 \\ PMT &= 100 \\ FV &= 100 \\ PV &= 92.59 \end{aligned}$$

$$\begin{aligned} n &= 2 \\ i &= 8 \\ PMT &= -200 \\ FV &= -200 \\ PV &= \end{aligned}$$

LONG-TERM LIABILITIES

12. Which statement is correctly associated with an operating lease?
- a. The lessor keeps the value of the asset on its books and records depreciation on that asset
 - b. Rent and depreciation expense are both recorded by the lessee
 - ☒ c. The lessee keeps the value of the asset on its books; the lessor records depreciation expense
13. Which set of conditions will cause interest expense to rise over the life of a related long-term bond?
- a. When the bond was issued at par
 - ☒ b. When the bond's effective interest is greater than its stated rate
 - c. When the bond's effective interest is less than its stated rate
14. You just read that the interest paid on government bonds rose; you considered that rate to be the "riskless," rate of interest. What would you expect to happen to the present (market) value of bonds in general, considering no other factors?
- a. Increase
 - ☒ b. Decline
 - c. Remain unchanged
- Discount*

THE FOLLOWING QUESTIONS ARE WORTH 4 POINTS EACH.

CURRENT LIABILITIES

15. If straight-line depreciation is used for financial reporting purposes and accelerated depreciation is used for tax reporting purposes, which statement gives correct advice concerning cash flows? Assume there are no other factors that affect your answer, e.g., a change in tax rates or taxable income.
- a. An amount of cash equal to depreciation expense is set aside when recording depreciation
 - ☒ b. In the early years of an asset's life, tax expense as shown on the balance sheet will be greater than the taxes paid to the IRS
 - c. Accelerated depreciation methods give larger cash savings in the later years of an asset's life
 - d. In the early years of an asset's life, tax expense as shown on the balance sheet will be less than the taxes paid to the IRS
16. In November, Kellogg randomly distributed 2,000 coupons entitling each holder to a \$1 refund on a box of corn flakes. They expected about 50% of the recipients to take advantage of the offer, although none had yet to do so by the end of their fiscal year, December 31. How should they account for this offer by December 31?
- a. Do nothing
 - ☒ b. Credit a conditional liability for \$1000
 - c. Credit cash for \$2,000
 - d. Credit an asset and debit an expense for \$1,000 this year

17. Another firm is suing your firm at the end of your firm's fiscal year. Management's best guess is that it is possible that it will lose the suit. If such occurred, your attorney believes the damages will be approximately \$1,000,000. How should this situation be addressed in your firm's financial statements for that year?
- The suit and the potential loss should not be mentioned in the financial statements or its footnotes
 - ☒ The suit and the potential loss should, as a minimum, be mentioned in the footnotes
 - The potential loss should, as a minimum, be included on the income statement but not on any other statement
 - The potential loss should, as a minimum, be included on the income statement and balance sheet

LONG-TERM LIABILITIES

18. If the book value of ten \$1,000 bonds, each with a stated interest rate of 10% per annum, was shown as \$10,189 at the end of last year, and the effective interest rate at the time the bonds were issued was 8% per annum, what is this year's interest expense, assuming none of these bonds were redeemed and no others were issued?
- $BV = 10,189$
 $i = 8\%$
- \$1000
 - \$1019
 - \$800
 - ☒ \$815
19. If the effective interest rate method is correctly applied over the life of a long-term borrowing, the book value of that debt should be equal to its face value at the time of maturity when that debt was issued at:
- ☒ All of the answers below are correct
 - Par
 - Premium
 - Discount

OWNERS' EQUITY

20. Three of the following would occur when a 3 for 1 stock split occurred. Which one would not occur?
- A drop in stock price
 - ~~A reduction in par value~~
 - ☒ An increase in the amount reported as additional paid-in capital
 - The amount reported as owners' equity would not change
21. One difference between bonds and stock is:
- Dividend declaration affects net income; interest doesn't
 - ~~Bonds generally have fewer restrictive covenants than stocks~~
 - ☒ Interest is a tax deductible expense; dividends paid are not a deductible expense
 - Both normally receive a share of excess earnings

