

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

1. Most businesses earn revenues
 - A) when they collect accounts receivable.
 - B) through sales of goods or services to customers.**
 - C) by borrowing money from a bank.
 - D) by selling shares of stock to shareholders.

2. 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.

3. On the statement of cash flows, an amount paid for utilities would be classified as
 - A) an operating activity.**
 - B) an investing activity.
 - C) a financing activity.
 - D) a production activity.

4. 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.**

5. The operating activities section is often believed to be the most important part of a statement of cash flows because
 - A) it gives the most information about how operations have been financed.
 - B) it shows the dividends that have been paid to shareholders.
 - C) it indicates a company's ability to generate cash from sales to meet current cash payments for goods or services.**
 - D) it shows the net increase or decrease in cash during the period.

6. 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.

7. The assumption that a business can continue to remain in operation into the future is the
- A) cost principle.
 - B) unit-of-measure assumption.
 - C) continuity assumption.**
 - D) separate-entity assumption.
8. The assumption that the assets and liabilities of the business are accounted for on the books of the company but not included in the records of the owner is the
- A) unit-of-measure assumption.
 - B) continuity assumption.
 - C) cost principle.
 - D) separate entity assumption.**
9. The principle that requires us to record a transaction when we provide service to a client and bill them is
- A) cost-benefit.
 - B) cost principle.
 - C) full disclosure.
 - D) revenue recognition.**
10. Which of the following costs is most likely to be the largest expense item on the income statement of a merchandising chain such as Wal-Mart?
- A) Wage, salary and benefits expense
 - B) Cost of Sales**
 - C) Advertising
 - D) Income tax expense
11. What accounting constraint refers to the tendency of accountants to resolve uncertainty in a way least likely to overstate assets and net income?
- A) Comparability.
 - B) Materiality.
 - C) Conservatism.**
 - D) Consistency.
12. Which is an advantage of corporations relative to partnerships and sole proprietorships?
- A) Lower taxes.
 - B) Harder to transfer ownership.
 - C) Reduced legal liability for investors**
 - D) Most common form of organization
13. Which of the following regarding retained earnings is false?
- A) Retained earnings is increased by net income.
 - B) Retained earnings is a component of stockholders' equity on the balance sheet.**
 - C) **Retained earnings is an asset on the balance sheet.**
 - D) Retained earnings represents earnings not distributed to stockholders in the form of dividends.
14. Which is NOT one of the three primary business activities?
- A) Financing.

- B) Operating.
 - C) Advertising.**
 - D) Investing
15. As of December 31, 2005, Stoneland Corporation has assets of \$3,500 and stockholders' equity of \$2,000. What are the liabilities for Stoneland Corporation as of December 31, 2005?
- A) \$1,500.**
 - B) \$1,000.
 - C) \$2,500.
 - D) \$2,000.
16. 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.**
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. The principle which holds that all of the expenses incurred in earning revenue should be identified with the revenue recognized and reported for the same period is the
- A) revenue principle.
 - B) liability principle.
 - C) timing principle.
 - D) matching principle.**
 - E) cost principle.
19. Accountants value transactions at cost because
- A) it reflects the most timely market valuation of real estate and other long term assets
 - B) it provides an objective measure of the value of a business's people
 - C) in considers the long range social and environmental impact on the finances of the company
 - D) it is objective and relevant at the date the original transaction was completed**
 - E) all of the above
20. Which financial statement is primarily concerned with operating profitability of a corporation?
- A) Balance Sheet
 - B) Income statement**
 - C) Cash Flows statement
 - D) Retained earnings statement

Problem I – Financial Statements (30 points)

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

Accrued income taxes	\$ 335
Accounts payable	553
Accumulated depreciation	1,460
Buildings	3,000
Bonds payable (due in 2005)	800
Cash	570
Common stock (900 shares outstanding)	900
Cost of goods sold	31,020
Current portion of long-term debt	640
Depreciation expense	435
Dividends paid during the year	225
Equipment	4,060
Income tax expense	105
Insurance receivable	810
Interest expense	400
Inventories	2,052
Land	15,000
Land held for future use	9,240
Patents	2,210
Prepaid insurance	493
Retained earnings, beginning	1,400
Sales	65,000
Supplies	150
Short term investments	800
Unearned Revenue	400
Wages expense	1,140
Wages payable	222

Instructions:

- a) Prepare an income statement and a retained earnings statement for Bean Counters, Inc for the year ended December 31, 2004. Be sure to include headings and earnings per share.
- b) Prepare a classified balance sheet for Beach Counters, Inc. as of December 31, 2004.

