B6013 ACCOUNTING I

Course Description:

The purpose of the financial accounting core course is to provide a comprehensive, graduate level introduction to financial accounting. It is designed to provide future users of accounting information (e.g., investors, analysts, creditors, and managers) with the foundations of accounting concepts, mechanics, and a perspective upon which intelligent use of accounting information rests. The course focuses on typical financial statements (balance sheet, income statement, and cash flow statement) along with the environment in which they are produced and used. The perspective emphasized is that accounting reports provide information useful for a variety of purposes.

Type and Length of Exam:

Closed book (no notes allowed). 4 hours. Calculators are permitted and recommended.

Specific Topics Covered:

Accounting procedures, the Balance Sheet, the Income Statement, the Statement of Cash Flows, Revenue Recognition, Long-lived Assets, Current Assets, Inventories, Conventional Liabilities (e.g., bonds), Less Conventional Liabilities (e.g., leases and pensions), Tax Recognition, Owners= Equity, Long-term Investments in Corporate Securities, and Issues in International Accounting (e.g., foreign currency translation and inflation accounting).

Recommended Reading for Review:

Any graduate level introductory financial accounting text, such as:

Stickney & Weil, Financial AccountingBAn Introduction to Concepts, Methods, and Uses

Sample Exam:

See attached.
Note: the web address for the 1997 Sears annual report is
http://www.sears.com/company/annrep97/indexa.htm

COLUMBIA BUSINESS SCHOOL

B6013 ACCOUNTING I

SAMPLE EXEMPTION EXAMINATION

Time: 4 hours

Questions answered:	1	2	everyone answers these two.		
Circle four:	3	4	5	6	7

INSTRUCTIONS:

1. This exam is closed book.
2. A calculator is recommended. Computers are not permitted.
3. This exam consists of seven questions. You must answer Questions 1 and 2. You must choose four questions out of the remaining five. Please circle the numbers of the questions you answer. There will be no extra credit for answering more than four questions. If you answer more than four questions, we will only grade the first four questions answered. The assigned weights are as follows:

   Question 1: 40%
   Question 2: 20%
   Question 3-7: 10% each
4. You will need a copy of Sears= 1997 Financial Statements to complete the exam.
5. To facilitate partial credit, show all supporting calculations. Make sure your answers are legible.

<u>Question 1 (40%)</u> - You must answer this question

You were given the 1997 Annual Report of *Sears*. The following questions relate to this report (specifically, to the Financial Statements and the Accompanying Notes). Note the financial statements are included in the Management Discussion and Analysis portion of the report.

<u>Part I</u>: Warm-up and General

a. What was Sears' *Income from Continuing Activities* in 1997?

b. What was Sears' *Total Shareholders' Equity* on 1997 Balance Sheet? Does it represent a *stock* (provide the date) or a *flow* (provide the time interval)?

c. Did Sears generate more *Net Income* or *Cash from Operating Activities*? What was the difference?

d. What was the percentage change in *Total Liabilities* during 1997? What was the percentage change in *Total Shareholders' Equity* during 1997?

e. Based only on your answer to part **d** above, give a range estimate for the percentage change in *Total Assets* during 1997. Explain your answer and use the Financial Statements to verify the actual change in total assets during 1997 was within that range.

<u>Part II</u>: Assets

f. Did Sears gain or lose on its sales of *property and investment*? How much? What were the proceeds from those sales?

g. How does Sears define *Goodwill*?

h. Did Sears add back its *Bad Debt Expense* in the Statement of Cash Flows? Conjecture what could explain their decision to do or not to do so.

i. Use **only** the *Provision for Uncollectible Accounts* and the *Allowance for Uncollectible Accounts* in the main financial statements to determine Sears' *Writeoffs* during 1997. What percentage of *Net Income* do the writeoffs represent?

j. Suppose Sears used FIFO for all its inventories. Would its inventory balance for 1997 have been higher or lower than the reported amount? By how much?

k. Suppose Sears used FIFO for all its inventories. What would be the 1997 *Cost of Sales* under this assumption?

l. Assume marginal tax rate of 35%. What were the tax savings during 1997 from using LIFO?