22. What is the essential difference between the book value (BV) and market value (MV) of a share of common stock?
- ~~a. None, they are essentially the same thing~~
 - ~~b. BV measures the net worth of the company whereas MV measures the owners' residual interests in the company~~
 - c. BV per share of common stock excludes additional paid in capital; MV includes that amount
 - ☒ d. MV is determined by the stock's supply and demand in capital markets whereas BV is based on the values reported in the financial statements
23. Pickerill Fabrics, Inc. issued 100 shares of common stock, causing the 2004 ~~balance in its common~~ stock account to increase \$2,000 from its 2003 level. Additional paid in capital account related to the new issue increased by \$1,000. At what price per share were the 100 shares issued to the public?
- a. \$10
 - b. \$20
 - ☒ c. \$30
 - d. Some amount other than a, b or c
- Handwritten notes for Q23:*

$$\begin{array}{r} 200 \\ + 1000 \\ \hline 3000 \end{array}$$

$$3000 / 100 = 30$$

$$100 \uparrow 2,000$$
24. Your firm repurchased 100,000 shares of common stock for \$18 per share and considers those shares to be treasury stock. Which statement correctly describes an effect of this event?
- a. If the Price/Earnings (P/E) ratio remains the same, the stock should increase in market value
 - b. The Debt to Equity ratio will be unaffected
 - ☒ c. Net assets will not be affected
 - ~~d. Additional Paid-in Capital will increase \$1,800,000~~
25. Shares of your \$1 par value common stock are currently selling for \$50. If a 15% dividend is declared on the 10,000 shares issued/9,000 shares outstanding, what amount should be credited to the common stock account when recognizing this dividend?

- a. \$1,350
- ☒ b. \$1,500
- c. \$67,500
- ☒ d. \$75,000

Handwritten calculations for Q25:

$$\begin{array}{r} 10,000 \times \$50 \\ \times .15 \\ \hline 75,000 \end{array}$$

Cash
$$\begin{array}{r} 600,000 \times .15 \\ \hline 90,000 \end{array}$$

STATEMENT OF CASH FLOWS

26. If cash inflow from investing activities was \$200 and cash outflow from financing activities was \$200, then:
- a. No conclusion is possible from the above information
 - ☒ b. Net income must therefore equal cash flow from operating activities
 - ~~c. The firm must not have generated any cash from operations~~
 - d. Cash flow from operations equals the net change in the cash account

THE FOLLOWING QUESTIONS ARE WORTH 5 POINTS EACH.

LONG-TERM DEBT

27. A noninterest bearing \$1,000 note is given on 1/1/2002 in exchange for a long-term asset. The full amount is due on 1/1/2004. Prevailing annual interest rates for similar type loans is 10%. What will the book value of the loan be on the 2002 financial statements?

- a. \$900
- ☒ b. \$826
- c. \$909
- d. \$1,000
- ☒ e. Some other amount

28. Investors paid "102" for the bonds your firm issued. From your firm's perspective, which statement is correct?

- a. They demanded a higher interest rate than that stated on the bond
- ~~b. Interest expense relative to these bonds will exceed the amount of cash paid to the bonds' holders~~
- ~~c. The account Discount on Bonds will be debited when recording interest payments~~
- ☒ d. The book value of the bonds will be declining over their life
- ~~e. The amount of cash paid in interest will equal the amount recorded as interest expense.~~

OWNERS' EQUITY

29. Your firm declares and pays dividends at the end of each fiscal year. In 2003, your firm was not able to pay any of the required 6% dividends to holders of 10,000 shares of outstanding cumulative preferred stock (\$100 par). If the firm has \$190,000 available for dividend distribution at the end of 2004, how much will be paid to the holders of common stock?

- a. \$60,000
- ☒ b. \$70,000
- c. \$120,000
- ~~d. \$130,000~~
- ~~e. \$190,000~~

$$\begin{aligned} \$100 \times 6\% &= \$6 \times 10,000 \text{ shares} = 60,000 \text{ 2003} \\ &\times 60,000 \\ &\underline{120,000} \\ 190,000 - 120,000 &= 70,000 \end{aligned}$$

30. Due to other treasury stock transactions, your books show \$40,000 in the Additional Paid-in Capital - Treasury Stock account. If you resell all 100,000 shares (they were originally bought for \$18) at \$17/share, by what amount, if any, will retained earnings be affected?

