

Final Exam Review 2 – Take-Home Questions

The following questions are adapted from Financial Accounting: Tools for Business Decision-Making, by Kimmel, Weygandt, Kieso, Trenholm, & Irvine, 5th Canadian Edition.

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Disclaimer:

These questions are for review purposes only. These questions do not, in any way, indicate the type, content, or style of questions that will be on the final exam. This package is for additional practice so students can determine what they know...and what they do not know.

NOTE that these questions do not include concepts prior to Chapter 6. The final exam WILL be cumulative (include all chapters from 1 to 10). For a review of the first 5 chapters see the Midterm Review Package and the end of chapter Practice Questions that were posted before the midterm.

NOTE: The charts usually have more rows than you will need. Account names HAVE NOT been provided because they WILL NOT be provided on the final exam.

For a more effective review, we suggest that you print the charts out and fill them in by hand, instead of on the computer. You will not be using a computer on the final exam!

Solutions to these questions are available in a separate document. Try the questions first – don't peek!

FER2-1

On January 6, Compton Limited sold merchandise on account to Singh Inc. for \$24,000, terms 2/10, n/30. The merchandise originally cost Compton \$16,000. On January 15, Singh paid the amount due. Both Compton and Singh use a perpetual inventory system.

Instructions

- (a) Record the business activities in Compton Limited's accounting equation using account names to record the sale and related collection.

	Assets			Liabs.	Equity			
					Owners' Capital	Retained Earnings		
	Profit							
	Revenue		Expenses					
Cash	Accounts Receivable	Inventory	Accounts Payable	Sales revenue	Sales returns	Sales discounts	Cost of goods sold	
Jan 6		24,000			24,000			
			-16,000					16,000
Jan 15	23,520	-24,000					-480	
Balance	23,520	0			24,000		-480	16,000

FER2-1 (continued)

(b) Record the business activities in Singh Inc.'s accounting equation using account names to record the purchase and related payment.

	Assets			Liabilities	Equity				
					Owners' Capital	Retained Earnings			
	Profit								
	Revenue			Expenses					
Cash	Accounts Receivable	Inventory	Accounts Payable		Sales revenue	Sales returns	Sales discounts	Cost of goods sold	
Jan 6			24,000	24,000					
Jan 15	-23,520		-480	24,000					
Balance	-23,520		23,520	0					

FER2-2

Hohnberger Enterprises purchased equipment on March 15, 2012, for \$74,000. The company also paid the following amounts: \$1,000 for delivery charges; \$200 for insurance while the equipment was in transit; \$1,800 for a one-year insurance policy; \$2,100 to train employees to use the new equipment; and \$2,800 for testing and installation. The equipment was ready for use on April 1, 2012, but the company did not start using it until May 1, 2012.

Hohnberger has estimated the equipment will have a 10-year useful life with no residual value. The company has a December 31 year end.

Instructions

- (a) Calculate the cost of the equipment.

Invoice 74,000
Delivery 1,000
Del Insu. 200
Testing 2,800
Total 78,000

Insurance policy is prepaid; training is an expense.

- (b) When should the company begin depreciating the equipment: March 15, April 1, or May 1? Why?

April 1 – when ready for use.

- (c) Using straight-line depreciation, calculate the depreciation expense on the equipment for 2012 and 2013.

Year	Depr. Expense	Accumulated Depr.	Book value
2012	5,850 ***	5,850	72,150
2013	7,800	13,650	64,350

***** $\$78,000 \div 10 \text{ years} \div 12 = \$650 \text{ per month. In 2012} - \$650 \times 9 = \$5,850.$**

FER2-3

Zerbe Consulting Inc.'s gross salaries for all their employees for the biweekly (2 weeks) period ended August 22 was \$15,000. Deductions included \$743 for CPP, \$260 for EI, and \$6,258 for income tax. Record the entries in the expanded accounting equation using account names for (a) the payment of salaries on August 22, and (b) the employer payroll costs on August 22, assuming they will not be paid to the government until September, and (c) the payment of the employee benefits to the government on September 8.

