

Key Ratios

10/10

- Working Capital

$$= \text{Current Assets} - \text{Current Liabilities}$$

- Current Ratios

$$= \frac{\text{current assets}}{\text{current liabilities}}$$

- Quick Ratio

$$= \frac{(\text{current assets} - \text{inventory} + \text{prepayments})}{\text{current liabilities}}$$

- Debt/Assets

$$= \frac{\text{total debt}}{\text{total assets}}$$

- Gross Profit Rate

$$= \frac{\text{gross profit}}{\text{Sales}}$$

- Profit Margin

$$= \frac{\text{Net profits}}{\text{Sales}}$$

②

$$\text{Receivables Turnover} = \frac{\text{Credit sales}}{\text{average accounts receivable}}$$

Avg Collection Period

$$= \frac{365}{\text{Receivables Turnover}}$$

Did not study
- See where I messed up



MIT Sloan School of Management
15.501 Corporate Financial Accounting
Midterm Examination
October 8, 2008

NAME:

10/10 Practice

SECTION: (Circle one)

[A]

or

[B]

Instructions:

- 1) Exam Length: 1 hour and 20 minutes
- 2) This exam is 16 pages long (including the cover page). Please make sure your copy of the exam is not missing any pages.
- 3) A non-programmable calculator may be used during this exam. No other material is to be used during the exam.
- 4) Write your answers in the space provided *and show any supporting computations you make*. Do not attach additional material.
- 5) The total number of points on this exam is 130.

Manage your time efficiently.

Make sure to look through the entire exam before you start!

Question	Possible Points	Actual Points
1	36	
2	14	
3	24	
4	18	
5	18	
6	20	

Question 1

Instructions: Circle the letter corresponding to your response.

1. If a deterministic or stable selling price exists and a firm does not face substantial marketing or cash collection costs, when is revenue recognition most appropriate?

- a. At the time of sale
- b. At completion of production *right*
- c. At the time of cash collection
- d. At the expiration of returns and warranty periods

2. Trademarks would appear in which balance sheet section?

- a. Intangible assets *- can value + sell 'i'*
- b. Investments
- c. Property, plant, and equipment
- d. Current assets

3. The best definition of assets is the

- a. cash owned by the company.
- b. collection of resources belonging to the company and the claims on these resources.
- c. owners' investment in the business.
- d. resources belonging to a company that have future benefit to the company.

4. Jenner Corporation began the year with retained earnings of \$155,000. During the year, the company issued \$210,000 of common stock, recorded expenses of \$600,000, and paid dividends of \$40,000. If Jenner's ending retained earnings was \$165,000, what was the company's revenue for the year?

- a. \$610,000
- b. \$650,000
- c. \$820,000
- d. \$860,000

$$\begin{array}{r} \cancel{210000} + 40 - 155 \\ 640 - 155 \\ 475? \end{array}$$

CONFUSED
- does not add up

$$RE = \quad - 600 - 40 = 165$$
$$\quad - 640 = 165$$
$$\quad = 805$$

5. Which of the following items has no effect on retained earnings?

- a. Expense
- b. Dividends
- c. Land purchase
- d. Revenue

~~all do?~~

6. Are advanced receipts from customers treated as revenue at the time of receipt? Why or why not?

- a. Yes, they are treated as revenue at the time of receipt because the company has access to the cash.
- b. No, the amount of revenue cannot be adequately determined until the company completes the work.
- c. Yes, the intent of the company is to perform the work and the customer is confident that the services will be completed.
- d. No, revenue cannot be recognized until the work is performed.

7. Based on the following data, what is the amount of current assets?

Accounts payable	31,000
Accounts receivable	50,000
Cash	15,000
Intangible assets	50,000
Inventory	69,000
Long-term investments	80,000
Long-term liabilities	100,000
Marketable securities	40,000
Notes payable	28,000
Plant assets	670,000
Prepaid expenses	1,000

also current

- a. \$96,000
- b. \$175,000
- c. \$106,000
- d. \$105,000

never memorized
all the ratios

8. Simpson Corporation has current assets of \$1,250,000 and current liabilities of \$750,000. If they pay \$250,000 of their accounts payable, what will their new current ratio be?

- a. 2.0:1
- b. 1.7:1
- c. 2.5:1
- d. 1.25:1

$$\frac{\text{assets}}{\text{liabilities}} = \frac{1250}{500}$$

assets go down too!
 $\frac{1000}{500} = 2$
- same as before
payment

9. Blue Corporation issued a one-year 12% \$200,000 note on April 30, 2007. What was interest expense for the year ended December 31, 2007?

- a. \$24,000
- b. \$18,000
- c. \$16,000
- d. \$14,000

8 months

$$\begin{matrix} 10\% & = & 20 \\ 8\% & & 16 \end{matrix}$$

$$200,000 \cdot .08$$

10. Employees at B Corporation are paid \$5,000 cash every Friday for working Monday through Friday. The calendar year accounting period ends on Wednesday, December 31. How much salary expense should be recorded two days later on January 2?

- a. \$5,000
- b. \$3,000
- c. None, matching requires the weekly salary to be accrued on December 31.
- d. \$2,000

11. One might infer from a debit balance in Allowance for Doubtful Accounts that:

- a. A posting error has been made.
- b. More accounts have been written off than had been estimated.
- c. The direct method is being used.
- d. Bad Debt Expense has been overestimated.

need to memorize which side is debit + credit

Use the test to take the test

Dr	Cr
+	-
-	+

12. The financial statements of the Colter Manufacturing Company report net sales of \$400,000 and accounts receivable of \$80,000 and \$40,000 at the beginning of the year and end of year, respectively. What is the average collection period for accounts receivable in days?

- a. 40
- b. 80
- c. 54.7 ✓
- d. 50

$$\frac{365}{\text{Rec turn}} = \frac{365}{\left(\frac{\text{credit sales}}{\text{Avg AR}} \right)}$$

$$\frac{365}{\left(\frac{400,000}{60,000} \right)}$$

$$40 \frac{2}{3} = 40.66666666666667$$

$$\frac{60,000}{365}$$

This stuff is slow
- but know the detail!

Question 2

Joan Batenilli decides to open a pizza parlor near the local college campus. Analyze the following transactions for the month of June:

- Joan Batenilli invests \$25,000 cash in exchange for common stock to start a pizza parlor business on June 1.
- Purchased baking equipment for \$4,000 on June 2, paying \$2,000 in cash and with the remainder due in 60 days.
- Purchased cooking supplies for \$1,200 cash on June 2. *Operating - oh COGS*
- Paid a bill from Campus News for \$200 for advertising in the campus newspaper on June 15. *- I was thinking*
- Billed the Tiger Football Team \$100 for pizzas ordered on June 30.
- Joan Batenilli was paid dividends of \$800 on June 30.
- Incurred utility expenses of \$200 for the month on account. *just incurred*
- Over the month, cash receipts from customers for pizza sales amounted to \$1,500. *Overs (investment PPE) not paid*
- Over the month, paid salaries of \$200 to student workers.

Instructions:

Know which statement is which!

Read carefully

On the following page, prepare a statement of cash flows for Joan Batenilli's pizza parlor for the month of June.

Operating	-200 - 200 + 1500 - 200 = 900 - 100	
Investing	-2,000 - 1200 =	-3,200 - 2000
Financing	<u>25,000 - 800 =</u>	<u>24,200</u>
Net		21,900 22,100
Old Cash	<hr/>	0
New Cash	<hr/> <hr/>	21,900 22,100

Question 3

Taylor Company accumulates the following adjustment data at December 31.

1. Depreciation of \$1,000 on equipment purchased in January.
 2. Salaries of \$1,250 are unpaid.
 3. Prepaid insurance totaling \$900 has expired.
 4. Revenue of \$3,000 collected in advance has been earned.
 5. Revenue of \$2,400 has been earned but unbilled.
 6. Utility expenses of \$250 are unpaid.
 7. Interest of \$500 on a note payable is outstanding for the year but unpaid.
-

Instructions:

A. Using the table on the following page, for each of the above items, indicate:

- (a.) The type of adjustment (prepaid expense, unearned revenue, accrued revenue, or accrued expense).
- (b.) The account relationship (asset/liability, liability/revenue, etc.)
- (c.) The status of account balances before adjustment (understatement or overstatement).
- (d.) The adjusting entry.
- (e.) The income effect.

B. Assume net income before the adjustments listed above was \$56,700. What is the adjusted net income?

broad cat here
They just wanted
broad cat here -

narrow cat

is over for
all

know each cat!

but I thought can't be booked yet

Type of Adjustment	Account Relationship	Account Balances Before Adjustment or (Understatement or Overstatement)	Adjusting Entry	Income Effect
1 Prepaid Depreciation Expense must be 1/4	Assets / Expenses Depreciation is a fund	Over Under ✓	Dr: Depreciation Expense 1000 Cr: Accumulated Depreciation 1000	0 -1000
2 Accrued expenses	Liability Expense AP	Under Over "can be both"	Dr: Salaries Payable 1250 Cr: Retained Earnings Wage Expense 1250	-1,250
3 Prepaid insurance totaling \$900 has expired.	Prepaid Expenses Asset	Under Over	Dr: Insurance Expense 900 Cr: Prepaid Insurance 900	-900
4 Revenue of \$3,000 collected in advance has been earned.	Unearned Rev Cash Liability	Over Under	Dr: Unearned Revenue 3000 Cr: Revenue 3000	+3000 0

Dr/Cr

I did more specific

Liability

owed work

* mislead - had been collected!

	Type of Adjustment	Account Relationship	Account Balances Before Adjustment (Understatement or Overstatement)	Adjusting Entry	Income Effect
5	Accrued Revenue	AR Asset Retained Earnings Revenue	Under Over Under	AR 2400 Retained Earnings 2400 Revenue	+2400
6	Accrued expenses	AP Liability Retained Earnings Expense	Under Over Under	AP 250 Retained Earnings 250 Utility Expense	-250
7	Accrued Expense	AP Liability Retained Earnings Expense	Under Over Under	AP 500 Interest Payable 500 Retained Earnings 500 Interest Expense	-500

Each expense category separate

I also lump the payables

break retained earnings into Revenue/Expense

Question 4

Selected transactions for the Barkley Company are listed below.

1. Paid monthly utility bill.
2. Purchased new display case for cash.
3. Paid cash for repair work on security system.
4. Billed customers for services performed.
5. Received cash from customers billed in transaction 4.
6. Dividends paid to owners.
7. Incurred advertising expenses on account.
8. Paid monthly rent.
9. Received cash from customers when service was rendered.

Instructions:

Describe the effect of each transaction on assets, liabilities, and stockholders' equity. Provide your responses below.

Example: Made initial cash investment in the business.

Answer: Increase in assets and increase in stockholders' equity.

1. Decrease cash, decreased AP

- depends on when accrued

decrease retained earning (expense)
Stockholders' equity

2. ↑ in ~~interest~~ PPE asset
↓ in cash

) no net change in assets
↑ say explicitly here

3. ↓ in cash, ↓ in retained earning / SE ✓

4. (already performed? - just accrued here
↑ AP asset ↑ revenue/retained earning / SE ✓

5. ↓ AP asset ↑ cash_{to} asset no net change in assets ✓

#9.

