

ACG 201
TEST IA
Fall 2004

NAME _____

Class Time
Circle one: 10:00 12:00 1:00

MULTIPLE CHOICE: There is only one BEST answer. 2 points each.

1. D

11. B

2. D

12. D

Multiple Choice 40

3. A

13. B

Problem I 30

4. B

14. B

Problem II 20

5. C

15. D

Problem III 10

6. D

16. B

 100

7. D

17. A

8. B

18. C

9. C

19. B

10. C

20. B

Multiple Choice – (2 points each) select *the ONE best answer*

1. Under the definition of accounting, which of the following is not one of the activities performed on the transactions of a business entity?
 - A. Summarizing.
 - B. Interpreting.
 - C. Classifying.
 - D. Forecasting.**

2. Which of the following is a measure of solvency?
 - A. Current ratio
 - B. Price earnings ratio
 - C. Earnings per share
 - D. Debt to total assets ratio**

3. Working capital is
 - A. Available to meet the growth needs and non-current obligations of a company.**
 - B. Nearly always the same as net income.
 - C. used to evaluate a company's solvency and long-term debt paying ability.
 - D. calculated by subtracting current assets from current liabilities.

4. Which of the following is not an example of conservatism in accounting?
 - A. Expensing tires when purchased even though they last two years.
 - B. Recording gains in market value of short term investments.**
 - C. Recording depreciation on equipment during its useful life rather than waiting to record the loss at the time it is sold.
 - D. Estimating and recording the estimated expense of defending a lawsuit when it is filed.

5. A corporation has which of the following set of characteristics?
 - A. Shared control, tax advantages, increased management skills and resources
 - B. Simple to set up and maintains control with founder
 - C. Easier to transfer ownership and raise funds, no personal liability**
 - D. Harder to raise funds and gives owner control

6. Retained earnings is the amount of
 - A. cash that stockholders may withdraw as dividends when needed
 - B. cash left over after all liabilities for the period have been satisfied.
 - C. cash invested by the owners of the business
 - D. earnings reinvested in the business which the board of directors has not paid out as dividends**

7. The statement of cash flows would disclose the payment of a dividend
 - A. nowhere on the statement.
 - B. in the operating activities section.
 - C. in the investing activities section.
 - D. in the financing activities section.**

8. Which of the following financial statements usually prepared first?
 - A. Balance sheet.

- B. **Income statement.**
 - C. Retained Earnings statement.
 - D. Statement of cash flows.
9. Which of the following is a cash flow from investing activities?
- A. Purchase of merchandise for resale.
 - B. Sale of inventory to customers.
 - C. **Sale of a franchise or a copyright.**
 - D. Payment of a note payable.
10. On the Statement of Cash Flows paying a dividend to owners is an example of
- A. operating activities.
 - B. investing activities.
 - C. **financing activities.**
 - D. shareholder activities.
11. The price earnings ratio is unique among financial ratios because
- A. The lower the ratio, the better the performance of a company
 - B. **It is an indication of expectations rather than historical financial statement information**
 - C. It is required to be shown on the face of the income statement of a public company
 - D. It is an outstanding indicator of liquidity
12. Which of the following is a transaction which should be recorded in an accounting system?
- A. Signing a contract to purchase a parcel of land
 - B. Termination of an employee without pay
 - C. Pledging to give 10% of your Company's annual income to a charity
 - D. **Receiving cash of \$5,000 for services to be performed in the future.**
13. If total assets increased by \$25000 during a period of time and stockholders' equity increased by \$5000 during the same period, then the amount and direction (increase or decrease) of the period's change in total liabilities is a(n):
- A. \$20,000 decrease
 - B. **\$20,000 increase**
 - C. \$25,000 increase
 - D. \$30,000 increase
14. Which of the following components of an financial statement is an application of the full disclosure principle which clarifies information presented in the financial statements, as well as provides additional detail:
- A. Auditor's report.
 - B. **Notes to financial statements**
 - C. Management discussion and analysis section.
 - D. President's state of the company report.
15. In the annual report, where would a financial statement reader find out if the company's financial statements give a fair depiction of its financial position and operating results?
- A. Notes to the financial statements.
 - B. Management discussion and analysis section.

- C. Balance sheet.
- D. Auditor's report.**

16. The going concern assumption underlies the

- A. Monetary unit assumption
- B. The cost principle**
- C. The materiality constraint
- D. Time period assumption

17. A good accountant must have integrity, follow the rules, have basic math skills, and objectively document reality. These characteristics are most like those of

- A. A scorekeeper in a football game**
- B. A politician in Washington
- C. A lawyer in a courtroom
- D. A construction worker after the hurricane

18. On a balance sheet, assets are listed in the order of

- A. Dollar amount (largest first).
- B. Date of acquisition (earliest first).
- C. Ease of conversion to cash.**
- D. Importance to the operation of the business.

19. Primary responsibility for the information in a corporation's financial statements rests with

- A. The shareholders of the corporation.
- B. The managers of the corporation.**
- C. The Securities and Exchange Commission.
- D. The certified public accountant who audited the financial statements.

20. A business's balance sheet cannot be used to accurately predict what the business might be sold for because

- A. it identifies all the revenues and expenses of the business.
- B. Assets are generally listed on the balance sheet at their historical cost, not their current value.**
- C. it gives the results of operations for the current period.
- D. some of the assets and liabilities on the balance sheet may actually be those of another entity.

