Woman C.P.A.

Volume 36 | Issue 2 Article 5

4-1974

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Recommended Citation

Duckworth, Patricia L. (1974) "Education: Answers to Multiple Choice Questions on the May 1973 CPA Exam," *Woman C.P.A.*: Vol. 36 : Iss. 2 , Article 5.
Available at: https://egrove.olemiss.edu/wcpa/vol36/iss2/5

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Education

Answers to Multiple Choice Questions on the May 1973 CPA Exam

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In recent years the Uniform CPA Examination has included a number of multiple choice questions. In the unofficial answers published by the AICPA, the correct answer is listed without explanation. With the thought that it would be useful for all who work through the problems, including students studying for the CPA examination, the method of arriving at the answers to one set of multiple choice questions on the May 1973 examination follows:

Examination in Accounting Practice Part I, May 9, 1973 Group I, No. I

1. Goldstein Cereals, Inc., distributes coupons to consumers which may be presented (on or before a stated expiration date) to grocers for discounts on certain cereals. The grocers are reimbursed when they send the coupons to Goldstein. In the Company's experience 30% of such coupons are redeemed, and on the average one month elapses between the date a grocer receives a coupon from the buyer and the date Goldstein receives it. On May 1, 1972, Goldstein issued coupons with a total value of $10,000 and an expiration date to the buyer of December 31, 1972. As of December 31, 1972, Goldstein had disbursed $2,500 to grocers for these coupons. The December 31, 1972, balance sheet should include a liability for unredeemed coupons of

a. $0.
b. $375.
c. $500.
d. $2,250.

Answer: c. $500.

Issued coupons with a total value of	$10,000
30% expected to be redeemed	$3,000
Coupons redeemed as of 12-31-72	2,500
Coupons expected to be redeemed (liability)	$ 500

(Welsch[3], pages 642 and 643)

2. Ecol Corporation issued voting preferred stock with a fair value of $1,000,000 in exchange for all of the outstanding common stock of Ogee Service Company. Ogee has tangible net assets with a book value of $500,000 and a fair value of $600,000. In addition, Ecol Corporation issued stock valued at $100,000 to an investment banker as a "finder's fee" for arranging the combination. As a result of this combination Ecol Corporation should record an increase in net assets of

a. $500,000.
b. $700,000.
c. $600,000.
d. $1,100,000.

Answer: d. $1,100,000.

Fair market value of preferred stock	$1,000,000
"Finders fee" for arranging the combination	100,000
Increase in assets of Ecol Corporation	$1,000,000

(APB Opinion #29 states that the cost of a nonmonetary asset acquired in exchange for another nonmonetary asset is the fair market value of the asset surrendered to obtain it and a gain should be recognized in the exchange.)[1]

3. During 1972 Hoffman Company had a net income of $50,000 (no extraordinary items) and 50,000 shares of common stock and 10,000 shares of preferred stock outstanding. Hoffman declared and paid dividends of $.50 per share to common and $6.00 per share to preferred. Although the preferred stock is convertible into common stock on a share-for-share basis, it is not classified as a common stock equivalent. For 1972 Hoffman Company should report fully diluted earnings (loss) per share of

a. $.83 1/3.
b. $1.00.
c. $(.20).
d. $.50.

Answer: c. (.20)

Net income	$50,000
Preferred stock dividends	−60,000
	$(10,000)

(10,000.) ÷ 50,000 shares = (.20)
(APB #15 requires that fully diluted earnings show maximum potential dilution of current earnings per share on a prospective basis.)[1]

4. On April 15, 1972, a fire destroyed the entire merchandise inventory of John Anderson's retail store. The following data are available:

Sales, January 1 through April 15	$72,000
Inventory, January 1	10,000
Purchases, January 1 through April 15	70,000
Markup on cost	20%

The amount of the loss is estimated to be

a. $24,000.
b. $20,000.
c. $22,400.
d. $8,000.

Answer: b. $20,000.

Inventory, January 1	$10,000
Purchases, Jan. 1 thru April 15	70,000
	$80,000
72,000 ÷ 120%*	−60,000
Inventory April 15	$20,000

*cost + .20 cost = 72,000; therefore cost = $60,000.
(See Welsch[3], pages 378 and 379.)

