

ADM2342A Fall 2012

Student Name _____

Quiz #1

Student ID: _____

[marked out of 30 for convenience: worth 5% of ADM2342A 's course mark]

Question 1 (3 marks)

What are the objectives of financial reporting by business enterprises?

Solution

The objectives of financial reporting are to provide information:

- (a) that is useful to investors, members, contributors, creditors and other users in making their resource allocation decisions and/or assessing management stewardship.
- (b) to help users in evaluating an entity's economic resources, obligations and equity/net assets and the changes to these items.
- (c) to help users evaluate the economic performance of an entity.

Question 3 (6.5 marks)

Listed below are several information characteristics and accounting principles and assumptions. Match the letter of each with the appropriate phrase that states its application. (Items *a* through *k* may be used more than once or not at all.)

- | | |
|----------------------------------|---------------------------------|
| a. Economic entity assumption | g. Matching principle |
| b. Going concern assumption | h. Full disclosure principle |
| c. Monetary unit assumption | i. Relevance characteristic |
| d. Periodicity assumption | j. Reliability characteristic |
| e. Historical cost principle | k. Comparability characteristic |
| f. Revenue recognition principle | |

- ___ 1. Stable-dollar assumption (do not use historical cost principle).
- ___ 2. Earning process completed and realized or realizable.
- ___ 3. Presentation of error-free information with representational faithfulness.
- ___ 4. Yearly financial reports.
- ___ 5. Accruals and deferrals in adjusting and closing process. (Do not use going concern.)
- ___ 6. Useful standard measuring unit for business transactions.
- ___ 7. Notes as part of necessary information to a fair presentation.

- ___ 8. Affairs of the business distinguished from those of its owners.
- ___ 9. Business enterprise assumed to have a long life.
- ___ 10. Valuing assets at amounts originally paid for them.
- ___ 11. Application of the same accounting principles as in the preceding year.
- ___ 12. Summarizing significant accounting policies.
- ___ 13. Presentation of timely information with predictive and feedback value.

Solution

- | | | | | |
|------|------|------|-------|-------|
| 1. c | 4. d | 7. h | 10. e | 13. i |
| 2. f | 5. g | 8. a | 11. k | |
| 3. j | 6. c | 9. b | 12. h | |

Question 3 (7 marks)

James, the Controller of SHD Corporation, asks his assistant to correct the company's December 31, 2011 trial balance.

The preliminary trial balance, which does not balance, is reproduced below:

SHD Corporation Trial Balance December 31, 2011		
	Debit	Credit
Cash	10,000	
Accounts Receivable	15,000	
Prepaid Insurance	600	
Equipment	40,000	
Inventories	9,000	
Accounts Payable		11,590
Common Shares		10,000
Retained Earnings		100,000
Sales revenue		17,100
Salaries Expense		
Office Supplies Expense		
Depreciation Expense	2,550	
	143,300	138,690

The assistant's review uncovered the following errors:

1. The accounts payable for the purchase of inventories in the amount of \$6,560 was recorded as \$5,650 in error (the inventory account was debited correctly).
2. Depreciation expense was understated by \$450.
3. Office supplies were overstated by \$150.
4. A collection from a customer in the amount of \$4,000 was not posted to the receivable ledger (the cash account was debited correctly).

Required

Prepare a corrected trial balance.

Solution

**SHD Corporation
Trial Balance
December 31, 2011**

	Debit	Credit
Cash	10,000	
Accounts Receivable (\$15,000 - \$4,000)	11,000	
Prepaid Insurance	600	
Equipment	40,000	
Inventories	9,000	
Accounts Payable (\$11,590 + \$6,560 - \$5,650)		12,500
Common Shares		10,000
Retained Earnings		100,000
Sales		17,100
Salaries	64,000	
Office Supplies (\$2,150 - \$150)	2,000	
Depreciation Expense (\$2,550 + \$450)	3,000	
	139,600	139,600

Question 4 (13.5 marks)

You have been hired by the CFO of Perez Corporation, a public company. As new senior accountant you have been asked to help with the preparation of the 2011 income statement. In 2011, Perez reported pre-tax income from continuing operations of \$3,150,000. However, you have been advised that the following transaction have NOT yet been considered in that amount.

1. A review of the company's depreciation policies for its computer equipment revealed that depreciation expense relating to 2010 was overstated in error by \$19,000.
2. During the year, the company wrote off receivables for which no allowance for doubtful accounts had been set up. The amount of the receivable was \$62,500.
3. In 2011, the company sold old equipment for \$160,000. The equipment had a net book value (carrying amount) of \$120,000. The associated gain or loss is not considered unusual.

4. During the year, Perez disposed of one its subsidiaries. The CFO told you that the transaction meets the criteria for discontinued operations. The after-tax losses on the subsidiaries operations and from disposal were \$120,000 and \$290,000 respectively.

5. The company made a payment during the year in the amount of \$400,000 to settle a lawsuit. The lawsuit related to a 2009 event which the company's lawyers had been working on since that time. Based on the lawyer's advice, no payable for potential legal costs/damages/penalties arising from the lawsuit had been recognized in the financial statements.

Required

Prepare the 2011 income statement in good form for Perez taking into account the effects (if any) of the above items. The statement should start with income from continuing operations before income taxes. Unless otherwise stated, you may assume an income tax rate of 40% for all items. Note disclosure and earnings per share calculations are not required. The company has 100,000 common shares outstanding.

Solution
Perez Corporation
PARTIAL INCOME STATEMENT
For the Year Ended December 31, 2011

Income from continuing operations – before tax		\$2,727,500
Income taxes		<u>(1,091,000)</u>
Income before discontinued operations		\$1,636,500
Discontinued operations		
Loss from operations (net of \$80,000* tax)	(\$120,000)	
Loss from disposal (net of \$193,333** tax)	<u>(290,000)</u>	<u>(410,000)</u>
Net Income		<u>\$1,226,500</u>

EPS (before discontinued operations)	\$16.36***
EPS (before discontinued operations)	\$4.10
EPS (after discontinued operations)	\$12.27

Calculations:

Income from continuing operations (before adjustments)		\$3,150,000
1. Would be credited directly to retained earnings	0	
2. Expense	(62,500)	
3. Gain \$160,000 - \$120,000	40,000	
4. To be shown in discontinued operations section	0	
5. Loss	<u>(400,000)</u>	
Income from continuing operations (after adjustments)		\$2,727,500

* $\$80,000 = \$120,000 / (1 - .4) \times .4$.

** $\$193,333 = \$290,000 / (1 - .4) \times .4$.

*** $\$16.36 = \$1,636,500 / 100,000$ shares.