

Name _____

ID# _____

Accounting 15.501/516

Spring 2004

Midterm 1

Exam Guidelines

1. **Fill in your name above. Exams without names will not be graded. If you do not have an ID number, leave the corresponding space blank.**
2. **This exam has 14 pages including the cover page. Please make sure you have every page.**
3. **You are not allowed to refer to any material in answering this exam.**
4. **The exam has to be completed in 80 minutes. The total number of points is also 80, so you have approximately 1 point / minute. Budget your time accordingly.**
5. **Work in a clear, readable manner. Ample space is provided for every answer**
6. **Show computations for partial credit.**
7. **If you feel assumptions are necessary to answer a question, state all assumptions clearly.**
8. **Laptops and computers are prohibited. You may use calculators.**
9. **Do not fill in the following table.**

Question	Total points	Points received
1: Balance sheet equation	32	
2: Accounts receivables & revenue recognition	16	
3: Inventories	17	
4: Cash flow statement	15	
Total	80	

Question 1

32 points

Wilbur Retailers is a retail grocery store that always sells for cash. The following is a list of transactions and accounting entries for the half-year ended June 30, 2003. Using the Balance-Sheet-Equation Worksheet provided next page, record the dollar effect of every accounting entry. The first row provides you with the beginning balances in every account. Providing ending balances for every column. Assume Wilbur records all adjusting entries at the end of every six months.

1. On Jan 1, 2003 Wilbur Retailers purchases merchandise on account for \$349,000.
2 points
2. On Jan 1, 2003, Wilbur also pays rent for the next twelve months @ \$1,200 per month.
2 points
3. On March 1, Wilbur acquires new cash registers and price-scan equipment during the year for \$15,000. It makes \$8,000 down payment and promises to pay the rest in a bulk amount seven months from now.
3 points
4. On May 1, the company reaches an agreement with a supplier, Fast & Fresh for a long-term supply contract. Under this agreement, the company will source in July its remaining inventory requirements of \$ 357,000 for the rest of the year from Fast & Fresh in return for a 10% discount.
2 points
5. During the first half of 2003, Wilbur makes sales worth \$ 550,000, all in cash.
2 points
6. Wilbur also records warranty expenses on these sales, estimated at 0.5% of total sales.
2 points
7. During the first half of 2003, the company pays warranty costs worth \$1,452.
2 points
8. In May, the company pays its suppliers of inventory \$414,000 in cash. The payments are for earlier purchases on account.
2 points
9. During the first half of 2003, company receives labor services from selling and administrative employees totaling \$ 82,000. The company believes that all these were accrued expenses for the year. The company pays \$80,000 in cash towards salaries.
2 points
10. The company takes stock of its merchandise inventory as of June 30th. The value of this inventory as of June 30th is \$221,000. The company records cost of goods sold.
4 points
11. On June 30, the company recognizes rent expense for the current half-year.
3 points
12. The company estimates and records depreciation expense for the half-year for an amount of \$8,900.
2 points

	Cash	Inventory	Prepaid rent	Buildings & Office equipment	- Accum. Deprecn.**	Accounts payable	Accrued Warranty liability	Salaries payable	Capital stock	Retained earnings
Beg. balance	10,000	200,000	0	163,000	(32,600)	20,000	1,000	1,000	100,000	218,400
1.										
2.										
3.										
4.										
5.										
6.										
7.										
8.										
9.										
10.										
11.										
12.										
13.	42,148	221,000	7,200	178,000	(41,500)	42,000	2,298	3,000	100,000	259,550

**** Accum. Deprecn. = Accumulated Depreciation**

Space for computations

Question 2**16 points**

All figures reported below are in thousands of dollars. You may ignore this in your calculations. Assume that the following is CISCO's gross accounts receivables outstanding at the end of 2003 and 2002.

<u>As of Dec 31</u>	<u>2003</u>	<u>2002</u>
Accounts Receivables, gross	1,351	1,105

On Dec 31, 2003, Cisco estimates that uncollectible amounts are 15% of its total accounts receivables as of that date. At the end of 2002, CISCO had estimated uncollectible amounts to be 10% of its total year-end accounts receivables. The ending balance in Allowance for Doubtful Accounts every year equals the estimated uncollectible amount at the end of the corresponding year.

(a) What is the ending balance in the Allowance for Doubtful Accounts for 2003?

What is the beginning balance?

2 points

(b) What is the bad debt expense that Sears recorded in 2003, assuming no write-offs of accounts receivables? Provide the journal entry to record this bad debt expense.