Problem I – Financial Statements (30 points)

You are provided with the following information for Number Crunchers, Inc, effective as of its December 31, 2004 year end.

Accrued income taxes	\$ 135
Accounts payable	553
Accounts receivable	810
Accumulated depreciation	1,460
Cash	570
Common stock (900 shares)	900
Cost of goods sold	20,820
Current portion of long-term debt	640
Depreciation expense	435
Dividends paid during the year	225
Equipment	5,060
Income tax expense	105
Industrial development bonds	6,000
Interest expense	400
Inventories	2,052
Land	15,400
Land Held for future expansion	9,240
Long term lease obligation	800
Pension expense	81
Prepaid expenses	12
Retained earnings, beginning	1,400
Sales	46,000
Supplies	150
Short term investments	1,800
Trademark	210
Unearned Revenue	400
Wages expense	1,140
Wages payable	222

Instructions:

- Prepare an income statement and a retained earnings statement for Number Crunchers, Inc for the year ended December 31, 2004.
- Prepare a classified balance sheet for Number Crunchers, Inc. as of December 31, 2004.

Financial Statements

Income Statement

For the year ended December 31, 2004

Sales	\$	46,000
Expenses		
Cost of goods sold	\$	20,820
Depreciation expense		435
Income tax expense		105
Interest expense		400
Pension expense		81
Wages expense		1,140
		22,981
Net income	\$	23,019

Retained Earnings Statement

For the year ended December 31, 2004

Retained earnings beginning	\$	1,400
add Net income		23,019
Less: dividends paid during the year		(225)
Retained earnings ending	\$	24,194

Balance Sheet

Current assets

Cash	\$	570
Short term investments		1,800
Accounts receivable		810
Supplies		150
Inventories		2,052
Prepaid expenses		12
		5,394
Land held for future use		9,240
		14,634
Property		15,400
Equipment		5,060
Less: Accumulated depreciation		(1,460)
		19,000
Tademark		210
Total	\$	52,844

Current liabilities

Accrued income taxes	\$	135
Accounts payable		553
Unearned revenue		400
Current portion of debt		640
Wages payable		222
		1,950
Long term lease obligation		800
Industrial develop. bonds		6,000
		8,750
Common stock		900
Retained earnings		24,194
		25,094
Total	\$	33,844

Problem II (20 points)

The following information is available from the 2004 annual reports of Price Company and Stockton Company. Both companies manufacture cash registers

	(Amounts in millions)	
	<u>Price</u>	<u>Stockton</u>
Sales	\$26,510	\$34,512
Cost of sales	6,610	8,887
Net income	565	1,271
Current assets	11,712	28,447
Beginning total assets	17,102	33,130
Ending total assets	22,088	36,167
Current liabilities	7,966	14,950
Total liabilities	16,136	31,222
Average common shares outstanding	125	240
Year-end share price	50	65
Preferred stock dividends paid	-0-	-0-

The following are the averages for the cash register industry

1. Current ratio (Industry 2.00:1) CA/CL $11712/7966=$ $28447/14950=$
2. Debt to total assets ratio Debt/Total Amt $16136/22088 = .73$ $31222/36167 = 86%$
(Industry average 60%)
3. Earnings per share (average \$3.00) EPS=Net income/number of shares
4. Price-earnings ratio (average 15) $50/4.52=11$ $65/5.30=12$ $565/125=4.52$ $1271/240=5.30$

Required:

1. Based on the above information, evaluate Price's solvency compared to Stockton. Defend your answer by calculating the most relevant ratio for both companies and comparing it to the industry average.

	Price	Stockton
Debt/Total assets	16,136	31,222
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	$=73.1%$	$=86.4$
	22,088	36,167

Price's solvency is better than Stockton's, but both are worse than the average of 60%. Indicates higher risk of not meeting long term obligations

2. Based on the above information, comment on the Wall Street expectations for Price compared to Stockton and the industry average. Defend your answer by calculating The most relevant ratio for both companies.

Price earning ratio indicates Wall Street expectations

Price/EPS	$50/4.52=11.06$	$65/5.30=12.27$
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Wall Street has higher expectations of Stockton than Price, however both are less well liked by Wall street than others in the industry which have an average rating of 15.

Short Answer – Question III (10 points)

Under accounting principles generally accepted in the United States of America, research and development costs to come up with new inventions, technology or creative works are recorded as an expense when incurred. Several international students visiting your campus comment that such costs are recorded as assets and depreciated over 5 to 10 years in their country. Indicate whether you agree with the United States accounting principle and select one of the following principles, assumptions or constraints to concisely defend your answer (cost, materiality, relevance, consistency, comparability, conservatism, and going concern) .

Agree, defended by the CONSERVATISM constraint.

We do not know for sure that the invention or technology will be an asset with future value. The accounting constraint of conservatism says we are slow to record assets and fast to record expenses or obligations. Clearly, unlike a building which has relatively certain future use and value, research and development by nature are uncertain in value and should be expensed until their economic value is objectively established. This generally happens when they are sold.

Consistency or comparability the accounting principle has been consistently applied And should continue to be so to enhance comparability.