

Name _____

Section _____

ACCOUNTING 15.511
SUMMER 2004
MIDTERM EXAM

Exam Guidelines:

- You have 80 minutes to complete the exam. Please use your time efficiently and read the questions carefully.
- This exam contains 12 pages, including the cover page. Please make sure your copy is not missing any pages.
- If necessary, make assumptions to solve problems, and state your assumption clearly.

Good luck!

PROBLEM 1 (30 Minutes, 30 Marks)

CW Company engages in the following activities during Year 1:

1. January 1, Year 1: CW issues 10,000 shares of stock at \$20 par-value.
2. January 20, Year 1: CW purchases a building for \$50,000 and purchases equipment for \$20,000. It pays half the price in cash and the other half through a bank loan.
3. March 1, Year 1: CW acquires finished goods for \$20,000. CW pays cash for half of the merchandise, and the remainder is purchased on account.
4. March 30, Year 1: CW pays \$25,000 in employee salaries.
5. July 1, Year 1: CW decides to rent additional building space and pays for six months rent, at \$2000 a month, in advance.
6. August 22, Year 1: CW sells all of the finished goods for \$400,000, of which \$200,000 is on account and the remainder is received in cash. CW expects to collect 95% of its credit sales.

On the sales made on August 22, CW also offers certain services on the sold merchandise for the first three months. CW estimates these services to amount to \$5000.

7. October 30, Year 1: CW collects \$100,000 in cash from its accounts receivable, and uses this money to pay down its accounts payable.
8. November 23, Year 1: CW Company performs services on sold merchandise at cost of \$5000 to date.
9. December 30, Year 1: Depreciation for the year is \$2000 on the building and \$2400 on the equipment.
10. December 30, Year 1: CW pays \$250,000 in dividends.

A. Make entries to record the above transactions. You may use the Balance Sheet Equation or a journal entry.

B. Make necessary adjusting entries on December 31, Year 1.

PROBLEM 2 (5 minutes, 5 marks)

Answer ONE of the following two:

A. Why is conservatism important in accounting?

OR

B. Why is objectivity important in accounting?

PROBLEM 3 (15 minutes, 15 marks)

The following is a comparative balance sheet for a company.

	12/31/03	12/31/02	Difference
<u>Assets:</u>			
Cash	40,500	13,000	27,500
Accounts receivable	27,000	45,750	(18,750)
Inventory	12,000	9,000	3,000
Long-term Investments	0	3,000	(3,000)
Buildings	15,000	29,750	(14,750)
Accumulated depreciation on buildings	(2,000)	(6,000)	4,000
Equipment	40,000	20,000	20,000
Accumulated depreciation on equipment	(2,000)	(4,500)	2,500
Patent	5,000	6,250	(1,250)
Total Assets	102,750	76,000	
<u>Liabilities and Owners' Equity:</u>			
Account payable	9,000	3,000	6,000
Taxes payable	9,000	10,000	(1,000)
Long-term debt	15,000	18,000	(3,000)
Common stock	50,000	40,000	10,000
Retained earnings	20,750	6,000	14,750
Total Liabilities and Equity	102,750	76,000	

For 2003, the company recorded net income of \$25,000.

- A. What effect does the accounts receivable account have on cash flow from operating activities for 2003? (5 Marks)**
- B. What effect does the taxes payable account have on cash flow from operating activities for 2003? (5 Marks)**
- C. Are cash flows from investing activities positive or negative for 2003 and why? Assume no loss or gain has in the disposal of PP&E. (5 Marks) (This is difficult. Attempt to get the direction, positive or negative, by inspecting changes in the appropriate accounts from the balance sheet.)**
- D. [Extra Credit] What is the effect of dividends on cash flows from investing activities? (5 Marks)**

PROBLEM 4 (20 Minutes, 25 Marks) Financial Statement Analysis

For this financial data, please see the Income Statement, Balance Sheet, and Statement of Cash Flows (pp. 53-55) of:

Intel Corporation. "2002 Annual Report." 2003.

Available at: <http://www.intc.com> (accessed July 31, 2004).

Using the information for Intel, answer the following:

A. ROA can be defined as: $ROA = \text{Profit margin} \times \text{Asset Turnover}$

Calculate Intel's ROA, profit margin, and asset turnover for 2001 and 2002. For simplicity, ignore interest income and interest expense in your calculations.

B. What is your inference from the trends in these ratios?

C. For the years 2001 and 2002, calculate one ratio each year that is indicative of Intel's short-term liquidity. Briefly comment on Intel's liquidity.

D. For 2002 calculate the Days Inventory held by Intel. What is the cost and/or risk of holding high inventory for Intel?

PROBLEM 5 (10 minutes, 15 marks)

The press release below was issued by Applied Industrial Technologies (NYSE: AIT) on January 17, 2002.

"Applied Industrial Technologies today reported that financial results for its second quarter ended December 31, 2001 were consistent with the company's guidance provided in a December 11, 2001 news release. The company has taken a charge of \$12,100,000, or \$0.63 per share, for impaired goodwill associated with its fluid power businesses. This non-cash charge is being recognized on the company's statement of consolidated income as the effect of a change in accounting principle related to Goodwill and Other Intangible Assets. This impairment within the fluid power businesses is primarily attributed to the downturn in the industrial economy in the years following the company's acquisitions. Regarding the goodwill impairment charge, Applied Chairman and Chief Executive Officer David L. Pugh commented, 'The charge was dictated by early adoption of a new accounting principle (SFAS 142). This new accounting standard requires goodwill and intangible assets with indefinite useful lives to no longer be amortized but instead be tested for impairment.' "

- Press release courtesy of Applied Industrial Technologies. Used with permission.

- A. What accounts would be affected as you record the goodwill impairment of \$12,100,000? Use the balance sheet equation below or make a journal entry.**

B. What is the impact of the impairment loss on the operating cash flow for the firm?

C. Why do you think managers emphasize that this is a “non-cash” charge?