

## First Examination – Finance 3321 Fall 2016 (Moore)

Class Time: \_\_\_\_\_

Printed Name: \_\_\_\_\_

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Student's Signature: \_\_\_\_\_

Clearly Circle the **BEST** response for each of the following questions: (3 points each for 1-22)

1. Which type of intermediary focuses on assessing the degree to which firms' financial reports are in conformance with mandated disclosure standards?
  - a. Information Intermediary
  - b. Auditors
  - c. Financial Analysts
  - d. Bond Raters
  - e. Financial Press and Media
  
2. Competitive Positioning is part of which main element in Figure 1-2?
  - a. Business Environment
  - b. Business Strategy
  - c. Capital Markets
  - d. Accounting Environment
  - e. Accounting Strategy
  
3. Which is the **first step** in a structured equity security analysis and valuation?
  - a. Prospective Analysis
  - b. Accounting Analysis
  - c. Financial Analysis
  - d. Business Strategy Analysis
  - e. Implementing Valuation Models
  
4. Which of the following **is not** one of the 5 main dimensions of the "Five-Forces" model?
  - a. Switching Costs
  - b. Rivalry Among Existing Firms
  - c. Threat of New Entrants
  - d. Bargaining Power of Customers
  - e. Threat of Substitute Products

5. One of the main reasons that firms are allowed flexible financial accounting standards under GAAP is:
- It provides firms a better opportunity to report the underlying economic substance of transactions and events.
  - It gives the firms the opportunity to reduce the volatility of earnings so that investors can provide better forecasts of future performance.
  - It allows managers to better tie earnings to performance for compensation purposes.
  - It gives firms the opportunity to mark-to-market the physical assets so that balance sheet values are more relevant to decision makers.
  - None of the above.
6. Which one of the following would be recognized as an adjustment to comprehensive income?
- Recognition of Inventory write-downs
  - Recognition of Goodwill Impairment
  - Recognition of Extraordinary items such as losses from hurricane damages
  - Recognition of gains or losses to the market value of financial assets still owned by the firm
  - Recognition of profits of losses from foreign operations of the firm
7. Which of the following line items is reported **latest (towards the end)** in the income statement?
- Extraordinary Expenses
  - Comprehensive Income
  - Goodwill impairment charges
  - Income from Continuing Operations
  - Gross Profit
8. Identify the proper sequence in which following items would be presented on the income statement is:
- Net Revenue
  - Gross Profit
  - Comprehensive Income
  - Income from Continuing Operations
  - Operating Income
- 1, 2, 3, 4, 5
  - 1, 5, 2, 4, 3
  - 1, 2, 5, 4, 3
  - 1, 5, 3, 2, 4
  - 1, 2, 3, 5, 4

9. Which of the following statements is **correct**?
- The FASB has the legal authority to proscribe GAAP.
  - Transparent financial reporting practices allow users to get a true and fair picture of the firm.
  - Conservatism of financial reporting standards never reduces valuation relevance.
  - The external auditor certifies the financial statements are correct.
10. An industry having a **high degree** of price competition would be characterized by:
- Low Industry Concentration, Few Legal Barriers to Entry, Low Product Differentiation
  - Few Exit Barriers, High First mover advantage, Low Product Differentiation
  - Low Industry Concentration, Steep Learning Curves, Low Firm Excess Capacity
  - Low Concentration, Low Fixed-Variable Cost Ratio, Few Legal Barriers to Entry
  - Supply > Demand, Low First Mover Advantage, Low Fixed to Variable Cost Ratio
11. Which of the following would lead to the **lowest degree** of industry price competition?
- Low Industry Concentration, Low Legal Barriers to Entry, Low Product Differentiation
  - Few Barriers to Entry, High First Mover Advantage, High Product Differentiation
  - Low Industry Concentration, Low Distribution Access, Low Customer Switching Costs
  - High Industry Concentration, High Fixed-Variable Cost Ratio, High product differentiation
  - Supply < Demand, Many Legal Barriers to Entry, Steep Industry Learning Curves
12. Assume a company has been classified as belonging in a purely differentiated product (specialty good) industry. Which one of the following disclosures **would not** be considered a key accounting policy?
- Net Sales/Warranty Liabilities
  - Inventory is measured on a Lifo basis at lower of cost or market
  - Disclosure regarding new product development R&D expenses
  - Disclosure new customer service programs
  - Disclosure regarding the strategic placement of new distribution centers
13. Which of the following strategies would lead to a **mixture** of cost leadership and product differentiation?
- Economies of scale and scope, simpler product design, Lower input costs
  - Superior product variety, more flexible delivery, High Brand Advertising
  - Lower input costs, Low-cost Distribution, Low investment in R&D
  - High investment in brand image, High investment in R&D, Low Cost Distribution
  - Complex product designs, Superior Product Quality, Superior customer service
14. A driver's ability to avoid purchasing gasoline at the expensive gas stations by conveniently purchasing at a cheaper station is example of:
- Bargaining power of firm over suppliers
  - Bargaining power of supplier over firm
  - Bargaining power of customers over firm
  - Bargaining power of firm over customers
  - None of the above

