

TEST REVIEW
ACCOUNTING 101 - UNIT II - CHAPTERS 5, 6 & 7

Study suggestions: Review your class notes, homework exercises and problems.

Review **Key Points** at the end of each chapter.

Answer the **Self-Examination Questions** (the answers are in your textbook)

Use **your Study Guide**

Know accounting

Know the account classification (i.e. asset, liability, or owner's equity) and normal balance of all accounts

Chapter 5 Accounting for Merchandising Businesses

The revenue account is called Sales (not Fees Earned)

Multiple-Step Income Statement

Sales - Sales Returns and Allowances - Sales Discounts = Net Sales

Net Sales - Cost of Merchandise Sold = Gross Profit

Gross Profit - Operating Expenses = Net Income

There are a lot of new accounting terms in this chapter, such as

Merchandise Inventory

Perpetual inventory system

Periodic inventory system

Physical inventory

Merchandise Inventory Shrinkage

You need to understand Credit Terms, such as 2/10, n/30 and Credit Period

You need to know how transportation costs are determined. (FOB Shipping Point or FOB Destination)

There are a lot of new accounts in this chapter

You need to know how to journalize merchandise transactions

Chapter 6 Inventories

Know the effect of inventory errors on the financial statements

Understand the three inventory cost flow assumptions

Using FIFO and LIFO compute the cost of inventory under the perpetual inventory system

Using FIFO, LIFO, and Average Cost, compute the cost of inventory under the periodic inventory system

Compute the proper valuation of inventory using the Lower of Cost or Market

Estimate the cost of inventory using the retail method

Estimate the cost of inventory using the gross profit method

Be able to compute inventory turnover and the number of day's sales in inventory.

Chapter 7 Sarbanes-Oxley, Internal Controls, and Cash

The three primary things in this chapter are:

Bank reconciliation and related journal entries

Petty cash fund

Cash Short and Over account

SAMPLE PROBLEMS

Problem 1 Purchase related transaction

Merchandise is purchased on account from a supplier, List price \$15,000, trade discount 40%, terms 2/10, n/30 FOB shipping point with transportation costs of \$ 150 paid by the seller, and added to the invoice. The purchaser returned \$1,000 of the merchandise prior to payment. The invoice was paid within the discount period; what is the amount of cash paid by the buyer?

Problem 2 Sales related and purchase related transactions

Merchandise is sold on account to a customer for \$15,000, terms 1/10, n/30, FOB destination. The merchandise cost \$ 10,000. The seller paid transportation costs of \$750. The buyer returned some of the merchandise and a credit memorandum for \$1,500 for returned merchandise was issued by the seller prior to receiving payment. The returned merchandise cost \$1,000.

- (a) What is the journal entry recorded by the seller for the sale of the merchandise?

- (b) What is the journal entry recorded by the seller for the return of the merchandise?

- (c) What is the journal entry recorded by the seller for the receipt of payment if the invoice is paid within the discount period?

- (d) What is the journal entry recorded by the buyer for the purchase of the merchandise?

- (e) What is the journal entry recorded by the buyer for the return of the merchandise?

- (f) What is the journal entry recorded by the buyer for the payment, if the invoice is paid within the discount period?

Problem 3 Sales related transactions

What are the correct journal entries for the following transactions using the perpetual inventory system.

- (a) Sale of \$ 1,000 of merchandise for cash or bank credit card (MasterCard), the cost of the merchandise is \$600.

- (b) Sale of \$500 of merchandise on account or a non-bank credit card (American Express), when the sale is subject to a sales tax of 8% and the merchandise cost \$300.

Problem 4 Merchandise inventory shrinkage

The perpetual inventory records indicate that \$210,725 of merchandise should be on hand on December 31, 1998. The physical inventory indicates that \$204,975 of merchandise is actually on hand. What is the adjusting journal entry required to record inventory shrinkage for the year ended December 31, 1998?

SAMPLE PROBLEMS

Problem 5 Subsidiary ledgers and general ledger accounts

What are subsidiary ledgers and what do they contain?

Which accounts in the general ledger are called controlling accounts?

What do they control?

Problem 6 Bank reconciliation and related journal entries

How would you account for the following items on a bank reconciliation? (a) Add to or deduct from bank balance or (b) Add or deduct from depositor's cash balance. Prepare a bank reconciliation.

(a) The bank statement balance was \$10,520; the cash account balance in the general ledger was \$14,075.

