

Examination:

Financial Accounting

Winter semester: 2002/03

Examiner:

Prof. Alfred Luhmer

The following aids can be used:

calculator

Hint: A total of 120 points can be achieved. There are 7 problem sets. 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 entries, i.e. debit or credit, are used to record a decrease in the following accounts?
 - a) prepaid rent
 - b) notes payable
 - c) salary expense
 - d) owner's investment
 - e) unearned revenues
 - f) allowance for uncollectible accounts
3. What are deferrals and accruals? Give an example for each.
4. A change in depreciation rates will lead to a change in reported cash flows from operating activities. Is this statement true? Why?
5. What are three main characteristics of intangible assets?
6. What is meant by "LIFO liquidation" and how can it occur?
7. Briefly describe the two different approaches to interim reporting.
8. What is the essence of the periodicity assumption and why is it needed?
9. When do we call accounting information "relevant"?
10. Explain the term contra account. What is an advantage of using it? Give an example.

Problem 2 (5 points)

Describe the cost flow assumptions used in average cost, FIFO, and LIFO methods of inventory valuation. Assume prices are increasing, what method would you choose if it is your objective to report a high accounting income? Explain!

Problem 3 (10 points)

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

1. A contingency which is not recorded.
2. This results when bonds are sold above par.
3. The adjusting entry for this type of deferral involves an expense and asset account.
4. Probable future sacrifices of economic benefits.
5. 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.
6. Statement showing financial condition at a point in time.
7. These methods always allocate higher depreciation charges to earlier periods of the plant asset's useful life.
8. "It merely increases business for stock exchanges" could be an argument against what reporting requirement for listed companies?
9. In a period of declining prices, this inventory valuation method generally results in the lowest balance sheet figure for inventory.
10. These two types of accounts are closed at the end of an accounting cycle.

Problem 4 (10 points)

A machine is purchased at a price of € 80.000. This machine has a useful life of 4 years and possesses a salvage value of € 20.000.

1. Give the depreciation schedule using the sum-of-the-year-digits method in the following format:

Year	Depreciation base	Depreciation fraction	Depreciation charge	Book value at year end
1				
2				
3				
4				

2. What is the underlying assumption used to justify this allocation method?

Problem 5 (30 points)

Mike Sailor started his own business called "Mike's Yacht Rental & Apparel" on January 1, 2002. After completion of the first fiscal year, on December 31, 2002, the accounts show the following balances before any adjusting entries have been made:

Cash	10.000	Accounts Receivable	4.000
Supplies	1.000	Accounts Payable	600
Equipment	8.000	Merchandise Inventory	3.000
Unearned Revenue	4.800	Owner's Capital	16.000
Expenses	1.400	Revenues Earned	10.000
Prepaid Insurance	2.400	Owner's Withdrawal	1.600

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

- The insurance policy bought on January 1, 2002, provides protection for three years.
- A count of the supplies reveals that € 800 of supplies are still on hand.
- Merchandise worth € 1000 has been delivered to a customer but has not been billed yet. The invoice is sent out on December 28, 2002.
- The equipment, purchased on July 1, 2002, has an estimated life of four 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 "Mike's Yacht Rental & Apparel".

Problem 6 (5 points)

The following information is available for "Home Stereo Paradise":

Allowance for doubtful accounts at December 31, 2001	€ 22.000
Credit sales during 2002	800.000
Accounts receivable deemed worthless and written off during 2002	50.000

As a result of a review and aging of accounts receivable in early January 2003, however, it has been determined that an allowance for doubtful accounts of € 15.000 is needed at December 31, 2002.

Required:

- What amount should be charged to "bad debt expense" for the fiscal year ending on December 31, 2002? Explain!
- Prepare the journal entry to record the bad debt expense.
- What other method for calculating bad debt expense do you know?

Problem 7 (30 points)

Recently, the municipality Magdeburg decided to rebuild a bridge that was destroyed during World War II. Following the decision a contract was offered to a construction company. The contract was immediately signed and the following data are available: (numbers in thousands)

Contract price: € 12.000

	<u>2003</u>	<u>2004</u>	<u>2005</u>
Cost to date	2.000	5.000	10.000
Estimated cost to complete	6.000	5.000	---
Progress billings during the year	1.500	4.000	6.500
Cash collected during the year	1.300	3.100	7.600

Required:

- (1) What will be the estimated current period gross profit and revenue for 2003, 2004, and 2005 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 2004 is estimated to be € 8.000 instead of € 5.000. How would that be recorded under the percentage-of-completion method? What would be the journal entry for the completed-contract method?

Good luck!