<u>Part III</u>: Liabilities and Owner's Equity

m. Consider the 9.375% Debentures, due 2011 (under Sears, Roebuck and Co.), and assume Sears did not retire any of these debentures during 1997. Were the debentures issued at a premium or at a discount? Explain.

n. Consider the Zero Coupon Bonds, $500 million face value, due 1998 (under Sears Overseas Finance N.V.). Record all transactions in 1998, assuming the bonds will retire on the date of maturity. Could you estimate what is the date of maturity?

o. If Sears classified all of its leases as *Capital leases*, would its *Total Assets* be more or less than reported? Its *Shareholders' Equity*?

p. What is the entry that Sears will record in **1998** with respect to its current *operating leases?*

q. What does the *Valuation Allowance* for deferred taxes represent? What is Sears' explanation for not having any allowance?

Part IV: Miscellaneous

r. How does Sears expense its *catalog book preparation costs*?

<u>Question 2 (20%</u>) - You must answer this question

The Fried Company has assembled the accompanying balance sheets and income statement and reconciliation of retained earnings for 1999.

Balance Sheets as of December 31 (in millions)

999 1998

Assets:		
Cash	$ 10	$ 25
Accounts receivable	40	28
Inventory	70	50
Prepaid general expenses	4	3
Plant assets, net	202	150
	$ 326	$ 256
Liabilities and Shareholders' Equity:		
Accounts payable for merchandise	$ 74	$ 60
Accrued tax payable	3	2
Long-term debt	50	--
Capital stock	100	100
Retained earnings	99	94
	$ 326	$ 256

Income Statement and Reconciliation of Retained Earnings

For the Year Ended December 31, 1999 (in millions)

Sales			$ 250
Less cost of goods sold:			
Inventory, December 31, 1998	$ 50		
Purchases		160	
Cost of goods available for sale	$ 210		
Inventory, December 31, 1999		70	140
Gross profit			$ 110
Less other expenses:			
General expense		$ 51	
Depreciation		40	
Taxes		10	101
Net income			$ 9
Dividends			4
Net income of the period retained			$ 5
Retained earnings, December 31, 1998			94
Retained earnings, December 31, 1999			$ 99

On December 30, 1999, Fried paid $98 million in cash to acquire a new plant to expand operations. This was partly financed by an issue of long-term debt for $50 million. Some plant assets were sold for their book value of $6 million during 1999. Because net income was $9 million, the highest in the company's history, Naftali Fried, the chief executive officer, was distressed by the company's extremely low cash balance.

Required:

a. Prepare a statement of cash flows using the *direct method* for reporting cash flows from operating activities. Do not forget to prepare a schedule that reconciles net income to net cash provided by operating activities.

b. What is revealed by the statement of cash flows? Does it help you reduce Mr. Fried's distress?

Why? Briefly explain to Mr. Fried why cash has decreased even though net income was $9 million.

Question 3 (10%) - You have to choose four questions out of Questions 3, 4, 5, 6 and 7.

Ratzkovsky Stores is one of the country's largest retailing companies, owning department stores such as The Bon and Jordan Marsh and specialty stores such as Ann Taylor. It is a subsidiary of the Hanania Corporation. The following footnote was in Ratzkovsky's annual report:

	Accounts Receivable—Customers (in thousands)	
	December 31, 1998	**December 31, 1997**
Revolving credit accounts	$687,416	$671,157
Installment accounts	57,053	69,792
Other accounts	33,625	29,183
	778,094	770,132
Allowance for doubtful accounts	(12,193)	(14,111)
	$765,901	$756,021

Suppose additional analysis revealed that sales made on credit were 65% of total sales and the *provision for doubtful accounts* for fiscal 1998 was 0.80% of credit sales, or $21,000 (in thousands).

