EMBA Financial Accounting
Test II
December 9, 1995

Open Book
Time Allowed 3 hours

I have neither given nor received aid on this test.

__________________________
Signature

Questions and parts of questions count 4 points each, except where marked, and for 19
where each part counts 3 points.
1. Assuming no beginning inventory, what can be said about the trend of inventory prices if cost of goods sold computed when inventory is valued using the FIFO method exceeds cost of goods sold when inventory is valued using the LIFO method?

   a. Prices decreased.
   b. Prices remained unchanged.
   c. Prices increased.
   d. Price trend cannot be determined from information given.

2. Jones & Keith, Inc. report the following details in their inventory account.

   Beginning inventory, 1/1/94  400  $2.20  $880
   Purchase, 2/1/94    1,000   2.36  2,360
   Sales, 2/15/94     1,300
   Purchase, 3/1/94    1,500   2.40  3,600
   Sales, 3/14/94     1,000
   Closing inventory, 3/31/94  600

   What is the cost of goods sold for the first quarter of 1994, assuming LIFO perpetual?
3. Using the facts in the previous question, what would the closing inventory be valued at, assuming they company uses FIFO periodic.

4. A company purchased land to be used as the site for the construction of a plant. Timber was cut from the building site so that construction of the plant could begin. The proceeds from the sale of the timber should be

   a. Classified as other income.
   b. Netted against the costs to clear the land and expensed as incurred.
   c. Deducted from the cost of the plant.
   d. Deducted from the cost of the land.

5. Legal fees incurred in successfully defending a patent should be capitalized when the patent has been

<table>
<thead>
<tr>
<th>Internally Developed</th>
<th>Purchased from an Inventor</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>b. Yes</td>
<td>No</td>
</tr>
<tr>
<td>c. No</td>
<td>Yes</td>
</tr>
<tr>
<td>d. No</td>
<td>No</td>
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</tbody>
</table>
6. Office equipment recorded under a capital lease containing a bargain purchase option should be amortized (=depreciated)

a. Over the period of the lease using the interest method of amortization
b. Over the period of the lease using the straight-line method of amortization.
c. In a manner consistent with the lessee’s normal depreciation policy for owned assets.
d. In a manner consistent with the lessee’s normal depreciation policy for owned assets except that the period of amortization should be the lease term.

7. Barrett & Murdock purchase equipment for $60,000. They estimate the expected life to be 5 years, and the residual value to be $10,000. The depreciation expense for the second year assuming double-declining balance is:

a. 10,000
b. 20,000
c. 12,000
d. 24,000
e. 14,400

8. A purchased patent has a remaining legal life of 15 years. It should be:

a. Expensed in the year of acquisition
b. Amortized over 15 years regardless of its useful life.
c. Amortized over its useful life if less than 15 years.
d. Amortized over 40 years.
9. A machine with an original estimated useful life of ten years was moved to another location in the factory after it had been in service for three years. The efficiency of the machine is increased for its remaining useful life. The reinstallation costs should be capitalized if the remaining useful life of the machine is

<table>
<thead>
<tr>
<th></th>
<th>Five years</th>
<th>Ten years</th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>b.</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>c.</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>d.</td>
<td>Yes</td>
<td>Yes</td>
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</tbody>
</table>

10. Navarre & Peccarelli Enterprises is a steady-state company with annual income of $1.5 million. Depreciation is a steady $250,000 a year. Currently there is no inflation in the economy. Given these facts, what is (justify your answers):

a. Navarre & Peccarelli’s operating cash flow?

b. Navarre & Peccarelli’s free cash flow, i.e., the cash available for investors after all internal cash needs are taken care?
11. Which of the following costs of goodwill should be capitalized and amortized?

<table>
<thead>
<tr>
<th>Developing Goodwill</th>
<th>Restoring Goodwill</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>b. Yes</td>
<td>No</td>
</tr>
<tr>
<td>c. No</td>
<td>No</td>
</tr>
<tr>
<td>d. No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

12. Hawes & Haney have a customer who was injured by one of their products. The customer asked for $500,000 damages. Based on discussions with the customer’s attorneys, the company’s attorney believed that the suit probably could be settled for $25,000. There was no guarantee of this, of course. On the other hand, if the suit went to trial Hawes & Haney might win. The company’s lawyer believed that it was unlikely that the $500,000 would be awarded, but felt that an award of $100,000 was not unreasonable to expect at a trial.

a. What amount, if any, would you enter as a liability? [3]

b. What amount(s), if any, would you report in the footnotes? [3]
13. Byrd & Cooper lease a truck for $14,000 per year for five years. The truck has a useful life of six years and will revert to the lessor after the five years. The market rate is 8 percent.

a. What will the lease payable be? [3]

b. What will the interest expense in the second year on the lease be? [3]
14. Lease Y contains a bargain purchase option and the lease term is equal to 75 percent of the estimated economic life of the leased property. Lease Z contains a bargain purchase option and the lease term is equal to less than 75 percent of the estimated economic life of the leased property. How should the lessee classify these leases?

<table>
<thead>
<tr>
<th>Lease Y</th>
<th>Lease Z</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Operating lease</td>
<td>Operating Lease</td>
</tr>
<tr>
<td>b. Operating lease</td>
<td>Capital lease</td>
</tr>
<tr>
<td>c. Capital lease</td>
<td>Capital lease</td>
</tr>
<tr>
<td>d. Capital lease</td>
<td>Operating lease</td>
</tr>
</tbody>
</table>

15. On January 1, 1994 Hester & Highenboten Hospital Supplies issued a $400,000, 12 percent payable semiannually, 10 year bond at a discount of $42,384 when the effective interest rate was 14 percent payable semiannually. Compute the bonds’ book value at the end of the first year.
16. On January 1, King & Lazaroni issue $100,000 of 10-year, 6 percent debentures payable semiannually. These bonds were sold to yield 8% semiannually. For how much did these bonds sell?

a. $ 86,401  
b. $ 91,542  
c. $100,000  
d. $127,172  
e. Other -- state your price!

17. Wiegand & Williams Inc. plan to pay a stock dividend of $100,000. Income that year is $200,000. Capital stands at one million dollars. Retained earnings are another one million dollars. There is no debt in the firm.

a. What is the return on equity before the stock dividend? [2]

b. What will the capital account stand at after the stock dividend? [2]

c. What will the return on equity be after the stock dividend? [2]
18. McCormack & Koyzis Syndicates issue $1,000,000 of 5% preferred stock. Net income is currently standing at $100,000. What is the EPS after the preferred stock issue?

19. Pages 425-6 of your text provides you with the Kellogg Company’s balance sheets and income statement. Using these numbers, what is:

a. Their receipts from sales to customers?

b. What payments did they make to the IRS?

c. What is their inventory turnover in 19X1, using year-end figures?

d. What is their return on equity in 19X1, using year-end figures.
e. What are their days receivable in 19x1, using year-end figures.

f. What was their depreciation expense?
ACCOUNTING
December 9, 1995

1.

2.

3.

4.

5.

6.

7.

8.

9.

10A. 10B.

11.

12A. 12B.

13A. 13B.

14

15.

16.

17A. 17B. 17C.

18.

19A 19B 19C

19D 19E 19F