

BA MANI

5077

Examination: Financial Accounting Summer semester 2004
Examiner: Prof. Dr. Alfred Luhmer
The following aid can be used: non-programmable calculator without communication and word processing tools

Hints:

- You must enter your solutions into the answer sheet.
- A total of 120 points can be achieved. There are 5 problem sets. The achievable points for each problem set are given in parentheses. You are advised to base your time allocation on the points.

Problem set 1 - Preparation of financial statements [35 points]

Elisabeth Ladder and Ami Run founded their partnership "Ladder&Run Tights Store" on September 30, 2003. Three months later, on December 31, 2003, they intend to prepare financial statements for the first time.

Elisabeth volunteers and prepares the following unadjusted trial balance:

Trial balance "Ladder&Run Tights Store"		
Cash	27.000	
Accounts receivable (net)	2.100	
Equipment	36.000	
Supplies	500	
Uncollectible accounts expense	800	
Accounts payable		2.500
Unearned revenue		8.000
Elizabeth's investment		5.000
Ami's investment		5.000
Elizabeth's withdrawal	1.200	
Ami's withdrawal	1.000	
Sales revenue		39.400
Expenses	21.300	
Other liabilities		30.000
	89.900	89.900

The following additional information was obtained from looking through the source documents:

1. The equipment was purchased on September 30. It has an estimated useful life of six years.
2. An insurance policy was bought on October 31, and provides protection for two years. It cost € 4.800 and was paid for in cash.
3. By December 31, half of the unearned revenue has been earned.
4. As part of their salary allowance, Elisabeth additionally withdrew € 1.500.
5. "Other liabilities" includes a line of credit for which an interest liability of € 900 has accrued.

Required:

- a) Do all accounts have normal balances?
- b) Prepare the journal entries for the adjustments.
- c) What types of adjusting entries do you know? Why do we need adjusting entries?
- d) Prepare the adjusted trial balance.
- e) Indicate the accounts that are closed at the end of an accounting period.
- f) Prepare the income statement.
- g) Prepare the balance sheet assuming a salary allowance of € 3.000 for Elizabeth and a ratio of 40% for Elizabeth and 60% for Ami for the remainder.

Problem set 2 - Accounting for receivables [20 points]

In January 2003, the partners Will Bounce and Johnny Cash decided to loosen up their tight credit policy and - for the first time - to offer customers purchases on credit. At the end of the year, on December 31, they have the following open accounts:

Customer	Amount	Bill sent on:
Fox	€ 20.000	January 31
Miller	5.000	February 29
Sutton	15.000	April 1
Kieso	18.000	November 4
Weygandt	12.000	November 9
Alexander	28.000	December 18
Nobes	35.000	December 24

Required:

- a) Prepare an aging schedule to determine the net realizable value (NRV) of the receivables outstanding.
- b) Give the journal entry to record allowance for uncollectible accounts.
- c) Assume that on January 2, the account "Nobes" must be written off. Briefly explain how that affects the book value of the receivables. Give the journal entry for the write-off.
- d) On January 12, a payment of € 35.000 is received from Nobes. Give the journal entries to record this transaction.
- e) Under what circumstances is the application of the direct method for recording uncollectibles acceptable? What is an argument in favor of that method?

Problem set 3 - Accounting for long-term contracts [25 points]

To increase the attractiveness of the Otto-von-Guericke University Magdeburg even further, the state Saxony-Anhalt plans to have a couple university buildings built. The state contracts with Stanford Constructions. The accountant of Stanford Constructions has the following information pertaining to the contract available (numbers in thousands):

Contract price: € 25.000

	2003	2004	2005
Cost to date	10.000	20.000	30.000
Estimated cost to complete	10.000	10.000	0
Progress billings during the year	12.000	8.000	5.000
Cash collections	8.000	12.000	5.000

Required:

- a) What will be the estimated current period gross profit and revenue in 2003, 2004, and 2005, respectively, under the percentage-of-completion method?
- b) Give all journal entries to record cost of construction, progress billings, cash collections, and revenue and gross profit for the three years.
- c) Assume that in 2005, Stanford Construction and the state Saxony-Anhalt renegotiate the contract and agree on a contract price of € 31.000. Give the journal entries to record cost of construction and revenue in 2005.

Problem set 4 - Shareholders' equity [20 points]

Olvenstedt Development Corporation (ODC) has outstanding 10.000 shares of € 10 par common shares which had been issued at € 30 per share. ODC then entered into the following transactions.

1. Purchased 1.000 treasury shares at € 35 per share.
2. Resold 500 of the treasury shares at € 40 per share.
3. Resold 500 of the treasury shares at € 31 per share.
4. It declares a property dividend for which an appreciation of securities applies.
5. It distributes item 4 to its shareholders.