Required:

a. Compute the amount of total sales for fiscal 1998.

b. Assume that there were no bad debt recoveries in fiscal 1998. Compute the amounts of accounts receivable written off as uncollectible in fiscal 1998, and the total collections related to credit sales during 1998.

c. Assume Ratzkovsky had used the aging of accounts receivable instead of percentage of credit sales to calculate the allowance for bad debt. Do you have enough information to conclude if, over its life, such assumption change would increase or decrease the reported income? Explain.

Question 4 (10%) - You have to choose four questions out of Questions 3, 4, 5, 6 and 7.

During its first year of operations, 1948, the Greenberg company produced 100 units of its only product, TSS. The company incurred labor and materials expenditures of $100 (paid in cash), and depreciation on its assets of $50. By the end of the year 70 units were sold for $210 (in cash), and 30 units remained in inventory. Greenberg uses FIFO for all of its inventories. There were no other relevant transactions during the year.

Required:

a. Assume Greenberg treats depreciation as a *period* cost (i.e., expenses it in the year incurred). What is the depreciation related expense in the *income statement* for 1948? Prepare an *Income Statement* for 1948, and provide the reconciliation of net income to cash from operating activities.

b. Assume Greenberg treats depreciation as a product cost (i.e., capitalizes and includes it in the inventory until sold). What is the depreciation related expense in the *income statement* for 1948? Prepare an *Income Statement* for 1948, and provide the reconciliation of net income to cash from operating activities.

c. Suppose the information regarding the treatment of the depreciation as a product or a period cost was not available. How would you be able to tell it, using the financial statements you prepared in **a** and **b** above?

<u>Question 5 (10%)</u> - You have to choose four questions out of Questions 3, 4, 5, 6 and 7.

On January 2, 1996, the Tenenhouse Financial Corporation sold a large issue of Series A $1,000 denomination bonds. The bonds had a stated coupon rate of 6% (annual), had a term to maturity of *four* years, and made annual coupon payments (on December 31). Market conditions at the time were such that the bonds were sold at their face value.

During the ensuing two years, market interest rates fluctuated widely, and by January 2, 1998, the Tenenhouse bonds were trading at a price that provided an annual yield of 10%. Tenenhouse=s management was considering purchasing the Series A bonds in the open market and retiring them; the necessary capital was to be raised by a new bond issueCthe Series B bonds. Series B bonds were to be $1,000 denomination coupon bonds with a stated coupon rate of 8% (annual), making annual coupon payments (on December 31), and a *three* year term. Management felt that these bonds could be sold at a price yielding no more than 10%, especially if the Series A bonds were retired.

Required:

Show the journal entries necessary to record the following transactions:

a. Purchase and retirement of one Series A bond on January 2, 1998.

b. Issue of one Series B bond on January 2, 1998 (yield was 10%).

c. The first coupon payment on a Series B bond on December 31,1998.

Question 6 (10%) - You have to choose four questions out of Questions 3, 4, 5, 6 and 7.

Melnik Shops. Inc., a chain of specialty women's apparel stores, reported the following information about leases in its annual report (in thousands):

December 31	**1997**	**1996**
Capital lease asset, gross	$1,960	$1,960
Less: Accumulated depreciation	1,421	1,323
Capital lease asset, net	$ 539	$ 637
Capital lease obligation	$ 842	$ 864

The only asset under a capital lease is a warehouse and office building. The building has an economic life of twenty years and is being depreciated on a straight-line basis. Lease payments are made on the last day of the year.

Required:

a. Calculate the depreciation expense on the warehouse and office building for the fiscal year ending December 31, 1997.

b. The interest on the lease obligation was $108 (in thousands) in fiscal 1997. What is the interest rate used for the lease obligation? What was the total lease payment on December 31, 1997? Reconstruct the 1997 journal entry.

c. In what year was the building placed into service?

