

**Spring 2005**  
Financial Accounting 201  
EXAM #2

NAME \_\_\_\_\_  
SECTION TIME (Circle one) 8:00 9:00

Answer all multiple choice questions below; there is only one BEST answer (2 points each)

- 1.       C
- 2.       B
- 3.       C
- 4.       C
- 5.       B
- 6.       A
- 7.       D
- 8.       B
- 9.       D
- 10.      B
- 11.      A
- 12.      D
- 13.      A
- 14.      D
- 15.      A

**Note:** Put answers to problems on Pages provided. Turn in all pages of exam.

Put answer sheets in front of exam.

**SCORE**

	Possible	Actual
Multiple Choice	30	
Problem I	20	
Problem II	40	
Short Answer	<u>10</u>	
Total	<u>100</u>	

**Multiple Choice** (2 points each) There is only **ONE BEST** answer.

### **MULTIPLE CHOICE**

1. Which of the following is **NOT** normally required for revenue to be recognized according to the revenue principle for accrual basis accounting?
  - a. The price is fixed or determinable.
  - b. Services have been performed.
  - c. Cash already has been collected.**
  - d. Evidence of an arrangement for customer payment exists.
  
2. The matching principle states that expenses should be matched with revenues. Another way of stating the principle is to say that
  - a. Assets should be matched with liabilities.
  - b. Efforts should be matched with accomplishments.**
  - c. Dividends should be matched with stockholder investments.
  - d. Cash payments should be matched with cash receipts.
  
3. When should a company report the cost of an insurance policy as an expense?
  - a. When the company first signs the policy.
  - b. When the company pays for the policy.
  - c. When the company receives the benefits from the policy, over its period of coverage.**
  - d. When the company receives payments from the insurance company for its insurance claims.
  
4. Which of the following is the entry to be recorded by a law firm when it receives a retainer from a new client that will be earned when services are provided in the future?
  - a. *Debit* to Accounts Receivable; *credit* to Legal Services Revenue.
  - b. *Debit* to Unearned Revenue; *credit* to Legal Services Revenue.
  - c. *Debit* to Cash; *credit* to Unearned Revenue.**
  - d. *Debit* to Unearned Revenue; *credit* to Cash.
  
5. Which of the following accounts would not appear in a closing journal entry?
  - a. Interest revenue.
  - b. Accumulated depreciation.**
  - c. Retained earnings
  - d. Salary expense
  
6. If **accounts payable** has debit postings of \$19,000, credit postings of \$10,000, and a beginning normal balance of \$11,000, its ending balance is
  - a. \$2,000**
  - b. \$9,000
  - c. \$20,000
  - d. \$21,000

7. Closing entries result in net income being calculated in the income summary account and then transferred to the
  - a. Revenue account.
  - b. Common Stock account.
  - c. Dividends account.
  - d. Retained Earnings account.**
  
8. The revenue recognition principle dictates that revenue should be recognized in the accounting records
  - a. When cash is received
  - b. When it is earned.**
  - c. At the end of the month.
  - d. In the period that income taxes are paid.
  
9. The accounting cycle is
  - a. The time period from using cash to purchase merchandise through the collection of cash from sales of merchandise.
  - b. The calendar year.
  - c. The 12-month time period which an entity uses for its accounting period.
  - d. The series of steps performed for a time period beginning with collection and analysis of data from source documents and ending with preparation of financial statements.**
  
10. A company has appropriately applied the matching principle in 2004 in each case described below EXCEPT:
  - a. Sales commissions are charged to expense in 2004 on all sales revenue realized in 2004 even though some of the commissions have not been paid.
  - b. Insurance expense is recognized for the total cost of a 1-year policy purchased in August, 2004.**
  - c. A loss is recognized in 2004 on land that is sold below its cost.
  - d. Utility expenses (e.g., for electricity and water used) are recognized in 2004 even though the last bill received in 2004 has not been paid.
  