Date	Assets	Liabilities			Equity				
					Owner's Capital	Retained Earnings			
	Cash	CPP Payable	EI payable	Employee Tax Payable		Revenue	Salaries	Expenses	Benefits
(a)	-7,739	743	260	6,258			15,000		
(b)		743	364						1,107
(c)	-8,368	-1,486	-624	-6,258					
Balance	-16,107	0	0	0			15,000		1,107

FER2-4

Condensed data from the comparative statement of financial position of Dressaire Inc. follow:

	2012	2011	Horizontal Analysis
Current assets	\$120,000	\$ 80,000	+ 50.0%
Non-current assets	\$400,000	\$350,000	+ 14.7%
Current liabilities	\$ 70,000	\$ 90,000	- 22.2%
Non-current liabilities	\$165,000	\$105,000	+ 57.1%
Owners' capital	\$150,000	\$115,000	+30.4%
Retained earnings	\$135,000	\$120,000	+12.5%

Instructions

Analyze the outcome of the above horizontal analysis. What can you say about the business between 2012 and 2011?

- Increase in current assets indicated that the business has current assets which it can use to settle its current liabilities as they come due.
- Increase in non-current assets indicates that the business is investing in its future, which may lead to additional revenue in upcoming years.
- Decrease in liabilities indicates that the business is using its current assets to pay its current liabilities, which is good, as debt is being reduced.
- The large increase in non-current liabilities means that the business has borrowed money. This could be why current liabilities have declined (they may have paid them using the cash that was borrowed) and why current assets are so high (it could be that some of the borrowed cash is still on hand). It also explains how the company paid for its new non-current assets.
- The increase in owners' capital indicates that the owners invested more funds into the business. This can also explain the increases in current and non-current assets.
- The increase in retained earnings indicated that the business made a profit, which is good.

FER2-5

An important part of accounts receivable is to recognize that businesses owe many customers. Those customer's invoices can then be aged. The aging categorizes all invoices by how long they are outstanding.

The following question will help you to recognize and create an accounts receivable sub-ledger while, at the same time, testing your understanding Chapter 4, merchandising businesses.

NOTE: no information is available regarding the cost of the inventory sold. This question focuses on Accounts Receivable only, which is why inventory is ignored for purposes of this question.

The transactions that follow were for Discovery Sports Ltd. with its customers during the company's first month of business:

- Feb. 2 Sold \$1,140 of merchandise to Andrew Noren on account, terms n/30.
- 4 Andrew Noren returned \$140 of the merchandise purchased on February 2.
- 5 Sold \$750 of merchandise to Dong Corporation on account, terms 2/10, n/30.
- 8 Sold \$842 of merchandise to Michael Collins for cash.
- 10 Sold \$920 of merchandise to Rafik Kurji, who paid cash.
- 14 Dong Corporation paid.
- 17 Andrew Noren purchased an additional \$696 of merchandise on account, terms n/30.
- 22 Sold \$1,738 of merchandise to Batstone Corporation, terms 2/10, n/30.
- 28 Andrew Noren paid \$1,000 towards his outstanding accounts receivable.

Instructions

Record the business activities into the accounting equation using account names.

SEE THE CHART ON THE NEXT PAGE.

FER2-5 (continued)

	Assets			Liabilities	Equity				
					Owners' Capital	Retained Earnings			
	Profit								
	Revenue			Expenses					
Cash	Accounts Receivable	Inventory	Accounts Payable		Sales revenue	Sales returns	Sales discounts	Cost of goods sold	
Feb 2		1,140			1,140				
Feb 4		-140				-140			
Feb 5		750			750				
Feb 8	842				842				
Feb 10	920				920				
Feb 14	735	-750					-15		
Feb 17		696			696				
Feb 22		1,738			1,738				
Feb 28	1,000	-1,000							
Balance	3,497	2,434			6,086	-140	-15		

FER2-6

Condensed data from the comparative statement of financial position of Dressaire Inc. follow:

	2015	2014	Horizontal Analysis
Current assets	\$ 80,000	\$100,000	- 20.0%
Non-current assets	\$350,000	\$300,000	+16.7%
Current liabilities	\$ 90,000	\$ 65,000	+38.5%
Non-current liabilities	\$105,000	\$150,000	- 30.0%
Owners' capital	\$115,000	\$100,000	+ 15.0%
Retained earnings	\$120,000	\$ 85,000	+ 41.2%

Instructions

Analyze the outcome of the above horizontal analysis. What can you say about the business between 2014 and 2015?