**Questions 15-17 (Operating and Capital Lease Adjustments)**

- Use the following information for questions 15-17

ABC Company is a startup company in an industry that exclusively uses capital leases for its expensive medical testing equipment. ABC, however, used operating lease accounting in its first year of operations. Assume the average lifespan of ABC's leased equipment is 20 years and that their current cost of debt is 7.45%. Last year, the cost of debt was 6.50%. The annual lease payments are \$600,000. ABC's industry uses straight-line depreciation and the effective tax rate is 30%. The financial year 2016 just ended and all leases were re-negotiated on the final day of the year. Payments are also made on the last day of the year.

15. Assume that you have the task of restating the financial statements to reflect the leases as being capitalized (as opposed to operating lease treatment). How much is the capitalized operating lease liability that you would present on the re-stated balance sheet?
- \$12,000,000
  - \$6,140,023
  - \$5,997,455
  - \$6,440,826
  - \$6,611,104
16. Now, **assume** the present value of the lease payments over the entire life of the contract was \$6,000,000. Adjust ABC's books to reflect the lease as being capitalized. The depreciation expense that should be charged against income in the **8th year** is:
- \$457,430
  - \$600,000
  - \$364,238
  - \$307,000
  - \$300,000
17. Adjust ABC's books to reflect the lease as being capitalized. Maintain the \$6,000,000 assumption. Compute the appropriate charge for interest expense in the **2017 Income Statement** that is associated with capitalizing the leases.
- \$457,432
  - \$447,000
  - \$390,000
  - \$399,102
  - \$894,000

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**End of Lease Problems**  
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18. Which of the following **is not** used to determine the Rivalry Among Existing Firms?
- First Mover Advantage
  - Excess Capacity
  - Concentration
  - Supplier Switching Costs
  - Industry Growth

19. Aggressive use of which of the following accounting choices can lead to the problem of “off-balance sheet financing”?
- Operating leases
  - Failure to write down obsolete inventory
  - Reporting all related party transactions
  - Overstating depreciation for long-term assets
  - Using the intrinsic method to account for executive stock options
20. Which of the following must result in **understated liability** balances?
- Delays in the write-down (expensing) of current assets such as inventory.
  - Understating the growth rate in future post-retirement benefit costs
  - Overstated amortization of goodwill
  - Overstating the growth rate in future post-retirement benefit costs
  - Understating the discount rate used in discounting future defined benefit payments.

**Use the following information for problems 21 and 22**

You are performing an accounting analysis on ABC Company and noted excessive goodwill balances relative to reported PPE. The following table was constructed from ABC’s 10-K information. Assume all new goodwill is recognized at the end of the year for the purpose of restatement. Further, assume a tax rate of 30%. The first year to be restated is 2012. ABC has a December 31 fiscal year end. Assume goodwill has a 4-year useful life and that you are adjusting the account. Assume all M&A activity takes place on the last day of the fiscal year.

