

Solutions to review problems- Comm 293 Section 204- February 26, 2008

Question 1 (8marks)

Journal Entries and Financial Statements

- a) Calculate income for the year after adjusting for any errors based on the additional information provided above. Ignore income taxes. (8 marks)

Start with net income as given	45,375
<u>Add/subtract adjustments</u>	
Reduce inventory by gross profit	(16,000) (Could also argue for 12,800)
Record amortization \$16000/6	(2,667)
Dividends are really an expense	(30,000)
Unrealized gain on investments (17,500-15,600)	+1,900
Set up unearned revenue	(16,000)
Equipment should be at cost not market	<u>(1,000)</u>
Revised net income (loss)	(18,392)

Question 3 (14 marks) Accounts Receivable

Required:

- (a) Determine the December 31, 2005 balances in "Bad Debts Expense" and "Allowance for Doubtful Accounts" if the company uses the percentage of credit sales method. **(5 marks)**

(b)

Credit sales = 15,000,000*.85=12,750,000

The balance in the Accounts Receivable account is:

opening balance	DR	1,900,000
Credit sales	DR	12,750,000
Collections	CR	12,500,000
Write offs	CR	125,000
Recoveries	DR	<u>15,000</u>
Balance	DR	2,040,000

The balance in the Allowance for Doubtful accounts

opening balance	CR	75,000
Write offs	DR	125,000
Recoveries	CR	15,000
Current year amt	CR	<u>127,500*</u>
Balance	CR	92,500

Bad debt expense for the year ***12,750,000*.01=127,500**

- (c) Determine the December 31, 2005 balance of "Allowance for Doubtful Accounts" if the company uses the aging method. **(5 marks)**

Balance in Accounts receivable (part a) 2,040,000

Current portion 2,040,000*.8*.05= 81,600

Non Current portion 2,040,000*.2*.25= 102,000

Balance in ADA should be **\$183,600CR**

The present balance before any entry is a DR35,000 (opening balance of 75,000cr—writeoffs of 125,000dr+recoveries of 15,000cr)

Therefore the journal entry is:

Dr Bad Debt expense \$218,600
Cr Allowance for D/A \$218,600

- (d) Is the "Allowance for Doubtful Accounts" going to be adequate as at December 31, 2005 if the company uses the percentage of credit sales method? Fully explain your answer. **(4 marks)**

If the ageing method is correct, the % of net credit sales is insufficient because the % of net credit sales results in an allowance of \$92,500 while the aging method indicates the balance should be \$183,600. Mgt should consider if the write offs were unusual this year.

Question 4 (9 marks)

Temporary Investments

As at December 31, 2004, Kerrisdale Paints Inc. has the following temporary investments:

	<u># of shares</u>	<u>Cost/Share</u>	<u>Market Value/share</u>
Rose	500	\$43	\$ 34
Dogwood	200	\$20	24

During 2005, transactions relating to this portfolio were as follows:

- January 25 Received a dividend of \$1.10 per share on the shares of Dogwood
- April 1 Purchased 200 additional common shares in Rose for \$30 per share plus a brokerage fee of \$120
- October 31 Sold 300 common shares of Rose for \$33 per share less a brokerage fee of \$198.

On December 31, 2005, the shares of Rose and Dogwood were trading for \$34 and \$25 respectively. Assume Kerrisdale Paints **has always** followed the policy of recording its temporary investments at market.

Required:

- (b) Provide all of the necessary journal entries that would be required for 2005 with respect to temporary investments. **(9 marks)**

Book method which adjusts the temporary investments directly- temporary investments would have been adjusted to market directly in 2004

2005 transactions

DR	Cash	220	
CR	Dividend revenue		220
DR	Temporary investments	6,120	
CR	Cash		6,120
	(200*30+120)		

DR	Cash	9702	(300*33-198)
DR	Loss on sale	207	
CR	Temporary investments		9,909(Note 1)

DR	Temporary investments	589	
CR	Unrealized gain		589(Note 2)

Note 1

		#	\$	
Rose	opening	500	17,000	market value from last year
	Purchase	<u>200</u>	<u>6,120</u>	
	Subtotal	700	23,120	Average cost 33.03/share
	Sell	(300)	(9,909)	Average cost
	Ending	400	13,211	

Note 2

On books	Dogwood	200 shares at \$24=	4,800
	Rose	400 shares at \$33 =	<u>13,211</u>
			<u>18,011</u>

FMV	Dogwood	200*25	5,000
	Rose	400*34	<u>13,600</u>
			<u>18,600</u>

Must recognize unrealized gain

18,600- 18011 is an unrealized gain

Valuation allowance method used

During 2004:	STI (Rose)	21,500	
	Cash		21,500
	STI (Dogwood)	4,000	
	Cash		4,000
31/12/2004	Unrealized loss	3,700	
	Valuation allowance		3,700
	Difference between carrying value of 25,500 and FMV of 21,800		
1/4/2005	STI (Rose)	6,120	
	Cash		6,120
31/10	Average Cost = $\frac{21,500+6,120}{500+200} = 39.46/\text{share}$		
	Cash	9,702 [(300x33) - 198]	
	Loss	2,136	
	STI (Rose) [39.46*300]		11,838
31/12		<u>Book Value</u>	<u>Market Value</u>
	Rose	\$15,782*	\$13,600 (400 shares left x 34)
	Dogwood	4,000	5,000 (200 x 25)
		19,782	18,600

- 21500-11838+6120

Valuation allowance 2,518
 Unrealized gain 2,518

Question 5 (10 marks)

Inventory

Required:

- (a) Calculate the gross profit margin and gross profit margin ratio for the year ended December 31, 2005 using the LIFO, FIFO and Weighted Average methods. Assume a **periodic inventory system** is used. (10 marks)

Number of units purchased-8100 for \$1,641,000
Number of units sold-7700 for \$2,692,500
Number of units-EI-400

Sales for all methods is \$2,692,500

	LIFO	FIFO	Weighted average
Purchases	1,641,000	1,641,000	1,641,000
Less: Ending inventory	76,000(400*190)	72,000(400*180)	81,036 (400*1641000/8100)
COGS	1,565,000	1,569,000	1,559,964
Gross Profit	1,127,500	1,123,500	1,132,536
G.P.%	41.8%	41.7%	42.1%