- The decrease in current assets is concerning because current liabilities have increased and the business needs current assets in order to pay its debts as they come due.
- The increase in non-current assets is a positive sign that the business is investing in its future ability to generate revenue with new equipment.
- The large increase in current liabilities indicates that the business may not be keeping up with paying its debts. The reason for this is unclear – more information is needed.
- Non-current liabilities have decreased, indicating that the business has paid down its loans, which is good, as less interest will be paid in future. Perhaps it used some of its cash (a current asset) to pay the loans.
- Owner's capital has increased slightly – perhaps this cash was also used to pay the loans.
- The increase in retained earnings shows that the business is quite profitable.

FER2-7

Romez Limited borrowed \$60,000 from the bank on July 1 for three months; 5% interest is payable the first of each month, starting August 1. Romez's year end is August 31. Prepare entries to record (a) the receipt of the bank loan on July 1; (b) (1) the accrual of interest on July 31, (2) the payment of interest on August 1, (3) the accrual of interest on August 31, (4) the payment of interest on September 1.

Date	Assets	Liabilities			Equity			
	Cash	Accts Payable	Loan Payable	Interest Payable	Owner's capital	Retained earnings		
						Profit		
						Revenue	Interest Expense	
July 1	60,000		60,000					
July 31				250			250	
Aug 1	-250			-250				
Aug 31				250			250	
Sept 1	-250			-250				
Balance	59,500		60,000	0			500	

FER2-8

Spector Limited purchased a truck on January 1, 2010, for 62,000. The truck had a residual value of \$6,000, and an estimated 4 year useful life. On January 1, 2012, Spector sold the delivery truck for \$10,000. Spector uses straight-line depreciation and had a December 31 yearend.

Create a chart which shows the depreciation expense, accumulated depreciation, and book value (also called carrying value) for 2010, 2011, and 2012. Record the depreciation expense for December 31, 2010, December 31, 2011, and all the necessary entries for 2012, including the sale of the truck, in the chart on the next page.

Year	Depr. Expense	Accumulated Depr.	Book value
2010	14,000	14,000	48,000
2011	14,000	28,000	34,000
2012	0	28,000	34,000

Calculations of the gain or loss on sale:

Book value \$34,000 – selling price \$10,000 = loss on sale \$24,000

FER2-8 (continued)

	Assets			Liabs.	Equity				
					Owners' Capital	Retained Earnings			
	Profit								
	Revenue		Expenses						
Cash	Truck	Accum. Depr.	Accounts Payable		Sales revenue	Gain on sale	Depreciation	Loss on sale	
1/1/10	-62,000	62,000							
31/12/10			-14,000				14,000		
31/12/11			-14,000				14,000		
Disposal	10,000	-62,000	28,000					24,000	
Balance		0	0					24,000	

FER2-9

Chinook Limited's general ledger reports a balance in Accounts Receivable of \$360,000 at the end of December.

Instructions

- Assuming that the Allowance for Doubtful Accounts has a balance of \$-4,400 and that uncollectable accounts are estimated to be \$36,000 by aging the accounts, record the entry at December 31.
- Assuming the same information as in (a) except that uncollectable accounts are expected to be 9% of the accounts receivable, record the entry at December 31.
- Assuming the same information as in (a) except that the Allowance for Doubtful Accounts has a balance of \$+2,400, record the entry at December 31.

Part (a): **Need -36,000, have -4,400, adjustment is -31,600**

	Assets			Liabs.	Equity			
					Owners' Capital	Retained Earnings		
	Profit							
	Revenue	Expenses						
Cash	Accounts Receivable	AFDA			Bad Debts			
Open		360,000	-4,400					
Adjust			-31,600			31,600		
End		360,000	-36,000			31,600		

Charts for Part (b) and (c) are on the next page.

