

COURSE: Accounting 215
 LECTURE SESSION: F
 QUARTER: Fall 2003
 TEST: First Midterm

DATE: October 15, 2003
 INST.: Bill Wells
 Version: 1 (2)

(Your name)

What time does your quiz session meet? 1:30

4
8
3
8
4
8
3
38
(112/150)

1. 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.
- When this examination is returned to you, you are 1) expected to retain it until the end of the quarter, and 2) return it to your TA upon request.
- 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.
- Assume all items are material and thus subject to GAAP unless indicated otherwise

INVESTOR – FINANCIAL ANALYSIS (7)

1. (3) There are only two ways the "dividend yield" ratio can increase. Name one of those two possibilities.

Dividend per share increases $\frac{\text{Div per share}}{\text{market share price}}$

2. For some reason, management wants to increase the earnings per share they will report. Which of the following will not accomplish that objective, all other things held constant?

- a. Sell a part of the business for more than what was paid for it
 b. Increase the gross profit margin
 c. Increase income from operations
 d. ☒ Increase the number of shares in the hands of the owners

CREDIBILITY – MANAGEMENT (8)

3. After a thorough inquiry, an accountant is uncertain as to how to record an otherwise recognizable event. Using conservatism as a guide, the accountant should concurrently:

	<u>Net income</u>	<u>Net assets</u>		
a. <input checked="" type="radio"/>	Understate	Understate	under	rev
b. <input type="radio"/>	Understate	Overstate	ove	exp
c. <input type="radio"/>	Overstate	Overstate	acc	loses
d. <input type="radio"/>	Overstate	Understate	—	gains

4. (2 EACH; 4 TOTAL) Besides conservatism, three other reasons were discussed in lecture that might justify deviating from GAAP. Name two of those reasons.

industry,

cost-benefit

CREDIBILITY – THE AUDIT (15)

5. As the partner in charge of an audit, you did just about everything wrong. Three of the four sanctions below are possible. Which one is not possible?

- a. The SEC refuses to accept future financial statements that you have audited
 b. The State Boards of Accountancy pulls your license to practice public accounting
 c. ☒ You are prohibited from practicing before the FASB
 d. You are found guilty in a court and are fined

6. Which statement best describes the depth of inquiry made by external auditors in the conduct of a financial audit?

- ☒ a. All transactions and events (TE) are reviewed for their accuracy
- b. All TE which underlie the Income Statement are examined
- c. All TE which underlie the Balance Sheet are examined
- ☒ d. Only some TE are examined

-4

7. Which statement incorrectly describes an audit opinion?

- ☒ a. It will refer to the standards under which the audit was conducted
- b. It will express an opinion about the degree to which GAAP was followed
- c. It will express an opinion about the fairness of the financial statements
- ☒ d. A partner will sign the opinion with his or her own name

-4

8. (3) Which extract from an audit opinion is typical of a "qualified" audit opinion?

- a. The statements do not fairly present the financial condition of the company...
- ☒ b. The firm's statements were prepared according to GAAP except for the way they accounted for inventory...
- c. We were unable to form an opinion about the fairness of the firm's statements because...

THE WALL STREET JOURNAL (5)

9. (1 EACH) The following companies and their alleged misdeeds are listed in column 1 and 2 respectively. Match each company with each alleged misdeeds by putting the letter corresponding to the company in the space preceding the misdeeds. (Source: "Scandal Scorecard", The Wall Street Journal, Friday Oct 3, 2003 (No author cited).