6. ↓ Cash asset ↓ retained earnings / SE ✓

7. ↑ AP (liability) ↑ expenses / ↓ re / SE ✓
 ↑ say

8. 'accrued now'
 - same as 6. ✓

9. ↑ cash ↑ Revenue / ↑ RE / SE ✓

just say stuff explicitly!

Oh this is the Friday one

Question 5

The Dolton Sign Company uses the allowance method in accounting for uncollectible accounts. Past experience indicates that 6% of accounts receivable will eventually be uncollectible. Selected account balances at December 31, 2006, and December 31, 2007, appear below:

	12/31/2006	12/31/2007
Net Credit Sales	\$400,000	\$500,000
Accounts Receivable	\$80,000	\$100,000
Allowance for Doubtful Accounts	\$4,000	?

Instructions:

A. Record the following events in 2007.

Aug 10 ^{Dr} Determined that the account of Jack Dune for \$700 is uncollectible. ^{Cr}

Allowance for Db Fil accounts 700	AR 700
--------------------------------------	-------------

Sept 21 Determined that the account of Lori Lyons for \$3,000 is uncollectible.

3000	3000
------	------

Oct 10 Received a check for \$400 as payment on account for Jack Dune, whose account had previously been written off as uncollectible.

AR
400

XA
400 and 400

Cash
400

AR
400 400 *always other side*

B. Prepare the adjusting journal entry to record the bad debt provision for the year ended December 31, 2007.

Allowance for Db. accounts

2000	
5,300	
6000	11

2000	Revenue
2000	Bad Debt Expense
5,300	
\$ 4,08,000	

write off - but its the opposite of a write off - Confused

at this pt XA = \$1,700 700

- I was not keeping track

? subset of retained earnings

C. What is the balance of Allowance for Doubtful Accounts at December 31, 2007?

6,000 ✓

D. What is the receivables turnover ratio for 2007?

$$\frac{\text{Sales}}{\text{Avg AR}} = \frac{500,000}{\cancel{40,000}^{85,000}} = \frac{50}{9}$$

Remove XA
 Since $\frac{80,000 - 4,000}{100,000 - 6,000}$ avg

~~$9 \overline{) 45 \cancel{50}}$~~

Wrong way of doing long division
 - What am I thinking!

5.88

* remove allowance of doubtful accounts when calculating turnover ratio

Question 6

The following items are taken from the financial statements of Sutch Company for 2007:

Accounts payable	\$15,000
Accounts receivable	11,000
Accumulated Depreciation – Video Equipment	28,000
Advertising Expense	21,000
Cash	24,000
Common Stock	90,000
Depreciation Expense	12,000
Dividends	15,000
Insurance Expense	3,000
Note Payable (due 2010)	70,000
Prepaid Insurance	6,000
Rent Expense	17,000
Retained Earnings (beginning)	12,000
Salaries Expense	34,000
Salaries Payable	3,000
Service Revenue	145,000
Supplies	4,000
Supplies Expense	6,000
Video Equipment	210,000

Instructions:

- A. On the following two pages, prepare an income statement and a classified balance sheet for Sutch Company for the period ending December 31, 2007. (Assume the note payable is a long-term liability.)

Income Statement

Revenue

Operating Expenses (list each out)

Other Expenses

~~Profit~~
Net
income

Balance Sheet *1 pt in fine*

Sta Cash

:

Stk Asset

:


Lg Tem Asset

etc

B. Compute the current ratio, debt to total assets ratio, and profit margin.

Ratio	Calculation	Answer
Current Ratio	$\frac{\text{Current Assets}}{\text{Liabilities}}$ ✓	
Debt/Assets Ratio	$\frac{\text{Total Liabilities}}{\text{Total Assets}}$ ✓ be more explicit	
Profit Margin	$\frac{\text{Revenue}}{\text{Net Income}}$ Flip 3 Total Sales	

↑
Should be fraction



**MIT Sloan
MANAGEMENT**

MIT Sloan School of Management
15.501 Corporate Financial Accounting
Midterm Examination
October 8, 2008

NAME: _____

SECTION: (Circle one)

[A] or [B]

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Question 1

Instructions: Circle the letter corresponding to your response.

1. If a deterministic or stable selling price exists and a firm does not face substantial marketing or cash collection costs, when is revenue recognition most appropriate?
 - a. At the time of sale
 - b. At completion of production
 - c. At the time of cash collection
 - d. At the expiration of returns and warranty periods

2. Trademarks would appear in which balance sheet section?
 - a. Intangible assets
 - b. Investments
 - c. Property, plant, and equipment
 - d. Current assets

3. The best definition of assets is the
 - a. cash owned by the company.
 - b. collection of resources belonging to the company and the claims on these resources.
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 - d. resources belonging to a company that have future benefit to the company.

4. Jenner Corporation began the year with retained earnings of \$155,000. During the year, the company issued \$210,000 of common stock, recorded expenses of \$600,000, and paid dividends of \$40,000. If Jenner's ending retained earnings was \$165,000, what was the company's revenue for the year?
 - a. \$610,000
 - b. \$650,000
 - c. \$820,000
 - d. \$860,000

5. Which of the following items has no effect on retained earnings?
- Expense
 - Dividends
 - Land purchase
 - Revenue
6. Are advanced receipts from customers treated as revenue at the time of receipt? Why or why not?
- Yes, they are treated as revenue at the time of receipt because the company has access to the cash.
 - No, the amount of revenue cannot be adequately determined until the company completes the work.
 - Yes, the intent of the company is to perform the work and the customer is confident that the services will be completed.
 - No, revenue cannot be recognized until the work is performed.
7. Based on the following data, what is the amount of current assets?

Accounts payable	31,000
Accounts receivable	50,000
Cash	15,000
Intangible assets	50,000
Inventory	69,000
Long-term investments	80,000
Long-term liabilities	100,000
Marketable securities	40,000
Notes payable	28,000
Plant assets	670,000
Prepaid expenses	1,000

- \$96,000
- \$175,000
- \$106,000
- \$105,000

3

8. Simpson Corporation has current assets of \$1,250,000 and current liabilities of \$750,000. If they pay \$250,000 of their accounts payable, what will their new current ratio be?
- 2.0:1
 - 1.7:1
 - 2.5:1
 - 1.25:1
9. Blue Corporation issued a one-year 12% \$200,000 note on April 30, 2007. What was interest expense for the year ended December 31, 2007?
- \$24,000
 - \$18,000
 - \$16,000
 - \$14,000
10. Employees at B Corporation are paid \$5,000 cash every Friday for working Monday through Friday. The calendar year accounting period ends on Wednesday, December 31. How much salary expense should be recorded two days later on January 27?
- \$5,000
 - \$3,000
 - None, matching requires the weekly salary to be accrued on December 31.
 - \$2,000
11. One might infer from a debit balance in Allowance for Doubtful Accounts that:
- A posting error has been made.
 - More accounts have been written off than had been estimated.
 - The direct method is being used.
 - Bad Debt Expense has been overestimated.

4

12. The financial statements of the Colter Manufacturing Company report net sales of \$400,000 and accounts receivable of \$80,000 and \$40,000 at the beginning of the year and end of year, respectively. What is the average collection period for accounts receivable in days?

- a. 40
- b. 80
- c. 54.7
- d. 50

Question 2

Joan Batenilli decides to open a pizza parlor near the local college campus. Analyze the following transactions for the month of June:

1. Joan Batenilli invests \$25,000 cash in exchange for common stock to start a pizza parlor business on June 1.
2. Purchased baking equipment for \$4,000 on June 2, paying \$2,000 in cash and with the remainder due in 60 days.
3. Purchased cooking supplies for \$1,200 cash on June 2.
4. Paid a bill from Campus News for \$200 for advertising in the campus newspaper on June 15.
5. Billed the Tiger Football Team \$100 for pizzas ordered on June 30.
6. Joan Batenilli was paid dividends of \$800 on June 30.
7. Incurred utility expenses of \$200 for the month on account.
8. Over the month, cash receipts from customers for pizza sales amounted to \$1,500.
9. Over the month, paid salaries of \$200 to student workers.

Instructions:

On the following page, prepare a statement of cash flows for Joan Batenilli's pizza parlor for the month of June.

Joan Batenilli's Pizza Parlor
Statement of Cash Flows
For the month of June

OPERATING ACTIVITIES

Additions:

Receipts from customers, 1,500

Subtractions:

Payment for cooking supplies, (1,200)

Payment for advertising, (200)

Payment for salaries, (200)

Net cash provided by operating activities: (100)

INVESTING ACTIVITIES

Payment for baking equipment, (2,000)

Net cash provided by investing activities: (2,000)

FINANCING ACTIVITIES

Issuance of common stock, 25,000

Payment of dividend, (800)

Net cash provided by financing activities: 24,200

Net increase in cash: 22,100

Question 3

Taylor Company accumulates the following adjustment data at December 31.

1. Depreciation of \$1,000 on equipment purchased in January.
2. Salaries of \$1,250 are unpaid.
3. Prepaid insurance totaling \$900 has expired.
4. Revenue of \$3,000 collected in advance has been earned.
5. Revenue of \$2,400 has been earned but unbilled.
6. Utility expenses of \$250 are unpaid.
7. Interest of \$500 on a note payable is outstanding for the year but unpaid.

Instructions:

A. Using the table on the following page, for each of the above items, indicate:

- (a.) The type of adjustment (prepaid expense, unearned revenue, accrued revenue, or accrued expense).
- (b.) The account relationship (asset/liability, liability/revenue, etc.)
- (c.) The status of account balances before adjustment (understatement or overstatement).
- (d.) The adjusting entry.
- (e.) The income effect.

B. Assume net income before the adjustments listed above was \$55,700. What is the adjusted net income?

	Type of Adjustment	Account Relationship	Account Balances Before Adjustment (Understatement or Overstatement)	Adjusting Entry	Income Effect
1	Prepaid expense	Asset/Expense	Assets: Overstated Expenses: Understated	Debit Depreciation Expense 1,000 Credit Accumulated Depreciation 1,000	(1,000)
2	Accrued expense	Liability/Expense	Liabilities: Understated Expenses: Understated	Debit Wage Expense 1,250 Credit Salaries Payable 1,250	(1,250)
3	Prepaid expense	Asset/Expense	Assets: Overstated Expenses: Understated	Debit Insurance Expense 900 Credit Prepaid Insurance 900	(900)
4	Unearned revenue	Liability/Revenue	Liabilities: Overstated Revenues: Understated	Debit Unearned Revenue 3,000 Credit Revenue 3,000	+3,000

9

	Type of Adjustment	Account Relationship	Account Balances Before Adjustment (Understatement or Overstatement)	Adjusting Entry	Income Effect
5	Accrued revenue	Asset/Revenue	Assets: Understated Revenues: Understated	Debit Accounts Receivable 2,400 Credit Revenue 2,400	+2,400
6	Accrued expense	Liability/Expense	Liabilities: Understated Expenses: Understated	Debit Utility Expense 250 Credit Accounts Payable 250	(250)
7	Accrued expense	Liability/Expense	Liabilities: Understated Expenses: Understated	Debit Interest Expense 500 Credit Interest Payable 500	(500)

ADJUSTED NET INCOME:
56,700 - 1,000 - 1,250 - 900 + 3,000 + 2,400 - 250 - 500 = \$58,200

10

Question 4

Selected transactions for the Barkley Company are listed below.

