Chapter 5: Users of financial statements, fraud triangle, Sarbanes-Oxley Act, financial statements, debt-to-assets ratio, asset turnover ratio, net profit margin ratio

1) A cross-sectional analysis is prepared to show:
   a. how a company compares to a competitor
   b. trends in a single company over a period of time
   c. how one industry compares to another industry
   d. how new product development costs relate to cash dividends paid to shareholders

2) What is the annual, audited report filed with the SEC by publicly traded companies?

3) Complete the fraud triangle diagram, including a brief description of each element.

4) In terms of one of the qualitative characteristics of accounting information, why is the convergence of international and US accounting standards important?

5) Longhorn Laugh Factory’s auditor took a look at the company’s financial statements, and subsequently issued a qualified audit opinion. What does this mean?

6) Longhorn Laugh Factory is a publicly traded company which has a September 30 fiscal year end. The company’s old auditor, Herky, retired last year, so the company’s audit committee hired Cy as their new auditor. Cy is usually busy watching football during the fall, so the company decided to move its fiscal year end to June 30 in order to accommodate Cy’s schedule.

Does Longhorn Laugh Factory need to report these events to the SEC? If so, what form would Longhorn use?
7) Key financial metrics for Campanile Creations, Inc. are listed below.

2009
- Total assets: $1,250,000
- Total stockholders equity: $330,000
- Sales revenue: $600,000
- Net income: $425,000

2010
- Total assets: $1,425,000
- Total liabilities: $825,000
- Total stockholders equity: $600,000
- Sales revenue: $665,000
- Net income: $375,000

Calculate the debt-to-assets ratio for 2010.

\[
\frac{\text{Total Liabilities}}{\text{Total Assets}} = \frac{+825,000}{+1,425,000} = 0.58 \approx 58\%
\]

Calculate the asset turnover ratio for 2010.

\[
\frac{\text{Sales Revenue}}{\text{Average Total Assets}} = \frac{+665,000}{(\frac{+1,250,000}{2} + \frac{+1,425,000}{2})} = 0.497
\]

Calculate the net profit margin ratio for 2010.

\[
\frac{\text{Net Income}}{\text{Sales Revenue}} = \frac{+375,000}{+665,000} = 0.565 \approx 57\%
\]
1) Which of the following statements regarding inventory systems is not correct?
   a) Periodic systems require that inventory be physically counted at the end of the period.
   b) Bar codes and optical scanners are used extensively in a periodic inventory system.
   c) Perpetual systems update accounting records every time an item is bought, sold, or returned.
   d) Perpetual inventory systems allow managers to continually estimate shrinkage.

2) How can groups of employees intentionally circumvent internal controls? What is the name given to this practice?

3) What does the gross profit percentage indicate?
   a. How well management is controlling operating expenses
   b. How much above cost a company sells its products
   c. How much cash is generated per dollar of sales
   d. How efficient management is in utilizing fixed assets

4) Campanile Creations sells merchandise to its customers for $1,000, at a cost to the company of $500 per unit. When customers purchase merchandise on account, the invoice terms are 2/10, n/30. The company entered into the following transactions during the year ended December 31, 2010:
   a. Sold merchandise for cash, $19,000.
   b. Sold merchandise to Maple Co.; invoice price, $8,000.
   c. Sold merchandise to Willow, Inc.; invoice price, $5,000.
   d. Two days after the sale, accepted a return of two items from Maple Co., which received a credit on its account.
   e. Sold merchandise to Larch, Ltd.; invoice price, $4,000.
   f. Received full payment from Maple Co. on account nine days after the invoice date.
   g. Received full payment from Larch, Ltd. twelve days after the invoice date.
   h. Ten days after receiving payment from Maple Co., accepted a return of two additional units (because the units ultimately were determined to be defective) and issued a cash refund.

Complete the following table by indicating the effect of each of the transactions listed above. Then, calculate the amount of Net Sales that would have been reported on the income statement for the year ended December 31, 2010.

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Sales Revenue</th>
<th>Sales Discounts</th>
<th>Sales Returns and Allowances</th>
</tr>
</thead>
<tbody>
<tr>
<td>a</td>
<td>$19,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>b</td>
<td>$8,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>c</td>
<td>$5,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>d</td>
<td>$4,000</td>
<td></td>
<td>$2,000</td>
</tr>
<tr>
<td>e</td>
<td>$4,000</td>
<td>$120</td>
<td></td>
</tr>
<tr>
<td>f</td>
<td>$1,190</td>
<td></td>
<td></td>
</tr>
<tr>
<td>g</td>
<td>$1,190</td>
<td></td>
<td></td>
</tr>
<tr>
<td>h</td>
<td>(40)</td>
<td></td>
<td>$2,000</td>
</tr>
<tr>
<td>Totals</td>
<td>$31,920</td>
<td>$4,000</td>
<td>$4,000</td>
</tr>
</tbody>
</table>

Net Sales = $31,920
5) The following information pertains to Helser Home Supplies, Inc.