<u>Question 7 (10%)</u> - You have to choose four questions out of Questions 3, 4, 5, 6 and 7.

Eldor Corporation is a railway and motor carrier with 1996 operating revenues of approximately $4.8 billion. Footnote 3 to the financial statements provided the following:

The provision for income taxes consists of the following (in millions of dollars):

		1996		**1995**	
Current:					
Federal		$287.8		$282.6	
State			41.6		52.7
	Total current		329.4		335.3
Deferred:					
Federal		79.2		57.8	
State			17.9		8.9
	Total deferred		97.1		66.7
Total			$426.5		$402.0

Required:

a. Provide the journal entry to record *income tax expense* for 1996.

b. Assume the Aeffective@ (i.e., average) tax rate for Eldor in 1996 was 32%, and that the permanent differences for that year were $25.0 (in millions of dollars) -- due to tax exempt interest received. What was Eldor=s net income for 1996?

c. The account *taxes payable* decreased by $50.0 (in millions of dollars) during 1996. What were Eldor=s tax payments for the year?

ADDITIONAL QUESTIONS TO HELP

STUDY FOR THE B6013 EXEMPTION EXAM

<u>Question 1</u>

The QRS company started its operations in 1994. Five years later, the balance sheet for December 31, 1998, showed the following account balances (there were no other accounts listed):

Accounts receivable 100, Dividend payable 12, Accumulated depreciation 85, Prepaid advertising 30, Cash 469, Wages payable 5, Accounts payable 100, Retained earnings 287, Loan from bank 38, Inventory 100, Rent payable 7, Paid in capital 500, Loan to ABC 25, PP&E 410, Advances from customers (?).

During *1999* the following transactions occurred:

1. QRS purchased $607 worth of inventory, and paid its suppliers $706.
2. Costs of goods sold amounted to $611.
3. Total collections from customers were $1,270, and the ending balance of accounts receivable was $120.
4. Dividend payments were $62. There was no dividend payable at the end of the year.
5. Depreciation expense for the year was $60.
6. <u>In addition</u> to the transactions described in items 2 and 3 above, a special sale was made to the customer who paid in advance in 1998 (see December 31, 1998 balances). The selling price was $150 and the costs of the goods sold were $96. The customer paid the remaining balance in cash.
7. QRS won the 1999 Malcolm Baldridge National Quality Award, and anticipates a sales increase of 35%, starting next year.
8. QRS made an order for a new product from one of its suppliers. 120 units of the product will be supplied on April 30, 2000. The agreed upon price was $2.50 per unit, and QRS paid in advance $75. This amount is not included in item 1 above.
9. The employees of QRS earned $70, and were paid $65 as wages.
10. QRS purchased, in cash, the right to use the trade name *quintessential* from M. Feldberg for $200. This trade name is amortized over 40 years, starting this year.
11. QRS paid the bank $13: $3 as interest and $10 to reduce the principal.
12. QRS earned, but did not collect, $5 of interest on its loan to the ABC company.

13. Rent expense for 1999 was $36, while rent payments were $50.

14. $20 of the prepaid advertising were used during the year.

Required:

1. What was the balance of the account *Advances from customers* on December 31, 1998?

b. Record all transactions that occurred during 1999. (You may use T accounts.)

2. Prepare an *Income Statement* for the year ended December 31, 1999.

d. Prepare a *Balance Sheet* for December 31, 1999.

e. Prepare a *Statement of Cash Flows* for the year ended December 31, 1999.
(If you use the *direct* method - do not forget to reconcile.)

Question 2

On March 1, 1997, the Upside-down construction company contracted to construct a factory building for the Inside-out Inc., for a total contract price of $8,400, with an initial estimated construction costs of $6,400. On December 31, 1998, Upside-down changed its construction costs estimate. The building was completed by October 31, 1999. The annual contract costs incurred, estimated costs to complete the contract, and billings to Inside-out for 1997, 1998 and 1999 are given below:

	1997	**1998**	**1999**
Contract costs incurred during the year	$3,200	$2,600	$1,450
Estimated costs to complete the contract at 12/31	3,200	1,450	0
Billings to Inside-out during the year	3,200	4,100	1,100

All bills were paid in full by Inside-out during the year issued.