(b) Cash received on account of \$510 was recorded as \$150.

(c) Deposit of \$5,000 made on the late on the last day of the month was not recorded on the bank statement.

(d) Bank service charges were \$50.

(e) A check of a customer, in the amount of \$495 was returned by the bank because of insufficient funds.

(f) There were outstanding checks at the end of the month of \$355.

(g) A short-term, non-interest bearing note in the amount of \$1,500 was collected by the bank.

(h) A check written in payment of a supplier's invoice in the amount of \$250, was recorded as \$25.

(i) What is the amount of cash to be reported on the balance sheet at the end of the accounting period?

Which of the above items appearing on the bank reconciliation require a journal entry? Journalize the entry or entries required.

Problem 7 Cash Short and Over Account

What is the journal entry to record cash sales if the actual cash received was \$13,180.30 and the amount indicated by the cash register total was \$13,189.70?

What is the normal balance of the Cash Short and Over account?

If the Cash Short and Over account has a debit balance at the end of the month, how is it reported on the financial statements?

Problem 8 Petty Cash Fund

What is the journal entry to establish a petty cash fund in the amount of \$250?

What account(s) is or are debited in the journal entry to reimburse the petty cash fund?

What account(s) is or are credited in the journal entry to reimburse the petty cash fund?

SAMPLE PROBLEMS

Problem 9 Perpetual inventory using FIFO

The company uses a perpetual inventory system. On the basis of the following inventory, purchases, and sales data, determine the cost of the merchandise sold and the value of the ending inventory using the first-in, first-out method.

January 1	Inventory	45 units at \$10.00
February 15	Sale	25 units
March 10	Purchase	50 units at \$9.00
May 30	Sale	50 units
July 31	Purchase	25 units at \$8.00
October 1	Sale	15 units

Problem 10 Perpetual inventory using LIFO

Assume that the business in problem 14 uses a perpetual inventory system, costing by the last-in, last-out method; determine the cost of merchandise sold and the value of ending inventory.

Problem 11 Periodic inventory by three methods

There are 50 units of the item in the physical inventory at December 31. The periodic inventory system is used. The units of an item available for sale during the year were as follows:

January 1	Inventory	50 units at \$ 9.06
March 10	Purchase	45 units at \$10.00
July 31	Purchase	35 units at \$11.00
November 5	Purchase	40 units at \$12.00

- (a) Determine the cost of ending inventory by the first-in, first-out (FIFO) method.

- (b) Determine the cost of ending inventory by the last-in, first-out (LEFO) method.

- (c) Determine the cost of ending inventory by the average cost method.

Problem 12 Lower of cost or market inventory

On the basis of the following data, determine the value of the inventory at the lower of cost or market.

Commodity	Inventory	Unit	Unit
	Quantity	Cost Price	Market Price
Corn	15,000	2.75	3.00
Wheat	10,000	4.25	4.00
Soybeans	20,000	6.50	6.75
Oats	5,000	4.45	4.35

SAMPLE PROBLEMS

Problem 13 Retail inventory method

On the basis of the following data, estimate the cost of merchandise inventory at January 31, by the retail method:

		Cost	Retail
January 1	Merchandise inventory	\$365,000	\$550,000
Jan 1 - 31	Purchases (net) for January	\$355,000	\$650,000
	Sales (net) for January		\$625,000

Problem 14 Gross profit inventory method

Hank's Hardware's inventory was destroyed by a fire on February 15. The following data was obtained from the accounting records, which he kept at home. Estimate the cost of merchandise destroyed on February 15.

January 1	Merchandise inventory	\$125,000
Jan 1 - Feb 15	Purchases (net)	\$150,000
	Sales (net)	\$200,000
	Estimated gross profit (rate 30%)	

Problem 15 Compute inventory turnover and the number of days' sales in inventory

The cost of merchandise sold for the Nicholas Company was \$4,380,000 in 1998. The beginning and ending inventories were \$525,000 and 615,000 respectively.

- (a) Compute inventory turnover for 1998

- (b) Compute the number of days' sales in year end inventory.