2+2 points

(c) Assume that during 2003, Cisco identified specific customer defaults worth \$100. What is the journal entry to record these defaults? What is the new bad debt expense for 2003? *2+2 points*

(d) Assume credit sales during the year amount to \$1,556. Using the information in part (c), what is Cisco's cash collection on credit sales? *4 points*

(e) CISCO offers delivery service on some big orders. Assume customers phone in their orders and Cisco bills them immediately upon order receipt. However, customers are required to pay only when delivery is complete. If Cisco were to use the bill-and-hold practice, when would Cisco recognize income from such sales? Can you think of a recent SEC guideline that would prevent Cisco from using bill-and-hold? What would this guideline stipulate as the correct time to recognize income?

1+0.5+0.5 points

Question 3**17 points**

Qmart is a retail merchandiser. In 2003, Qmart reports LIFO cost of goods sold (COGS) for \$29,861. Qmart faces (and has always faced) a corporate tax rate of 40%. On analyzing Qmart's financial statements for 2001, you find the following footnote:

"...Inventories are stated at lower of cost or market. The last-in-first-out method is used to determine the value of inventories. Inventories reported for 2003 and 2002 using LIFO were respectively 5,537 and \$6,104. If inventories had been valued using FIFO, they would have been higher by \$ 371 and \$ 267 respectively. In 2003, Qmart liquidated LIFO layers. As a result of this liquidation, net income after taxes in 2003 is higher by \$ 24....." All values are in thousands of dollars. You may ignore this for your calculations.

Please make the following (simplifying) assumptions:

Qmart has never written down inventory, that is, market value of inventory has always been above LIFO cost. All of Qmart's sales and purchases during the year are in cash. COGS includes only costs paid for inventory sold. Qmart liquidated LIFO layers for the first time in 2003. The retained earnings of Qmart at the end of 2003 was \$75,000.

(a) If Kmart switched to reporting under FIFO in 2003, how would net income after taxes change? What is the value of new purchases under FIFO? *3+3 points*

(b) If Qmart had not liquidated LIFO inventories during the year 2003, but sold the same volume of goods, what would its tax savings be? *3 points*

(c) What is the cumulative tax savings to Kmart *over its life till date* from using LIFO and not FIFO? *4 points*

(d) Assume Qmart follows an alternate accounting method for reporting expenses. Instead of reporting LIFO cost of goods sold, Qmart just reports new purchases during the year as expenses for that year. How would Qmart's retained earnings reported at the end of 2003 be different if it had been using this new method of reporting expenses since its inception? Assume all other accounting policies remain the same. *4 points*

Question 4**15 points**

Provided below are Intel's balance sheet for 2003 and 2002, as well as the income statement for 2001. Use these to answer questions (a) through (b).

Balance sheet information

As on Dec 27	2003	2001
Cash & cash equivalents	7,971	7,404
Short-term investments	5,568	3,382
Accounts receivables, net	2,960	2,574
Inventories	2,519	2,276
Other operating current assets	3,864	3,289
Total current assets	22,882	18,925
PP&E, net	16,661	17,847
Long-term investments in securities	514	56
Goodwill	3,705	4,330
Other long-term assets	3,381	3,066
Total long-term assets	24,261	25,299
Total assets	47,143	44,224
Short-term debt	224	436
Accounts payable	1,660	1,543
Other operating current liabilities	4,995	4,616
Total current liabilities	6,879	6,595
Long-term debt	936	929
Other long-term liabilities	1,482	1,232
Capital stock	6,830	7,621
Retained earnings	31,016	27,847
Total stockholders equity	37,846	35,468
Total liabilities and stockholders equity	47,143	44,224

Income statement

For the year ended Dec 27	2003
Net revenue	30,141
Cost of sales	13,047
Gross margin	17,094
Operating expenses	7,915
Other non-cash expenses	1,545
Interest expenses	192
Income before taxes	7,442
Income taxes	1,801
Net income	5,641

Space for computations

(a) Assume “short-term investments” is a current asset that results from investing activities (as opposed to operating activities). Similarly, “short-term debt” is a current liability that results from financing activities. “Cost of sales” and “Operating expenses” on the income statement include depreciation expense of \$4,651. “Other non-cash expenses” refers to non-cash (or accrued) expenses reported by Intel that have no effect on operating current assets and operating current liabilities. Please calculate operating cash flows and operating accruals. For partial credit, show step-by-step calculations following the format for an indirect cash flow statement you would see in an annual report.

9 points

(b) Assume dividends are paid in cash when declared. What is the value of cash outflow on dividends? If this is the only financing cash flow, what is cash outflow/inflow on investments?

6 points