

COMPREHENSIVE EXAMINATION A

(Chapters 1 - 5)

Problem	Topic	Points	Approximate Minutes
A - I	Multiple Choice	20	10
A - II	Matching	12	8
A - III	Adjusting Entries	15	20
A - IV	Ratios	12	15
A - V	Journal Entries.....	18	12
A - VI	Income Statement for a Merchandising Company	14	10
A - VII	Assumptions, Principles, and Constraints	<u>9</u>	<u>10</u>
		<u>100</u>	85
	Checking Work		<u>5</u>
			<u>90</u>

Problem A - I — Multiple Choice (20 points)

Circle the one best answer.

1. The primary accounting standard-setting body in the United States is the
 - a. Securities and Exchange Commission.
 - b. Internal Revenue Service.
 - c. Financial Accounting Standards Board.
 - d. Corporate Board of Directors.

2. An increase in a revenue
 - a. decreases net income.
 - b. decreases assets.
 - c. increases liabilities.
 - d. increases stockholders' equity.

3. A corporation with total stockholders' equity of \$75,000 paid a \$12,000 business debt. As a result of this transaction, total stockholders' equity
 - a. did not change.
 - b. increased by \$12,000.
 - c. decreased by \$12,000.
 - d. increased to \$75,000.

4. The left side of an account is always
 - a. the debit side.
 - b. the credit side.
 - c. the balance of that account.
 - d. carried forward to the next accounting period.

5. Posting is the process of
 - a. preparing a chart of accounts.
 - b. adding a column of figures.
 - c. transferring journal entries to ledger accounts.
 - d. recording entries in a journal.

6. The purpose of recording depreciation on productive assets is to
 - a. reflect the decline in the market value of the assets each period.
 - b. reduce income when the company has an exceptionally profitable year.
 - c. be in conformity with the revenue recognition principle.
 - d. allocate the original cost of a productive asset to expense over its useful life.

7. Tanner Company debited Prepaid Insurance for \$600 on May 1, 2007, for a one-year fire insurance policy. If the company prepares monthly financial statements, failure to make an adjusting entry on May 31, for the amount of insurance that has expired would cause
 - a. assets to be overstated by \$600 and expenses to be understated by \$600.
 - b. expenses to be overstated by \$50 and assets to be understated by \$50.
 - c. assets to be overstated by \$50 and expenses to be understated by \$50.
 - d. expenses to be overstated by \$600 and assets to be understated by \$600.

8. Which one of the following accounts is not closed at the end of an accounting period?
 - a. Retained Earnings account
 - b. Dividends account
 - c. Service Revenue account
 - d. Insurance Expense account

9. The revenue recognition principle dictates that revenue should be recognized in the accounting period in which it is
- collected.
 - earned.
 - earned and collected.
 - most likely to be collected.
10. Gross profit is calculated by
- subtracting total expenses from total revenues.
 - subtracting cost of goods sold from net sales.
 - subtracting the ending inventory from cost of goods sold.
 - adding cost of goods sold to net sales.

Problem A - II — Matching (10 points)

Match the items below by entering the appropriate letter in the space.

- | | |
|--------------------------------------|---|
| ___ 1. Partnership | A. A liability created when cash is received in advance of performing a service for a customer. |
| ___ 2. Liquidity | B. The constraint of determining whether an item is large enough to likely influence the decision of an investor or creditor. |
| ___ 3. Liabilities | C. Company will remain in business long enough to carry out its existing objectives. |
| ___ 4. Revenue recognition principle | D. Noncurrent assets that do not have physical substance. |
| ___ 5. Ledger | E. An economic entity which is not a separate legal entity. |
| ___ 6. Matching principle | F. The principle that companies recognize revenues in the accounting period in which it is earned. |
| ___ 7. Unearned revenues | G. The ability of a company to pay obligations that are expected to become due within the next year. |
| ___ 8. Materiality | H. A contra revenue account. |
| ___ 9. Income summary | I. The recognition of efforts (expenses) at the same time as accomplishments (revenues). |
| ___ 10. Intangible assets | J. Creditors' claims on total assets. |
| ___ 11. Going concern assumption | K. A temporary account used in closing revenue and expense accounts. |
| ___ 12. Sales discounts | L. ___ Contains all asset, liability, and stockholders' equity accounts. |