1. Paid monthly utility bill.
2. Purchased new display case for cash.
3. Paid cash for repair work on security system.
4. Billed customers for services performed.
5. Received cash from customers billed in transaction 4.
6. Dividends paid to owners.
7. Incurred advertising expenses on account.
8. Paid monthly rent.
9. Received cash from customers when service was rendered.

Instructions:

Describe the effect of each transaction on assets, liabilities, and stockholders' equity. Provide your responses below.

Example: Made initial cash investment in the business.

Answer: Increase in assets and increase in stockholders' equity.

1. Decrease in assets and decrease in stockholders' equity.
2. No net change in assets.
3. Decrease in assets and decrease in stockholders' equity.
4. Increase in assets and increase in stockholders' equity.
5. No net change in assets.
6. Decrease in assets and decrease in stockholders' equity.
7. Increase in liabilities and decrease in stockholders' equity.
8. Decrease in assets and decrease in stockholders' equity.
9. Increase in assets and increase in stockholders' equity.

Question 5

The Dolton Sign Company uses the allowance method in accounting for uncollectible accounts. Past experience indicates that 6% of accounts receivable will eventually be uncollectible. Selected account balances at December 31, 2006, and December 31, 2007, appear below:

	12/31/2006	12/31/2007
Net Credit Sales	\$400,000	\$500,000
Accounts Receivable	\$80,000	\$100,000
Allowance for Doubtful Accounts	\$4,000	?

Instructions:

A. Record the following events in 2007.

Aug 10 Determined that the account of Jack Dune for \$700 is uncollectible.

Dr Allowance for Doubtful Accounts 700

Cr Accounts Receivable – Jack Dune 700

Sept 21 Determined that the account of Lori Lyons for \$3,000 is uncollectible.

Dr Allowance for Doubtful Accounts 3,000

Cr Accounts Receivable – Lori Lyons 3,000

Oct 10 Received a check for \$400 as payment on account for Jack Dune, whose account had previously been written off as uncollectible.

Dr Accounts Receivable – Jack Dune 400

Cr Allowance for Doubtful Accounts 400

Dr Cash 400

Cr Accounts Receivable – Jack Dune 400

B. Prepare the adjusting journal entry to record the bad debt provision for the year ended December 31, 2007.

After the events in A., Allowance for doubtful accounts has a credit balance of 700

6% of \$100,000 is \$6,000, which is the closing balance that is desired

Bad debt expense, then, is 5,300

The journal entry is:

Dr Bad Debt Expense 5,300

Cr Allowance for Doubtful Accounts 5,300

C. What is the balance of Allowance for Doubtful Accounts at December 31, 2007?

From above, 6% of \$100,000 is \$6,000

D. What is the receivables turnover ratio for 2007?

The receivables turnover ratio is Net Credit Sales / Average Net Receivables

From above, Net Credit Sales for 2007 is 500,000

Average Net Receivables is $\frac{1}{2} \times [(80,000 - 4,000) + (100,000 - 6,000)]$, which is 85,000

So $500,000 / 85,000 = 5.88$

Question 6

The following items are taken from the financial statements of Sutich Company for 2007:

Accounts payable	\$15,000
Accounts receivable	11,000
Accumulated Depreciation – Video Equipment	28,000
Advertising Expense	21,000
Cash	24,000
Common Stock	90,000
Depreciation Expense	12,000
Dividends	15,000
Insurance Expense	3,000
Note Payable (due 2010)	70,000
Prepaid Insurance	6,000
Rent Expense	17,000
Retained Earnings (beginning)	12,000
Salaries Expense	34,000
Salaries Payable	3,000
Service Revenue	145,000
Supplies	4,000
Supplies Expense	6,000
Video Equipment	210,000

Instructions:

A. On the following two pages, prepare an income statement and a classified balance sheet for Sutich Company for the period ending December 31, 2007. (Assume the note payable is a long-term liability.)

SUTCH COMPANY
INCOME STATEMENT FOR THE PERIOD ENDING DECEMBER 31, 2007

Service Revenue	\$145,000
Less:	
Insurance Expense	(3,000)
Supplies Expense	(6,000)
Rent Expense	(17,000)
Advertising Expense	(21,000)
Salaries Expense	(34,000)
Depreciation Expense	(12,000)
Net Income:	\$52,000

SUTCH COMPANY
BALANCE SHEET FOR DECEMBER 31, 2007

ASSETS	LIABILITIES AND STOCKHOLDERS' EQUITY	
<u>Current Assets</u>	<u>Current Liabilities</u>	
Cash	Accounts payable	15,000
Accounts receivable	Salaries Payable	3,000
Prepaid Insurance	<u>Total Current Liabilities</u>	18,000
Supplies	<u>Non-current Liabilities</u>	
<u>Total current assets</u>	Note Payable (due 2010)	70,000
	<u>Total Non-current Liabilities</u>	70,000
<u>Non-current assets</u>	<u>Total Liabilities:</u>	88,000
Video Equipment	Total Liabilities:	88,000
(Accumulated Depreciation - Video Equipment)	<u>Stockholders' Equity</u>	
<u>Total non-current assets</u>	Common Stock	90,000
	Retained Earnings	49,000
Total:	Total Stockholders' Equity:	139,000

B. Compute the current ratio, debt to total assets ratio, and profit margin.

Ratio	Calculation	Answer
Current Ratio	Current Assets / Current Liabilities 45,000 / 18,000	2.5
Debt/Assets Ratio	Total Liabilities / Total Assets 88,000 / 227,000	38.8%
Profit Margin	Net Income / Total Sales 52,000 / 145,000	35.9%



MIT Sloan School of Management
15.501 Corporate Financial Accounting
Midterm Examination
October 14, 2009

NAME:

SECTION: (Circle one)

[A]

or

[B]

10/11 Practice

Instructions:

- 1) Exam Length: 1 hour and 20 minutes
- 2) This exam is 16 pages long (including the cover page). Please make sure your copy of the exam is not missing any pages.
- 3) A non-programmable calculator may be used during this exam. No other material is to be used during the exam.
- 4) Write your answers in the space provided *and show any supporting computations you make*. Do not attach additional material.
- 5) The total number of points on this exam is 80.

Manage your time efficiently.

Make sure to look through the entire exam before you start!

Question	Possible Points	Actual Points
1	8	
2	10	
3	13	
4	9	
5	10	
6	12	
7	18	

Question 1 (8 points)

Instructions: Circle the letter corresponding to your response.

1. Manuel's Tune-Up Shop follows the revenue recognition principle. Javier services a car on August 31. The customer picks up the vehicle on September 1 and mails the payment to Manuel on September 5. Manuel receives the check in the mail on September 6. When should Manuel show that the revenue was earned?
 a. August 31
b. August 1
c. September 5
d. September 6
2. A furniture factory's employees work overtime to finish an order that is sold on January 31. The office sends a statement to the customer in early February and payment is received by mid-February. The overtime wages should be expensed in:
 a. January.
b. February.
c. the period when the workers receive their checks.
d. either January or February depending on when the pay period ends.
3. Which of the following reflect the balances of prepayment accounts prior to adjustment?
a. Balance sheet accounts are understated and income statement accounts are under-stated.
b. Balance sheet accounts are overstated and income statement accounts are over-stated.
 c. Balance sheet accounts are overstated and income statement accounts are under-stated.
 d. Balance sheet accounts are understated and income statement accounts are over-stated.

income over
I don't really get
It has to be paid
Oh prior to adjustment

Does not make sense
or
↓ income
— balance sheet
↑
↓

4. The general term employed to indicate an expense that has not been paid or revenue that has not been received and has not yet been recognized in the accounts is:

- a. contra asset.
- b. prepayment.
- c. asset.
- d. accrual.

5. Waterfalls Corporation purchased a one-year insurance policy in January 2009 for \$60,000. The insurance policy is in effect from March 2009 through February 2010. If the company neglects to make the proper year-end adjustment for the expired insurance:

- a. net income and assets will be understated by \$50,000
- b. net income and assets will be overstated by \$50,000
- c. net income and assets will be understated by \$10,000
- d. net income and assets will be overstated by \$10,000

ie counting off used up insurance

6. After aging the accounts receivable for recording bad debts expense, estimated uncollectible accounts are \$25,000. If the balance of the Allowance for Doubtful Accounts is \$8,000 debit before adjustment what is the balance after adjustment?

- a. \$25,000
- b. \$8,000
- c. \$33,000
- d. \$17,000

	Dr Cr
Bal	8000

	25000

7. Henson Company began the year with retained earnings of \$175,000. During the year, the company recorded revenues of \$250,000, expenses of \$190,000, and paid dividends of \$20,000. What was Henson's retained earnings at the end of the year?

- a. \$255,000
- b. \$215,000
- c. \$405,000
- d. \$235,000

$$175 + 250 - 190 - 20 =$$
$$175 + 60 - 20$$
$$175 + 40$$
$$215$$

Current assets

8. Use the following data to determine the total amount of working capital.

Cash	\$65,000	Accounts Payable	\$70,000
Prepaid Insurance	30,000	Salaries Payable	10,000
Accounts Receivable	50,000	Mortgage Payable	<u>80,000</u>
Inventory	70,000	Total Liabilities	\$160,000
Trademark	70,000		
Land held for Investment	75,000	Common Stock	\$120,000
Land	90,000	Retained Earnings	<u>250,000</u>
Building	80,000		
		Total Stockholders' Equity	<u>\$370,000</u>
		Total Liabilities and Stockholders' Equity	\$530,000
Total Assets	\$530,000		

- a. \$135,000.
- b. \$295,000. ✓
- c. \$205,000.
- d. \$125,000.

Much better!

$$65 + 30 + 50 + 70$$

~~100~~

$$215$$

or no ins.
or - liabilities
current

$$215 - 80$$

$$208 - 65$$

$$158 - 15$$

$$135$$

Question 2 (10 points)

Instructions: Match the items below in the space provided.

- | | |
|---|---------------------------------------|
| A. Aging the accounts receivable | F. Accrued revenues |
| B. Dividends | G. Direct write-off method |
| C. Revenue recognition principle | H. Assets |
| D. Prepaid expenses | I. Accrued expenses |
| E. Matching principle | J. Working capital |

- ✓ J 1. The excess of current assets over current liabilities.
- ✓ D 2. Expenses paid before they are incurred
- ✓ G 3. Bad debt losses are not estimated and no allowance account is used.
- ✓ H 4. Future economic benefits.
- ✓ AE 5. Efforts are related to accomplishments *match expenses to revenue*
- ✓ A 6. Analysis of customer account balances by length of time they have been unpaid.
- ✓ C 7. Revenue is recognized when earned
- ✓ F 8. Revenues earned but not yet received
- ✓ I 9. Expenses incurred but not yet paid
- ✓ B 10. Distributions of cash from a corporation to its stock holders.