COMPANY	MISDEAD
G Global Crossing	E Insider trading
I ImClone Systems	X Using "cookie jar" reserves to dip into in hard times and manipulating leases
X Xerox Corp.	C Analyst issuing rosy recommendations to win investment banking business
AA Arthur Andersen LLP	G Artificially inflated revenue when swapping line capacity
C Citigroup	AA Destruction of evidence

CREDIBILITY – CONTROL (0)

-8

BUSINESS DYNAMICS (4)

10. (4) Which statement best describes the main difference between managerial (MA) and financial accounting (FA)?
- a. MA is governed by a set of rules put out by the FASB and enforced by the SEC
 - b. FA is primarily intended for use by those outside the firm whereas MA is used by the firm's managers
 - c. FA is primarily intended for use by those inside the firm whereas MA is used by the firm's owners
 - d. MA is just another description of FA; they both mean the same thing and provide the same type of information

ENVIRONMENT (0)

BUSINESS ENTITY (14)

11. (3) If you wanted to limit the potential liability from misdeeds, as an owner of that business, which type of organization should you prefer? (Circle the correct answer)

Partnership

Sole proprietorship

C Corporation

12. (4) An investment banker is best associated with which role?

- a. Raising new capital (money)
- b. Serving as part of the governing body of a corporation
- c. Setting accounting and reporting standards
- d. Enforcing the application of accounting and reporting standards
- e. Handling the cash flows of the organization, i.e., like a bank

13. (4) If an error (accidental or intentionally) is made in the preparation of financial statements, which group should bear the primary responsibility for that error? (NOTE: All may bear some responsibility but the focus is on the word primary.)

- a. The senior management of that company
- b. The board of directors
- c. An investment banker
- d. External auditors

14. (3) From the Secretary of State's (Washington) website, which type of organization do "professionals such as accountants and lawyers" normally use?

~~partnership~~

-3

FINANCIAL REPORTING (49)

15. (2) Each of the four financial statements is related to at least one other statement. What information is found on the income statement that is also found on the statement of retained earnings? (Be specific in your answer.)

The income statement shows net income which also is in the equation to find end retained earnings which is found on the statement of retained earnings.

16. (18PC) The information found in column 1 below may be found on one or more of the financial statements listed in columns 2-5. If that information may be found on a particular report, place in X in the appropriate row and column intersection. NOTE: There are only 18 correct answers so you should enter only 18 Xs. Each entry over 18 will result in a 1 point decrease in your score on this problem.

Information found on financial statements	Income Statement	Statement of Retained Earnings	Statement of Cash Flows	Balance sheet
Income from discontinued operations	X			
For the period 1/1 to 12/31 2003	X	X	X	
Prepaid and unconsumed items such as insurance				X
Owners Equity				X
Accumulated Depreciation				X
Fees Earned	X			X
Name of reporting entity, e.g. Bill Corp.	X	X	X	X
Depreciation Expense	X			
Cash from financing activities			X	
Gross Profit Margin	X			
Accounts payable	X			X
Total Contributions by owners (assume they were not cash)	X	X		X
As of 12/31/2002				X

17. Suppose your company was made up of three divisions, A, B, and C. During the year C was sold but prior to the sale, it had experienced revenues, expenses, gains and losses just like the other two divisions. Which of the income statement totals should include activity from Division C?

- a. Gross profit margin
- b. Income from operations
- ☒ c. Income from continuing operations
- ☒ d. Net income
- e. All of the above

18. (1 EACH – 5 TOTAL) Column 1 contains a list of transactions that may or may not include a cash flow. For each transaction, place a check mark in one of the columns to the right to indicate whether the transaction would or would not be included in a statement of cash flows. If it would be included, place a check mark in the appropriate category of cash flows, i.e., operating, investing, or financing.

Transaction	Operating	Investing	Financing	Not included
Borrow \$20,000 from the bank			X	
Payment of a bill for utilities	X			
Purchase of land by giving the seller shares of stock in your company that had a market value of \$320,000				X
Raising \$469,000 by issuing new stock to new owner			X	
Sale of a piece of land for \$345,000		X		

19. (2 EACH/4 TOTAL) Narrative information must accompany the financial statements in two distinctly different reports/comments/places. What are those reports/comments/places?

Footnotes

manager analysis + opinion (report)

20. (2 EACH/4 TOTAL) The balance sheets shown to you in class, in the text, and from COSTCO are all "classified." What does that mean or give a brief example of how the assets on those statements are "classified."

