

COMPREHENSIVE EXAMINATION A

PART 1

(Chapters 1-6)

Problem A-I — Multiple Choice.

Choose the *best* answer for each of the following questions and enter the identifying letter in the space provided.

- _____ 1. How does failure to record accrued revenue distort the financial reports?
- It understates revenue, net income, and current assets.
 - It understates net income, stockholders' equity, and current liabilities.
 - It overstates revenue, stockholders' equity, and current liabilities.
 - It understates current assets and overstates stockholders' equity.
- _____ 2. A contingent liability which is normally accrued is
- notes receivable discounted.
 - accommodation endorsements on customer notes.
 - additional compensation that may be payable on a dispute now being arbitrated.
 - estimated claims under a service warranty on new products sold.
- _____ 3. Which of the following items is a current liability?
- Bonds due in three months (for which there is an adequate sinking fund classified as a long-term investment).
 - Bonds due in three years.
 - Bonds (for which there is an adequate appropriation of retained earnings) due in eleven months.
 - Bonds to be refunded when due in eight months, there being no doubt about the marketability of the refunding issue.
- _____ 4. On June 15, 2014 Stine Corporation accepted delivery of merchandise which it purchased on account. As of June 30 Stine had not recorded the transaction or included the merchandise in its inventory. The effect of this error on its balance sheet for June 30, 2014 would be
- assets and stockholders' equity were overstated but liabilities were not affected.
 - stockholders' equity was the only item affected by the omission.
 - assets and liabilities were understated but stockholders' equity was not affected.
 - assets and stockholders' equity were understated but liabilities were not affected.
- _____ 5. Reversing entries are most commonly used in relation to year-end adjusting entries that
- allocate the expired portion of a depreciable asset to expense.
 - amortize intangible assets.
 - provide for bad debt expense.
 - accrue interest revenue on notes receivable.

- _____ 6. Of the following adjusting entries, which one would cause an increase in assets at the end of the period?
- a. The entry to record the earned portion of rent received in advance.
 - b. The entry to accrue unrecorded interest expense.
 - c. The entry to accrue unrecorded interest revenue.
 - d. The entry to record expiration of prepaid insurance.
- _____ 7. Why is it necessary to make adjusting entries?
- a. The accountant has made errors in recording external transactions.
 - b. Certain facts about the affairs of the business are not included in the ledger as built up from external transactions.
 - c. The accountant wants to show the largest possible net income for the period.
 - d. The accountant wants to show the net cash flow for the year.
- _____ 8. Notes to financial statements should **not** be used to
- a. describe the nature and effect of a change in accounting principles.
 - b. identify substantial differences between book and tax income.
 - c. correct an improper financial statement presentation.
 - d. indicate basis for asset valuation.
- _____ 9. Consistency is best demonstrated when
- a. expenses are reported as charges against the period in which incurred.
 - b. the effect of changes in accounting methods is properly disclosed.
 - c. extraordinary gains and losses are not reported on the income statement.
 - d. accounting procedures are adopted which give a consistent rate of net income.
- _____ 10. The current assets section of a balance sheet should **never** include
- a. a receivable from a customer not collectible for over one year.
 - b. the premium paid on short-term bond investment.
 - c. goodwill arising from the purchase of a going business.
 - d. customers' accounts with credit balances.

Problem A-II — Adjusting and Reversing Entries.

The following list of accounts and their balances represents the unadjusted trial balance of Alt Company at December 31, 2014:

Cash	\$ 27,290	
Equity Investments (trading)	60,000	
Accounts Receivable	69,000	
Allowance for Doubtful Accounts		\$ 500
Inventory	54,720	
Prepaid Rent	36,000	
Plant Assets	160,000	
Accumulated Depreciation-Plant Assets		14,740
Accounts Payable		11,370
Bonds Payable		90,000
Common Stock		170,000
Retained Earnings		97,180
Sales Revenue		214,800
Cost of Goods Sold	154,400	
Freight-Out	11,000	
Salaries and Wages Expense	32,000	
Interest Expense	2,040	
Rent Revenue		21,600
Miscellaneous Expense	890	
Insurance Expense	12,850	
	<u>\$620,190</u>	<u>\$620,190</u>

Additional Data:

Problem A-II — (cont.)