Question 3 (13 points)

Milius Corporation began operations on January 1, 2009. The firm's cash account revealed the following transactions for the month of January:

Date	Transaction	Amount
<i>Cash Receipts</i>		
Jan. 1	Investment by John Milius for common stock	\$ 35,000
Jan. 1	Loan from Upper Valley Bank, due June 30, 2009, with 6% annual interest	\$ 40,000
Jan. 15	Advance from a customer for merchandise scheduled for delivery in February, 2009	\$ 1,200
Jan. 1-31	Sales to customers	\$ 60,000
<i>Cash Disbursements</i>		
Jan. 1	Rental of retail space at a monthly rental of \$3,000	\$ (6,000)
Jan. 1	Premium on property and liability insurance for coverage from January 1 to December 31, 2009	\$ (1,200)
Jan. 19	Payment of utility bills	\$ (750)
Jan. 23	Payment of salaries	\$ (3,500)
Jan. 1-31	Purchase of merchandise	\$ (44,800)
<i>Balance, January 31, 2009</i>		<i>\$ 79,950</i>

The following information relates to Milius Corporation as of January 31, 2009:

- (1) Customers owe the firm \$9,500 from sales made during January.
- (2) The firm owes suppliers \$3,900 for merchandise purchased during January.
- (3) Unpaid utility bills total \$260, and unpaid salaries total \$1,260.
- (4) Merchandise inventory on hand totals \$5,500.

make sure use

Instructions:

- (a) Using the space allotted on the following pages, prepare an income statement for January, assuming that Milius Corporation uses a cash basis of accounting.
- (b) Using the space allotted on the following pages, prepare an income statement for January, assuming that Milius Corporation uses the accrual basis of accounting.

when they get cash count it

Income Statement (Period)

Revenue

- Each expenses

Net Income

Note adjustments

(a)

Revenue 60,000 + 1200

Expenses

Rent 60,000

Insurance 1,200

Utilities 750

Salaries 3,500

COGS 44,800

Total 56,250

~~Net~~ Income 3,750 4,950

+ adjustments (read carefully)

(b)

Revenue 60,000 + 9,500

Expenses

Loan Interest 200

Rent 3,000

Ins 1,800

Utility 750 + 260

Salaries 3,500 + 1260

COGS 44,800 + 3,900 - 5,500

Total ~~52,150~~ 52,270

Net Income ~~7,850~~ 17,230

Question 4 (9 points)

Skynet commences business on September 1, 2000. It pays the one-year insurance premium of \$3,600 for property and liability protection on this date. On September 1, 2001, it renews the insurance policy and pays a \$4,800 one-year insurance premium. Skynet's accounting period ends December 31 of each year. Assuming that Skynet uses the accrual basis of accounting, use T-accounts, journal entries, or the Balance Sheet Equation to show the entries it will record on September 1 and December 31 of both 2000 and 2001.

Sept 1 2000

Prepaid Ins
3600

Cash
3600

← wait this for

Dec 31 2000

Ins Expenses
1200

Retained Earnings
1200 ✓

for year

Sept 1 2001

~~Ins Expenses
2400~~

← don't record that now

Prepaid Ins
4800

~~Retained Earnings
2400~~

Cash
4800

Dec 31 2001

Ins Exp
2400
1600

Retained Earnings
2400
1600

Skynet borrows \$250,000 on October 1, 2008. The debt carries an annual interest rate of 6% and is payable in two installments, on April 1 and October 1 of each year. The debt matures on October 1, 2012. Skynet's accounting period ends on December 31 of each year. Assuming that Skynet uses the accrual basis of accounting, use T-accounts, journal entries, or the Balance Sheet Equation to show how it will record the annual interest expense for 2008.

Interest Payable

Liabilities

~~15,625~~ | ~~15,625~~

Interest on Notes Payable

~~15,625~~

↑ always other side
but I thought

Liabilities Dr | Cr
- | +

~~15,625~~
3,750
Expense

3,750
+

↑
F guess I should
write both broad +
specific categories

SE
~~15,625~~

~~6,250/year~~
~~5,208/month~~
duh 6% annual interest
 $\frac{3}{12} \cdot 6\%$
 $1.5\% \cdot 250,000$
 $= 3,750$

Skynet makes sales on account during 2009 totaling \$126,900. Collections from customers from sales on account during 2009 total \$94,300. Skynet uses the allowance method for uncollectible accounts, and estimates that it will ultimately not collect 4% of sales on account. During 2009, the firm wrote off \$2,200 of accounts receivable as uncollectible. If the Allowance for Uncollectible Accounts has a credit balance of \$1,320 on December 31, 2008, what amount of Bad Debt Expense will Skynet recognize in 2009, and what will be the balance of the Allowance for Uncollectible Accounts on December 31, 2009?

$4\% = 5,076$

Allowance for Bad Debt Expenses

	±	
2200	1320	Bal
	5076	
	<hr/>	
	4196	Bal



Question 5 (10 points)

Instructions: Analyze the transactions described below and indicate their effect on the basic accounting equation. Use a plus sign (+) to indicate an increase and a minus sign (-) to indicate a decrease.

	Assets		=	Liabilities	+	Stockholders' Equity	
	+	-					
1. Received cash for services rendered.	+	0		+		0	0 = no change
2. Purchased office equipment on credit.	+	✓		+	✓	0	
3. Paid employees' salaries.	-	✓		0		-	✓
4. Received cash from customer in payment on account.	+/-			0		0	
5. Paid telephone bill for the month.	-	✓		0		-	✓
6. Paid for office equipment purchased in transaction 2.	-	-		+	-	0	
7. Purchased office supplies on credit.	+	+		+		0	
8. Dividends were paid.	0			0		+ -	
9. Obtained a loan from the bank.	+			+		0	
10. Billed customers for services rendered.	+			+		+	can both be +?

I wish this clear ↓ was clear

Services accrued here

AR = asset

Accrued + paid

↓ and this

Consumables - not assets

they assume asset

cash paid

AR is an asset.

Services accrued here?

So for most part I know
 - its just what assumption are they making
 and read everything
 one real mistake → 8.

Question 6 (12 points)

here we go again
on this!

The financial statements of Omni Consumer Products reveal the following for four recent years (amounts in millions):

	2005	2006	2007	2008
Credit sales	5181	6137	6713	7292
Total Sales	\$8,330	\$9,456	\$10,035	\$10,615
Credit Sales/Total Sales	62.2%	64.9%	66.9%	68.7%
Bad Debt Expense	\$57	\$64	\$82	\$96

	2004	2005	2006	2007	2008
Accounts Receivable, Gross	\$1,592	\$2,099	\$2,223	\$2,456	\$2,607
Less Allowance for Uncollectible Accounts	(\$47)	(\$61)	(\$66)	(\$84)	(\$99)
Accounts Receivable, Net	\$1,545	\$2,038	\$2,157	\$2,372	\$2,508

Instructions:

- Compute the amount of accounts written off as uncollectible during 2005, 2006, 2007, and 2008 and enter it in the space below. (Use the space on the following page to show your work.)
- Compute the amount of cash collections from credit customers during 2005, 2006, 2007, and 2008 and enter it in the space below. (Use the space on the following page to show your work.)
- Calculate the accounts receivable turnover ratio for 2005, 2006, 2007, and 2008 and enter it in the space below. (Use the space on the following page to show your work.)

	2005	2006	2007	2008
Write-offs	43 ✓	59 ✓	64 ✓	81 ✓
Cash collections				
Accounts receivable turnover ratio	1.35	.35	.34	.34

I should do
a F system!

$$\frac{\text{Credit Sales}}{\text{A.A.R.}} =$$

should avg
start + end

$$\text{Allowance} = \text{last years allowance} + \text{bad debt expense}$$

- Write off

$$\text{Writeoffs} = \left(\begin{array}{l} \text{last year} \\ \text{allowance} \end{array} \right) + \begin{array}{l} \text{bad debt} \\ \text{expense} \end{array} - \text{current allowance}$$

flip signs

~~$$\begin{array}{r} \text{Write off} = - \text{last years} \quad - \text{bad debt} \quad + \text{current allowance} \\ \quad \quad \quad \text{allowance} \quad \quad \quad \text{expense} \\ \quad \quad \quad -47 \quad \quad \quad -57 \quad \quad \quad +61 \\ \quad \quad \quad = 51 \end{array}$$~~

$$\begin{array}{r} = - \text{last year} \quad + \text{bad debt} \quad + \text{current} \\ \quad \quad \quad - \quad \quad \quad + \quad \quad \quad + - \\ \quad \quad \quad = 47 \quad \quad \quad +57 \quad \quad \quad -61 \\ \quad \quad \quad = 43 \end{array}$$



Cash collection

$$\begin{array}{l} \text{last} \\ \text{years} \\ \text{AR} \end{array} + \begin{array}{l} \text{years} \\ \text{sales} \\ \text{taken} \\ \text{credit} \end{array} - \begin{array}{l} \text{years} \\ \text{writeoff} \end{array} = \begin{array}{l} \text{end of year} \\ \text{AR} \end{array}$$

This page is intentionally left blank

↑ why not total sales
- says from credit customers

Avg AR I did wrong

~~with Dan~~

~~credit~~

oh I flipped in calculator

even though I wrote correct answer on paper

- dislike this basic calc I have to use

Question 7 (18 points)

Tyrell Corporation begins operations on January 1, 2008. That same day, Rick Deckard invests \$50,000 for common stock of the firm, and the firm borrows \$40,000 from a local bank. The firm must repay the loan with interest for both 2008 and 2009 on December 31, 2009. The interest rate is 10% per year. The firm purchases a building for \$60,000 cash for its operations. On March 31, the firm decides to launch a marketing campaign and prepays \$36,000 for 12 months of advertising (beginning immediately).

During 2008, the firm makes cash sales to clients totaling \$52,900 and sales on account totaling \$116,100. Of the sales on account, the firm collects \$54,800 by December 31, 2008. The firm incurs and pays other costs as follows: salaries, \$34,200; utilities, \$2,600. It has unpaid bills at the end of 2008 as follows: salaries, \$2,400; utilities, \$180. Ignore taxes.

Instructions:

- (a) Using the space allotted on the following pages, prepare an income statement for Tyrell Corporation for 2008, assuming that the firm uses the accrual basis of accounting and recognizes revenue at the time of sale.
- (b) Using the space allotted on the following pages, prepare a balance sheet for Tyrell Corporation as of December 31, 2008. Show supporting computations for each balance sheet item.

just know what goes under each entry
& read carefully!



MIT Sloan School of Management
15.501 Corporate Financial Accounting
Midterm Examination
October 14, 2009

NAME: **SUGGESTED SOLUTIONS**

SECTION: (Circle one)

[A] or [B]

Instructions:

- 1) Exam Length: 1 hour and 20 minutes
- 2) This exam is 16 pages long (including the cover page). Please make sure your copy of the exam is not missing any pages.
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- 4) Write your answers in the space provided *and show any supporting computations you make*. Do not attach additional material.
- 5) The total number of points on this exam is 80.

Manage your time efficiently.

Make sure to look through the entire exam before you start!

Question	Possible Points	Actual Points
1	8	
2	10	
3	13	
4	9	
5	10	
6	12	
7	18	

Question 1 (8 points)

Instructions: Circle the letter corresponding to your response.