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 1</td>
<td>Beginning inventory is comprised of 5 units at $20 each</td>
</tr>
<tr>
<td>April 13</td>
<td>Purchased 22 units at $33 each.</td>
</tr>
<tr>
<td>August 31</td>
<td>Purchased 17 units at $25 each</td>
</tr>
<tr>
<td>December 28</td>
<td>Sold 33 units</td>
</tr>
</tbody>
</table>

What is the amount in dollars of cost of goods available for sale?

\[ 41251 \]

6) Cyclone Chocolates is a local chocolate shop that also has a website on which it sells its chocolate. The 2010 annual report for Cyclone Chocolates contained the following phrase: “Our e-commerce operation records revenue upon the estimated customer receipt date of the merchandise.”

Does Cyclone Chocolates ship goods FOB shipping point or FOB destination? Does the shop or the customer pay for shipping?

**FOB destination; shop pays for shipping**

7) Cyclone Company's bank statement had an ending balance of $10,300 on September 30, 2011. The company’s general ledger showed a balance of $24,000 in its Cash account on that date. During the reconciliation process, the following information was noted:

- A comparison of checks written before and during September with the paid checks included with the bank statement showed outstanding checks at the end of September of $33,600.
- A comparison of deposits made with those listed on the bank statement showed that deposits of $33,295 were in transit on September 30. The comparison also revealed an error made in recording a deposit of a check received from a customer on account. The $1,500 deposit was correctly listed on the bank statement, but was recorded on the company’s books at $5,100.
- A monthly service charge of $40 and interest of $135 were listed on the statement.
- A credit memo in the amount of $4,400 for an electronic funds transfer from a customer appeared on the bank statement.
- A customer check in the amount of $14,900 was returned to the company in the September bank statement; the check had been stamped NSF.

Which items should be added to the bank balance?

\[ \text{Balance per bank} - 43,100 + 33,295 = 36,000 \]

Which items should be added to the balance per books?

\[ \text{Balance per books} - 33,100 + 135 - 14,900 - 40 + 4,400 = 19,995 \]

What is the reconciled cash balance?

\[ 19,995 \]

8) On March 1, 2011, your company sold $4,000 of merchandise to a customer on account with terms of 3/10, n/30. On March 5, the customer returned $400 of the merchandise for credit because it was defective. If the customer pays the account in full on April 8, how much should the customer pay?

\[ 4,000 - 400 = 3,600 \]

\[ 3,600 \times 0.97 = 3,492 \]
Chapter 7: inventory types, COGS, specific identification, FIFO, LIFO, weighted average cost, lower of cost or market, purchases, inventory turnover ratio, days to sell

1) Which of the following statements regarding inventory costing methods is not correct?
   a. When unit costs are rising, FIFO provides the highest cost of goods sold.
   b. When unit costs are rising, FIFO provides the highest net income.
   c. When unit costs are falling, LIFO provides the highest ending inventory.
   d. When unit costs are rising, FIFO provides the highest gross profit.

2) On February 1, 2011, the balance in the inventory account was $150,000. During the month, additional inventory was purchased for $450,000. For February, sales revenue was $550,000 and gross profit was $200,000. How much was ending inventory on February 28th?

3) Friley Company has 2,000 units on hand at the end of the accounting period. The units have a cost of $85 each. Due to obsolescence, the replacement price of these units has fallen to $75 per unit. What amount will be used in the entry to write-down the inventory?
   a. $20,000
   b. $150,000
   c. $170,000
   d. GAAP does not allow inventory write-downs because doing so would violate the historical cost principle.

4) Which of the following statements regarding inventory turnover is not correct?
   a. The days to sell ratio provides the same information as the inventory turnover ratio, but in an easier to understand format.
   b. A higher turnover inventory ratio could lead to investment income because funds will be freed up for other purposes.
   c. A sudden decline in the inventory turnover ratio indicates that sales have improved and the product line is being properly marketed.
   d. More efficient purchasing and production will cause the inventory turnover ratio to be higher.