- The balance in the Insurance Expense account contains the premium costs of three policies:
 Policy 1, remaining cost of \$2,550, 1-yr. term, taken out on May 1, 2013;
 Policy 2, original cost of \$9,000, 3-yr. term, taken out on Oct. 1, 2014;
 Policy 3, original cost of \$1,300, 1-yr. term, taken out on Jan. 1, 2014.
- On September 30, 2014, Alt received \$21,600 rent from its lessee for an eighteen month lease beginning on that date.
- The regular rate of depreciation is 10% per year. Acquisitions and retirements during a year are depreciated at half this rate. There were no purchases during the year. On December 31, 2013, the balance of the Plant and Equipment account was \$220,000.
- On December 28, 2014, the bookkeeper incorrectly credited Sales Revenue for a receipt on account in the amount of \$20,000.
- At December 31, 2014, salaries and wages accrued but unpaid were \$4,200.
- Alt estimates that 1% of sales will become uncollectible.
- On August 1, 2014, Alt purchased, as a short-term investment, 60 \$1,000, 6% bonds of Allen Corp. at par. The bonds mature on August 1, 2015. Interest payment dates are July 31 and January 31.

8. On April 30, 2014, Alt rented a warehouse for \$3,000 per month, paying \$36,000 in advance.

Instructions

- (a) Record the necessary correcting and adjusting entries.
- (b) Indicate which of the adjusting entries may be reversed at the beginning of the next accounting period.

Problem A-III — Key Conceptual Terms.

Various accounting assumptions, principles, constraints, and characteristics are listed below. Select those which best justify the following accounting procedures and indicate the corresponding letter(s) in the space(s) provided. A letter may be used more than once or not at all.

- | | | |
|--------------------|------------------------|----------------------------|
| a. Historical cost | f. Economic entity | k. Revenue recognition |
| b. Relevance | g. Cost constraint | l. Full disclosure |
| c. Monetary unit | h. Conservatism | m. Faithful representation |
| d. Going concern | i. Periodicity | |
| e. Consistency | j. Expense recognition | |

- _____ 1. Chose the solution that will be least likely to overstate assets or income.
- _____ 2. Describing the depreciation methods used in the financial statements.
- _____ 3. Applying the same accounting treatment to similar accounting events.
- _____ 4. The quality which helps users make predictions about present, past, and future events.
- _____ 5. Recording a transaction when goods or services are exchanged for cash or claims to cash.
- _____ 6. Preparing consolidated statements.
- _____ 7. Information must make a difference or a company need not disclose it.
- _____ 8. Provides the figure at which to record a liability.
- _____ 9. The preparation of timely reports on continuing operations.
- _____ 10. Accrual accounting (do not use "going concern").
- _____ 11. Reporting those items which are significant enough to affect decisions. Select two.
- _____ 12. Additivity of financial statement figures relating to different time periods.
- _____ 13. Ignoring the phenomenon of price-level changes (do not use "historical cost").
- _____ 14. Not reporting assets at liquidation prices (do not use "historical cost").
- _____ 15. Characterized by completeness, neutrality, and being free from error.
- _____ 16. Establishment of an allowance for doubtful accounts.
- _____ 17. Use of estimating procedures for amortization policies. Select two (do not use "periodicity") (17 and 18).
- _____ 18. See item 17 above.

Problem A-IV — Balance Sheet Form.

List the corrections needed to present in good form the balance sheet below. Errors include misclassifications, lack of adequate disclosure, and poor terminology. Do not concern yourself with the arithmetic. If an item can be classified in more than one category, select the category most favored by the authors of your textbook.