11. A person who wants to determine the balance of a particular account should refer to the
  - a. Ledger.**
  - b. Source document.
  - c. Chart of accounts.
  - d. Journal.
  
12. An adjusted trial balance
  - a. Shows the ending balances in a "debit" and "credit" format before posting the adjusting journal entries.
  - b. Is prepared after closing entries have been posted.
  - c. Is a tool used by financial analysts to review the performance of publicly traded companies.
  - d. Shows the ending balances resulting from the adjusting journal entries in a "debit" and "credit" format.**

13. Company A owns a building. Which of the following statements regarding depreciation is false from an accounting perspective?
- As the market value of the building increases, depreciation should increase.**
  - Depreciation is an estimated expense to be recorded each period during the building's life.
  - As depreciation is recorded, stockholders' equity is reduced.
  - As depreciation is recorded, total assets are reduced.
14. Posting is performed by transferring information from the
- Source documents to the journal.
  - Ledger to the journal.
  - Source documents to the ledger.
  - Journal to the ledger.**
15. A gift shop signs a three-month note payable to help finance increases in inventory for the Christmas shopping season. The note is signed on November 1 in the amount of \$20,000 with annual interest of 6%. What is the adjusting entry to be made on December 31 for the interest expense accrued to that date, if no entries have been made previously for the interest?
- |                                 |            |            |
|---------------------------------|------------|------------|
| <b>a. Interest Expense.....</b> | <b>200</b> |            |
| <b>Interest Payable.....</b>    |            | <b>200</b> |
| b. Interest Expense.....        | 300        |            |
| Interest Payable.....           |            | 300        |
| c. Interest Expense.....        | 200        |            |
| Cash.....                       |            | 200        |
| d. Interest Expense.....        | 300        |            |
| Note Payable.....               |            | 300        |

**Problem I (20 points)**

In March 2005, Mary Tone Organized a corporation to provide package delivery services. The company, called Tone Deliveries, Inc., began operations immediately. Transactions during the month of March were as follows:

- Mar. 2** The corporation issued 40,000 shares of capital stock to Mary Tone in exchange for \$80,000 cash.
- Mar. 4** Purchased a truck for \$45,000. Made a \$15,000 cash down payment and issued a note payable for the remaining balance.
- Mar. 5** Paid Sloan Properties \$2,500 to rent office space for the month.
- Mar. 9** Billed customers \$11,300 for services for the first half of March.
- Mar. 15** Paid \$7,100 in salaries earned by employees during the first half of March.
- Mar. 19** Paid Bill's Auto \$900 for maintenance and repair services on the company truck.
- Mar. 20** Collected \$3,800 of the amounts billed to customers on March 9.
- Mar. 28** Billed customers \$14,400 for services performed during the second half of the month.
- Mar. 30** Paid \$7,500 in salaries earned by employees during the second half of the month.
- Mar. 30** Received an \$830 bill for SY Petroleum for fuel purchased and used in March. The entire amount is due by April 15.
- Mar. 30** Declared a \$1,200 dividend payable on April 30.

The account titles used by Tone Deliveries are:

- |                     |                     |
|---------------------|---------------------|
| Cash                | Retained Earnings   |
| Accounts Receivable | Dividends           |
| Truck               | Service Revenue     |
| Notes Payable       | Maintenance Expense |
| Accounts Payable    | Fuel Expense        |
| Dividends Payable   | Salaries Expense    |
| Capital Stock       | Rent Expense        |

Journalize the above business events in general journal form on the following page. Be sure to identify the date of each transaction.