SOLUTIONS TO PROBLEMS

Problem 1 Purchase related transaction

List price for merchandise	\$15,000
Less Trade discount of 40%	<u>(6,000)</u>
Invoice amount	9,000
Less return	<u>(1,000)</u>
	8,000
Less 2% cash discount	160
	7,840
Plus transportation	<u>150</u>
Amount paid by the buyer	\$7,990

Problem 2 Sales related and purchase related transactions

(a) Journal entry recorded by the seller for the sale of the merchandise:

Accounts Receivable	15,000	
Sales		15,000
Cost of Merchandise Sold	10,000	
Merchandise Inventory		10,000
Transportation Out	750	
Cash		750

(b) Journal entry recorded by the seller for the return of the merchandise:

Sales Returns and Allowances	1,500	
Accounts Receivable		1,500
Merchandise Inventory	1,000	
Cost of Merchandise Sold		1,000

(c) Journal entry recorded by the seller for the receipt of payment:

Cash	13,365	
Sales Discounts	135	
Accounts Receivable		13,500

(d) Journal entry recorded by the buyer for the purchase of the merchandise:

Merchandise Inventory	15,000	
Accounts Payable		15,000

(e) Journal entry recorded by the buyer for the return of the merchandise:

Accounts Payable	1,500	
Merchandise Inventory		1,500

(f) Journal entry recorded by the buyer for the payment:

Accounts Payable	13,500	
Merchandise Inventory		135
Cash		13,365

SOLUTIONS TO PROBLEMS

Problem 3 Sales related transactions

(a) Sale of \$1,000 of merchandise for cash or bank credit card, the cost of the merchandise is \$600.

Cash	1,000	
Sales		1,000
Cost of Merchandise Sold	600	
Merchandise Inventory		600

(b) Sale of \$500 of merchandise on account or a non-bank credit card, when the sale is subject to a sales tax of 8% and the merchandise cost \$300.

Accounts Receivable	540	
Sales		500
Sales Tax Payable		40
Cost of Merchandise Sold	300	
Merchandise Inventory		300

Problem 4 Merchandise inventory shrinkage

Cost of Merchandise Sold	5,750	
Merchandise Inventory		5,750

Problem 5 Subsidiary ledgers and general ledger accounts

A **subsidiary ledger** is a ledger containing individual accounts with a common characteristic.

The **accounts receivable subsidiary ledger** contains an account for each credit customer that shows the amounts of sales and cash received.

The **accounts payable subsidiary ledger** contains an account for each creditor which shows the amounts of purchases and cash payments.

General ledger controlling accounts are **Accounts Receivable and Accounts Payable**

A **controlling account** in the general ledger summarizes the balances of the accounts in a subsidiary ledger.

Problem 6 Bank reconciliation and related journal entries

Bank Reconciliation:

Balance per bank statement	\$10,520
Add: Deposit in transit	<u>5,000</u>
	15,520
Deduct: Outstanding checks	<u>(355)</u>
Adjusted bank balance	\$15,165

Cash balance per general ledger	\$14,075
Add: Error in recording deposit	360
Note collected by bank	<u>1,500</u>
	<u>1,860</u>
	..\$15,935
Deduct: Error in recording check	225
Bank service charges	50
NSF check	<u>495</u>
	<u>770</u>
Adjusted book balance	\$ 15,165

The amount of cash to be reported on the balance sheet at the end of the accounting period is \$15,165.

SOLUTIONS TO PROBLEMS

Problem 6 - continued

The items appearing on the above that bank reconciliation that require a journal entry are:

- (b) Cash received on account of \$5 10 was recorded as \$150.
- (d) Bank service charges were \$50.
- (e) A check, of a customer, in the amount of \$495 was returned by the bank because of insufficient funds.
- (g) A short-term, non-interest bearing note in the amount of \$1,500 was collected by the bank.
- (h) A check written in payment of a supplier's invoice in the amount of \$250, was recorded as \$25.

Cash	1,860	
Account Receivable		360
Notes Receivable		1,500
Accounts Receivable	495	
Miscellaneous Administrative Expense	50	
Accounts Payable	225	
Cash		770

Problem 7 Cash Short and Over Account

The journal entry to record cash sales if the actual cash received was \$13,180.30 and the amount indicated by the cash register total was \$13,189.70:

Cash	13,180.30	
Cash Short and Over	9.40	
Sales		13,189.70

The Cash Short and Over account does not have a normal balance.

If the Cash Short and Over account has a debit balance at the end of the month, it is included in Miscellaneous Administrative Expense in the income statement. A credit balance is included in the Other Income section.

Problem 8 Petty Cash Fund

What is the journal entry to establish a petty cash fund in the amount of \$250?