4) Maple Company uses FIFO to value its inventory. At the end of the year, the following information is available regarding the four items the company sells.

<table>
<thead>
<tr>
<th>Item</th>
<th>Quantity on hand</th>
<th>FIFO cost</th>
<th>Replacement Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>53</td>
<td>$11.00</td>
<td>$9.35</td>
</tr>
<tr>
<td>B</td>
<td>18</td>
<td>$12.00</td>
<td>$13.80</td>
</tr>
<tr>
<td>C</td>
<td>95</td>
<td>$7.00</td>
<td>$8.05</td>
</tr>
<tr>
<td>D</td>
<td>140</td>
<td>$14.00</td>
<td>$12.95</td>
</tr>
</tbody>
</table>

If the company applies the lower of cost or market rule, what amount should it report on its balance sheet for inventory?

43,189.55

5) On March 31, your company has the following information related to inventory:
   - Cost of inventory on hand, $49,000
   - Cost of inventory out on consignment, $1,500
   - Cost of inventory shipped to a customer on March 29, FOB Destination, $3,200. The customer will receive the merchandise on April 2.
   - Cost of inventory shipped to your company by a supplier on March 30, FOB Shipping point, $2,500. Your company receive the merchandise on April 4.

How much should your company report for inventory on its March 31 balance sheet?

454,200
6) Martin Company orders and sells chocolate by the pound. On February 1, the company had 630 pounds of chocolate on hand which was purchased at $1.00 per pound. The company made a number of purchases of chocolate during the month of February, which are detailed in the table below. During the month, the company sold 3,400 pounds of chocolate at $1.55 per pound.

<table>
<thead>
<tr>
<th>Date of Purchase</th>
<th>Pounds</th>
<th>Cost Per Pound</th>
<th>Total Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>February 5</td>
<td>1,000</td>
<td>$1.15</td>
<td>$1,150</td>
</tr>
<tr>
<td>February 9</td>
<td>1,200</td>
<td>$1.20</td>
<td>$1,440</td>
</tr>
<tr>
<td>February 20</td>
<td>1,200</td>
<td>$1.18</td>
<td>$1,416</td>
</tr>
<tr>
<td>February 28</td>
<td>1,300</td>
<td>$1.25</td>
<td>$1,625</td>
</tr>
</tbody>
</table>

**Part A:** Compute the number of pounds of chocolate on hand at February 28th and the cost of goods available for sale for the month of February.

\[ \text{Cost of Goods Available} = 630 \times 1 + 1,150 + 1,440 + 1,416 + 1,625 = 6,321 \]

**Part B:** Assume that the company uses FIFO. Compute its ending inventory on February 28th, the cost of goods sold during February, and the company's gross profit during February.

\[ \text{Cost of Goods Sold} = 630 \times 1 + 1,150 + 1,440 + 1,416 = 6,321 \]

\[ \text{Gross Profit} = 45,127 - 6,321 = 38,806 \]

**Part C:** Assume that the company uses LIFO. Compute its ending inventory on February 28th, the cost of goods sold during February, and the company's gross profit during February.

\[ \text{Cost of Goods Sold} = 1,300 \times 1.25 + 300 \times 1.20 + 1,000 \times 1.15 = 4,380 \]

\[ \text{Gross Profit} = 45,127 - 4,380 = 40,747 \]

**Part D:** Assume that the company uses the weighted average inventory method. Compute its ending inventory on February 28th, the cost of goods sold during February, and the company's gross profit during February.

\[ \text{Cost of Goods Sold} = \left( \frac{630 \times 1}{3,400} \right) + \left( 1,000 \times 1.15 \right) + \left( 1,200 \times 1.20 \right) + \left( 1,200 \times 1.18 \right) + \left( 1,300 \times 1.25 \right) \]

\[ = 4,171 \]

\[ \text{Gross Profit} = 45,127 - 4,171 = 40,956 \]
Chapter 8: Accounts receivable, percentage of credit sales method, aging of AR method, notes receivable, interest revenue, receivables turnover ratio, days to collect

1) Which of the following terms correctly describes when a company sells its right to collect accounts receivable to a third party?
   a. Channeling
   b. Factoring
   c. Out-selling
   d. Outsourcing
   e. Collecting

2) A note receivable is received on August 1 that is due in 8 months. When calculating the interest accrual on December 31 for this note, the fraction that should be used for the time portion of the calculation is:
   a. 4/8 (or 1/2)
   b. 5/8
   c. 5/12
   d. 8/12
   e. 4/12

3) Rowe Company allows its credit customers to sign notes receivable to settle outstanding credit accounts. Rowe's accountant is a CPA who is busy with tax season, so the company's CFO has asked for your help in analyzing its notes receivable account. Your job is the fill in the missing information in the table below for each independent note.

