

Sauder School of Business
University of British Columbia

Comm 293

Practice Questions- Scott Sinclair, CA Section 204

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Question 1 (8 marks: suggested time 15 minutes)

Journal Entries

A friend of yours, Scott Crocker, is the president of Scott's Chocolates Inc. ("Scott's"). The company that produces organic chocolates has just completed its first year of operations. The following is the Balance Sheet and other information provided by the bookkeeper:

Scott's Chocolates Inc.
Balance Sheet
Year ended October 31,2005

Account	Debit	Credit
Cash in current account	\$ 3,000	
Cash in Washington State bank (Note 1)	15,000	
Accounts receivable (Note 2)	27,500	
Inventory (Note 3)	95,000	
Equipment (Note 4)	17,000	
Dividends paid (Note 5)	30,000	
Short term investments (Note 6)	15,600	
Accounts payable		\$ 46,133
Demand loan		9,925
Amortization of equipment (Note 4)		-
Common Shares, 9500 issued		101,667
Income for the first year		45,375
Totals	\$203,100	\$203,100

Additional information:

1. Scott's plans to expand into Washington State. The Food and Drug Branch of the United States Government has requested that \$15,000 be placed into a bank account in Seattle for a three year period to cover any potential lawsuits against the company arising from the sale of its products in the USA.
2. Accounts receivable are comprised of the following:
The accounts owed by customers from credit sales \$23,000
Deposits from customers on sales orders (10,500)
Amounts advanced to majority shareholder 15,000
3. The inventory is comprised of the following:
Raw materials at cost to the company \$31,000
Finished product at retail selling price 64,000
The company usually earns a gross profit of 25% on its products.
4. The equipment was purchased for \$16,000 on November 1, 2004. At the end of the year the same equipment was selling for \$17,000. The equipment should last for 6 years and be worthless at that time.

Question 1 (8 marks: suggested time 15 minutes) continued

5. The Company paid \$30,000 to the majority shareholder for management services rendered. Since the payment was made to a shareholder the bookkeeper recorded it as dividends paid.
6. The excess cash received from the initial issue of the common shares was invested in shares of Canadian Oil Sands Inc., a public company whose shares trade on the Toronto Stock Exchange. The market price of the shares at October 31, 2005 was \$17,500.
7. The company signed an agreement with the local School Board on August 1, 2005 to provide the school district with chocolates for fund raising events equally over the next 10 months commencing September 1, 2005. On October 1, 2005, the Company received a cheque for \$20,000 representing payment for the total contract. The total amount was recorded as revenue.

Required:

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

Question 2 (12 marks: suggested time 21 minutes)

Revenue Recognition

Greek Construction Inc. has been selected as the general contractor for construction of the 2010 Olympic Speed Skating Oval in Richmond. The contract has a fixed price of \$5,000,000 and construction costs are anticipated at \$4,000,000. The controller of the company explained to the Board that they could adopt either the percentage of completion or the completed contract method in accounting for this contract. The Board decided to adopt the percentage of completion method.

Construction on the Oval commenced in April 2006 and the results of the four-year construction period were as follows:

Dec. 31, 2006	Total costs incurred to date	\$1,000,000
	Estimated additional costs to complete construction	\$3,000,000
Dec. 31, 2007	Total costs incurred to date (2006 & 2007)	\$2,750,000
	Estimated additional costs to complete construction	\$2,000,000
Dec. 31, 2008	Total costs incurred to date (2006 & 2007 & 2008)	\$3,750,000
	Estimated additional costs to complete construction	\$1,500,000
Dec. 31, 2009	Total costs incurred to date	\$5,250,000
	Estimated additional costs to complete construction	none – construction completed

Required:

- a. Calculate the gross income (construction revenue less costs to construct) Peak Co. should recognize each year of the contract assuming it adopts the percentage of completion method for accounting for this contract. **(12 marks)**

Question 2 (12 marks: suggested time 21 minutes) continued

Question 3 (14 marks: suggested time 17 minutes)

Accounts Receivable

Video Electronics Inc. is the largest wholesaler of electronic games in Western Canada. Approximately 85% of the company's sales are made on credit and customers have twenty days from the date of sale to remit payment.

The following information is available for the year ended December 31, 2005:

Accounts receivable, gross (1/1/2005)	\$ 1,900,000
Allowance for doubtful accounts (1/1/2005)	75,000
Total sales in 2005	15,000,000
Payments on account received from customers	12,500,000
Write-offs of accounts receivable	125,000
Recoveries of bad debts during the 2005	15,000

Video provides for doubtful accounts using either of the following calculations:

- (i) 1% of credit sales for the year, or
- (ii) 5% of current receivables and 25% of receivables which are overdue as at year-end.

As at December 31, 2005, 80 % of gross accounts receivable are current.

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)**

Question 3 (14 marks: suggested time 17 minutes) continued

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

(c) 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)**

Question 4 (9 marks: suggested time 15 minutes)

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:

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

Question 5 (10 marks: suggested time 15 minutes)

Inventory

In January of 2005, Jacob Distributors (Jacob) signed an exclusive marketing agreement for a palm pilot the size of a credit card. The purchasing and selling information for the year is presented below:

	Units purchased	Price per unit
Purchases		
February 20	1500 units	\$190/unit
May 16	1800 units	\$200/unit
October 11	3300 units	\$220/unit
December 1	1500 units	\$180/unit

Sales	Units sold	Selling Price
March 15	1200 units	\$350/unit
June 15	2000 units	\$375/unit
November 15	3000 units	\$345/unit
December 15	1500 units	\$325/unit

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)**

Question 5 (10 marks: suggested time 15 minutes) continued