Tanner Corporation
Balance Sheet
For the year ended December 31, 2014

Assets

Current Assets:		
Cash	\$ 18,000	
Equity investments—trading (fair value, \$32,000)	27,000	
Accounts receivable	75,000	
Inventory	60,000	
Supplies inventory	3,000	
Investment in subsidiary company	<u>60,000</u>	\$243,000
Investments:		
Treasury stock		78,000
Tangible Fixed Assets:		
Buildings and land	213,000	
Less: Reserve for depreciation	<u>60,000</u>	153,000
Deferred Charges:		
Discount on bonds payable		3,000
Other Assets:		
Cash surrender value of life insurance		<u>54,000</u>
		<u>\$531,000</u>

Liabilities and Capital

Current Liabilities:		
Accounts payable	\$ 45,000	
Reserve for income taxes	42,000	
Customer's accounts with credit balances	<u>3</u>	\$ 87,003
Long-Term Liabilities:		
Bonds payable		<u>120,000</u>
Total Liabilities		207,003
Capital Stock:		
Capital stock	225,000	
Earned surplus	74,997	
Cash dividends declared	<u>24,000</u>	<u>323,997</u>
		<u>\$531,000</u>

Problem A-V — Balance Sheet and Income Statement Classifications.

Specify, to the left of each account, the letter of the financial statement classification the account would appear in. Use only the classifications shown.

Balance Sheet
Statement

- a. Current Assets
- b. Investments
- c. Property, Plant, and Equipment
- d. Intangible Assets
- e. Other Assets
- f. Current Liabilities
- g. Long-term Debt
- h. Capital Stock
- i. Retained Earnings

Income and Retained Earnings

- j. Sales Revenue
- k. Cost of Goods Sold
- l. Operating Expenses
- m. Other Revenues and Gains
- n. Other Expenses and Losses
- o. Extraordinary Item
- p. Retained Earnings Section
- q. Not on the Statements

Account balances taken from the ledger of Morin Company on December 31, 2014 follow:

- | | |
|---|---|
| _____ 1. Common Stock, \$10 par | _____ 16. Inventory |
| _____ 2. Loss on Disposal of Equipment | _____ 17. Salaries and Wages Expense |
| _____ 3. Buildings | _____ 18. Merchandise on order with supplier |
| _____ 4. Office Expense | _____ 19. Interest Revenue |
| _____ 5. Allowance for Doubtful Accounts | _____ 20. Selling Expenses |
| _____ 6. Notes Payable (Short Term) | _____ 21. Interest Expense |
| _____ 7. Accum. Depreciation—Buildings | _____ 22. Income Taxes Payable |
| _____ 8. Mortgage Payable due 2016 | _____ 23. Insurance Expense |
| _____ 9. Depletion Expense | _____ 24. Advertising Expense |
| _____ 10. Freight-Out | _____ 25. Equity Investments |
| _____ 11. Sales Revenue | _____ 26. Accounts Receivable |
| _____ 12. Dividends | _____ 27. Land |
| _____ 13. Retained Earnings Dec. 31, 2013 | _____ 28. Accounts Payable |
| _____ 14. Cash | _____ 29. Error made in computing 2012 depreciation expense |
| _____ 15. Sales Discounts | _____ 30. Gain on Redemption of Debt |

Problem A-VI — Future Value and Present Value.

In computing your answers to the cases below, you can round your answer to the nearest dollar. Present value tables are provided on the next page.

Use the following information in answering Cases 1 and 2 below:

On January 1, 2008, Gray Company sold \$900,000 of 10% bonds, due January 1, 2018. Interest on these bonds is paid on July 1 and January 1 each year. According to the terms of the bond contract, Gray must establish a sinking fund for the retirement of the bond principal starting no later than January 1, 2016. Since Gray was in a tight cash position during the years 2008 through 2013, the first contribution into the fund was made on January 1, 2014.

Case 1: Assume that, starting with the January 1, 2014 contribution, Gray desires to make a total of four equal annual contributions into this fund. Compute the amount of each of these contributions assuming the interest rate is 8% compounded annually.

Case 2: Assume, instead, that starting with the January 1, 2016 contribution, Gray desires to make a total of five equal semiannual contributions into this fund. Compute the amount of each of these contributions assuming the annual interest rate is 12%, compounded semiannually.

Case 3: On January 2, 2014, Nelson Company loaned \$100,000 to Holt Company. The terms of this loan agreement stipulate that Holt is to make 5 equal annual payments to Nelson at 10% interest compounded annually. Assume the payments are to begin on December 31, 2014. Compute the amount of each of these payments.

