

FINANCIAL ACCOUNTING EXAM 2.3 SOLUTION

Question 1

(1/2 point each, for a total of 1 point)

Part 1(a)

During December 2013, Ellen's Wellness Spa had a very successful holiday marketing promotion and collected \$1,200 of annual service fees from customers for services to be rendered during 2014. Ellen's policy is to recognize service revenues evenly over twelve months. No earlier entries have been recorded. **Record a journal entry for the December 2013 collections.**

	Debit	Credit
Cash	\$1,200	
Deferred revenues		\$1,200

Part 1(b)

On December 31, 2013, Tim's Custom Bikes discovered that chains on bikes recently sold to customers were defective and needed to be replaced within two months to ensure customers wouldn't find themselves stranded with broken chains. The company was not aware of the defective chains prior to this date and had not previously recorded any entries in anticipation of the defects. Tim's immediately notified affected customers to come to its repair shop to have the chains replaced under warranty during January and February, 2014. On December 31, 2013 the company estimated the total cost to replace the chains would be \$250: \$150 for the new chains and \$100 for labor. **What journal entry, if any, should Tim's record on December 31, 2013.**

	Debit	Credit
Cost of sales	\$250	
Accrued liabilities: warranty and recalls		\$250

Question 2

(1 point)

Valbona's Company	
2013 Indirect Cash Flow Statement	
<i>In Dollars, for year ended December 31, 2013</i>	
Operating activities	
Net income	\$450
Depreciation	\$125
Accounts receivable	\$100
Inventories	(\$200)
Prepaid expenses	(\$50)
Accounts payable	\$850
Accrued taxes	\$90
Other accrued liabilities	(\$510)
Deferred revenues	\$1,200
Net cash from operations	\$2,055
Investing activities	
Purchase property, plant, and equipment	(\$2,400)
Net cash from investing activities	(\$2,400)
Financing activities	
Issue common stock	\$2,100
Net cash from financing activities	\$2,100
Net change in cash during year	\$1,755
Beginning cash balance	\$700
Ending cash balance	\$2,455

Question 3

(1/2 point each for a total of 1 point)

Question 3(i)

CIRCLE the letter associated with the best response.

Based on the available information in **Harley-Davidson's** financial statements and related footnotes in the exam supplement, it is reasonable to conclude:

- (a) Harley-Davidson's \$60,008 thousand Provision for credit losses adjustment on the cash flow information footnote for fiscal 2013 increased net cash from operations.
- (b) Harley-Davidson's (\$46,474) thousand inventories adjustment on the cash flow information footnote represents a \$46,474 thousand net increase in inventories due to operating activities during fiscal 2013.
- (c) Harley-Davidson's (\$36,653) thousand accounts receivable, net adjustment on the cash flow information footnote for fiscal 2013 differs from \$30,986 thousand change in accounts receivable, net on the balance sheet (from 2012 to 2013) because this cash flow adjustment does not include the net effects of an allowance for doubtful accounts.
- (d) (b) and (c)
- (e) none of the above

Question 3(ii)

CIRCLE the letter associated with the best response.

Based on the available information in **Harley-Davidson's** financial statements and related footnotes in the exam supplement, it is reasonable to conclude:

- (a) Harley-Davidson spent \$27,013 thousand cash during fiscal 2013 on property, plant and equipment as reflected in the change on the balance sheet from 2012 to 2013.
- (b) Harley-Davidson declared and paid the same amount for dividends during fiscal 2013.
- (c) Harley-Davidson spent \$479,231 cash to repurchase its common stock during 2013.
- (d) (b) and (c)
- (e) all of the above

Part 4(a)

Record a single journal entry that summarizes the entries Harley-Davidson recorded during fiscal 2013 to meet customers' warranty and recall claims. That is, to repair motorcycles under warranty programs. (1 point)

	Debit	Credit
Accrued liabilities: warranty and recalls	\$64,462	
Cash		\$19,339
Inventories		\$45,123

Part 4(b)

Identify the Harley-Davidson financial-statement line items that were affected by the journal entries Harley-Davidson recorded during fiscal 2013 to meet customers' warranty and recall claims recorded in Part 4(a) and the direction of these effects (as indicated below).

(1/2 point per statement, for a total of 2 points.)

Harley-Davidson Financial Statements, fiscal 2013					
Balance Sheet			Statement of Shareholders' Equity		
Line Items	Increases	Decreases	Line Items	Increases	Decreases
Cash and cash equivalents	<input type="checkbox"/>	<input checked="" type="checkbox"/>	NONE	<input type="checkbox"/>	<input type="checkbox"/>
Inventories	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Accrued liabilities	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Statements of Operations			Statements of Cash Flows Plus Cash Flow Information footnote for Operating Section		
Line Items	Increases	Decreases	Line Items	Increases	Decreases
NONE	<input type="checkbox"/>	<input type="checkbox"/>	Inventories	<input checked="" type="checkbox"/>	<input type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>	Accounts payable & accrued liabilities	<input type="checkbox"/>	<input checked="" type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>	Net cash provided by operating activities of continuing operations	<input type="checkbox"/>	<input checked="" type="checkbox"/>

Part 5(a)

Record a single journal entry that summarizes the entries Harley-Davidson recorded during fiscal 2013 to replenish its allowance for doubtful accounts receivable AND replenish its allowance for credit losses for finance receivables. Ignore adjustments.

