

## Test 1 Spring 2003 Solutions

Multiple Choice ( 2 pts. each) Select the one BEST answer.

- Which of the following statements about the price/earnings ratio is false?
  - The price/earnings ratio is a constant relationship for most companies.
  - A high price/earnings ratio indicates investors have high confidence in the future potential of the company.
  - It is more useful to compare a company's price/earnings ratio to a competitor's ratio or the industry average ratio.
  - The price/earnings ratio is computed by dividing the market price of stock by the earnings per share.
- Outback Steak House collected \$150,000 cash for gift certificates and \$400,000 cash from meals served in December 2002. In January 2003, \$100,00 of the gift certificates were used by customers and additional cash of \$300,000 was collected for meals served. How much is revenue for Outback Steak House under generally accepted accounting principles in December 2002 and January 2003 respectively?

	<u>December 2002</u>	<u>January 2003</u>
A.	\$550,000	\$300,000
B.	400,000	300,000
C.	400,000	400,000
D.	400,000	450,000
- The primary purpose of an audit by independent CPA's is to
  - lend credibility to an entity's financial statements.
  - prove the accuracy of an entity's financial statements.
  - prepare the financial statements and disclosures.
  - report on the fairness of the corporation's stock price.
- If you wanted to know what accounting rules a company follows related to its inventory, where would you look?
  - the balance sheet.
  - the income statement.
  - the notes to the financial statements.
  - the headings to the financial statements.
- On a balance sheet, assets are listed in the order of
  - dollar amount (largest first).
  - date of acquisition (earliest first).
  - ease of conversion to cash.
  - importance to the operation of the business.
- Which of the following would not be a cash flow from financing activities?
  - Issuance of common stock.
  - Borrowing on a long-term note payable.
  - Collection of a cash dividend.
  - Repayment of principal on a long-term note payable

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7. Which of the following is a cash flow from operating activities?
- A. Purchase of merchandise for resale.
  - B. Sale of a piece of land no longer used in operations.
  - C. Sale of long-term investments in common stock.
  - D. Payment of a note payable.
8. Which of the following would not be a cash flow from investing activities?"
- A. Purchase of long-term investments.
  - B. Sale of a patent.
  - C. Collection of principal of a note receivable
  - D. Collection of interest revenue on a long-term note.
- Both answers are correct – This ended up being a bonus question.*
9. Which of the following statements is true about a sole proprietorship?
- A. The owner and the business are separate legal entities but not separate accounting entities.
  - B. The owner and the business are separate accounting entities but not separate legal entities
  - C. The owner and the business are separate legal entities and separate accounting entities
  - D. Most large businesses in this country are organized as sole proprietorships.
10. A group of people establishing a business might prefer to set it up as a corporation rather than a partnership
- A. to have limited liability
  - B. to avoid double taxation.
  - C. because of ease of formation.
  - D. because a corporation is considered to be a separate accounting entity and a partnership is not.
11. You are a potential stockholder and are concerned that a particular company you are ready to invest in might have too much debt. Which financial statement would provide you information needed in order to evaluate your concern?
- A. Balance sheet
  - B. Income statement
  - C. Statement of retained earnings
  - D. Cash Flows statement
12. Which of the following ratios usually is not considered to be a test of profitability?
- A. Current ratio.
  - B. Profit margin.
  - C. Return on assets.
  - D. Earnings per share.

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13. On January 1, 20A, Brown Company had retained earnings of \$2,500,000. During 20A, Brown had revenues of \$2,200,000, expenses of \$1,500,000 and dividends of \$300,000. What was Brown Company's net income and retained earnings on December 31, 20A?
- A. \$400,000 and \$2,900,000.
  - B. \$400,000 and \$3,200,000
  - C. \$400,000 and \$2,500,000
  - D. \$700,000 and \$2,900,000
14. Which financial statement for a business would you look at to determine the company's operations performance during an accounting period?
- A. balance sheet.
  - B. statement of retained earnings.
  - C. income statement.
  - D. statement of cash flows.
15. A company would report a net loss when
- A. retained earnings decreased due to paying dividends to shareholders.
  - B. its assets decreased during an accounting period.
  - C. its liabilities increased during an accounting period.
  - D. its expenses exceeded its revenues for an accounting period.
16. The amount of rent expense reported on the income statement is
- A. the amount of cash paid for rent in the current period.
  - B. the amount of cash paid for rent in the current period less any unpaid rent at the end of the period.
  - C. the amount of rent used up in the current period to earn revenue.
  - D. an increase in net income.
17. On the multiple step income statement, an example of a non-operating (other) expense is
- A. interest expense
  - B. selling expense
  - C. research and development costs
  - D. all of the above are non-operating
  - E. non of the above is non-operating
18. Which of the following would appear in the intangible asset section of a classified balance sheet?
- A. Patents
  - B. Accumulated depreciation
  - C. Cash
  - D. Accounts receivable
  - E. None of the above is correct.

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19. Which of the following reports is required to be filed with the SEC within 60 days of the end of the fiscal year of a public corporation:
- A. 10K
  - B. 10Q
  - C. 8K
  - D. 1050
20. The accounting organization which prescribes accounting rules used by business in the USA is:
- A. SEC
  - B. FASB
  - C. GAO
  - D. IRS
  - E. AICPA

### Problem I(50 points)

The following data were taken from the records of Richmond Wins, Inc for the year ended December 31, 2002:

Accounts Payable	\$ 10,000
Accounts Receivable	14,000
Accumulated Depreciation – Building	13,400
Advertising Expense	6,400
Building	75,000
Capital Stock (4000 shares)	40,000
Cash	10,000
Cost of Goods Sold	52,000
Depreciation Expense	1,000
Dividends Declared and Paid	2,200
Insurance Expense	1,900
Interest Payable	1,400
Inventory of Merchandise	30,000
Land	15,000
Prepaid Insurance	2,200
Rent Revenue	1,700
Retained Earnings (January 1, 2002)	64,100
Retained Earnings (December 31, 2002)	77,500
Salaries Expense	24,000
Salaries Payable	3,800
Sales	100,000
Supplies	400
Supplies Expense	800
Unearned Rent Revenue	100

Required:

1. Prepare a multi-step income statement in good form at December 31, 2002.
2. Calculate earnings per share in the space below. Last year EPS was \$2. Has profitability improved?

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### 1. Multi-step Income Statement

*Richmond Wins, Inc.  
Income Statement  
For the Year Ended December 31, 20B*

Sales		\$100,000
Cost of Goods Sold		<u>52,000</u>
Gross Profit		48,000
Operating Expenses:		
Advertising	\$6,400	
Depreciation	1,000	
Insurance	1,900	
Supplies	800	
Salaries	<u>24,000</u>	
Total Operating Expenses		<u>34,100</u>
Income from Operations		13,900
Other Revenue and Expenses		
Rent Revenue		<u>1,700</u>
Net Income		<u>\$15,600</u>

### 2. Earning Per Share Calculation

EPS = \$15,600 / 4000 shares = \$3.90  
Profitability has improved since last year.

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### Problem II Short Answer (10 points)

The Sarbanes/Oxley Act is the most important legislation to affect the public accounting profession since the Securities Act of 1933 and 1934. What is one provision of the Act that affects top management or boards of directors of public companies and why is the provision important?