Financial Information on an “As-Reported” Basis				
	2012	2013	2014	2015
<b>Beginning Balance</b>	<b>20,000,000</b>	<b>23,000,000</b>	<b>26,000,000</b>	<b>31,000,000</b>
<b>New Goodwill</b>	<b>3,000,000</b>	<b>5,000,000</b>	<b>8,000,000</b>	<b>2,000,000</b>
<b>Goodwill Impaired</b>	<b>0</b>	<b>2,000,000</b>	<b>3,000,000</b>	<b>10,000,000</b>
<b>Ending Goodwill</b>	<b>23,000,000</b>	<b>26,000,000</b>	<b>31,000,000</b>	<b>23,000,000</b>

21. On a re-stated basis, how much goodwill should be reported on the 2012 Balance Sheet?
- nothing
  - \$20,000,000
  - \$23,000,000
  - \$18,000,000
  - \$5,000,000
22. In order to complete the restatement process, how much **additional goodwill impairment** would you have to recognize in 2013?
- \$4,000,000
  - \$3,000,000
  - \$5,000,000
  - \$5,750,000
  - \$3,750,000

### Problem 1 – Overs and Unders (10 Points)

Analyze the following transactions (omissions or incorrect accounting treatments) and assess whether the accounts are Overstated, Understated, or No Effect. Fill in the appropriate boxes as (O), (U), (N)

		Assets	Liabilities	Equity	Revenues	Expenses	Net Income
1	The company failed to write down a 50% impairment of inventory						
2	The company used too large a discount rate to estimate the present value of future service costs on a defined benefit pension plan						
3	The company used too low a rate in estimating account receivable defaults						
4	The company capitalized all research and development costs						
5	The company recognized all gift card sales as revenues in the year sold even though they don't expire for 3 years						
6	The company failed to impair goodwill despite having a competitive advantage loss						
7	Regular equipment maintenance expenditures were recognized as capital improvements to the assets						
8	A car manufacturer knew of potentially faulty accelerators on new cars sold under warranty but didn't adjust financial statement for the estimated costs						
9	The company failed to recognize foreign currency losses related to international sales transactions						
10	The company, an importer, failed to hedge foreign exchange risk in a year when the dollar was strengthening. The company pays invoices in the underlying foreign currencies						

**Problem 2 – Decomposing Fixed and Variable Costs (10 Points)****Use the following Dell information for this problem (5 Points Each)**

PERIOD ENDING	2-Feb-07	1-Feb-08
Total Revenue	57,420,000	61,133,000
Cost of Revenue	47,904,000	49,462,000
Gross Profit	9,516,000	11,671,000
Operating Expenses		
Research & Development	498,000	610,000
Selling General and Administrative	5,948,000	7,538,000
Total Operating Expenses	6,446,000	8,148,000
Operating Income or Loss	3,070,000	3,523,000
Net Income	2,583,000	2,947,000

**Show all work to receive credit**

Estimate the total variable Cost of Goods Sold for Dell in the year ending 1 Feb. 2008.

Estimate the Fixed to Variable Cost of Goods Sold ratio for Dell for the year ending 2008.

**Short Problem 3 – Goodwill and M&A Activity (6 Points)**

Acquirer Company buys Target Company. Target's pre-acquisition balance sheet at historical cost showed Total Assets at \$730,000 and Total Liabilities at \$420,000. Upon acquisition, Acquirer revalued Target's identifiable assets at \$1,350,000 and liabilities at \$380,000.

Assume the Acquirer recognized goodwill of \$600,000 in this transaction. What is the price Acquirer paid for Target Company?

**Show your work in order to receive ANY credit points.**

**Short Essay Problem 1 (write concisely, with bullet points and sentences, but make your answer clear) (8 Points)**

Company: \_\_\_\_\_

This Essay is directly related to the company your group is analyzing. Identify 5 (five) specific value drivers for the industry you analyzed and explain, briefly, how these business activities create value and lead to creating or maintaining competitive advantages.

Also, identify the three relevant competitors your group is using for industry benchmarks:

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_