- a. \$60,000 increase
- b. \$40,000 decrease
- c. \$40,000 increase
- ☒ d. \$60,000 decrease
- e. No affect

$$\begin{aligned} 100 & \text{ shares} \\ 1,800,000 \\ 40,000 \end{aligned}$$

$$\begin{aligned} 100,000 \times \$17 &= 1,700,000 \\ 100,000 \times \$18 &= 1,800,000 \end{aligned}$$

$$\begin{aligned} 100,000 & \text{ shares} \\ \downarrow 100,000 & \end{aligned}$$

Loss of 100,000

$$\begin{aligned} -100,000 \\ +40,000 \\ \hline -60,000 \end{aligned}$$

31. Restricted retained earnings suggests:

- a. ~~Some earnings are unaccounted for; until they are uncovered, they are identified as restricted~~
- ☒ b. Dividends may be paid only to the extent unrestricted retained earnings exist
- c. A stock split is impending; until it is completed, the estimated value of the split is shown as restricted retained earnings
- d. When a net loss occurs, rather than reducing retained earnings, the loss portion is shown under the "restricted" caption
- e. The firm has plans to use some of its available cash for future projects, the total of which is shown under the "restricted" caption

STATEMENT OF CASH FLOWS

32. A Statement of Cash Flows prepared according to GAAP should (more than one answer is possible):

- a. Include footnote information about significant noncash transactions
 - b. Categorize long-term borrowings by the firm and the related interest payments as "financing" flows
 - c. Show cash outflows for dividends under the "financing" caption
 - d. Reconcile beginning and ending balances in all working capital accounts
 - ☒ e. a and c are correct
 - f. b and d are correct
 - g. a, b, c, and d are all correct
33. Assume that 1) ending inventory was revalued downward \$500 at year-end because its market value was less than its historical cost, and 2) the appropriate loss was recorded. When determining the operating portion of a statement of cash flows according to the indirect method, what should be done about that loss?

- ☒ a. Add \$500 to net income
- b. No adjustment is necessary
- c. Deduct \$500 from net income
- d. Deduct \$500 from retained earnings
- e. Add \$500 to retained earnings at the beginning of the period

↓ ↓ inventory
= ↑ to NE

34. Equipment with a book value of \$30,000 was sold for \$10,000 cash, causing a \$20,000 loss during 2004. Given the additional information below, what amount of cash was spent for the acquisition of new equipment (all new equipment was acquired with cash)?

2004 depreciation expense	\$12,000	2003 equipment ending balance	\$430,000
2004 equipment ending balance	\$450,000	2003 accumulated depreciation	\$120,000
2004 accumulated depreciation	\$110,000		

- a. \$22,000
- b. \$32,000
- c. \$42,000
- d. \$52,000
- e. \$62,000
- ☒ f. \$72,000

Cash	Dep. exp	equip	accum Dep.	loss
20,000	12,000	430,000	120,000	
		2,000	2,000	
		18,000		
		450,000	110,000	
				20,000

13,000 120

Use the following to answer questions 35 and 36

<u>BALANCE SHEET</u>	<u>2003</u>	<u>2004</u>
Accounts Receivable	400	600
(Allowance for Doubtful Accounts)	(50)	(70)
Inventory	500	500
Accounts Payable	200	400
Unearned Revenue	100	200

INCOME STATEMENT

Revenue (assume all was initially charged)	1,100
Cost of Goods Sold	500
Bad debts Expense	60

35. How much cash was received from customers?

- a. \$1000
- b. \$860
- c. \$900
- d. \$940
- ☒ e. \$960

cash	A/R	U/R	allowance	BDE	Rev
100 860	400 1,100 40 860	100 100	50 40	60	1,100
	600	200	70	60	1,100

36. How much cash was paid to the inventory suppliers?

- a. \$100
- b. \$200
- ☒ c. \$300
- d. \$400
- e. \$500

cash	inv	COGS	A/P
	500	500	200 300 500
	500	500	400

37. Of the following, which would not be added back during the process of determining cash flow from operations using the indirect method?

- ~~a. Decrease in merchandise inventory~~
- ~~b. Increase in accounts payable~~
- ☒ c. Decrease in dividends payable
- ~~d. Decrease in prepaid items~~
- ~~e. Increase in interest payable~~

inv	int payable
50 40	

ERROR CORRECTION

38. You forgot to accrue interest on a note payable at the end of 2003. During 2004, long after last year's books were closed but before this year's books were closed, you expensed the entire amount of interest when you paid back the note. What effect will the above have on the items underlined below?

	<u>2003 Income</u>	<u>2004 Income</u>	<u>End of 2004 liabilities</u>
a. <input checked="" type="radio"/>	Overstated	Understated	None
b. <input type="radio"/>	Overstated	Overstated	Understated
c. <input type="radio"/>	Understated	Overstated	None
d. <input type="radio"/>	Understated	Understated	None
e. <input type="radio"/>	Overstated	Understated	Understated

exp ↓

NI ↓ TL

exp ↑

NI ↓