Part (b): $\text{Need} - (360,000 \times 9\%) = -32,400$, have $-4,400$, adjustment is $-28,000$

	Assets			Liabilities	Equity		
					Owners' Capital	Retained Earnings	
	Profit						
	Revenue	Expenses					
Cash	Accounts Receivable	AFDA			Bad Debts		
Open		360,000	-4,400				
Adjust			-28,000			28,000	
End		360,000	-32,400			28,000	

Part (c): $\text{Need} -36,000$, have $+2,400$, adjustment is $-38,400$

	Assets			Liabilities	Equity		
					Owners' Capital	Retained Earnings	
	Profit						
	Revenue	Expenses					
Cash	Accounts Receivable	AFDA			Bad Debts		
Open		360,000	2,400				
Adjust			-38,400			38,400	
End		360,000	-36,000			38,400	

FER2-10

Eyre Inc. borrows a 10-year, 7%, \$300,000 mortgage on November 1, 2015, to buy a new building. The mortgage interest is paid on the first day of every month, starting December 1, 2015. Prepare the entry at November 1, when Eyre took out the loan. Record the following interest entries: November 30 when the company accrues interest, December 1 when it pays the interest, and December 31, when it accrues interest at the end of the year.

Date	Assets	Liabilities			Equity			
					Owner's capital	Retained earnings		
	Cash	Accounts Payable	Note Payable	Interest Payable			Profit	
					Revenue		Expense	
Nov 1	300,000		300,000					
Nov 30				1,750			1,750	
Dec 1				-1,750				
Dec 31				1,750			1,750	
Balance			300,000	1,750			3,500	

FER2-11

Jintao's gross payroll for the month of August was \$40,500 for all employees. The company deducted \$2,000 for CPP, \$720 for EI, and \$8,000 for income tax from the employees' pay.

Required:

Record the payment of salaries on August 31, 2015 and the accrual of the company employee benefits on the same date. Record the payment of the employee benefits to the government on September 8, 2015.

Date	Assets	Liabilities			Equity			
					Owner's Capital	Retained Earnings		Salaries
	Cash	CPP Payable	EI Payable	Employee Income Tax Payable		Revenue	Expenses	
Aug 31	-29,780	2,000	720	8,000			40,500	
Aug 31		2,000	1,008					3,008
Sept 8	-13,728	-4,000	-1,728	-8,000				
Balance	-43,508	0	0	0			40,500	3,008

FER2-12

Spector Limited purchased a computer on January 1, 2010, for \$10,980. The computer had no residual value and a useful life of three (3) years. On September 1, 2012, Spector sold the computer for \$1,500 cash. Spector uses straight-line depreciation and had a December 31 yearend.

Create a chart which shows the depreciation expense, accumulated depreciation, and book value (also called carrying value) for 2010, 2011, and 2012. Record the depreciation expense for December 31, 2010, December 31, 2011, and all the necessary entries for 2012, including the sale of the computer, in the chart on the next page.

Year	Depr. Expense	Accumulated Depr.	Book value
2010	3,660	3,660	7,320
2011	3,660	7,320	3,660
2012	2,440	9,760	1,220

Calculation of the gain or loss on sale:

Book value = 1,220; Selling price = \$1,500; Gain = 280

FER2-12 (continued)

	Assets			Liabs.	Equity				
					Owners' Capital	Retained Earnings			
	Profit								
	Revenue		Expenses						
Cash	Computer	Accum. Depr.	Accounts Payable		Sales revenue	Gain on sale	Depreciation	Loss on sale	
1/1/10	-10,980	10,980							
31/12/10			-3,660				3,660		
31/12/11			-3,660				3,660		
1/9/12			-2,440				2,440		
Disposal	1,500	-10,980	9,760				280		
Balance		0	0				280	9,760	

FER2-13

Gemini Ltd. has accounts receivable of \$370,000 at March 31, 2012. An analysis of the accounts shows these amounts:

Month of Sale	2012
March	\$260,000
February	50,400
January	34,000
October-December	25,600
	<u>\$370,000</u>

At March 31, 2012, there is an \$-8,800 balance in the allowance for doubtful accounts. The company estimates its uncollectable accounts as follows:

Number of Days Outstanding	Estimated % & Amount Uncollectable
0-30	2% x \$260,000 = \$5,200
31-60	10% x \$50,400 = \$5,040
61-90	30% x \$34,000 = \$10,200
Over 90	50% x \$25,600 = <u>\$12,800</u>
	Total \$33,240

Instructions

- Prepare an aging schedule to determine the total estimated uncollectable accounts receivable at March 31, 2012.
- Record the entry that the business would have to make at March 31, 2012, to record the bad debts expense estimate that you just calculated. Make the entry into the accounting equation on the next page using account names.

