

Original

Examination: Financial Accounting **Winter semester: 2001/02**
Examiner: Prof. Alfred Luhmer
The following aids can be used: calculator

Hint: A total of 120 points can be achieved. The achievable points for a problem set are given in parentheses. You are advised to base your time allocation on these points.

Examination questions:

Problem 1 (30 points)

Give short and precise answers!

1. Name the three basic forms of business organization and indicate whether they are treated as separate accounting entities and/or separate legal entities.
2. What is the purpose of adjusting entries at the end of an accounting period and what are the two major categories of adjusting entries?
3. A bond is issued at a quote of 97. Is the stated rate of interest higher or lower than the market rate of interest and what is a typical name for the account that is used to record the difference in valuation between the face value and the market value?
4. What is a contingent liability? Give an example!
5. What entries, i.e. debit or credit, are used to record an increase in the following accounts?
 - a) office equipment
 - b) prepaid property taxes
 - c) bonds payable
 - d) rent expense
 - e) unearned revenues
 - f) allowance for uncollectible accounts
6. What is the essence of the going-concern assumption and why is it needed?
7. What is the difference between cash sales and credit sales and what effect does it have on period income?
8. What cost flow assumptions may be used for inventory valuation? Briefly explain two of them.
9. What are the main characteristics of intangible assets?
10. What is "goodwill"?

Problem 2 (10 points)

What is the correct answer?

1. Which of the following does not result in dissolution of a partnership?
 - a) admission of a new partner
 - b) withdrawal of a partner
 - c) death of a partner
 - d) sale of partnership assets
 - e) bankruptcy of a partner

2. If the partnership agreement does not state an income sharing rule, partnership income is distributed according to
 - a) the established ratio
 - b) the capital investment ratio
 - c) the time each partner worked for the partnership
 - d) none of the above

3. Which of the following accounts is not closed at the end of an accounting period?
 - a) bad debt expense
 - b) revenue from sales
 - c) unearned revenues
 - d) owner's withdrawals

4. The financial statement which summarizes operating, investing, and financing activities for a period of time is the
 - a) income statement
 - b) balance sheet
 - c) statement of cash flows
 - d) retained earnings statement

5. The AC Company acquired three power plants for € 120 million in January 2001. The market value of the plants in December 2001 was € 200 million. The plants will be recorded and reported in the balance sheet for the fiscal year ending December 31, 2001, as assets at
 - a) € 260 million
 - b) € 140 million
 - c) € 120 million
 - d) € 380 million

6. Which of the following costs should not be included in cost of land?
 - a) cost to remove old buildings
 - b) purchase price of land
 - c) cost of filling to level land
 - d) cost of driveways

7. Which of the following is a characteristic of the installment sales accounting method?
 - a) gross profit is deferred
 - b) collection of cash is emphasized
 - c) revenue is recognized in period of sale
 - d) all of the above

8. The revenue recognition principle provides that revenue is recognized when
 - a) it is realizable
 - b) it is realized or realizable and it is earned
 - c) it is realized
 - d) all of the above

9. If, for whatever reason, the ending inventory for a given year is overstated and this error will not be detected in the next year, which of the following statements is correct?
 - a) the given year's profit is understated
 - b) next year's profit is overstated
 - c) cost of goods sold for the given year is overstated
 - d) none of the above

10. Which of the following statements about the declining-balance method of depreciation is not true?
 - a) a constant percentage is applied to determine depreciation charges
 - b) depreciation charges are decreasing over time
 - c) a possible salvage value of the asset must be deducted from cost to determine the depreciable amount
 - d) a possible salvage value is irrelevant for determining the depreciable amount

Problem 3 (10 points)

What accounting term is defined or indicated by the phrase or sentence?

1. A contingency which is not recorded.
2. The adjusting entry for this type of deferral involves a revenue and a liability account.
3. In a partnership, this results when the new partner's capital credit on the date of admittance is greater than his or her investment in the firm.
4. This type of bond can be retired before maturity at the issuer's option.
5. Statement showing financial condition at a point in time.
6. These methods always allocate higher depreciation charges to earlier periods of the plant asset's useful life.
7. It is a sale for which you cannot record revenues.
8. Under this accounting method for long-term contracts, you do not record a current period loss if the overall profitability is still given.
9. "It merely increases business for stock exchanges" could be an argument against what reporting requirement for listed companies?
10. It adjusts income statement items from the accrual basis to the cash basis.

