S. Olayan School of Business
Acct 210
Midterm II
Summer 2003-2004

Name: [redacted] **Date: July 31, 2004**

Duration: 2 hours

Instructions:

1. This examination paper consists of 7 pages including this page. Please make sure your paper has all pages before commencing to write.

2. Write your name on both the exam and answer booklets. **Write your answers in the answer booklet. You have to hand in both of the exam copy and the answer booklet.**

3. Read the questions carefully and budget your time wisely. Show all calculations.

4. This is a closed book examination. However, silent hand-held calculators are permitted.

5. Kindly make sure to sign and write your ID # next to your name on the attendance sheet when you hand in your paper.

Question	Type	Points	Minutes
1	True or False	10	10
2	Multiple choice	30	40
3	Accounts Receivable	20	25
4	Inventories	20	20
5	Marketable Securities	20	25
	Total	100	120

Good Luck!

TRUE/FALSE

Indicate whether the sentence or statement is true or false.

1. An increase in inventory value above its original cost must be recognized.

True **False**

2. When the *direct write-off method* for dealing with uncollectibles is used, there is no need for an allowance account.

AFDA
A/R

True **False**

3. Inventory is always recorded at cost, no matter what the inventory's market value is.

True **False**

4. The periodic inventory system does not compute ending inventory and cost of goods continuously.

True **False**

5. The average cost method assigns the same cost per unit to cost of goods sold and ending inventory.

True **False**

6. Unrealized gains or losses for trading securities are not reported directly on the income statement.

True **False**

7. Equity securities have a maturity date.

Shares Equity → Div.
Bond Debt → Int

True **False**

8. The unrealized gain on marketable securities-available-for-sale is a temporary account that is closed to retained earnings.

True **False**

9. Investments in marketable securities generally will earn lower returns than could be achieved from putting the cash in a bank account.

True **False**

10. Available-for-sale and Trading securities are both 'marked-to-market'.

True **False**

LIFO more cons when prices ↗
FIFO " " " ↓
↓ income ↓ assets

II. MULTIPLE CHOICE:

1. When a company has been experiencing a sustained period of declining prices, the LIFO cost flow method will result in:
   a. the lowest net income and the lowest cost of ending inventory. prices ↓
   b. the highest net income and the lowest cost of ending inventory.
   c. the highest net income and the highest cost of ending inventory.
   d. the lowest net income and the highest ending inventory.

2. Which of the following statements is true under the perpetual inventory system?
   a. The cost of inventory purchased is debited to the purchases account. x
   b. The cost of goods sold account and inventory account balances are perpetually up-to-date.
   c. End-of-period physical counts are not necessary. x
   d. The balance in the merchandise inventory account is dormant during the year and only changed once a year after the physical inventory is taken.

3. The adjustment to estimate the amount of uncollectibles impacts the following statement(s):
   a. balance sheet only
   b. income statement only Bad Debt Exp I/S
   c. both the balance sheet and income statement
   d. neither the balance sheet or income statement AFDA B/S

4. When using the aging approach, the writing off of a specific account receivable will result in:
   a. an increase in total assets
   b. a decrease in total assets A/R
   c. no change in total assets AFDA
   d. a decrease in stockholders' equity x cr A/R

5. Which of the following would be classified as a contra asset account?
   a. Accounts written off
   b. Bad Debt Expense
   c. Purchases
   d. Allowance for doubtful accounts

6. The main drawback of the *direct write-off method* of accounting for uncollectibles is that it:
   a. takes into account time value of money x
   b. fails to include the bad debt expense in the period in which the sales revenue is recognized
   c. overstates liabilities
   d. fails to record sales revenue in the period the sales revenue is earned

7. The following journal entry represents:
   Bad debts expense XXX
   Allowance for doubtful accounts XXX
   a. recognition of sales on credit x

b. collection of cash from a previous credit sale ✗
c. writing off a bad debt
d. recording bad debt expense in anticipation of not collecting 100 percent of receivables

8. Jay Corporation had net credit sales during the year of $800,000 and cost of goods sold of $500,000. The balance in receivables at the beginning of the year was $100,000 and at the end of the year was $150,000. What was the receivables turnover ratio?
a. 6.4.
b. 8.0.
c. 5.3.
d. 4.0.

$$\frac{800{,}000}{\frac{100{,}000 + 150{,}000}{2}}$$

A/R: 100,000 | 150,000

300,000
~~175,000~~
125,000

9. Net credit sales for the month are $800,000. The accounts receivable balance is $160,000. The allowance is calculated as 7.5% of the receivables balance using the percentage of receivables basis (i.e. the ***aging*** method). If the Allowance for Doubtful Accounts has a credit balance of $5,000 before adjustment, what is the balance after adjustment?

a. $ 12,000.
b. $ 7,000.
c. $ 17,000.
d. $ 31,000.