Case 4: Jim Marsh, a lawyer contemplating retirement on his 65th birthday, decides to create a fund on an 8% basis which will enable him to withdraw \$60,000 per year beginning June 30, 2017, and ending June 30, 2021. To provide this fund, he intends to make equal contributions on June 30 of each of the years 2012 through 2016.

- (a) How much must the balance of the fund equal after the last contribution on June 30, 2016 in order for him to satisfy his objective?
- (b) What are each of his contributions to the fund?

Table 1
Future Value of 1

Periods	6%	8%	9%	10%	12%
1	1.06000	1.08000	1.09000	1.10000	1.1200
2	1.12360	1.16640	1.18810	1.21000	1.2544
3	1.19102	1.25971	1.29503	1.33100	1.4049
4	1.26248	1.36049	1.41158	1.46410	1.5735
5	1.33823	1.46933	1.53862	1.61051	1.7623

Table 2
Present Value of 1

Periods	6%	8%	9%	10%	12%
1	0.94340	0.92593	0.91743	0.90909	0.8928
2	0.89000	0.85734	0.84168	0.82645	0.7971
3	0.83962	0.79383	0.77218	0.75132	0.7117
4	0.79209	0.73503	0.70843	0.68301	0.6355
5	0.74726	0.68058	0.64993	0.62092	0.5674

Table 3
Future Value of an Ordinary Annuity of 1

Periods	6%	8%	9%	10%	12%
1	1.00000	1.00000	1.00000	1.00000	1.0000
2	2.06000	2.08000	2.09000	2.10000	2.1200
3	3.18360	3.24640	3.27810	3.31000	3.3744
4	4.37462	4.50611	4.57313	4.64100	4.7793
5	5.63709	5.86660	5.98471	6.10510	6.3528

Table 4
Present Value of an Ordinary Annuity of 1

Periods	6%	8%	9%	10%	12%
1	0.94340	0.92593	0.91743	0.90909	0.8928
2	1.83339	1.78326	1.75911	1.73554	1.6900
3	2.67301	2.57710	2.53130	2.48685	2.4018
4	3.46511	3.31213	3.23972	3.16986	3.0373
5	4.21236	3.99271	3.88965	3.79079	3.6047

Table 5
Present Value of an Annuity Due of 1

Periods	6%	8%	9%	10%	12%
1	1.00000	1.00000	1.00000	1.00000	1.0000
2	1.94340	1.92593	1.91743	1.90909	1.8928
3	2.83339	2.78326	2.75911	2.73554	2.6900
4	3.67301	3.57710	3.53130	3.48685	3.4018
5	4.46511	4.31213	4.23972	4.16986	4.0373

Solutions — Comprehensive Examination A

Problem A-I — Solution.

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

Problem A-II — Solution.

(a) 1. Prepaid Insurance	8,250	
Insurance Expense		8,250
(Both Policies 1 and 3 have expired and their costs belong in Insurance Expense. The monthly premium on Policy 2 is $\$9,000 \div 36 = \250 . At 12/31/14, 33 mos. of insurance, or \$8,250, remains unexpired)		
2. Rent Revenue	18,000	
Unearned Rent		18,000
(Monthly rent is $\$21,600 \div 18 = \$1,200$. At 12/31/14, 15 mos. of rent, or \$18,000, remains unearned)		
3. Depreciation Expense	19,000	
Accumulated Depreciation		19,000
[(Equipment retired during 2014 = $\$220,000 - \$160,000 = \$60,000$)		
10% of \$160,000 = \$16,000		
5% of \$60,000 = <u>3,000</u>		
Total depreciation = <u>\$19,000</u>]		
4. Sales Revenue.....	20,000	
Accounts Receivable		20,000
(To correct the entry made in error)		
5. Salaries and Wages Expense	4,200	
Salaries and Wages Payable		4,200
6. Bad Debt Expense	1,948	
Allowance for Doubtful Accounts		1,948
(Corrected Sales Revenue balance is $\$214,800 - \$20,000 = \$194,800$. 1% of \$194,800 is \$1,948.)		
7. Interest Receivable	1,500	
Interest Revenue		1,500
(Monthly interest is $\$60,000 \times .06 \times 1/12 = \300 . 5 months' accrued interest is \$1,500)		
8. Rent Expense	24,000	
Prepaid Rent		24,000
(To record 8 months' of rent expired at \$3,000 per month)		

- (b) 1, 2, 5, and 7. Items No. 1 and No. 2 represent prepaid items that were initially recorded in nominal accounts. Items No. 5 and No. 7 represent accrued items.