	Assets			Liabilities	Equity			
					Owners' Capital	Retained Earnings		
	Profit							
	Revenue	Expenses						
Cash	Accounts Receivable	AFDA	Accounts Payable		Revenue	Bad Debts		
Open		370,000	-8,800					
Adjust			-24,440				24,440	
End		370,000	-33,240				24,440	

Need -33,240, have -8,800, adjustment is -24,440

FER2-14

Condensed data from the income statement for Fleetwood Corporation follow:

	2012	Vertical Analysis	2011	Vertical Analysis
Net sales	\$800,000	100%	\$600,000	100%
Cost of goods sold	550,000	69%	375,000	63%
Gross profit	250,000	31%	225,000	37%
Operating expenses	175,000	22%	125,000	21%
Profit before income tax	75,000	9%	100,000	16%
Income tax expense	15,000	2%	20,000	3%
Profit	\$60,000	7%	\$80,000	13%

Instructions

Analyze the outcome of the above vertical analysis. What can you say about this business between 2011 and 2012?

- There has been a serious decline in the business's income statement over the past two years.
- Although net sales have increased, cost of goods sold has increased faster.
- The business's products have become much more expensive to buy.
- The result of this is a lower gross profit ratio.
- Operating expenses have also increased – together with the drop in gross profit, profit before income tax is much lower than before.
- Even though sales have increased in dollar terms, profit is lower because of the higher increase in expenses.

FER2-15

On December 31, 2015, when its Allowance for Doubtful Accounts had a balance of \$+2,000, Ceja Corp. estimated that \$16,800 of its accounts receivable would become uncollectable, and it recorded the bad debts estimate in the accounting equation using account names. On May 11, 2016, the following year, Ceja determined that Robert Worthy's account was uncollectable (bad) and wrote off his account, a total of \$1,900. On November 12, 2016, Robert Worthy paid \$1,000 of the amount that was previously written off.

Instructions

Prepare all the entries for both 2015 and 2016 using the accounting equation and account names.

	Assets			Liabilities	Equity			
					Owners' Capital	Retained Earnings		
	Profit							
	Revenue	Expenses						
Cash	Accounts Receivable	AFDA	Accounts Payable	Revenue	Bad Debts			
'15 open			2,000					
Adjust			-18,800			18,800		
'15 end			-16,800					
'16 open			-16,800					
11/5/16		-1,900	1,900					
12/11/16	1,000	±1,000	-1,000					

FER2-16

Spector Limited purchased equipment on January 1, 2010, for \$150,000. The equipment had no residual value and a useful life of ten (10) years. On December 1, 2013, Spector sold the equipment for \$80,000 cash. Spector uses straight-line depreciation and had a December 31 yearend.

Create a chart which shows the depreciation expense, accumulated depreciation, and book value (also called carrying value) for 2010, 2011, 2012, and 2013. Record the depreciation expense for December 31, 2010, December 31, 2011, December 31, 2012, and all the necessary entries for 2013, including the sale of the equipment, on the chart on the next page.

Year	Depr. Expense	Accumulated Depr.	Book value
2010	15,000	15,000	135,000
2011	15,000	30,000	120,000
2012	15,000	45,000	105,000
2013	13,750	58,750	91,250

Calculation of the gain or loss on sale:

Book value = 91,250; Selling price = 80,000; Loss = 11,250

FER2-16 (continued)

	Assets			Liabs.	Equity				
					Owners' Capital	Retained Earnings			
	Revenue		Expenses						
	Cash	Equipment	Accum. Depr.	Accounts Payable		Sales revenue	Gain on sale	Depreciation	Loss on sale
1/1/10	-150,000	150,000							
31/12/10			-15,000				15,000		
31/12/11			-15,000				15,000		
31/12/12			-15,000				15,000		
1/12/12			-13,750				13,750		
Disposal	80,000	-150,000	91,250					11,250	
Balance		0	0					11,250	

PUFFY LTD.
Statement of Cash Flows—Direct Method
Year Ended December 31, 2012

Operating activities		
Cash receipts from customers		\$974,000
Cash payments		
To suppliers.....	\$755,000	
For operating expenses	43,000	
For interest.....	14,000	
For income tax.....	<u>26,000</u>	<u>838,000</u>
Net cash provided by operating activities.....		136,000
Investing activities		
Sale of land.....	\$35,000	
Purchase of equipment.....	<u>(65,000)</u>	
Net cash used by investing activities.....		(30,000)
Financing activities		
Payment of cash dividends	\$(50,000)	
Repayment of bank loan.....	(50,000)	
Issue of common shares.....	<u>25,000</u>	
Net cash used by financing activities.....		<u>(75,000)</u>
Net increase in cash.....		31,000
Cash, January 1		<u>22,000</u>
Cash, December 31		<u>\$ 53,000</u>

Required:

Analyze the cash flow statement. Do you feel the business is doing well? Support your position using information from the cash flow statement!

