

Spring 2006
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. C
- 3. B
- 4. C
- 5. D
- 6. D
- 7. B
- 8. A
- 9. C
- 10. A
- 11. D
- 12. A
- 13. D
- 14. D
- 15. C
- 16. B
- 17. D
- 18. B
- 19. B
- 20. B

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	40	
Problem I	20	
Problem II	30	
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. 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.

3. Which of the following accounts would not appear in a closing journal entry?
 - a. Dividends.
 - b. Accumulated depreciation.**
 - c. Retained earnings
 - d. Salary expense

4. If **accounts receivable** 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

5. 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.**

6. The accounting cycle is
- The time period from using cash to purchase merchandise through the collection of cash from sales of merchandise.
 - The calendar year.
 - The 12-month time period which an entity uses for its accounting period.
 - 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 and closing.**
7. A company has appropriately applied the matching principle in 2004 in each case described below EXCEPT:
- 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.
 - Insurance expense is recognized for the total cost of a 1-year policy purchased in August, 2004.**
 - A loss is recognized in 2004 on land that is sold below its cost.
 - 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.
8. A person who wants to determine the balance of a particular account should refer to the
- Ledger.**
 - Source document.
 - Chart of accounts.
 - Journal.
9. Which of the following is **NOT** true of an adjusted trial balance
- It shows the ending balances in a "debit" and "credit" format after posting the adjusting journal entries.
 - It is useful in preparing the financial statements.
 - It is a tool used by financial analysts to review the performance of publicly traded companies.**
 - The "debit" and "credit" format is useful in diagnosing errors such as transpositions or reversing of debits and credits
10. 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.

11. 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.**
12. 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?
- | | | |
|--------------------------|-----|------------|
| a. Interest Expense..... | | 200 |
| Interest Payable..... | | 200 |
| b. Interest Expense..... | 300 | |
| Interest Payable..... | | 300 |
| c. Interest Expense..... | 200 | |
| Cash..... | | 200 |
| d. Interest Expense..... | 300 | |
| Note Payable..... | | 300 |
13. Which of the following transactions results in an increase in expenses?
- Purchase of office equipment on credit.
 - Payment on accounts payable.
 - Repayment of principle of bank loan.
 - Payment of wages.**
14. Which of the following is an example of an accrual?
- Equipment purchased for use in the business.
 - Bookkeeping fees collected but not yet earned.
 - Six months' rent paid in advance.
 - Interest earned but not yet received.**
15. An important purpose of closing entries is to
- Set permanent account balances to zero to begin the next period.
 - Update the nominal accounts at year end.
 - Transfer net income or loss to Retained Earnings.**
 - Help achieve the goals of the matching principle.
16. An advantage of the single-step income statement over the multi-step form is
- Its use in computing ratios.
 - Its simplicity.**
 - Its comprehensiveness.
 - The amount of information it provides.
17. On a multiple-step income statement, the amount of sales returns and allowances is
- subtracted from net sales to determine gross margin on sales.
 - subtracted from gross margin on sales to determine net sales.
 - added in the calculation of cost of goods sold.
 - subtracted from gross sales to determine net sales.**

18. Which of the following statements concerning the gross profit percentage is TRUE?
- a. In 2001, Walmart's gross profit percentage was one of the highest in the industry
 - b. A small change in the gross profit percentage has a large impact on net income**
 - c. The gross profit percentage is a good indication of how much dividends a company's owner can take out of the business
 - d. Gross profit percentage is a key indicator of success in service companies
19. The profit margin percentage
- a. Generally is about 20% (similar to a tip percentage) for most US retailers
 - b. Generally is 5% or less for most US businesses**
 - c. Is an indication of the management of a company's inventory
 - d. Is the approximate markup on most goods sold
20. Walmart sells a pair of socks that normally cost \$5.00 for \$2.88. Because of its clout, it buys the socks for \$2.00 instead of the \$2.50 it costs other stores
- a. Its gross profit is \$3.00
 - b. Its gross profit is \$.88**
 - c. Its gross profit is \$2.50
 - d. Its gross profit is \$2.88

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** Mary Tone paid the corporation \$40,000 cash and a delivery van worth \$20,000 in exchange for 60,000 shares of capital stock.
- Mar. 4** The corporation purchased a truck for \$45,000. It paid for the truck by paying \$15,000 cash as a down payment and signing 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. 24** Collected a retainer from a new customer of \$1,000 for services to be performed in April
- 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
Prepaid Deposits	Supplies
Truck	Service Revenue
Notes Payable	Maintenance Expense
Accounts Payable	Fuel Expense
Dividends Payable	Salaries Expense
Unearned revenue	Utility 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
Mar. 2	Cash Truck Capital stock	40,000 20,000	60,000
4	Truck Cash Note payable	45,000	15,000 30,000
5	Rent expense Cash	2,500	2,500
9	Accounts receivable Service receivable	11,300	11,300
15	Salary expense Cash	7,100	7,100
19	Cash Accounts receivable	900	900
20	Cash Unearned revenue	3,800	3,800
24	Accounts receivable Service receivable	1,000	1,000
28	Salary expense Cash	14,400	14,400
30	Fuel expense Accounts payable	7,500	7,500
30	Dividends Dividends payable	830	830

Problem II (30 points)

Recording 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. A year-end count of office supplies showed \$300 of supplies on hand.
- b. The employees work Monday through Friday and earn \$200/day. Payday is Friday. The last day of the year is Wednesday December 31. Employees will be paid January 2, 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.
- 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 \$48,000, estimated life of 6 years and salvage of \$6,000. No depreciation has been recorded.
- f. Prepaid insurance is 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.
- h. The note payable resulted from a loan on October 1 at 6% interest.

Required:

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

Unadjusted Trial Balance	
Cash	1,550
Supplies	850
Delivery Equipment	60,000
Prepaid Insurance	3,600
Note payable	60,000
Common Stock	1,000
Wages Expense	56,000
Unearned Rent	6,600
Revenues	<u>54,400</u>
	122,000
	<u>122,000</u>

General Journal

Date	Description	Debit	Credit
a.	Supply expense Supplies	550	550
b.	Salary expense Salary payable	600	600
c.	Unearned rent (Rent) revenues	2,200	2,200
d.	Accounts receivable (Rent) revenue	1,040	1,040
e.	Depreciation expense Accumulated depreciation	7,000	7,000
f.	Insurance expense Prepaid insurance	900	900
g.	Interest expense Accounts payable	750	750
h.	Interest expense Interest payable	900	900

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?

Should be recorded as liability since it is not yet earned.

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

No, accountant's are required to have integrity and the accountant can be held responsible such as was the case with World Com's bookkeeper.