5. The gross profit of Adelate Company for 1972 is $56,000, cost of goods manufactured is $300,000, the beginning inventories of goods in process and finished goods are $18,000 and $25,000, respectively, and the ending inventories of goods in process and finished goods are $28,000 and $30,000, respectively. The sales of Adelate Company for 1972 must have been

a. $341,000.
b. $346,000.
c. $356,000.
d. $351,000.

Answer: d. $351,000.

Beginning inventory finished goods	$ 25,000
Cost of goods manufactured	300,000
	$325,000
Ending inventory finished goods	−30,000
	$295,000
Gross profit of Adelate Co.	+56,000
Sales	$351,000

6. The business combination of Jax Company — the issuing company — and the Bell Corporation was consummated on March 14, 1973. At the initiation date, Jax held 1,000 shares of Bell. If the combination were accounted for as a pooling of interests, the 1,000 shares of Bell held by Jax would be accounted for as

a. Retired stock.
b. 1,000 shares of treasury stock.
c. (1,000 ÷ the exchange rate) shares of treasury stock.
d. (1,000 x the exchange rate) shares of treasury stock.

Answer: a. retired stock
(see APB Opinion #16)[1]

7. The partnership of Wayne and Ellen was formed on February 28, 1973. At that date the following assets were contributed:

	Wayne	*Ellen*
Cash	$25,000	$ 35,000
Merchandise	—	55,000
Building	—	100,000
Furniture and equipment	15,000	—

The building is subject to a mortgage loan of $30,000, which is to be assumed by the partnership. The partnership agreement provides that Wayne and Ellen share profits or losses 25% and 75%, respectively. Ellen's capital account at February 28, 1973, would be

a. $190,000.
b. $160,000.
c. $172,500.
d. $150,000.

Answer: b. $160,000.

Cash	$ 35,000
Merchandise	55,000
Building (net of mortgage)	70,000
	$160,000

8. Based on the same facts as described in item 7, if the partnership agreement provides that the partners initially should have an equal interest in partnership capital with no contribution of intangible assets, Wayne's capital account at February 28, 1973, would be

a. $100,000.
b. $115,000.
c. $200,000.
d. $230,000.

Answer: a. $100,000.

Cash	$ 25,000
Furniture and fixtures	15,000
Ellen's capital	160,000
	$200,000

200,000 ÷ 2 = $100,000.

9. Jones sold land to Smith for $200,000 cash and a noninterest-bearing note with a face amount of $800,000. The fair value of the land at the date of sale was $900,000. Jones should value the note receivable at

a. $900,000.
b. $800,000.
c. $700,000.
d. $1,000,000.

Answer: c. $700,000.

Fair market value of land	$900,000
Cash received	200,000
Value of the note receivable	$700,000

(See APB Opinion #29)[1]

10. On April 30, 1973, White sold land with a book value of $600,000 to Black for its fair value of $800,000. Black gave White a 12%, $800,000 note secured only by the land. At the date of sale, Black was in a very poor financial position and its continuation as a going concern was very questionable. White should

a. Use the cost recovery method of accounting.
b. Record the note at its discounted value.
c. Record a $200,000 gain on the sale of the land.
d. Fully reserve the note.

Answer: a. Use the cost recovery method of accounting
(APB Opinion #10 states that revenues should ordinarily be accounted for at the time the transaction is completed. If there is no reasonable basis for estimating the degree of collectibility, either the installment basis or cost recovery method of accounting may be used.)

11. On April 1, 1972, Austin Corporation sold equipment costing $1,000,000 with accumulated depreciation of $250,000 to its wholly owned subsidiary, Cooper Company, for $900,000. Austin was depreciating the equipment on the straight-line method over 20 years with no salvage value, which Cooper continued. In consolidation at March 31, 1973, the cost and accumulated depreciation, respectively, are

a. $1,000,000 and $300,000.
b. $900,000 and $50,000.
c. $900,000 and $60,000.
d. $750,000 and $50,000.