<ul style="list-style-type: none"> • The business appears to be doing well.
<ul style="list-style-type: none"> • Operating cash flow is positive. This is a good sign as this is the only sustainable source of cash.
<ul style="list-style-type: none"> • The business sold land (maybe it wasn't being used), and purchased new equipment. This is an investment in the business's future ability to generate additional revenues.
<ul style="list-style-type: none"> • The operating cash inflow was enough to cover the investing cash outflow.
<ul style="list-style-type: none"> • With the leftover operating cash inflow, the business paid some of its loan, which is good.
<ul style="list-style-type: none"> • This was also supported by additional cash investment by the owners (financing cash inflow).
<ul style="list-style-type: none"> • The business also kept the owners happy by paying dividends.
<ul style="list-style-type: none"> • Even with all the above, the cash balance increased. This will allow the company to make more investments, pay more of its debt, and/or pay more dividends.

FER2-18

During its first year of operations, which ended on December 31, 2014, Fort Nelson Resources Ltd. sold \$50,000, all on account, and collected \$33,000 of that. At the end of the year it determined that customers owing the company \$1,200 would not be able to pay and wrote off these accounts. By the end of the year, the company estimated that 10% of its accounts receivable were doubtful of collection. In 2015, the company sold \$65,000, all on account, collected \$57,000, and wrote off accounts receivable amounting to \$1,400. On December 31, 2015, the company still estimated doubtful accounts at 10% of outstanding accounts receivable.

Instructions

- Prepare the entries that Fort Nelson Resources would record in 2014.
- Prepare the entries that Fort Nelson Resources would record in 2015.

	Assets			Liabs.	Equity			
					Owners' Capital	Retained Earnings		
	Profit		Revenue	Bad Debts				
	Cash	Accounts Receivable					AFDA	Accounts Payable
Opening		0	0					
2014 sales		50,000				50,000		
2014 collect	33,000	-33,000						
2014 w/off		-1,200	1,200					
2014 adjust			-2,780				2,780	
2014 end		15,800	-1,580					
2015 sales		65,000				65,000		
2015 collect	57,000	-57,000						
2015 w/off		-1,400	1,400					
2015 adjust			-2,060				2,060	
2015 end		22,400	-2,240					

FER2-19

The following expenditures are made for a forklift:

1. Rebuilding of the diesel engine, \$10,000
2. New tires, \$4,000
3. New safety cab, \$5,000
4. Replacement of the windshield, \$800
5. Training a new operator, \$1,600
6. New paint job after the company changed its logo and colours, \$2,000
7. One-year accident insurance policy, \$1,110
8. Payment to an operator to reorganize where items were stored in the warehouse to increase efficiency, \$2,400.

Instructions

For each of the above amounts indicate if the amount would be capitalized (included in the cost of the forklift) or expensed OR recorded in some other way. Briefly explain your reasoning. Record all the entries into the accounting equation on the next page using account names assuming it was all paid in cash.

Cost:	Explanation
1 capitalize	Increases useful life and future benefit
2 expense	Normal maintenance
3 capitalize	Necessary to make ready for use
4 expense	repair
5 expense	Paid for employee, not equipment
6 capitalize	Necessary to make ready for use
7 prepaid	Separate asset
8 expense	Not applicable to forklift

	Assets				Liabs.	Equity						
						Owner's Capital	Retained Earnings					
	Cash	Prepaid Expenses	Forklift	Accum. Depr.	Accounts payable		Owner's Capital	Retained Earnings	Revenue	Expenses		
						Sales Revenue			Repairs & maintenance	Insurance	Training	Wages
1	-10,000		10,000									
2	-4,000								4,000			
3	-5,000		5,000									
4	-800								800			
5	-1,600										1,600	
6	-2,000		2,000									
7	-1,110	1,110										
8	-2,400											2,400