Problem 4 (30 points)

Peter Striker started his own business called NetRepairs on April 1, 2001. Nine months later, on December 31, 2001, the accounts show the following balances before any adjusting entries have been made:

Cash	€ 21.000	Prepaid Insurance	4.800
Supplies	1.000	Accounts Payable	2.800
Equipment	10.000	Note Payable	30.000
Unearned Revenue	3.200	Owner's Capital	12.000
Accounts Receivable	15.000	Owner's Withdrawal	7.800
Expenses	8.400	Revenues Earned	20.000

Peter looks through the source documents and discloses the following items:

- The insurance policy bought on July 1, 2001, provides protection for two years.
- A count of the supplies reveals that € 200 of supplies are still on hand.
- The note was issued on July 1, 2001, with a face value of € 30.000 and a 5% semiannual interest rate. The first interest payment is due on January 1, 2002.
- The equipment, purchased on October 1, 2001, has an estimated life of five years.

Required:

- Prepare an unadjusted trial balance to check whether the debits equal the credits for the account balances given above.
- Prepare the journal entries for the adjustments.
- Prepare the adjusted trial balance.
- Prepare the Income Statement, the Statement of Owner's equity, and the Balance Sheet for NetRepair.

Problem 5 (5 points)

Mr. Bounce recorded credit sales of € 360.000 in 2001. Since credit sales account for a major fraction of his overall sales he is always concerned whether has made high enough allowances for uncollectible accounts. The current balance in that account is € 13.000. At the end of the year, on December 31, he prepared a schedule of receivables outstanding and, on the basis of past experience, estimated the percentage of receivables in each category that are uncollectible.

<u>Age</u>	<u>Amount</u>	<u>Percentage estimated to be uncollectible</u>
Less than 30 days old	€ 50.000	3%
31 – 60 days old	60.000	6%
61 – 90 days old	30.000	9%
91 – 120 days old	15.000	15%
over 120 days old	25.000	30%

- What is the balance in the allowance for uncollectible accounts that should be reported in the balance sheet for the year ending December 31, 2001?
- What amount should be charged to bad debt expense in 2001? Give the journal entry.

Problem 6 (30 points)

To honour Magdeburg's former mayor Mr. Polte, the city's new mayor plans to have a bridge built across the beautiful river Elbe. For that reason he offers a contract to the construction company Pipe Dream, Ltd. The contract is immediately signed and the following data are available for the so-called "Polte project": (numbers in thousands)

Contract price: € 16.000

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Cost to date	3.000	7.000	14.000
Estimated cost to complete	9.000	7.000	---
Progress billings during the year	2.000	5.000	9.000
Cash collected during the year	1.000	4.000	11.000

Required:

- (1) What will be the estimated current period gross profit and revenue for 2002, 2003, and 2004 under the percentage-of-completion method? Give all journal entries to record cost of construction, progress billings, collections, and revenue and gross profit for the three years.
- (2) Assume cost to complete in 2003 is estimated to be € 10.000 instead of € 7.000. How would that be recorded under the percentage-of-completion method? What would be the journal entry for the completed-contract method?

Problem 7 (5 points)

Brett Shelfwarmer has his own retail store and estimating the inventory is a recurring task for him since he has quite a number of items in it and physical counts are simply too time-consuming. To estimate the current inventory he has the following numbers available:

	<u>At cost</u>	<u>At retail</u>
Beginning inventory	€ 350.000	560.000
Goods purchased	145.000	240.000

The sales for the period amounted to € 40.000 and Brett recorded freight-in cost of € 5.000.

- (1) Determine the value of the inventory on hand. Show calculations.
- (2) What is the major difference between the conventional approach and the cost approach of the retail method? Which one of the two retail method approaches approximates the lower-of-cost-or-market rule?