Problem A - IV — Financial Analysis (12 points)

The following data are taken from the financial statements of Logan Company. The average number of shares of common outstanding for the year was 10,000. The following data are in alphabetical order:

Accounts payable	\$ 25,000	Net sales	\$ 400,000
Accounts receivable	76,000	Other current liabilities	15,000
Cash	34,000	Salaries payable	4,000
Gross profit	185,000	Stockholders' equity	114,000
Net income	60,000	Total assets	285,000

Instructions

Compute the following:

- (a) Current ratio
- (b) Debt to total assets ratio
- (c) Earnings per share
- (d) Working capital

Problem A - V — Journal Entries (18 points)

Prepare the necessary general journal entries for the month of September for the Joiner Company for each situation given below. Joiner uses a perpetual inventory system.

- Oct. 5 Paid cash of \$14,000 for operating expenses that were incurred and properly recorded in the previous period.
- 8 Purchased merchandise for \$16,000 on account September 1. Credit terms: 2/10, n/30.
- 10 Paid freight bill of \$335 for merchandise purchased on September 8.
- 15 Paid for merchandise purchased on September 9. The company takes all discounts to which it is entitled.
- 20 Sold merchandise for \$13,000 to Fred Lord on account on September 12. The cost of the merchandise sold was \$7,800. Credit terms: 2/10, n/30.
- 25 Issued a credit memo to Fred Lord for \$800 for merchandise returned by him from the sale on September 20. The cost of the merchandise returned was \$480.

Problem A - VI — Multiple-Step Income Statement (15 points)

Below is a partial listing of the adjusted account balances of the Lowell Department Store at year-end on December 31, 2007.

Accounts Receivable	\$ 18,000
Cost of Goods Sold	255,000
Selling Expenses (includes depreciation)	35,000
Interest Expense	2,000
Accumulated Depreciation—Building	10,000
Sales Discounts	32,000
Merchandise Inventory	44,000
Administrative Expenses (includes depreciation)	17,000
Sales	360,000
Accounts Payable	15,000
Interest Revenue	700

Instructions

Using whatever data you believe appropriate, prepare a multiple-step income statement for the Lowell Department Store for the year ended December 31, 2007.

Problem A - VII — Assumptions and Principles (9 points)

Instructions: Each of the situations below may illustrate a violation of an accounting assumption or principle. Indicate the assumption or principle that is most clearly violated using the following codes:

Codes

- | | |
|----------------------------------|---|
| A. Economic entity assumption | G. Materiality |
| B. Monetary unit assumption | H. Full disclosure principle |
| C. Time period assumption | I. Cost principle |
| D. Going concern assumption | J. Conservatism |
| E. Revenue recognition principle | K. No violation of operating guidelines |
| F. Matching principle | |