FER2-20

At January 1, 2012, Bordeaux Inc. reported the following information on its statement of financial position:

Accounts receivable	\$480,000
Allowance for doubtful accounts	-35,000

During 2012, the company had the following summary transactions for receivables:

1. Sales on account, \$1,600,000
2. Sales returns and allowances, \$250,000
3. Collections of accounts receivable, \$1,500,000
4. Write-offs of accounts receivable deemed uncollectable, \$45,000
5. Customers who were previously written off sent in cheques for \$10,500

Instructions

- (a) Prepare all the entries required using the accounting equation with account names for the year.
- (b) Prepare the entry to record bad debts expense at December 31, assuming that aging the accounts receivable indicates that the amount for estimated uncollectable accounts is \$55,000.
- (c) The balance sheet at December 31 would show what?
- (d) The income statement at December 31 would show what?

Answers to (c) and (d):

Balance sheet:	
Current assets:	
Accounts receivable	\$285,000
Allowance for	
doubtful accounts	<u>(55,000)</u>
Net realizable value	<u>\$230,000</u>
Income statement: Bad debt expense \$54,500	

	Assets			Liabilities	Equity			
					Owners' Capital	Retained Earnings		
	Profit							
	Revenue		Expenses					
Cash	Accounts Receivable	AFDA	Accounts Payable		Revenue	Sales Returns & Allowances	Bad debts	
Open		480,000	-35,000					
1		1,600,000			1,600,000			
2		-250,000				-250,000		
3	1,500,000	-1,500,000						
4		-45,000	45,000					
5	10,500	±10,500	-10,500					
Balance		285,000	-500					
Adjust			-54,500				54,500	
Balance		285,000	-55,000					

FER2-21

The statement of cash flows for Cutting Edge Grooming Company is provided, below. Analyze the statement and indicate what you think about how the company did for this year. Do you think that the business should have paid dividends to the owner? Why or why not? Be sure to support your answer with information from the cash flow, both when you answer these specific questions but also when you analyze the statement!

CUTTING EDGE GROOMING COMPANY STATEMENT OF CASH FLOWS FOR THE YEAR ENDED XX/XX/XX



Cash Flows from Operating Activities

Cash receipts from:

Cash sales	\$ 90,000
Collections on account	30,000
Total cash receipts	<u>120,000</u>

Cash payments for:

Rent	(12,000)
Security deposit	(2,000)
Other operating expenses	<u>(58,000)</u>
Total cash payments	<u>(72,000)</u>

Cash Flows from Investing Activities

Purchase of equipment	<u>(20,000)</u>
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Cash Flows from Financing Activities

Owners cash contribution	50,000
Cash dividends paid	<u>(20,000)</u>

Net cash provided by financing activities 30,000

Net increase in cash 58,000

Cash balance, beginning of year 0

Cash balance, end of year \$ 58,000

<ul style="list-style-type: none">• A total for operating cash flow is missing – it is \$48,000, which is positive and therefore a good sign – this is the only source of sustainable cash flow.
<ul style="list-style-type: none">• The use of cash to purchase equipment is a good sign, as it shows that the management has confidence in the business’s future prospects
<ul style="list-style-type: none">• Cash flow from operations was sufficient to cover the purchase of equipment – a good sign
<ul style="list-style-type: none">• This must be the business’s first year of operation, since the beginning cash balance was zero. It is not surprising that the owners contributed cash to start the business up.
<ul style="list-style-type: none">• Excess cash flow from operations enabled the company to pay dividends. This is also a good sign.
<ul style="list-style-type: none">• Ending cash balance is positive – this is a good sign for the future,

FER2-22

If you were investing in a business what would you LIKE to see on the statement of cash flows for:

- a. Operating activities.
- b. Investing activities.
- c. Financing activities.

Be sure to explain WHY you would want to see those things.

There is room for your answer on the next page.