(1 point)

	Debit	Credit
Bad debts expense: accounts receivable	\$245	
Bad debts expense: finance receivable	\$60,008	
Allowance for bad debt: accounts receivable (contra asset)		\$245
Allowance for credit loss: finance receivable (contra asset)		\$60,008

Source: Schedule II

Part 5(b)

Identify the Harley-Davidson financial-statement line items that were affected by the journal entries recorded during fiscal 2013 to replenish its allowance for doubtful accounts receivable AND replenish its allowance for credit losses for finance receivables recorded in Part 5(a) and the direction of these effects (as indicated below).

IMPORTANT: INDICATE THE SEPARATE CURRENT AND NON-CURRENT LINE ITEMS, IF EFFECTED.

(1/2 point per statement, for a total of 2 points.)

Harley-Davidson Financial Statements, fiscal 2013					
Balance Sheet			Statement of Shareholders' Equity		
Line Items	Increases	Decreases	Line Items	Increases	Decreases
Accounts receivable, net	<input type="checkbox"/>	<input checked="" type="checkbox"/>	Net income	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Finance receivables, net (current)	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Financing receivables, net (non-current)	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Retained earnings	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Statements of Operations			Statements of Cash Flows Plus Cash Flow Information footnote for Operating Section		
Line Items	Increases	Decreases	Line Items	Increases	Decreases
Selling, administrative and engineering expense	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Net income	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Financial services provision for credit losses	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Provision for credit losses	<input checked="" type="checkbox"/>	<input type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>	Accounts receivable, net (Reported negative number increases)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>

Part 5(c)

Determine the direct effect(s) on the following Harley-Davidson metrics, everything else equal (ignore taxes) from replenishing its allowance for doubtful accounts receivable AND replenish its allowance for credit losses for finance receivables recorded in Part 5(a) during fiscal 2013.

(1/4 point per ratio, for a total of 1 point.)

	Increases	Decreases	No Effect
Working capital (current assets - current liabilities)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Financial leverage (liabilities / assets)	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
EBITDA (earnings before interest, taxes, depreciation & amortization)	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Net cash provided by operating activities of continuing operations	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>

Question 6

YOU MUST WRITE CLEARLY WITHIN THE GIVEN EXAM SPACE TO RECEIVE CREDIT.

If, in our sole judgment, we can not read your response you will not receive full credit.

(total of 10 points)

While there aren't correct responses to this portion of the exam, some are definitely better than others.

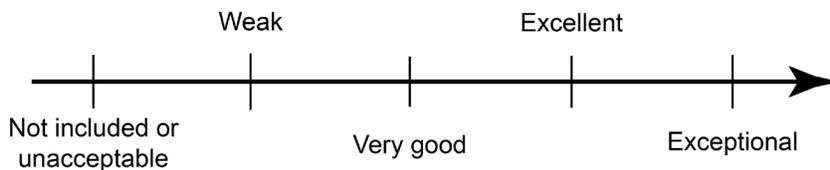
Below is a feedback form students received, along with their score out of 10 points.

Feedback Form

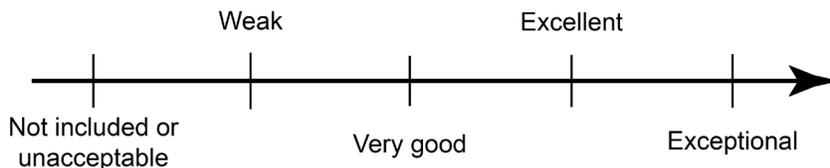
Question 6 asked: Which company appears to have the better future prospects at the most recent balance sheet dates, taking into consideration expected future ROEs, growth rates, and risks. Based on the information in the case and concepts covered thus far, there are excellent arguments on both sides. Hence, your responses were scored based on their overall merit and on the ratings below. You scored higher to the extent your analyses integrated business issues with patterns in the tabular data and your topic sentences were concise arguments (versus facts) substantiated with evidence, facts and/or logic.

The “X” on the scales below indicates how we rated this aspect of your response.

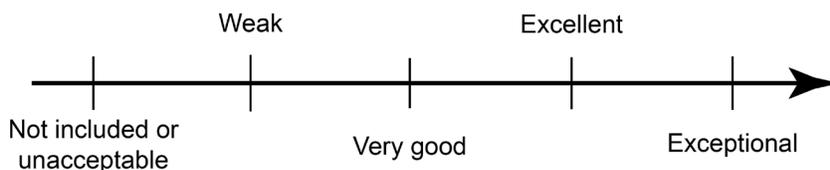
- **Expected future ROEs:**



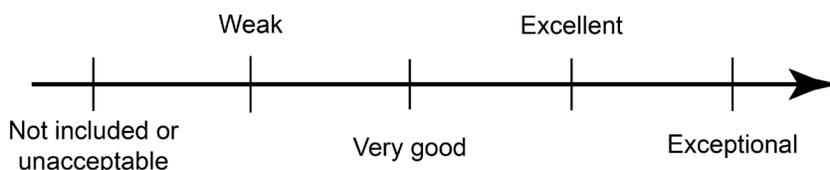
- **Expected future growth:**



- **Expected future risk:**



- **Other factors:** You rated higher on the scale below to the extent you raised other points that bolstered your position and we found them compelling.



- **Writing:** You rated higher on the scale below to the extent your response was well organized and written clearly, concisely, and persuasively.