Financial Statements

Bean Counters, Inc.

Income Statement

For the Year Ended December 31, 2004

Sales	65,000
Less: Expenses	
Cost of Goods Sold	(31,020)
Depreciation Expenses	(435)
Income Tax Expense	(105)
Interest Expense	(400)
Wages Expense	(1,140)
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Net Income	<u>31,900</u>
Earnings per share	\$ <u>35.44</u>

EPS=31900/900

Retained Earnings Statement

For the Year Ended December 31, 2004

Beginning Balance	1,400
Add: Net Income	31,900
Less: Dividends Paid	(225)
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Ending Retained earnings	<u>33,075</u>

Balance Sheet
As of December 31, 2004

<u>ASSETS</u>	
Cash	\$ 570
Short term investments	800
Insurance receivable	810
Inventories	2,052
Supplies	150
Prepaid insurance	<u>493</u>
Total Current Assets	<u>4,875</u>
Land Held for future use	<u>9,240</u>
Land	15,000
Building	3,000
Equipment	4,060
Less: Accumulated depreciation	<u>(1,460)</u>
Net Property	<u>20,600</u>
Patents	<u>2,210</u>
Total Assets	<u><u>36,925</u></u>

<u>LIABILITIES AND STOCKHOLDER'S EQUITY</u>	
Accrued income taxes	\$ 335
Accounts payable	553
Current portion of debt	640
Unearned revenue	400
Bonds payable in 2005	800
Wages payable	<u>222</u>
Current liabilities	<u>2,950</u>
Capital stock (900 shares)	900
Retained earnings	<u>33,075</u>
	<u>33,975</u>
	<u><u>36,925</u></u>

Problem II (20 points)

Ratio	2001 Target	2001 Wal-Mart
(All dollars are in millions)		
(a) Working capital	$\$7,304 - \$6,301 = \$1,003$	$\$26,555 - \$28,949 = (\$2,394)$
(b) Current ratio	1.2:1 ($\$7,304 \div \$6,301$)	.92:1 ($\$26,555 \div \$28,949$)
(c) Debt to total assets ratio	66.6% ($\$12,971 \div \$19,490$)	59.9% ($\$46,787 \div \$78,130$)
(d) Earnings per share	$\$1.40 = \frac{\$1,264}{904}$ (1.20 in 2000)	$\$1.41 = \frac{\$6,295}{4,465}$ (1.45 in 2000)
(e) Price-earnings ratio	$26.4 = \frac{\$36.97}{\$1.40}$	$40.3 = \frac{\$56.80}{\$1.41}$

Based on the above information, answer the following questions:

1. Which company is more liquid? Indicate what information above helped you answer the question .

Target ihas a better current ratio of 1.2 vs .92 for Walmart. Walmart is unable to meet its current obligations with current assets.

2. Which company was the most profitable in 2001? Indicate which ratio helped you answer the question and why.

Walmart was more profitable in total profit of \$6295 (see earnings per share)

3. Which company did investors believe had the best prospects in 2001? Which ratio helped you answer the question and why?

Walmart had a price earnings ratio of 40.3 vs 26.4 for Target/ both were loved by wall street, but Walmart had the more favorable outlook according to Wall street. It was not a good time to buy Walmart since it appears to be over valued.

Short Answer – Question III (10 points)

From 1995 to 2001, Andrew Fastow, the innovative and brilliant chief financial officer of Enron Corporation, set up subsidiaries to shelter some of Enron's operating losses. Using a technical loophole in generally accepted accounting principles these subsidiaries recorded losses of \$600,000,000 that would otherwise have been Enron's losses. The debts of these subsidiaries totaled twelve billion dollars and were guaranteed by the stock of Enron. That is, if the stock price of Enron fell below \$40, Enron would have to pay the debts. Andrew Fastow did not record any of these liabilities on the balance sheet of Enron and included a two sentence description of the subsidiaries in the footnotes of Enron's annual report..

Required: Do you agree with Andrew Fastow's accounting treatment of the subsidiary debt ? Select one or more of the following principles, assumptions, or constraints to concisely defend your answer (cost, materiality, relevance, consistency, full-disclosure, comparability, conservatism, and going concern).

I do not agree due to principles of conservatism and full disclosure. A conservative accountant will be careful to record any losses and slow to record revenue. Fastow was the opposite. Full disclosure requires footnote discussion of material information which financial statement readers need to know. The needed to know about the potential liabilities from loan guarantees.