7.5 X 800,000 = 60,000
160,000 X 7.5% = 12,000

AFDA: 5,000 / 60,000 / 65,000

A/R: 160,000

AFDA: 5,000 / 7,000 / 12,000

10. On January 1, 2001, Auburn Corp. purchased a $10,000 held-to-maturity security. The company was expecting a 6 percent rate of return. The security will mature on December 31, 2002. The original purchase price is $8,899.97.
What will be the value of the security in the books of Auburn on December 31, 2001?
a. $7,558.20
b. $10,000.00
c. $9,433.97
d. $8,899.97

Jan 1 2001 — Dec 31 2001 — Jan 1 2002 — Dec 31 2002

8,899.97 X 1.06

11. An increase in the market value of marketable securities (trading), from $432,000 to $476,000 will result in the following impacts:
a. increase in current ratio, increase in quick ratio, increase in debt to equity ratio
b. increase in current ratio, increase in quick ratio, decrease in debt to equity ratio
c. increase in current ratio, decrease in quick ratio, increase in debt to equity ratio ✗
d. decrease in current ratio, increase in quick ratio, increase in debt to equity ratio ✗

$C = \frac{CA}{CL}$

Quick = $\frac{\text{cash} + \text{M/S} + \text{A/R}}{CL}$

$\frac{\text{Deb}}{\text{Eq}} =$

12. If a firm's assets that can quickly be converted into cash total $200,000 and its quick ratio is 0.4, what must be the total current liabilities of this firm?
a. $500,000
b. $80,000
c. $142,857
d. $200,000

44,000

$\frac{CA}{CL} = 0.4$

$\frac{200{,}000}{CL} = 0.4$

loss on m.se write back

loss on m se shrinkage

13. In the perpetual inventory system a physical count of inventory will *still* be taken a the end of each period:
    a. to determine the amount of bad debts
    b. to determine the amount of purchases
    c. to determine the amount of inventory shrinkage from damage, theft, etc.
    d. to determine the market to book ratio

14. Inventory turnover is calculated as follows:
    a. cost of goods sold/average accounts receivable
    b. average inventory/cost of goods sold x
    c. cost of goods sold/average inventory
    d. cost of goods sold/sales x

15. The following information pertains to the Gill Corporation for 2002:

Net income:	$445,000
Cost of goods sold:	$943,000
January 1, 2002 inventory:	$95,000
December 31, 2002 inventory:	$35,000

$$\frac{943{,}000}{\frac{95{,}000+35{,}000}{2}} = \boxed{14.5}$$
65,000

Based upon the above information, determine the *days inventory held.*
    a. 341 days
    b. 365 days
    c. 0.086 days
    d. 25.16 days

PROBLEM 1: RECEIVABLES

1. Alissa Corporation was established on 1/1/2001. During 2001, the company experienced the following:
   - credit sales $200,000
   - collections on credit sales $120,000
   - write-offs of bad debts: $30,000
   - write-backs of accounts previously written off: $10,000 not collated in cash
   - aging analysis of accounts deemed uncollectible at 12/31/2001 shows $16,000 of potentially uncollectible accounts

Required:

a. Compute the balance of Alissa's accounts receivable on December 31, 2001.

b. Assuming that Alissa uses the aging approach to estimate uncollectible accounts, what is the amount of bad debt expense for 2001?

c. Compute the balance of Alissa's allowance for doubtful accounts (that would appear on the Balance Sheet) on December 31, 2001 .

d. Compute the balance of Alissa's net accounts receivable on December 31, 2001.

e. Assuming that Alissa estimates bad debts using the percentage-of-sales approach, what will be the amount of bad debts expense for 2001 if Alicia assumes that 12 percent of credit sales will become uncollectible? What will be the amount of net accounts receivable on December 31, 2001?

f. Assuming that Alissa estimates bad debts using the direct wrote-off approach, what will be the amount of bad debts expense for 2001? What will be the amount of net accounts receivable on December 31, 2001?

PROBLEM 2: INVENTORIES

Young Company uses the periodic inventory system. Information related to Young Company's inventory at December 31, 2001 is given below:

Jan.	1	Beginning inventory	400 units	@ $10.00 =	$ 4,000
Mar.	8	Purchase	800 units	@ $10.40 =	8,320
Sept.	16	Purchase	600 units	@ $10.80 =	6,480
Dec.	24	Purchase	200 units	@ $11.60 =	2,320
		Total units and cost	2,000 units		$21,120

During the year, the company sold 1,150 units for $13.00 each. Ending Inv. 850

Required:

a. Compute the ending inventory value and cost of goods sold for 2001 under FIFO, LIFO, and average cost flow assumptions.

b. What would be the gross profit and gross profit percentage under the FIFO cost flow assumption?

c. Assume that the company is using the LIFO cost flow assumption and that, at the end of the year, the market value of each unit of inventory is $9.00. Prepare the necessary adjusting entry.

PROBLEM 3: MARKETABLE SECURITIES

3. Zenith Corporation had the following information about its portfolio of marketable securities as of January 31, 2002:

Cost of securities (purchased 2/14/1999)	$200,000
Market value of securities on	
12/31/1999	$240,000
12/31/2000	$160,000
12/31/2001	$18,000

Unfortunately, Zenith's entire portfolio consisted largely of high-profile companies such as Enron, Worldcom, Adelphia Communications and Dynergy. The securities were classified as **available-for-sale securities**. On January 31, 2002, the company decided to salvage any remaining value and sold the entire portfolio for $12,000.

Required:

other comprehensive income

a. Prepare the adjusting entries required on 12/31/1999, 12/31/2000, and 12/31/2001.
b. Prepare the entry to record the sale of the securities on 1/31/2002.
c. What effect did the ownership of the securities have on Zenith's income for each year from **1999 through 2001**?
d. How would the sale of the securities affect Zenith's income statement, balance sheet and cash flow statement for 2002? State the dollar impact and direction of the change (if any).
e. Prepare the adjusting entry required at 12/31/02 assuming there were no further transactions involving Marketable Securities during the year?
f. How would the impact on the **Income Statement** for each year from **1999 through 2002 be different** if the securities had been classified as **trading** securities? Explain.