Answer: a. $1,000,000 and 300,000
1,000,000 ÷ 20 = $50,000
depreciation a year

Equipment cost to Cooper is same as to Austin	$1,000,000
Accumulated depreciation is $250,000 + 50,000	300,000

(See Gentry[2], page 132)

12. On June 30, 1972, the Ingalls Corporation sold equipment for $420,000 which had a net book value of $400,000 and a remaining life of 10 years. That same day the equipment was leased back at $1,000 per month for 5 years with no option to renew the lease or repurchase the equipment. Ingalls' rent expense for this equipment for the six months ended December 31, 1972, would be

a. $5,000.
b. $4,000.
c. $6,000.
d. $(14,000).

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cut in profits; and International Computers (Europe's largest computer maker) would have turned an $8.1 million *profit* into a $17.9 million *loss.* Mr. Ulman states (and logically so) that apparently much the same thing would happen to the published profits of U. S. companies.

Mr. Renshall of the British Institute stresses the urgency of recognizing the inflationary "facts of life" by suggesting that a good grasp of inflation accounting might have prevented the Rolls Royce collapse. The Institute is quite concerned that the British government inquiry into this accounting proposal might delay its goal of requiring companies to show inflation-adjusted accounts along with conventional figures in their 1974 annual reports.

The British government has denied any obstructionist motive; it feels a wider and deeper discussion of the proposal is warranted before the country rushes into such an accounting change-over with its widespread implications. The government particularly wants an examination of inflation-accounting effects on taxation and the flow of investment.

Inflation-accounting tends to increase profits for high-debt real estate holding companies and to cut reported profits of manufacturers with heavy capital investments. Accordingly, such accounting could switch some of the tax burden from the manufacturers to real estate firms.

Mr. Ulman's article states that only a handful of British companies have so far voluntarily presented their annual reports in terms of inflation-accounting, but more say they will be doing so this year.

Such action will undoubtedly spur other accountants (worldwide) to fulfill their financial responsibilities and attack the obvious reluctance of companies to publish profit revisions.

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"FASB-CASB—SIMILARITIES AND DIFFERENCES," Howard W. Wright, FINANCIAL EXECUTIVE, Volume XLI, No. 9, September 1973.

As a part-time, paid consultant to the Cost Accounting Standards Board (CASB), Howard Wright is obviously well qualified to present his views of the CASB. Unfortunately, the reader immediately gets the impression that Mr. Wright's purpose is criticism of the CASB and the five standards it has promulgated. A possible reason for his biased opinion becomes apparent when the article is taken in context with another article, "CASB†—Past, Present and Future" by Arthur Schoenhaut, presented in the same issue of the *Financial Executive.*

Schoenhaut, the executive secretary of the CASB, states that this body had to be created to fill the void produced by the ineffectiveness of Section 15 of ASPR. The article also mentions that Mr. Wright was the author of Part 2, Section 15 of ASPB and was opposed to the creation of the CASB. Mr. Schoenhaut's article was apparently printed as a rebuttal to Mr. Wright's highly critical opinions.

After analyzing the five standards presented by the CASB, Mr. Wright reviews future problems which are to be considered by the Board and gives his personal opinions on them. The Financial Accounting Standards Board (FASB) cannot yet be evaluated, he states, since it has been organized only recently. Although he suggests that the FASB might seem to be only a continuation of the old Accounting Principles Board, the potential exists for much better results.

In comparing the organizational structure of the two Boards, the author is again critical of the CASB for its heavy reliance upon staff members for research, for its short working sessions, and for the pro-government background of many of its personnel. In contrast, he believes that the FASB has a more practical organizational make-up, consisting as it does of full-time members not subjected to possibly conflicting outside influences and interests.

The main differences between the two boards result from the differences in their purposes. The CASB is a creature of government and politics, designed to specify the rules under which contract payments are made by the government. The FASB is a creature of private industry, designed to sharpen rules concerning accounting practice, primarily for the benefit of the investor.

Mr. Wright hopes that the FASB will be an improvement over the old Accounting Principles Board. The potential of its members, its financial backing, and its widespread support by the profession are all indicators that the FASB will be a success. If it is not, the author believes the government will promulgate accounting rules in the future. Although somewhat different in purpose, the two Boards can and should work together in Mr. Wright's opinion to solve problems, avoid confrontations, and prevent duplication of effort. This is the most constructive idea presented by the article. If the accounting profession is to advance in its ideas and practices, then mutual cooperation and good judgment among its members must prevail.