Required:

a. What were the *actual* total construction costs for the factory building?

b. What were the *earnings* that Upside-down recognized in each of the three years and overall if it adopted: (i) the completed contract method; (ii) the cost recovery method; or (iii) the percentage of completion method (where percentage of completion is based on costs incurred).

c. Provide all journal entries recorded in Upside-down books during 1997, if it used the cost recovery method.

d. Which of the above revenue recognition methods recognizes the largest earnings over the three years combined? Explain.

Question 3

The BiBiBiBi company operates in a complete and perfect world, where the prevailing interest rate is 25%. The corporation was launched on January 1, 2001, and invested in an asset that will provide a net cash inflow of $390,625 on December 31, 2003.

Required:

a. What was the initial investment in the asset?

b. Prepare an income statement using *economic depreciation* for each of the three years, and a balance sheet for December 31, 2001.

c. BiBiBiBi would like to provide its shareholder with a smooth stream of cash flows. In order to do so it borrowed $100,000 on December 31, 2001, and another $100,000 on December 31, 2002. Both loans were taken from a local bank, at 25%, with a payback date of December 31, 2003. The amounts borrowed were immediately distributed to shareholders. Incorporate the loans (and their distribution) into the cash flow stream of the BiBiBiBi company. What is the amount that the owners are going to receive on December 31, 2003? What is the initial investment?

Question 4

The Katash company is a leader in the poultry market. It produces, sells and markets fresh and ice-packed commodity chicken and frozen products known for their value and healthful qualities. Katash balance sheet for the fiscal year ended on December 31, 1998 and 1997 disclosed the following:

	1998	1997
Property plant and equipment (at cost)	$1,676,978	$1,498,268
Less Accumulated depreciation	$ 515,026	$ 427,152
	$1,161,952	$1,071,116

In the income statement for 1998 Katash disclosed the following:

Depreciation expense $ 106,630

In the cash flow statement for 1998, under Cash Flow from Investing Activities, Katash provided the following information:

Additions to property, plant and equipment	$ (213,576)
Proceeds from dispositions of property, plant and equipment	$ 15,294

Required:

a. What was the cost of property, plant and equipment purchased in 1998?

b. What was the net book value of property, plant and equipment disposed of during 1998?

c. Did Katash generate a gain or a loss on the disposition of property, plant and equipment? How much?

d. Katash calculates depreciation primarily using the straight line method. Assuming the average life of all of Katash assets is 10 years, what was the average age of the property, plant and equipment disposed of in 1998?

Question 5

The Sheffer Company=s statement of cash flows for 1998 showed the following calculation of the cash flow from operating activities:

Collections from customers		$ 2,245
Payments to suppliers		(1,375)
Payments to employees	(688)	
Payments to the IRS (for income tax)	(72)	
Cash flow from operating activities		$ 110

The company=s balance sheet at the beginning and end of 1998 showed the following:

	Beginning of year		**End of year**	
Accounts payable		$ 92		$ 103
Accounts receivable		218		262
Accumulated depreciation		93		122
Income tax payable		142		180
Merchandise inventory	141		89	
Plant and equipment (at cost)		338		371
Wages payable	36		37	

A note to the financial statements showed that the company bought plant and equipment during the year for $33.

Required:

a. Prepare an income statement for the Sheffer Company for 1998.

b. Did the Sheffer Company use the direct or the indirect method in preparing its statement of cash flows?

c. The FASB has tentatively decided to reduce the maximum length of time firms can amortize goodwill from 40 to 20 years. Suppose goodwill was recognized in 1998, and consider the financial statements for 2038. Will this change increase or decrease the Retained earning account? Explain.