Operating cash flow:
<ul style="list-style-type: none"> • Would like this to be positive, and increasing over time. • This is because this is the only sustainable source of cash.
Investing cash flow:
<ul style="list-style-type: none"> • Would like this to be negative, and steady over time. • This is because investing in long-term assets adds to the ability of the business to generate revenue and cash flow in the future, which will lead to higher operating cash flows. • This is a sign that management has confidence in the business's ability to continue as a going concern.
Financing cash flow:
<ul style="list-style-type: none"> • This can be either positive or negative. • If operating cash flow is insufficient to cover investing cash outflow, the difference must be made up by additional contributions by the owners, or by the drawdown of existing cash balances. • If operating cash flow is sufficient to cover investing cash outflows, then the excess can be used to pay down debt or pay dividends, or to increase cash balances for future use.

FER2-23

TMG Ltd., a wholesale business, uses the FIFO inventory costing method. The business had the following inventory transactions for the past month. Assume all sales and purchases are on account with n/30 terms.

April 1	Opening inventory, 115 items at \$25 each.
April 5	Purchased 245 items at \$24 each.
April 12	Sold 232 items for \$45 each.
April 19	Purchased 114 items at \$23.50 each.
April 23	Sold 224 items for \$43 each.
April 29	Purchased 195 items at \$23 each.

Calculate the cost of goods sold and the ending inventory, using a perpetual inventory system and the FIFO inventory costing method.

Date	Purchases			Cost of goods sold			Inventory on hand		
	Quantity	Unit cost	Total Cost	Quantity	Unit cost	Total Cost	Quantity	Unit cost	Total Cost
Apr 1							115	25	2,875
Apr 5	245	24	5,880				115	25	8,755
							245	24	
Apr 12				115	25	5,683	128	24	3,072
				117	24				
Apr 19	114	23.50	2,679				128	24	5,751
							114	23.50	
Apr 23				128	24	5,328	18	23.50	423
				96	23.50				
Apr 29	195	23	4,485				18	23.50	4,908
							195	23	
Apr 30				10	23.50	235	8	23.50	4,673
							195	23	
Totals:	554		13,044	466		11,246			

Check \$: $\$2,875 + \$13,044 = \$15,919 = \$11,246 + \$4,673$ Units: $115 + 554 = 669 = 466 + 203$

Enter each of the transactions into the accounting equation, using account names.

	Assets			Liabilities	Equity			
					Owners' Capital	Retained Earnings		
	Profit							
	Revenue	Expenses						
Cash	Accounts Receivable	Inventory	Accounts Payable		Sales	Cost of Goods Sold	Loss on Inventory	
Open			2,875					
Apr 5			5,880	5,880				
Apr 12		10,440				10,440		
			-5,683				5,683	
Apr 19			2,679	2,679				
Apr 23		9,632				9,632		
			-5,328				5,328	
Apr 29			4,485	4,485				
Adjust			-235					235
Balance		20,072	4,673	13,044		20,072	11,011	235

The cost of the inventory is slightly down for every purchase. What could be a possible reason for these slight changes in the cost of inventory at every purchase?

<ul style="list-style-type: none"> • Change in exchange rate, if goods are imported
<ul style="list-style-type: none"> • Reduction in shipping costs
<ul style="list-style-type: none"> • Reduction in supplier's selling price
<ul style="list-style-type: none"> • Discounts offered by supplier
<ul style="list-style-type: none"> • Other answers may be acceptable

On April 30 the business performs an inventory count and determines that there are only 203 items on the shelf. What may have caused the difference between the inventory records and what is on the shelf?

Theft, breakage, spoilage, human error in counting incoming or outgoing shipments

What should the business do about the fact that there are only 203 items on the shelf? Why do they need to do anything at all? If an entry is required provide the entry and update the inventory control chart and the accounting records. Show your calculations!

- An adjustment must be made to reduce inventory by 10 items. Reduce the oldest items first, in accordance with FIFO. The difference of $10 \times \$23.50 = \235 will be a loss on the income statement. It is possible to also charge this loss to cost of goods sold, but that would affect the gross margin. The missing items were probably not sold, so loss is better.
- This is necessary because inventory cannot be carried on the balance sheet at more than its realizable value – the balance sheet would violate the faithful characteristic otherwise.

On April 30 you review the selling price of the product and discover that, due to a competitor's new and less expensive product, you can now only sell your product for \$30 each. What, if anything, should the business do and why? If an entry is required provide the entry and update the inventory control chart and the accounting records. Show your calculations!

- Nothing needs to be done because the new expected selling price is still higher than the inventory's unit cost.