1. Manuel's Tune-Up Shop follows the revenue recognition principle. Javier services a car on August 31. The customer picks up the vehicle on September 1 and mails the payment to Manuel on September 5. Manuel receives the check in the mail on September 6. When should Manuel show that the revenue was earned?
 - a. August 31
 - b. August 1
 - c. September 5
 - d. September 6

2. A furniture factory's employees work overtime to finish an order that is sold on January 31. The office sends a statement to the customer in early February and payment is received by mid-February. The overtime wages should be expensed in:
 - a. January.
 - b. February.
 - c. the period when the workers receive their checks.
 - d. either January or February depending on when the pay period ends.

3. Which of the following reflect the balances of prepayment accounts prior to adjustment?
 - a. Balance sheet accounts are understated and income statement accounts are under-stated.
 - b. Balance sheet accounts are overstated and income statement accounts are over-stated.
 - c. Balance sheet accounts are overstated and income statement accounts are under-stated.
 - d. Balance sheet accounts are understated and income statement accounts are over-stated.

4. The general term employed to indicate an expense that has not been paid or revenue that has not been received and has not yet been recognized in the accounts is:
- contra asset.
 - prepayment.
 - asset.
 - accrual.
5. Waterfalls Corporation purchased a one-year insurance policy in January 2009 for \$60,000. The insurance policy is in effect from March 2009 through February 2010. If the company neglects to make the proper year-end adjustment for the expired insurance:
- net income and assets will be understated by \$50,000
 - net income and assets will be overstated by \$50,000
 - net income and assets will be understated by \$10,000
 - net income and assets will be overstated by \$10,000
6. After aging the accounts receivable for recording bad debts expense, estimated uncollectible accounts are \$25,000. If the balance of the Allowance for Doubtful Accounts is \$8,000 debit before adjustment what is the balance after adjustment?
- \$25,000
 - \$8,000
 - \$33,000
 - \$17,000
7. Henson Company began the year with retained earnings of \$175,000. During the year, the company recorded revenues of \$250,000, expenses of \$190,000, and paid dividends of \$20,000. What was Henson's retained earnings at the end of the year?
- \$255,000
 - \$215,000
 - \$405,000
 - \$235,000

8. Use the following data to determine the total amount of working capital.

Koonce Office Supplies Balance Sheet 31-Dec-10			
Cash	\$65,000	Accounts Payable	\$70,000
Prepaid Insurance	30,000	Salaries Payable	10,000
Accounts Receivable	50,000	Mortgage Payable	80,000
Inventory	70,000	Total Liabilities	\$160,000
Trademark	70,000	Common Stock	\$120,000
Land held for investment	75,000	Retained Earnings	250,000
Land	90,000		
Building	80,000		
		Total Stockholders' Equity	\$370,000
		Total Liabilities and Stockholders' Equity	\$530,000
Total Assets	\$530,000		

- \$135,000.
- \$295,000.
- \$205,000.
- \$125,000.

Question 2 (10 points)

Instructions: Match the items below in the space provided.

- | | | | |
|----|-------------------------------|----|-------------------------|
| A. | Aging the accounts receivable | F. | Accrued revenues |
| B. | Dividends | G. | Direct write-off method |
| C. | Revenue recognition principle | H. | Assets |
| D. | Prepaid expenses | I. | Accrued expenses |
| E. | Matching principle | J. | Working capital |
-
- | | | |
|---|-----|--|
| J | 1. | The excess of current assets over current liabilities. |
| D | 2. | Expenses paid before they are incurred |
| G | 3. | Bad debt losses are not estimated and no allowance account is used. |
| H | 4. | Future economic benefits. |
| E | 5. | Efforts are related to accomplishments |
| A | 6. | Analysis of customer account balances by length of time they have been unpaid. |
| C | 7. | Revenue is recognized when earned |
| F | 8. | Revenues earned but not yet received |
| I | 9. | Expenses incurred but not yet paid |
| B | 10. | Distributions of cash from a corporation to its stock holders. |

Question 3 (13 points)

Milius Corporation began operations on January 1, 2009. The firm's cash account revealed the following transactions for the month of January:

Date	Transaction	Amount
Cash Receipts		
Jan. 1	Investment by John Milius for common stock	\$ 35,000
Jan. 1	Loan from Upper Valley Bank, due June 30, 2009, with 6% annual interest	40,000
Jan. 15	Advance from a customer for merchandise scheduled for delivery in February, 2009	1,200
Jan. 1-31	Sales to customers	60,000
Cash Disbursements		
Jan. 1	Rental of retail space at a monthly rental of \$3,000	(6,000)
Jan. 1	Premium on property and liability insurance for coverage from January 1 to December 31, 2009	(1,200)
Jan. 19	Payment of utility bills	(750)
Jan. 23	Payment of salaries	(3,500)
Jan. 1-31	Purchase of merchandise	(44,800)
	Balance, January 31, 2009	\$ 79,950

The following information relates to Milius Corporation as of January 31, 2009:

- (1) Customers owe the firm \$9,500 from sales made during January.
- (2) The firm owes suppliers \$3,900 for merchandise purchased during January.
- (3) Unpaid utility bills total \$260, and unpaid salaries total \$1,260.
- (4) Merchandise inventory on hand totals \$5,500.

Instructions:

- (a) Using the space allotted on the following pages, prepare an income statement for January, assuming that Milius Corporation uses a cash basis of accounting.
- (b) Using the space allotted on the following pages, prepare an income statement for January, assuming that Milius Corporation uses the accrual basis of accounting.

Question 4 (9 points)

Skyrnet commences business on September 1, 2000. It pays the one-year insurance premium of \$3,600 for property and liability protection on this date. On September 1, 2001, it renews the insurance policy and pays a \$4,800 one-year insurance premium. S kyrnet's accounting period ends December 31 of each year. Assuming that S kyrnet uses the accrual basis of accounting, use T-accounts, journal entries, or the Balance Sheet Equation to show the entries it will record on September 1 and December 31 of both 2000 and 2001.

September 1, 2000:

Dr Prepaid Insurance, \$3,600
Cr Cash, \$3,600

December 31, 2000:

Dr Insurance Expense, \$1,200 (4 mths @ \$300/mth)
Cr Prepaid Insurance, \$1,200

September 1, 2001:

Dr Prepaid Insurance, \$4,800
Cr Cash, \$4,800

December 31, 2001:

Dr Insurance Expense, \$4,000 (8 mths @ \$500/mth, 4 mths @ \$400/mth)
Cr Prepaid Insurance, \$4,000

S kyrnet borrows \$250,000 on October 1, 2008. The debt carries an annual interest rate of 6% and is payable in two installments, on April 1 and October 1 of each year. The debt matures on October 1, 2012. S kyrnet's accounting period ends on December 31 of each year. Assuming that S kyrnet uses the accrual basis of accounting, use T-accounts, journal entries, or the Balance Sheet Equation to show how it will record the annual interest expense for 2008.

$\$250,000 \times 6\% \times 3/12 = \$3,750$

Dr Interest Expense, \$3,750
Cr Interest Payable, \$3,750

S kyrnet makes sales on account during 2009 totaling \$126,900. Collections from customers from sales on account during 2009 total \$94,300. S kyrnet uses the allowance method for uncollectible accounts, and estimates that it will ultimately not collect 4% of sales on account. During 2009, the firm wrote off \$2,200 of accounts receivable as uncollectible. If the Allowance for Uncollectible Accounts has a credit balance of \$1,320 on December 31, 2008, what amount of Bad Debt Expense will S kyrnet recognize in 2009, and what will be the balance of the Allowance for Uncollectible Accounts on December 31, 2009?

S kyrnet will have a bad debt expense of $4\% \times 126,900 = \$5,076$

To get the ending balance of the Allowance for Uncollectible Accounts:
Beginning Balance + Bad Debt Expense - Write-offs = Ending Balance
 $\$1,320 + \$5,076 - \$2,200 = \$4,196$

	(a.) Cash Basis	(b.) Accrual Basis
Sales Revenue	\$61,200 ^a	\$69,500 ^b
Less Expenses:		
Cost of Merchandise Sold		(\$43,200) ^c
Payments on Merchandise Purchased	(\$44,800)	
Utilities Expense	(\$750)	(\$1,010) ^d
Salaries Expense	(\$3,500)	(\$4,760) ^e
Rent Expense	(\$6,000)	(\$3,000)
Insurance Expense	(\$1,200)	(\$100) ^f
Interest Expense		(\$200) ^g
Total Expenses	(\$56,250)	(\$52,270)
Net Income (Loss)	\$4,950	\$17,230

^a\$61,200 = \$60,000 + \$1,200

^b\$69,500 = \$60,000 + \$9,500

^c\$43,200 = \$44,800 + \$3,900 - \$5,500

^d\$1,010 = \$750 + \$260

^e\$4,760 = \$3,500 + \$1,260

^f\$100 = \$1,200 x 1/12

^g\$200 = (6% x \$40,000) x 30/360

Question 5 (10 points)

Instructions: Analyze the transactions described below and indicate their effect on the basic accounting equation. Use a plus sign (+) to indicate an increase and a minus sign (-) to indicate a decrease.

	Assets	Liabilities	Shareholders' Equity
1	Received cash for services rendered.	(+)	(+)
2	Purchased office equipment on credit.	(+)	(+)
3	Paid employees' salaries.	(-)	(-)
4	Received cash from customer in payment on account.	(+)/(+)	(+)
5	Paid telephone bill for the month.	(-)	(-)
6	Paid for office equipment purchased in transaction 2.	(-)	(-)
7	Purchased office supplies on credit.	(+)	(+)
8	Dividends were paid.	(-)	(-)
9	Obtained a loan from the bank.	(+)	(+)
10	Billed customers for services rendered.	(+)	(+)

Question 6 (12 points)

The financial statements of Omni Consumer Products reveal the following for four recent years (amounts in millions):

	2005	2006	2007	2008
Total Sales	\$8,330	\$9,456	\$10,035	\$10,615
Credit Sales/Total Sales	62.2%	64.9%	66.9%	68.7%
Bad Debt Expense	\$57	\$64	\$82	\$96

	2004	2005	2006	2007	2008
Accounts Receivable, Gross	\$1,592	\$2,099	\$2,223	\$2,456	\$2,607
Less Allowance for Uncollectible Accounts	(\$47)	(\$61)	(\$66)	(\$84)	(\$99)
Accounts Receivable, Net	\$1,545	\$2,038	\$2,157	\$2,372	\$2,508

Instructions:

- Compute the amount of accounts written off as uncollectible during 2005, 2006, 2007, and 2008 and enter it in the space below. (Use the space on the following page to show your work.)
- Compute the amount of cash collections from credit customers during 2005, 2006, 2007, and 2008 and enter it in the space below. (Use the space on the following page to show your work.)
- Calculate the accounts receivable turnover ratio for 2005, 2006, 2007, and 2008 and enter it in the space below. (Use the space on the following page to show your work.)