<table>
<thead>
<tr>
<th>Note</th>
<th>Principal Amount on Note Receivable</th>
<th>Annual Interest Rate</th>
<th>Time Period</th>
<th>Interest Earned</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>$29,000</td>
<td>12%</td>
<td>9 months</td>
<td>$2,010</td>
</tr>
<tr>
<td>B</td>
<td>$75,000</td>
<td>10%</td>
<td>3 months</td>
<td>$1,825</td>
</tr>
<tr>
<td>C</td>
<td>200,000</td>
<td>8%</td>
<td>12 months</td>
<td>16,000</td>
</tr>
<tr>
<td>D</td>
<td>81,000</td>
<td>11%</td>
<td>8 months</td>
<td>5,940</td>
</tr>
</tbody>
</table>

4) On March 6, 2011, one of Pearson Company's customers who owes $3,000 declares bankruptcy. When the customer's account is written off,
   a. income before taxes will decrease by $3,000.
   b. net accounts receivable will decrease by $3,000.
   c. bad debt expense will increase by $3,000.
   d. there will be no effect on income or net accounts receivable.

5) On December 31, 2010, O'Bryan Corporation's total accounts receivable were $800,000. An aging of receivables is as follows:

<table>
<thead>
<tr>
<th>Amount owed</th>
<th>&lt; 30 days old</th>
<th>31-60 days old</th>
<th>61-90 days old</th>
<th>&gt;90 days old</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimated loss rate</td>
<td>1%</td>
<td>3%</td>
<td>10%</td>
<td>30%</td>
</tr>
</tbody>
</table>

If the balance in Allowance for Doubtful Accounts before adjustment is a credit of $11,750, how much is bad debt expense for 2010?
6) On January 1, 2010 the balance in Meeker Company’s Allowance for Doubtful Accounts was $33,000. During the year, $22,000 of accounts were written off as uncollectible. No accounts previously written off were recovered during the year. If the adjusted balance in the Allowance account on December 31, 2010 was $31,000, how much was Meeker’s bad debt expense for 2010?

4) The financial information below was summarized from the most recent income statements and balance sheets of Sadler Company.

<table>
<thead>
<tr>
<th>Part</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>For the year ended</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total revenues</td>
<td>$201,724,000</td>
<td>$262,498,000</td>
<td>$273,472,000</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>41,534,000</td>
<td>38,058,000</td>
<td>29,881,000</td>
</tr>
<tr>
<td>Net Income</td>
<td>89,950,000</td>
<td>124,768,000</td>
<td>141,722,000</td>
</tr>
<tr>
<td>As of the end of the year</td>
<td>1,178,000</td>
<td>2,152,000</td>
<td>5,581,000</td>
</tr>
<tr>
<td>Accounts receivable, net of allowance</td>
<td>732,066,000</td>
<td>1,002,056,000</td>
<td>1,275,037,000</td>
</tr>
</tbody>
</table>

**Part A:** Determine the company’s receivable turnover during 2009 and 2010.
(Hint: Since Sadler did not report net credit sales, you will need to use total revenues to calculate this ratio.)

\[
\text{Turnover} = \frac{\text{Total revenues}}{\text{Average Accounts Receivable}}
\]

For 2009:
\[
\text{Turnover} = \frac{201,724,000}{\frac{(1,178,000 + 2,152,000)}{2}} = 157.44
\]

For 2010:
\[
\text{Turnover} = \frac{273,472,000}{\frac{(2,152,000 + 5,581,000)}{2}} = 70.73
\]

**Part B:** Determine the days to collect during 2009 and 2010.

\[
\text{Days to Collect} = \frac{\text{Average Accounts Receivable}}{\text{Total Credit Sales}}
\]

For 2009:
\[
\text{Days to Collect} = \frac{1,178,000}{201,724,000} = 2.32
\]

For 2010:
\[
\text{Days to Collect} = \frac{2,152,000}{273,472,000} = 7.84
\]

7) On April 1, 2010, your company loaned $15,000 to an employee who signed an 18 month, 6% note, with the principal and interest to be paid on October 1, 2011. The adjusting entry on December 31, 2010, at the end of the company’s fiscal year should record how much interest receivable?