### General Journal

Date	Description	Debit	Credit
March 2	Cash Capital Stock	80,000	80,000
March 4	Truck Cash Notes Payable	45,000	15,000 30,000
March 5	Rent Expense Cash	2,500	2,500
March 9	Account Receivable Service Revenue	11,300	11,300
March 15	Salary Expense Cash	7,100	7,100
March 19	Maintenance Expense Cash	900	900
March 20	Cash Accounts Receivable	3,800	3,800
March 28	Accounts Receivable Service Revenue	14,400	14,400
March 30	Salary Expense Cash	7,500	7,500
March 30	Fuel Expense Accounts Payable	830	830
March 30	Dividends Dividends Payable	1,200	1,200

## **Problem II (30 points)**

### **Recording Seven Typical Adjusting Journal Entries**

Bauer's Board Store is completing the accounting process for its first year ended December 31, 2005. The transactions during 2005 have been journalized and posted. The following data are available to determine adjusting journal entries:

- a. The unadjusted balance in Office Supplies at December 31, 2005, was \$850. A year-end count showed \$300 of supplies on hand.
- b. Wages earned by employees during December 2005, averaged \$2,700/day. The last paychecks were issued Wednesday, December 28; the next payments will be made on January 6, 2006.
- c. A portion of the store's basement is rented for \$1,100 per month to N. Myers. On November 1, 2005, the store collected six months' rent in the amount of \$6,600 in advance from Myers. It was credited in full to Unearned Rent Revenue when collected.
- d. The remaining basement space is rented to Kim's Specialty Shop for \$520 per month, payable monthly. On December 31, 2005, the rent for November and December 2005 had not been collected or recorded. Collection is expected January 10, 2006.
- e. The store purchased delivery equipment at the beginning of the year with a cost of \$60,000, estimated life of 6 years and salvage of \$6,000. No depreciation has been recorded.
- f. On December 31, 2005, the unadjusted balance in Prepaid Insurance was \$3,600. This was the amount paid on July 1, 2005 for a two-year insurance policy with coverage beginning on July 1, 2005.
- g. Bauers sent some items to a repair shop. At the end of December 31, 2005, Bauers had not paid for work completed amounting to \$750. This amount has not yet been recorded by Bauers although the repairs were completed and the item was picked up in December, payment is expected to be made during January 2006.

#### **Required:**

Prepare the seven adjustment entries required at December 31, 2005.

### General Journal

Date	Description	Debit	Credit
a.	Supply Expense Supplies (850 - 300 = 550) (available - unused = used)	550	550
b.	Salary Expense Salary Payable (3 x 2,700 = 8,100)	8,100	8,100
c.	Unearned Rent Revenue Rent Revenue (2 x 1,100) Months	2,200	2,200
d.	Accounts Receivable Rent Revenue (2 x 500 ) Month	1,040	1,040
e.	Depreciation Expense Accumulated Depreciation ( <u>60,000 - 6,000</u> = 9,000) 6	9,000	9,000
f.	Insurance Expense Prepaid Insurance (3,600/2 x ½ month) = 900	900	900
g.	Repair Expense Accounts payable	750	750

### Short Answer – Question III (10 points)

Happy Trails, Inc., is a popular family resort just outside Yellowstone National Park. Summer is the resort's busy season, but guests typically pay a deposit at least six months in advance to guarantee their reservations.

The resort is currently seeking new investment capital in order to expand operations. The more profitable Happy Trails appears to be, the more interest it will generate from potential investors. Ed Grimm, an accountant employed by the resort, has been asked by his boss to include \$2 million of unearned guest deposits in the computation of income for the current year since that cash had been collected. Ed explained to his boss that because these deposits had not yet been earned they should be reported in the balance sheet as liabilities, not in the income statement as revenue. Ed argued that reporting guest deposits as revenue would inflate the current year's income and may mislead investors.

Ed's boss then *demanded* that he include \$2 million of unearned guest deposits in the computation of income or be fired. He then told Ed in an assuring tone, "Ed, you will never be held responsible for misleading potential investors because you are just following my orders."

#### Required - Short Answer

A. What is the appropriate accounting treatment of deposits received in advance, and why?

*Record as unearned since GAAP requires recording as revenue when earned not when collected.*

B. Is Ed's boss correct in saying that Ed cannot be held responsible for misleading potential investors, and why?

*No, accountants have an ethical and legal responsibility to have integrity and honesty in following generally accepted accounting principles.*