	2005	2006	2007	2008
Write-offs	\$43	\$59	\$64	\$81
Cash collections	\$4,631	\$5,954	\$6,416	\$7,061
Accounts receivable turnover ratio	2.89	2.93	2.96	2.99

Write-Offs = Beginning ADA + Bad Debt Expense – Ending ADA
2005: 47 + 57 - 61 = 43
2006: 61 + 64 - 66 = 59
2007: 66 + 82 - 84 = 64
2008: 84 + 96 - 99 = 81

Cash collections = Beginning A/R (Gross) – Write-Offs + Credit Sales
– Ending A/R (Gross)
2005: 1,592 - 43 + 5,181 - 2,099 = 4,631
2006: 2,099 - 59 + 6,137 - 2,223 = 5,954
2007: 2,223 - 64 + 6,713 - 2,456 = 6,416
2008: 2,456 - 81 + 7,293 - 2,607 = 7,061

Accounts Receivable Turnover Ratio is “computed by dividing net credit sales (net sales less cash sales) by the average net accounts receivables during the year” (Kimmel, Weygandt, and Kieso, p. 388)
2005: 5,181 / [0.5 * (1,545 + 2,038)] = 2.89
2006: 6,137 / [0.5 * (2,038 + 2,157)] = 2.93
2007: 6,713 / [0.5 * (2,157 + 2,372)] = 2.96
2008: 7,293 / [0.5 * (2,372 + 2,508)] = 2.99

Question 7 (18 points)

Tyrell Corporation begins operations on January 1, 2008. That same day, Rick Deckard invests \$50,000 for common stock of the firm, and the firm borrows \$40,000 from a local bank. The firm must repay the loan with interest for both 2008 and 2009 on December 31, 2009. The interest rate is 10% per year. The firm purchases a building for \$60,000 cash for its operations. On March 31, the firm decides to launch a marketing campaign and prepays \$36,000 for 12 months of advertising (beginning immediately).

During 2008, the firm makes cash sales to clients totaling \$52,900 and sales on account totaling \$116,100. Of the sales on account, the firm collects \$54,800 by December 31, 2008. The firm incurs and pays other costs as follows: salaries, \$34,200; utilities, \$2,600. It has unpaid bills at the end of 2008 as follows: salaries, \$2,400; utilities, \$180. Ignore taxes.

Instructions:

- (a) Using the space allotted on the following pages, prepare an income statement for Tyrell Corporation for 2008, assuming that the firm uses the accrual basis of accounting and recognizes revenue at the time of sale.
- (b) Using the space allotted on the following pages, prepare a balance sheet for Tyrell Corporation as of December 31, 2008. Show supporting computations for each balance sheet item.

(a)

Tyrell Corporation	
Income Statement for the	
Year Ending 12/31/2008	
Sales Revenue	\$169,000
Less Expenses:	
Interest Expense	(\$4,000)
Advertising Expense	(\$27,000)
Salaries Expense	(\$36,600)
Utilities Expense	(\$2,780)
Total Expenses	(\$70,380)
Net Income	<u>\$98,620</u>

(b)

Tyrell Corporation		
Balance Sheet as of 12/31/2008		
Current Assets	Current Liabilities	
Cash	Note payable	\$40,000
Accounts receivable	Interest payable	\$4,000
Prepaid advertising	Salaries payable	\$2,400
	Utilities payable	\$180
Noncurrent Assets	Shareholders' Equity	
PP&E	Common stock	\$50,000
	Retained earnings	\$98,620
Total Assets	Total Equities	\$195,200



MIT Sloan School of Management
15.501 Corporate Financial Accounting
Midterm Examination
October 13, 2010

NAME: Michael Plasencia

SECTION: (Circle one)

[A] (1:00pm-2:30pm)

or

[B] (2:30pm-4:00pm)

Instructions:

- 1) Exam Length: 1 hour and 20 minutes
- 2) This exam is 10 pages long (including the cover page). Please make sure your copy of the exam is not missing any pages.
- 3) A non-programmable calculator may be used during this exam. No other material is to be used during the exam.
- 4) Write your answers in the space provided *and show any supporting computations you make*. Do not attach additional material.
- 5) The last two pages can be detached if convenient.
- 6) The total number of points on this exam is 100.

Manage your time efficiently.

Make sure to look through the entire exam before you start!

Question	Possible Points	Actual Points
1	18	12
2	15	11
3	20	20
4	30	28
5	7	7
6	10	7

85

Question 1 (18 points)

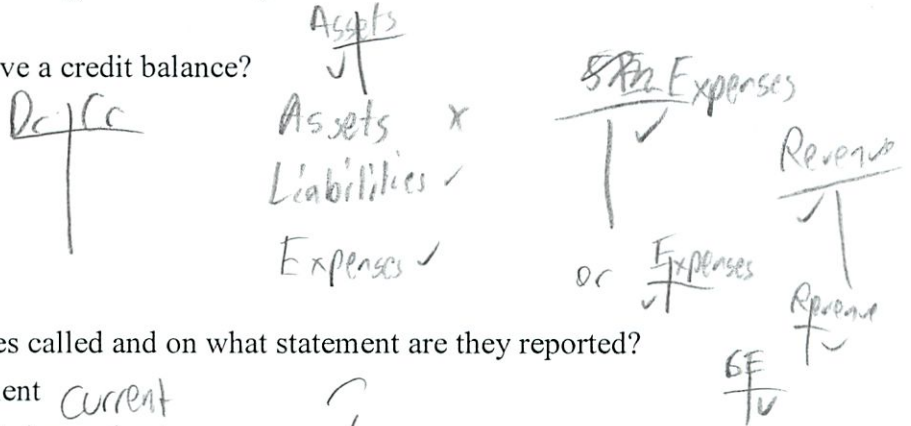
Required: Circle the letter corresponding to your response.

1. The nature of an asset is best described as:

- a. a resource owned by the company that is expected to provide the company future economic benefits.
- b. something with physical form that is valued at cost in the accounting records.
- c. something owned by a business that has a ready market value.
- d. an economic resource representing cash or the right to receive cash in the future.

2. Which account types normally have a credit balance?

- a. Revenues
- b. Liabilities
- c. Expenses
- d. Both a and b



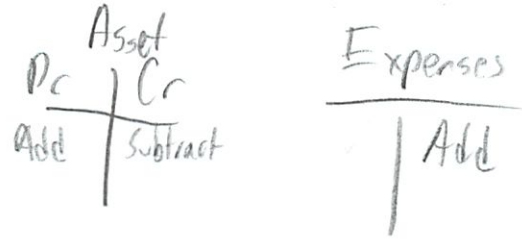
3. What are probable future sacrifices called and on what statement are they reported?

- a. Losses on the income statement
- b. Stockholders' equity on the balance sheet
- c. Dividends on the statement of stockholders' equity
- d. Liabilities on the balance sheet

Handwritten notes: 'current', 'Must'.

4. Details, Inc., purchased supplies for \$1,300 during 2010. At year end Details had \$800 of supplies left. The adjusting entry should

- a. debit Supplies \$800
- b. credit Supplies \$800
- c. debit Supplies \$500
- d. debit Supplies expense \$500



5. Harrigan Company, a small consulting firm, charges all of its operating expenses on Accounts Payable. On January 1, 2010, Harrigan's Accounts Payable balance was \$3,000 and, during the year, \$27,000 of additional operating expenses was charged on account. The ending Accounts Payable balance was \$9,000. What is the amount of cash paid for expenses during 2010?

- a. \$33,000
- b. \$30,000
- c. \$21,000
- d. \$18,000

$$\begin{aligned}
 3 + 27 - x &= 9 \\
 30 - x &= 9 \\
 -x &= -21
 \end{aligned}$$

6. Assets are recorded in the balance sheet in order of

- a. Market value
- b. Historic value
- c. Liquidity
- d. Maturity

7. From the following list of accounts, calculate the quick ratio. (Rounded to nearest tenth.)

Cash.....	\$6,000	Accounts payable.....	\$10,000
Marketable securities.....	3,000	Salary payable.....	4,000
Accounts receivable.....	9,000	Notes payable (due in two years)....	13,000
Inventory.....	11,000		
Prepaid insurance.....	1,000		

- a. 1.3
- b. 2.1
- c. 1.1
- d. 1.8

$$\frac{\text{Current Assets} - \text{Inventory} - \text{Prepaid}}{\text{Current Liability}} = \frac{6 + 3 + 9}{10 + 4}$$

only 2 ratio qv

8. The following ratios are available for Leer Inc. and Stable Inc.

	Current Ratio	Debt to Assets Ratio	Earnings per Share
Leer Inc.	2	75%	\$3.50
Stable Inc	1.5	40%	\$2.75

Compared to Stable Inc., Leer Inc. has:

- a. Higher liquidity, higher solvency, and higher profitability.
- b. Lower liquidity, higher solvency, and higher profitability.
- c. Higher liquidity, lower solvency, and higher profitability.
- d. Higher liquidity and lower solvency, but profitability cannot be compared based on information provided.

9. Maxwell Industries recorded and paid \$900 advertising for the current month. Which occurred?

- a. Current assets increase.
- b. Gross profit decreases.
- c. Operating income decreases.
- d. Retained earnings increases.

~~gross profit before expenses~~

Question 2 (15 points)

B - for investment purposes ?
 C - for operational purposes ?

Instructions: In the blank space beside each numbered balance sheet item, enter the letter of its balance sheet classification.

A. Current assets	E. Current liabilities
B. Long-term investments	F. Long-term liabilities
C. Long-term assets	G. Equity
D. Intangible assets	H. Should not appear on the balance sheet

- C 1. Machine
- A 2. Inventory
- C 3. Land for operations B-land for investment
- G 4. Common stock
- C 5. Building for operations B-building for operations
- E 6. Income taxes payable in 30 days
- E 7. Utilities payable
- A 8. Note receivable due in 30 days ← like if they loaned they will collect?
- ~~X~~ 9. Wages expenses owed - wages accrued come out of Shareholder's equity G
- ~~X~~ 10. Security deposit prepaid revenue
- ~~X~~ 11. Value of company logo - can't book revenue - so owe the company the money
- A 12. Cash
- ~~X~~ 13. Value of land in excess of cost - depends on manager's policy
- F 14. Mortgage payable far in the future
- A 15. Accounts receivable

Question 3 (20 points)

Period = quarter 4 2011

After accounting for bad debt expense and write-offs for the first three quarters, Image Communications' September 30, 2011, records show these account balances:

Accounts Receivable.....	\$260,000
Allowance for Doubtful Accounts.....	(8,100)

During the year, Image Communications estimates doubtful-account expense at 0.5% of credit sales. Credit sales in the final quarter (October through December) amount to \$340,000.

At year-end, the company ages its receivables and adjusts the balance in Allowance for Doubtful Accounts to correspond to the aging schedule. This schedule is as follows:

1,700 additional - just from that qu

Accounts Receivable	Age of Accounts			
	1-30 Days	31-60 Days	61-90 Days	Over 90 Days
\$230,000	\$160,000	\$35,000	\$14,000	\$21,000
Estimated percent uncollectible	0.2%	1%	5%	30%

320 350 700 6,300 = 7,670

During the last quarter of 2011, the company completed the following selected transactions:

- 28-Dec Wrote off as uncollectible the \$1,500 account receivable from Blue Carpets and the \$400 account receivable from Show-N-Tell Antiques
- 31-Dec Adjusted the Allowance for Doubtful Accounts and recorded doubtful-account expense at year-end, based on the aging of receivables.