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Answer: b. $4,000.

Cash rent for six months	$6,000
20,000 gain ÷ 10 (six month periods)	2,000
	$4,000

(See APB Opinion #5)[1]

13. The auditor's report covering the December 31, 1971, financial statements of Wald Corporation was qualified due to a legal suit pending against Wald. The suit was settled on June 30, 1972, and Wald was required to make payments of $40,000 per month for 20 months beginning January 1, 1973. The discounted present value of the future payments at June 30, 1972, and December 31, 1972, was $790,000 and $792,000, respectively. The charge against revenues for the year ended December 31, 1972, resulting from the settlement of the legal suit was

a. $792,000.
b. $800,000.
c. $0.
d. $790,000.

Answer: c. $0.
There would be no charge against revenue in 1972, the liability would be shown on the balance sheet.

14. Sanitate Company issued 200 7% bonds for $200,000. Each $1,000 bond carries two stock warrants. Each warrant grants an option to purchase one share of $85 par value common stock at $110 per share before December 31, 1973. At the date of the bond issue Sanitate's common stock is selling for $100 per share and the warrants sold for $10 each. The credit for the warrants that Sanitate should record at the date of issue is

a. $3,636.
b. $0.
c. $2,000.
d. $4,000.

Answer: d. $4,000.
400 warrants x 10 (selling price) = $4,000.
$4,000. would be shown as Stock Warrants Outstanding
(See Welsch[3], page 782)

15. Based on the same facts as described in item 14, if 95% of the warrants are exercised prior to December 31, 1973, the total "capital in excess of par" created by the sale of the related common stock would be

a. $10,880.
b. $9,500.
c. $3,800.
d. $13,300.

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Editor's Notes

Our original plan for these Editor's Notes was to give you a short account of our January trip to Europe. Many of you expressed an interest in the venture at the Joint Annual Meeting in Atlanta last October and hoped that our two sponsoring societies would organize such a trip in the future. So we thought we would tell you briefly how it went. But the short account became longer and longer, until we finally turned for help to our co-director of the trip, Dr. Mary Lou Bryant. The result is the article "If It's Monday, This Must Be Touche Ross" earlier in this issue.

A New Department

With this issue we inaugurate another new department, namely *Personal Management.* Its editor is Jean E. Krieger, CPA. She is a senior tax specialist with Haskins & Sells and a member of both ASWA and AWSCPA.

In her first column Ms. Krieger mentions some of the topics she plans to discuss in future issues. If you would like her to cover other subjects that are of special concern to you, do write to her directly — or write us a Letter to the Editor. The same goes for all the other departments.

In addition to subjects you would like to have discussed, we would also welcome some feedback on the technical level you want for these columns. This is especially important to the editors of the Tax Forum and the EDP Department where the level of expertise among accountants varies greatly. Are you a specialist in an area who wants highly technical information? Or do you have only a nodding acquaintance with the subject and want to learn about the basics, such as what is the difference between COBOL and FORTRAN? Without guidance from you we will cover the subjects we think will be of interest to you. We will also vary the technical level, so that some columns will be rather sophisticated, whereas others will be more basic. Please let us know whether you agree with this policy. After all, this is your journal.

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Answer: d. $13,300.

Warrants exercised 400 x 95% = 380 warrants

Option price of share	$110
Value of warrant at time of issue	10
	$120
Par value of stock	85
"Capital in excess of par"	$ 35

380 warrants exercised x $35 = $13,300

Footnotes

[1] Commerce Clearing House, Inc., *APB Accounting Principles as of June 30, 1973,* Volume Two, 1973

[2] James A. Gentry, Jr. and Glenn L. Johnson, *Finney & Miller's Principles of Accounting Advanced,* sixth edition (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1971).

[3] Glenn A. Welsch, Charles T. Zlatkovich, and John Arch White, *Intermediate Accounting,* third edition (Homewood, Illinois: Richard D. Irwin, Inc. 1972).

London Financial District