Required:

- a) Use the code given on the answer sheet to indicate the effect each of the five transactions has on the financial statement items listed in the table.
- b) Give the journal entry to record item 2.

Problem set 5 - Miscellaneous topics [20 points]

Write two short essays to discuss the following issues:

- a) What different approaches to amortize purchased goodwill do you know? What are arguments against or in favor of these approaches?
- b) The going-concern assumption and the periodicity assumption are two important inputs to the conceptual framework of financial accounting. What do these two assumptions mean and what impact do they have?

Good luck!

Problem set 1:

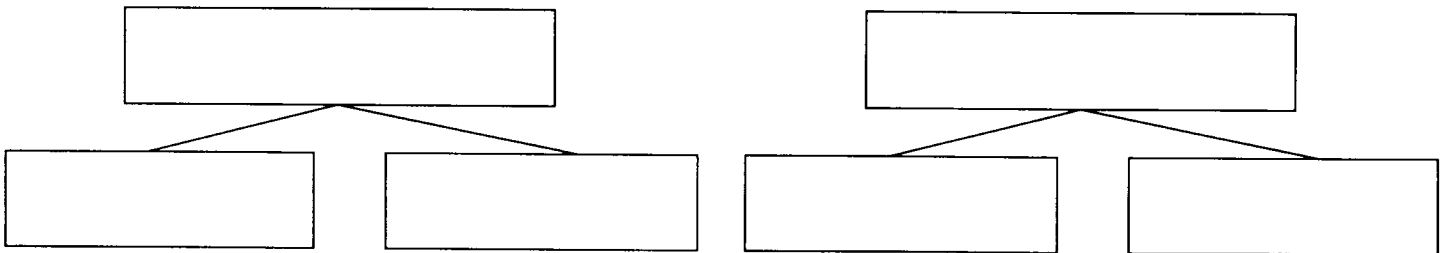
a) Do all accounts have normal balances?

YES NO

b) Journal entries for adjustments

	Account names	Amounts
# 1	Dr. Cr.	
# 2a	Dr. Cr.	
# 2b	Dr. Cr.	
# 3	Dr. Cr.	
# 4	Dr. Cr.	
# 5	Dr. Cr.	

c) Types of adjustments. Why are they needed?



Briefly explain: Why do we need adjusting entries?

Empty box for writing the answer to the question: "Briefly explain: Why do we need adjusting entries?"

d+e) Adjusted trial balance AND indicate whether accounts are closed or not.

Note: The number of rows that this table has is no indication for the number of entries required.

Adjusted Trial balance "Ladder&Run Tights Store"	Dr.	Cr.	Closed?	
			yes	no
Cash				
Accounts receivable				
Equipment				
Supplies				
Uncollectible accounts expense				
Accounts payable				
Unearned revenue				
Elizabeth's investment				
Ami's investment				
Elizabeth's withdrawal				
Ami's withdrawal				
Sales revenue				
Expenses				
Other liabilities				

f) **Income Statement**

Revenues	
Expenses	
Net income:

g) Balance sheet

Assets	Liabilities
	Partners' Equity E. Ladder, Capital A. Run, Capital
Total assets:	Total liabilities and partners' equity:

Problem set 2:

a)

Days account outstanding	Amount	Probability of Collection	Net realizable value
Less than 16 days		98%	
Between 16 and 30 days		90%	
Between 31 and 60 days		80%	
Over 60 days		20%	
Total			

b)

Account names	Amounts
Dr.	
Cr.	

c)

Account names	Amounts
Dr.	
Cr.	

Briefly explain how the transaction affects the book value of the receivables.

d) Account names

Amounts

Dr.	
Cr.	

e)

Briefly explain when application of direct method is acceptable.

Problem set 3:

a)

	2003	2004	2005
Current period recognizable revenue			
Current period recognizable gross profit			

b) Account names

Amounts

2003

2004

2005

To record cost of construction

Dr.			
Cr.			

To record progress billings

Dr.			
Cr.			

To record cash collections

Dr.			
Cr.			

To recognize revenue and gross profit

Dr.			
Cr.			

c)

To record cost of construction in 2005

Dr.	
Cr.	

To recognize revenue and gross profit in 2005

Dr.	
Cr.	

Problem set 4:

Code: I = increase; D = decrease; NE = no effect

#	Assets	Liabilities	Shareholders' Equity	Retained profits	Net income
1					
2					
3					
4					
5					

To record resale of treasury shares at € 40 per share

Dr.	
Cr.	

Problem set 5:

a)

b)