Problem A-III — Solution.

- | | | | |
|------|------------|-------|-------|
| 1. h | 6. f | 11. l | 16. j |
| 2. l | 7. g | 12. c | 17. d |
| 3. e | 8. a | 13. c | 18. j |
| 4. b | 9. i | 14. d | |
| 5. k | 10. j or k | 15. m | |

Problem A-IV — Solution.

1. "For the year ended" in the title should be deleted.
2. Equity investments should be reported at their fair value.
3. The amount of Allowance for Doubtful Accounts should be disclosed and deducted from Accounts Receivable.
4. The inventory costing method (cost, lower of cost or market) and the basis for pricing the inventory (LIFO, FIFO, etc.) should be disclosed.
5. Investment in Subsidiary should be classified as an investment.
6. Treasury Stock is misclassified under Investments. It should appear as a deduction from the Stockholders' Equity section.
7. Buildings and Land should be separated.
8. "Reserve for" Depreciation should be "Accumulated" Depreciation.
9. Discount on Bonds Payable should be classified with and deducted from Bonds Payable.
10. Cash Surrender Value of Life Insurance should be classified among Investments.
11. "Reserve" for Income Taxes should be titled Income Taxes Payable.
12. The small balance of \$3 for customer's accounts with credit balances, while not erroneously classified, might be offset against and buried in the Accounts Receivable account because it is so small in amount.
13. The maturity date and the interest rate should be disclosed for the Bonds Payable.
14. "Capital Stock" listed as a title should be "Stockholders' Equity;" "Capital stock" listed as an account should be "Common stock."

15. More information relative to the capital stock, such as par value and the number of shares authorized, issued, and outstanding should be disclosed.
16. "Earned surplus" should not be used; Retained Earnings is the preferred title.
17. Cash dividends declared is actually Dividends Payable and should be classified as a current liability.

Problem A-V — Solution.

- | | | | | |
|------|-------|----------|-------|-------|
| 1. h | 7. c | 13. p | 19. m | 25. b |
| 2. n | 8. g | 14. a | 20. l | 26. a |
| 3. c | 9. k | 15. j | 21. n | 27. c |
| 4. l | 10. l | 16. a, k | 22. f | 28. f |
| 5. a | 11. j | 17. l | 23. l | 29. p |
| 6. f | 12. p | 18. q | 24. l | 30. m |

Problem A-VI — Solution.

- Case 1. \$900,000 is the amount of an 8% annuity due for 4 periods. Use the table factor for the future value of an 8% ordinary annuity for 4 periods, and multiply by (1.08):

$$4.50611 \times (1.08) = 4.86660.$$

$$\text{Periodic payments} = \$900,000 \div 4.86660 = \underline{\$184,934}$$

- Case 2. Since interest is compounded semiannually, divide the 12% annual interest rate by 2, and use the table factor for the future value of a 6% ordinary annuity for 5 periods.

$$\text{Periodic payments} = \$900,000 \div 5.63709 = \underline{\$159,657}$$

- Case 3. \$100,000 is the present value of a 10% ordinary annuity for 5 periods.

$$\text{Periodic payments} = \$100,000 \div 3.79079 = \underline{\$26,380}$$

- Case 4. (a) At June 30, 2016, the balance in the fund is the present value of an 8% ordinary annuity of \$60,000 for 5 periods.

$$\text{Balance in the fund} = \$60,000 \times 3.99271 = \underline{\$239,563}$$

- (b) At June 30, 2016, \$239,563 is the future value of an 8% ordinary annuity for five periods.

$$\text{Periodic payments} = \$239,563 \div 5.8666 = \underline{\$40,835}$$