Required:

1. Record the December 28 and December 31 transactions using journal entries.
2. Prepare a T-account for Allowance for Doubtful Accounts and post to that account.

Asset	Revenue	Expense
+	+	-
XA	cc	cc?
+		

Question 3 (20 points)

Required: Write your answer in the space below.

Dr Cr

Dec 31 Gu Allowances
 Cr Allowance For Doubtful Accts
 \$1,700
 Dr Bad Debt Expense
 \$1,700

Allowance For Doubtful Accounts XA	
1,900	8,100 Bal
	1,700
adjustment 230	7900 Bal
	7670

Dec 28 Write off
 Dr 1,900 Allowance Doubtful
 Accounts
 Cr 1,900 Accounts Receivable

Accounts Receivable A	
Bal 260,000	1,900
340,000	Collections
Bal 598,100	

Dec 31 Adjustments
 Dr Allowance for Doubtful Accts
 \$230
 Cr Bad Debt Expens
 \$230

Guess could do both Dec 31
 at once

Bad Debt Expense Ay	
Bal 0	230
1,700	
Bal 1470	

3. Did not really memorize
Had to reconstruct
took a while

Question 4 (30 points)

Mark Davis formed a lawn service company as a summer job. To start the business on May 1, he deposited \$2,000 in a new bank account in the name of the corporation. The \$2,000 consisted of a \$1,600 loan from his father and \$400 of his own money. The corporation issued 200 shares of common stock to Davis.

Davis rented lawn equipment, purchased supplies, and hired high school students to mow and trim his customers' lawns. At the end of each month, Davis mailed bills to his customers. On August 31, Davis was ready to dissolve the business and return to the local university. Because he had been so busy, he had kept few records other than his checkbook and a list of accounts owed by customers.

At August 31, Davis' checkbook shows a balance of \$2,040, and his customers still owe him \$600. During the summer, he collected \$5,600 from customers. His checkbook lists payments for supplies totaling \$400, and he still has gasoline, gardening gloves, and other supplies that cost a total of \$50. He paid his employees wages of \$1,900, and he still owes them \$200 for the final week of the summer.

Davis rented some equipment from Ludwig Tool Company. On May 1, he signed a six-month lease on mowers and paid \$600 for the full lease period. Ludwig will refund the unused portion of the prepayment if the equipment is in good shape. To get the refund, Davis has kept the mowers in excellent condition. In fact, he had to pay \$300 to repair a mower that ran over a hidden tree stump. He has not yet returned the mowers, however.

To transport employees and equipment to jobs, Davis used a trailer that he bought for \$300. He figures that the summer's work used up one-third of the trailer's service potential. The business checkbook lists dividends paid to Davis during the summer of \$460. Also, Davis paid his father back during the summer.

do not need to fully journalize

Required:

1. Prepare the income statement of Davis Lawn Service, Inc., for the four months May through August. The business is not subject to income tax.
2. Prepare the classified balance sheet of Davis Law Service, Inc., at August 31.

\$400 SE - 200 shares

~~\$1600 Loan~~

*Aug 31 Cash = ~~\$2040~~
AR = ~~600~~*

Revenue = 5600 + ~~2000~~ + 600 = ~~2000~~

COGS = 400 expense

Inventory = \$50 asset

Wages = ~~1900 + 200~~

~~200 = Salaries payable~~

~~Mowers expense \$400~~

~~Mowers prepay \$200~~

~~Repairs \$300~~

~~Trailer \$300~~

~~- Depreciation \$100~~

~~Repay loan \$1,600~~

~~Dividends \$460~~

also rusty

*ent as
much practice
↑ record
as vote
- depreciat*

Question 4 (30 points)

Required: Write your answer in the space below.

Income Statement May - Aug

Revenue \$ 6200

Expenses

COGS \$ 350

Wages \$ 2100

Lease Mopos \$ 400

Repairs \$ 300

Depreciation \$ 100

Total \$ 3350

Net Income 2,950 ✓

Balance Sheet Aug 31

Assets

Cash \$ 2040

Accounts Receivable \$ 600

Supplies \$ 50

Prepaid Lease \$ 200
Current 2,890

Trailer \$ 200

Total Assets 3090

Liabilities

Salaries Payable \$ 200

Shareholders Equity

Contributed \$ 400

Retained \$ 2950

~~Dividends \$ 460~~

Total Liabilities

+ Equity \$ 3090

-2

Or am I doing this wrong
But what else to do?

Question 6 (10 points)

The following items and amounts are taken from the 2011 financial records of Hopkins Inc.:

Security deposit.....	\$3,200	Salaries payable.....	\$6,000
Equipment.....	29,000	Common stock.....	10,500
Salaries expense.....	42,000	Supplies expense.....	4,700
Utilities expense.....	1,100	Retained earnings, Jan. 1, 2011.....	12,000
Dividends.....	7,600 5,800	Insurance expense.....	2,200
Accounts payable.....	7,600	Service revenue.....	75,000
✓ Cash.....	9,900	Repair expense.....	4,500
✓ Accounts receivable.....	9,500		

Instructions:

Prepare a balance sheet for Hopkins Inc. for the year ending December 31, 2011.

Assets

Cash	9,900	} Short term
Accounts Receivable	9,500	
Equipment	29,000	} long term
Security Deposit	3,200	
Total Assets		51,600

Liabilities

Salaries Payable	6,000
Accounts Payable	7,600
Total	13,600

Shareholders' Equity

Contributed 10,500

Earned



Retained Earnings

Carry-over \$12,000

Revenue 75,000

Expenses

Salaries 42,000

Supplies 4,700

Repair 4,500

Insurance 2,200

Utilities 1,100

Total Expenses 54,500

Total Retained Earnings \$32,500

~~Dividends - \$5,000~~

Total Equity 38,000

Total Liabilities + Equity = 51,600

✓ Matches

-3



MIT Sloan School of Management
15.501 Corporate Financial Accounting
Midterm Examination
October 13, 2010

SUGGESTED SOLUTIONS

NAME: _____

SECTION: (Circle one)

[A] (1:00pm-2:30pm)

or

[B] (2:30pm-4:00pm)

Instructions:

- 1) Exam Length: 1 hour and 20 minutes
- 2) This exam is 10 pages long (including the cover page). Please make sure your copy of the exam is not missing any pages.
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- 4) Write your answers in the space provided *and show any supporting computations you make*. Do not attach additional material.
- 5) The last two pages can be detached if convenient.
- 6) The total number of points on this exam is 100.

Manage your time efficiently.

Make sure to look through the entire exam before you start!

Question	Possible Points	Actual Points
1	18	
2	15	
3	20	
4	30	
5	7	
6	10	

Question 1 (18 points)

Required: Circle the letter corresponding to your response.

1. The nature of an asset is best described as:
 - a. a resource owned by the company that is expected to provide the company future economic benefits.
 - b. something with physical form that is valued at cost in the accounting records.
 - c. something owned by a business that has a ready market value.
 - d. an economic resource representing cash or the right to receive cash in the future.

2. Which account types normally have a credit balance?
 - a. Revenues
 - b. Liabilities
 - c. Expenses
 - d. Both a and b

3. What are probable future sacrifices called and on what statement are they reported?
 - a. Losses on the income statement
 - b. Stockholders' equity on the balance sheet
 - c. Dividends on the statement of stockholders' equity
 - d. Liabilities on the balance sheet

4. Details, Inc., purchased supplies for \$1,300 during 2010. At year end Details had \$800 of supplies left. The adjusting entry should
 - a. debit Supplies \$800
 - b. credit Supplies \$800
 - c. debit Supplies \$500
 - d. debit Supplies expense \$500

5. Harrigan Company, a small consulting firm, charges all of its operating expenses on Accounts Payable. On January 1, 2010, Harrigan's Accounts Payable balance was \$3,000 and, during the year, \$27,000 of additional operating expenses was charged on account. The ending Accounts Payable balance was \$9,000. What is the amount of cash paid for expenses during 2010?
 - a. \$33,000
 - b. \$30,000
 - c. \$21,000
 - d. \$18,000

6. Assets are recorded in the balance sheet in order of

- a. Market value
- b. Historic value
- c. Liquidity
- d. Maturity

7. From the following list of accounts, calculate the quick ratio. (Rounded to nearest tenth.)

Cash.....	\$6,000	Accounts payable.....	\$10,000
Marketable securities.....	3,000	Salary payable.....	4,000
Accounts receivable.....	9,000	Notes payable (due in two years)....	13,000
Inventory.....	11,000		
Prepaid insurance.....	1,000		

- a. 1.3
- b. 2.1
- c. 1.1
- d. 1.8

8. The following ratios are available for Leer Inc. and Stable Inc.

	Current Ratio	Debt to Assets Ratio	Earnings per Share
Leer Inc.	2	75%	\$3.50
Stable Inc	1.5	40%	\$2.75

Compared to Stable Inc., Leer Inc. has:

- a. Higher liquidity, higher solvency, and higher profitability.
- b. Lower liquidity, higher solvency, and higher profitability.
- c. Higher liquidity, lower solvency, and higher profitability.
- d. Higher liquidity and lower solvency, but profitability cannot be compared based on information provided.

9. Maxwell Industries recorded and paid \$900 advertising for the current month. Which occurred?

- a. Current assets increase.
- b. Gross profit decreases.
- c. Operating income decreases.
- d. Retained earnings increases.

Question 2 (15 points)

Instructions: In the blank space beside each numbered balance sheet item, enter the letter of its balance sheet classification.

A. Current assets	E. Current liabilities
B. Long-term investments	F. Long-term liabilities
C. Long-term assets	G. Equity
D. Intangible assets	H. Should not appear on the balance sheet

- C 1. Machine
- A 2. Inventory
- C 3. Land
- G 4. Common stock
- C 5. Building
- E 6. Income taxes payable in 30 days
- E 7. Utilities payable
- A 8. Note receivable due in 30 days
- H 9. Wages expense
- A 10. Security deposit
- H 11. Value of company logo
- A 12. Cash
- H 13. Value of land in excess of cost
- F 14. Mortgage payable
- A 15. Accounts receivable

Question 3 (20 points)

After accounting for bad debt expense and write-offs for the first three quarters, Image Communications' September 30, 2011, records show these account balances:

Accounts Receivable.....	\$260,000
Allowance for Doubtful Accounts.....	(8,100)

During the year, Image Communications estimates doubtful-account expense at 0.5% of credit sales. Credit sales in the final quarter (October through December) amount to \$340,000.

At year-end, the company ages its receivables and adjusts the balance in Allowance for Doubtful Accounts to correspond to the aging schedule. This schedule is as follows:

Accounts Receivable	Age of Accounts			
	1-30 Days	31-60 Days	61-90 Days	Over 90 Days
\$230,000	\$160,000	\$35,000	\$14,000	\$21,000
Estimated percent uncollectible	0.2%	1%	5%	30%

During the last quarter of 2011, the company completed the following selected transactions:

- | | |
|--------|--|
| 28-Dec | Wrote off as uncollectible the \$1,500 account receivable from Blue Carpets and the \$400 account receivable from Show-N-Tell Antiques |
| 31-Dec | Adjusted the Allowance for Doubtful Accounts and recorded doubtful-account expense at year-end, based on the aging of receivables. |

Required:

- Record the December 28 and December 31 transactions using journal entries.