Situations

- _____ 1. Stockholders invested an additional \$60,000 cash in the business in 2007. This investment was reported as revenue on the 2007 income statement.
- _____ 2. Larson Paperweights values the marble it has on hand at its expected selling price since this is its expected value to the business. The marble's expected selling price exceeds the price Larson paid for it.
- _____ 3. Pandle Company reports its inventory at cost when current replacement cost is significantly below cost.
- _____ 4. Kailey's Novelties has 100,000 whistling dolls in inventory at a cost of \$5 each. Only eight were sold last month. Not wanting to write off this inventory and report a loss, Kailey has decided not to issue financial statements until at least half of the dolls have been sold.
- _____ 5. Zenger's Pizza is being liquidated because it has sustained losses for many years. It continues to depreciate its assets and prepare financial statements on the cost basis.
- _____ 6. Kim Penkins, president of Penkins Machinery, took a power saw out of inventory to use as a birthday present for his son. Supplies expense was debited.
- _____ 7. Blake Industries has developed an automobile engine that will run on sea water instead of gasoline, while providing equal performance. They have chosen not to release reports of this engine to the public.
- _____ 8. Minton Company made no entry to record depreciation on its equipment for 2007.
- _____ 9. Stevens Brokerage bought each of its 5,000 employees new staplers for their desks. Each stapler cost \$10 and was decorated with the company's logo. Since Stevens expenses all assets costing less than \$25, no asset was recorded. Using the following codes, classify each of the items listed below as either an assumption, a principle, or a constraint.

Solutions — Comprehensive Examination A

Problem A - I — Solution

- | | | | |
|------|------|------|-------|
| 1. c | 4. a | 7. c | 10. b |
| 2. d | 5. c | 8. a | |
| 3. a | 6. d | 9. b | |

Problem A - II — Solution

- | | |
|------|-------|
| 1. E | 7. A |
| 2. G | 8. B |
| 3. J | 9. K |
| 4. F | 10. D |
| 5. L | 11. C |
| 6. I | 12. H |

Problem A - III — Solution

1. Insurance Expense	150	
Prepaid Insurance		150
2. Unearned Rent	1500	
Rent Earned		1500
3. Office Supplies Expense	730	
Office Supplies		730
4. Depreciation Expense	625	
Accumulated Depreciation—Delivery Van		625
5. Salaries Expense	675	
Salaries Payable		675

Problem A - IV — Solution

- (a) Current Ratio = Current assets ÷ Current liabilities
 = \$110,000 ÷ \$44,000 = 2.5 : 1
- (b) Debt to total assets Ratio = Total debt ÷ Total assets
 = \$171,000 ÷ \$285,000 = 60%
 (Total debt = Total assets - Stockholders' equity = \$285,000 - \$114,000)
- (c) Earnings per share = Net income – Preferred stock dividends ÷ Average number of common shares outstanding = \$60,000 ÷ 10,000 = \$6.00 per share
- (d) Working capital = Currents assets – Current liabilities
 = \$110,000 - \$44,000 = \$66,000

Problem A - V — Solution

Oct. 5	Accounts Payable	14,000	
	Cash		14,000
Oct. 8	Merchandise Inventory	16,000	
	Accounts Payable		16,000
Oct. 10	Merchandise Inventory	335	
	Cash		335
Oct. 15	Accounts Payable	16,000	
	Merchandise Inventory		320
	Cash		15,680
Oct. 20	Accounts Receivable	13,000	
	Sales		13,000
	Cost of Goods Sold.....	7,800	
	Merchandise Inventory.....		7,800
Oct. 25	Sales Returns and Allowances	800	
	Accounts Receivable		800
	Merchandise Inventory	480	
	Cost of Goods Sold.....		480

Problem A - VI — Solution

LOWELL DEPARTMENT STORE
Income Statement
For Year Ended December 31, 2007

Sales revenues		
Sales	\$360,000	
Less: Sales discounts	<u>32,000</u>	
Net sales		\$328,000
Cost of goods sold		<u>255,000</u>
Gross profit		73,000
Operating expenses		
Selling expenses	35,000	
Administrative expenses	<u>17,000</u>	
Total operating expenses		<u>52,000</u>
Income from operations		21,000
Other revenues and gains		
Interest revenue	700	
Other expenses and losses		
Interest expense	<u>2,000</u>	<u>1,300</u>
Net income.....		<u>\$ 19,700</u>

Problem A - VII — Solution

- | | |
|------|------|
| 1. E | 6. A |
| 2. I | 7. H |
| 3. J | 8. F |
| 4. C | 9. K |
| 5. D | |