8) Pennell Corporation began the year with a debit balance of $4,800 in Accounts Receivable and a credit balance of $546 in its Allowance for Doubtful Accounts. Pennell’s sales were all on credit and amounted to $41,800 during the year ended December 31, 2010. Collections from customers amounted to $40,600 and the company wrote off customer account balances totaling $500 during the year. Pennell uses the percentage of credit sales method for determining its bad debt expense. Historically, bad debts have approximated 3% of credit sales.

Prepare the related adjusting entry and determine the ending balance in the Allowance for Doubtful Accounts.
Chapter 9: tangible/intangible assets, acquisition cost, depreciation, straight-line method, units-of-production method, double-declining-balance method, impairment, fixed asset turnover ratio

1) On January 1, 2011, Cessna Industries bought a parcel of land for use in its operations by paying the seller $100,000 in cash and signing a five year, 12% note payable in the amount of $400,000. In connection with the purchase of the land, Cessna incurred legal fees of $19,000, a real estate agent sales commission of $25,000, surveying fees of $1,000, and an appraisal fee of $5,000.

Compute the total acquisition cost of the parcel of land.

\[
\text{Total Acquisition Cost} = \text{Cash Payment} + \text{Note Payable} + \text{Legal Fees} + \text{Commission} + \text{Surveying Fees} + \text{Appraisal Fee}
\]

\[
\text{Total Acquisition Cost} = 100,000 + 400,000 + 19,000 + 25,000 + 1,000 + 5,000 = 555,000
\]

2) On January 1, 2011, Shilling Corporation purchased new equipment for $60,000. The equipment has a useful life of 8 years and an estimated residual value of $12,000. If your company uses the straight line method of depreciation, how much is depreciation expense for 2011?

\[
\text{Depreciation Expense} = \frac{\text{Cost} - \text{Residual Value}}{\text{Useful Life}}
\]

\[
\text{Depreciation Expense} = \frac{60,000 - 12,000}{8} = 4,800
\]

3) Which of the following is not an intangible asset?
   a. Goodwill
   b. Patents
   c. Research and development costs
   d. Copyrights

4) What fixed asset is never depreciated?

5) The book value of a fixed asset is:
   a. The acquisition cost of the asset minus accumulated depreciation
   b. The same as its current market value
   c. The same as its current replacement cost
   d. The acquisition cost of the asset minus its residual value

6) On April 1, 2011, your company sold a company car for $6,000. The car originally cost $28,000 and had accumulated $19,000 of depreciation as of the sale date. How much gain or loss should your company record?

\[
\text{Gain or Loss} = \text{Sale Price} - \text{Book Value}
\]

\[
\text{Gain or Loss} = 6,000 - \left( \frac{28,000 - 19,000}{2} \right) = 6,000 - 4,500 = 1,500 \text{ loss}
\]

7) Which of the following best describes depreciation?
   a. A method used by accountants to hide the true cost of expensive fixed assets
   b. A process used to match the cost of long-term tangible assets with the revenue they generate for the company
   c. A method used by management to put aside cash for future replacement of fixed assets
   d. A process companies use to adjust the cost of fixed assets to their current market value
8) On January 1, 2011, Friant Company purchased a piece of machinery for use in operations. The total acquisition cost was $50,000. The machine has an estimated useful life of five years and a residual value of $5,500. The machine is expected to produce a total of 500,000 units, with 89,000 of those units being produced in 2011.

Using the units of production method, calculate depreciation expense and year-end book value for 2011.

\[
\text{Depr. Exp.} = \left( \frac{450,000 - 5,500}{500,000} \right) \times \frac{89,000}{500,000} = 7,921
\]

\[
\text{Book value} = 450,000 - 7,921 = 442,079
\]

9) On January 1, 2011, Forbes, Inc. purchased machinery for $150,000. The machine has an estimated useful life of three years and a residual value of $17,000.


\[
2011 \quad (4150,000 - 8) \times \frac{2}{3} = 4100,000 \quad \text{Depr. Exp.}
\]

\[
4150,000 - 100,000 = 450,000 \quad \text{Book value}
\]

\[
2012 \quad (4150,000 - 100,000) \times \frac{2}{3} = 433,333 \quad \text{Depr. Exp.}
\]

\[
4150,000 - 100,000 - 433,333 = 414,667 \quad \text{Book value}
\]

\[
2013 \quad (4150,000 - 133,333) \times \frac{2}{3} = 411,111 \quad \text{Depr. Exp.}
\]

\[
4150,000 - 100,000 - 133,333 - 11,111 = 45,555 \quad \text{Book value}
\]