The allowance has a (credit) balance of \$8,100 on October 1st. Image Communications debits bad debt expense \$1,700 and credits the allowance \$1,700 based on 0.5% of credit sales. Before the December 28th write-offs, the (credit) balance is \$9,800.

Dec-28:	Dr Allowance for doubtful accounts, \$1,900
	Cr Accounts Receivable—Blue Carpets, \$1,500
	Cr Accounts Receivable—Show-N-Tell, \$400

After these write-offs, the allowance will have a (credit) balance of \$7,900.

The aging of accounts receivable yields the following:

Accounts Receivable	Age of Accounts			
	1-30 Days	31-60 Days	61-90 Days	Over 90 Days
\$230,000	\$160,000	\$35,000	\$14,000	\$21,000
Estimated percent uncollectible	0.2%	1%	5%	30%
Based on aging:	\$320	\$350	\$700	\$6,300

So the ending balance for the allowance should be $\$320 + \$350 + \$700 + \$6,300 = \$7,670$.

The bad debt expense based on percentage of sales on account has been too high. To get the ending (credit) balance in the allowance for doubtful accounts, bad debt expense should be lowered:

**Dec-31: Dr Allowance for doubtful accounts, \$230
Cr Bad debt expense, \$230**

2. Prepare a T-account for Allowance for Doubtful Accounts and post to that account.

Allowance for doubtful accounts	
	\$ 8,100 <i>1-Oct</i>
	1,700 <i>Oct-Dec</i>
<i>28-Dec</i> \$ 1,500	
<i>28-Dec</i> 400	
<i>31-Dec</i> 230	
	\$ 7,670 <i>Ending</i>

Question 4 (30 points)

Mark Davis formed a lawn service company as a summer job. To start the business on May 1, he deposited \$2,000 in a new bank account in the name of the corporation. The \$2,000 consisted of a \$1,600 loan from his father and \$400 of his own money. The corporation issued 200 shares of common stock to Davis.

Davis rented lawn equipment, purchased supplies, and hired high school students to mow and trim his customers' lawns. At the end of each month, Davis mailed bills to his customers. On August 31, Davis was ready to dissolve the business and return to the local university. Because he had been so busy, he had kept few records other than his checkbook and a list of accounts owed by customers.

At August 31, Davis' checkbook shows a balance of \$2,040, and his customers still owe him \$600. During the summer, he collected \$5,600 from customers. His checkbook lists payments for supplies totaling \$400, and he still has gasoline, gardening gloves, and other supplies that cost a total of \$50. He paid his employees wages of \$1,900, and he still owes them \$200 for the final week of the summer.

Davis rented some equipment from Ludwig Tool Company. On May 1, he signed a six-month lease on mowers and paid \$600 for the full lease period. Ludwig will refund the unused portion of the prepayment if the equipment is in good shape. To get the refund, Davis has kept the mowers in excellent condition. In fact, he had to pay \$300 to repair a mower that ran over a hidden tree stump. He has not yet returned the mowers, however.

To transport employees and equipment to jobs, Davis used a trailer that he bought for \$300. He figures that the summer's work used up one-third of the trailer's service potential. The business checkbook lists dividends paid to Davis during the summer of \$460. Also, Davis paid his father back during the summer.

Required:

1. Prepare the income statement of Davis Lawn Service, Inc., for the four months May through August. The business is not subject to income tax.
2. Prepare the classified balance sheet of Davis Law Service, Inc., at August 31.

To start the business on May 1, he deposited \$2,000 in a new bank account in the name of the corporation. The \$2,000 consisted of a \$1,600 loan from his father and \$400 of his own money.

Cash	Loan payable	Common stock
[1] \$2,000	\$1,600 [1]	\$400 [1]

At August 31, Davis' checkbook shows a balance of \$2,040, and his customers still owe him \$600.

Cash		Accounts receivable	
[1]	\$2,000		
[EB]	\$2,040	[EB]	\$600

At the end of each month, Davis mailed bills to his customers. [...] During the summer, he collected \$5,600 from customers.

Cash		Accounts receivable		Revenues	
[1]	\$2,000				
[3]	\$5,600	[2]	\$6,200		\$6,200 [2]
			\$5,600 [3]		
[EB]	\$2,040	[EB]	\$600		

His checkbook lists payments for supplies totaling \$400, and he still has gasoline, gardening gloves, and other supplies that cost a total of \$50.

Cash		Supplies		Supplies expense	
[1]	\$2,000	[4]	\$400		
[3]	\$5,600		\$350 [5]	[5]	\$350
[EB]	\$2,040	[EB]	\$50		

He paid his employees wages of \$1,900, and he still owes them \$200 for the final week of the summer.

Cash		Wage expense		Wages payable	
[1]	\$2,000				
[3]	\$5,600	[6]	\$2,100		
[EB]	\$2,040				\$200 [EB]

On May 1, he signed a six-month lease on mowers and paid \$600 for the full lease period. Ludwig will refund the unused portion of the prepayment if the equipment is in good shape. To get the refund, Davis has kept the mowers in excellent condition. In fact, he had to pay \$300 to repair a mower that ran over a hidden tree stump. He has not yet returned the mowers, however.

Cash	
[1]	\$2,000
[3]	\$5,600
	\$400 [4]
	\$1,900 [6]
	\$600 [7]
	\$300 [9]
[EB]	\$2,040

Prepaid lease		Lease expense		Repair expense	
[7]	\$600				
		\$400 [8]	[8] \$400		[9] \$300
[EB]	\$200				

To transport employees and equipment to jobs, Davis used a trailer that he bought for \$300. He figures that the summer's work used up one-third of the trailer's service potential.

Cash		Equipment--Trailer		Trailer expense	
[1]	\$2,000				
[3]	\$5,600				
				\$400 [4]	
				\$1,900 [6]	
				\$600 [7]	
				\$300 [9]	
				\$300 [10]	
[EB]	\$2,040				
		[10] \$300		[11] \$100	
			\$100 [11]		
		[EB] \$200			

NOTE: We have not covered depreciation for long-lived assets yet, so I'm treating the trailer as a current asset (like tools, perhaps) instead of PP&E.

The business checkbook lists dividends paid to Davis during the summer of \$460. Also, Davis paid his father back during the summer.

Cash		Loan payable		Dividends	
[1]	\$2,000				
[3]	\$5,600				
				\$400 [4]	
				\$1,900 [6]	
				\$600 [7]	
				\$300 [9]	
				\$300 [10]	
				\$460 [12]	
				\$1,600 [13]	
[EB]	\$2,040				
		[13] \$1,600	\$1,600 [1]	[12] \$460	
			\$0 [EB]		

The work thus far can be checked. If you sum the credit entries to the cash account, you find you have credited cash for \$5,560. Since you collected \$5,600 and raised \$2,000 at the outset, the net cash inflow is \$2,040, which is what the checkbook says.

The income statement can be prepared as follows:

Income statement for Davis' Lawn Service Company Summer ended Aug 31st	
Revenues	<u>\$6,200</u>
Expenses:	
Wage expense	\$2,100
Lease expense	400
Supplies expense	350
Repair expense	300
Trailer expense	<u>100</u>
Total expenses:	<u>\$3,250</u>
Net income	<u><u>\$2,950</u></u>

Ending retained earnings will be \$2,950 less dividends of \$460, or \$2,490.

Balance sheet for Davis' Lawn Service Company as of Aug 31st			
Cash	\$ 2,040	Wages payable	<u>\$ 200</u>
Accounts receivable	600	Total liabilities:	<u>\$ 200</u>
Supplies	50	Common stock	\$ 400
Prepaid lease	200	Retained earnings	<u>2,490</u>
Equipment--Trailer	<u>200</u>	Total equity:	<u>\$ 2,890</u>
Total assets:	<u><u>\$ 3,090</u></u>	Total liabilities + equity	<u><u>\$ 3,090</u></u>

Question 5 (7 points)

J&J Snack Foods Corp manufactures and markets foods and frozen beverages to the food service and supermarket industries. The 2009 annual report includes the following information:

We sell equipment service contracts with terms of coverage ranging between 12 and 60 months. We record deferred income on equipment service contracts which is amortized by the straight-line method over the term of the contracts.

In 2009, J&J Snack Foods Corp sold \$16,745,000 in service contracts related to frozen beverage machines. At September 26, 2009 and September 27, 2008, deferred income on service contracts of \$1,334,000 and \$986,000, respectively, were included in short-term liabilities, and deferred income on service contracts of \$90,000 and \$144,000 were included in other long-term liabilities, respectively.

Required:

What is the amount of service contract income recorded in 2009? Show any supporting calculations, and enter your answer in the box provided below.

Beginning balance for unearned service contract income: $986,000 + 144,000 = \$1,130,000$

Ending balance for unearned service contract income: $1,334,000 + 90,000 = \$1,424,000$

$$\text{Beginning Balance} + \text{Additions} - \text{Subtractions} = \text{Ending Balance}$$

Entering the data you have:

$$1,130,000 + 16,745,000 - \text{Service contract income} = 1,424,000$$

After arithmetic:

$$\text{Service contract income} = \$16,451,000$$

Answer:

\$16,451,000

Question 6 (10 points)

The following items and amounts are taken from the 2011 financial records of Hopkins Inc.:

Security deposit.....	\$3,200	Salaries payable.....	\$6,000
Equipment.....	29,000	Common stock.....	10,500
Salaries expense.....	42,000	Supplies expense.....	4,700
Utilities expense.....	1,100	Retained earnings, Jan. 1, 2011.....	12,000
Dividends.....	5,000	Insurance expense.....	2,200
Accounts payable.....	7,600	Service revenue.....	75,000
Cash.....	9,900	Repair expense.....	4,500
Accounts receivable.....	9,500		

Instructions:

Prepare a balance sheet for Hopkins Inc. for the year ending December 31, 2011.

First, calculate the net income:

Service revenue.....	\$ 75,000
Salaries expense.....	(42,000)
Repair expense.....	(4,500)
Supplies expense.....	(4,700)
Insurance expense.....	(2,200)
Utilities expense.....	(1,100)
	<u>\$ 20,500</u>

Calculate ending retained earnings balance:

Beginning balance + Net income – Dividends = Ending balance

$$12,000 + 20,500 - 5,000 = \$27,500$$

Then, prepare the balance sheet:

<u>Hopkins Inc.'s Balance Sheet as of December 31, 2011</u>			
Cash.....	\$ 9,900	Accounts payable.....	\$ 7,600
Accounts receivable.....	9,500	Salaries payable.....	6,000
Security deposit.....	3,200	<i>Total Liabilities</i>	<u>\$ 13,600</u>
<i>Total Current Assets</i>	<u>\$ 22,600</u>		
Equipment.....	29,000	Common stock.....	10,500
<i>Total Noncurrent Assets</i>	<u>\$ 29,000</u>	Retained earnings.....	27,500
		<i>Total Shareholders Equity</i>	<u>\$ 38,000</u>
Total Assets	<u>\$ 51,600</u>	Total Liabilities + Equity	<u>\$ 51,600</u>