Petty Cash	250	
Cash		250

The accounts debited in the journal entry to reimburse the petty cash fund are the various expense or asset accounts for which the petty cash was disbursed.

The cash account is credited in the journal entry to reimburse the petty cash fund.

Problem 9 Perpetual inventory using FIFO

<u>Date</u>	<u>Purchases</u>	<u>Cost of Merchandise Sold</u>	<u>Inventory</u>
January 1	Inventory		45 units at \$ 10
February 15		Sale 25 units at \$10 = 250	20 units at \$ 10
March 10	50 units at \$9		50 units at \$ 9
May 30		Sale 20 units at \$10 = 200 30 units at \$9 = 270	20 units at \$9
July 31	25 units at \$8		25 units at \$8
October 1		Sale 15 units at \$9 = 135	5 units at \$9 = 45
		_____	25 units at \$8 = <u>200</u>
		Total cost of merchandise sold \$855	Ending inventory \$245

Beginning inventory plus purchases - cost of merchandise sold = ending inventory

SOLUTIONS TO PROBLEMS

Problem 10 Perpetual inventory using LIFO

<u>Date</u>	<u>Purchases</u>	<u>Cost of Merchandise Sold</u>	<u>Inventory</u>
January 1	Inventory		45 units at \$10
February 15		Sale 25 units at \$10 = 250	20 units at \$10
March 10	50 units at \$9		50 units at \$ 9
May 30		Sale 50 units at \$9 = 450	20 units at \$10
July 31	25 units at \$8		25 units at \$ 8
October 1		Sale 15 units at \$8 = 120	20 units at \$ 10 = 200
		_____	10 units at \$8 = 80
		Total cost of merchandise sold \$820	Ending inventory \$280

Beginning inventory plus purchases - cost of merchandise sold = ending inventory

Problem 11 Periodic inventory by three methods

(a) The inventory cost by the first-in, first-out (FIFO) method is \$590; (40 at \$12 + 10 at \$11)

(b) The inventory cost by the last-in, first-out (LFIFO) method is \$453; (50 at \$9.06)

(c) The inventory cost by the average cost method is \$520; (50 at \$10.40)

January 1	Inventory	50 units at \$ 9.06	453.00
March 10	Purchase	45 units at \$10.00	450.00
July 31	Purchase	35 units at \$11.00	385.00
November 5	Purchase	<u>40 units at \$12.00</u>	<u>480.00</u>
	Total Units	170 Total Cost	1,768.00

(Average cost \$1,768 / 170 units = 10.40)

Problem 12 Lower of cost or market inventory

On the basis of the following data, determine the value of the inventory at the lower of cost or market.

Commodity	Inventory Quantity	Unit		Cost	Market	Lower of C or M
		Cost Price	Market Price			
Corn	15,000	2.75	3.00	41,250	45,000	41,250
Wheat	10,000	4.25	4.00	42,500	40,000	40,000
Soybeans	20,000	6.50	6.75	130,000	135,000	130,000
Oats	5,000	4.45	4.35	<u>22,250</u>	<u>21,75</u>	<u>21,750</u>
Total				\$236,000	\$241,750	\$233,000

SOLUTIONS TO PROBLEMS

Problem 13 Retail inventory method

On the basis of the following data, estimate the cost of merchandise inventory at January 31, by the retail method:

	Cost	Retail
Merchandise inventory, January 1	\$365,000	\$ 550,000
Purchases in January (net)	355,000	650,000
Merchandise available for sale	720,000	1,200,000

Ratio of cost to retail $720,000 / 1,200,000 = 60\%$

Sales for January (net)		625,000
Merchandise inventory, January 31 at retail		\$ 575,000
Merchandise inventory, January 31 at Estimated cost (575,000 X 60%)		\$ 345,000

Problem 14 Gross profit inventory method

Merchandise inventory, January 1		\$125,000
Purchases (net) Jan 1- Feb 15		150,000
Merchandise available for sale		275,000
Sales (net)	\$200,000	
Less Estimated gross profit at 30%	<u>60,000</u>	
Estimated cost of merchandise sold		<u>140,000</u>
Estimated merchandise inventory, February 15		\$135,000

Problem 15 Compute inventory turnover and the number of days' sales in inventory

(a) The inventory turnover for 1998 was 7.7

$$4,380,000 / (525,000 + 615,000) / 2 = 7.68$$

(b) The number of days' sales in year end inventory was 51.3 days

$$615,000 / (4,380,000 / 365) = 51.25$$