The assets are taken from the company.

The company is stated their info on — 4 —
the statement and is verifiable.

21. (2 EACH 8 TOTAL) Net income is a total derived from adding and subtracting 4 distinctly different elements of information. What are those four elements?

1. Revenue

3. Expenses

2. Gains

4. Losses

22. If assets and liabilities increased by \$200,000 and \$300,000 respectively from last to this year, then:

- a. Paid in capital and retained earnings collectively must have increased \$100,000
- ☒ b. Paid in capital could have increased \$100,000
- c. Retained earnings must have increased \$100,000
- ☒ d. None of the above are possibly correct

-4

FINANCIAL ACCOUNTING (38)

23. Which event would be recognized under both cash and accrual accounting at the time it happened?

- a. Recording depreciation
- b. Acquisition of supplies on a credit card
- ☒ c. Payments received from customers at the time of sale
- d. Purchasing land by giving the seller shares of stock in your company

24. On Tuesday, you 1) had \$1,000 of cash sales, 2) collected \$1,000 in cash from prior credit sales and 3) received \$1,000 deposit on a special order. What was Tuesday's revenue?

- ☒ a. \$1,000
- ☒ b. \$2,000
- c. \$3,000
- d. \$0

1,000

-4

25. (4) On which day (circle the correct day) should revenue be recognized given the following events?

Monday	Item is ordered by the customer
Tuesday	Item is ordered by the merchant
Wednesday	Merchant receives the item and calls the customer
<u>Thursday</u>	Customer picks up the item and signs a note saying she will pay tomorrow
Friday	Merchant receives the cash from the purchaser
Saturday	Merchant deposits the customer's money in the bank and writes a check to the person from whom the item was bought

26. If your firm started and ended the year with \$28,000 and \$30,000 of resalable merchandise respectively; which set of activities is possible?

	<u>Purchased</u>	<u>Sold</u>	<u>Lost or Stolen</u>
a.	\$256,000	\$270,000	\$12,000
<input checked="" type="radio"/> b.	\$636,000	\$515,000	\$119,000
c.	\$379,000	\$381,000	0
d.	\$465,000	\$482,000	\$15,000

28,000

30,000

-8

$$A = L + OE$$

27. The financial accounting term "matching" suggests:

- a. Revenue be matched to the period in which it is earned
- b. Revenue be matched to the expenses incurred
- c. Expenses be matched to the period in which they are purchased
- d. Expenses be matched to the period in which the revenue was earned

28. (2 EACH 6 TOTAL) When resalable merchandise inventory is sold on credit, that account and three others should reflect the sale. What are the names of those other three accounts?

accounts receivable
fee earned
~~retained earnings~~

-2

29. (12PC) In the matrix below, show how a piece of equipment that was originally purchased for \$90,000 was sold for \$50,000 cash when its book value was \$40,000. Be sure to label each column with the name of the account involved. (1 POINT FOR ACCOUNT, AMOUNT, DIRECTION)

Cash	Accumulated Depreciation	Equipment	Gain
50,000		(90,000)	10,000

-1

INVESTOR-UNDERSTANDING CONCEPTS (6)

30. (2 EACH; 6 TOTAL) In lecture, it was suggested that four major assumptions underlie the financial statements. Name or describe three of them.

Fiscal Periods - a time in which a company records its statements, either a yearly, quarterly or monthly.

stable Dollar - constant unit of measurement

going concern - the statement at the end of a fiscal period we assume the entity will continue in the

INTERNATIONAL (4) future, continue operating cycle to generate revenue.

31. (4) In the "Overview of FASB's International Activities," the FASB was described as actively participating with the International Accounting Standards Board. According to that document, what must foreign firms do if they choose to 1) file reports with the SEC and 2) use their own countries GAAP?

1) Follow the same regulations.

2) abide by their accepted accounting principals so that their statements are reliable, without bias, same as we do in the U.S.

-3