

FINANCIAL ACCOUNTING EXAM 2.4

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- The exam packet is comprised of:
 1. This 17-page document, which contains the questions you are to answer. Write all of your answers in this document, put your name on each page, and submit the document for grading.
 2. The Exam Supplement, which contains a chart of accounts you must use for **all** exam entries, a BSE matrix for a fictitious company, and financial statements and a few footnote excerpts for the following real company:
 - IBM (Fiscal 2014 10-K annual report, for year ended December 31, 2014)
 3. Scrap paper. Additional scrap paper is available at the front of the room.
- There are 100 possible points on the exam: 25 questions each worth 4 points. **Partial credit will not be awarded, so check your answers carefully.** There is also a 4-point bonus question.
- For all entries, you must use the most suitable accounts from those listed in the chart of accounts in the Exam Supplement. If you conclude two accounts are equally suitable, choose one and include a related note below your entry. If you use an account other than the one we concluded was most suitable and we agree with your logic, you will receive full credit.
- The exam is closed book and closed notes.
- You cannot use a laptop, tablet, cell phone, smart watch or other communication/mobile device.
- You may use a basic calculator (not to be shared with others). However, your calculator must not contain course related information. Additionally, your calculator must not be capable of storing “text” or communicating with others (no cell phones or other text messaging devices are permitted). We reserve the right to inspect your calculator and, in our sole judgment, deem it inappropriate for use during the exam. We will have basic calculators available for you to borrow.
- Once the exam starts, you may not take any materials from the room, including the exam document, the exam supplement, or any scrap paper (provided) until you have completed the exam and submitted your exam document to the Professor or Exam proctor.
- To protect the vast majority of students who will not cheat on the exam, there may be alternative versions of the exam that are the same in all respects except the questions contain some numbers that differ or are arranged differently.
- Regardless of one’s intent, staring at classmates’ exams is inappropriate. If you wish to take a break from staring at your exam, stare directly ahead or to either side without looking down.
- More generally, you are to honor the school’s core values in all respects.

Question 1

For parts (a) - (d) you are to create an income statement, statement of change in owners' equity, direct cash flow statement and indirect cash flow statement for Carly's Candies Company using the completed **BSE matrix in the separate exam supplement**.

(4 points for each statement, for a total of 16 points)

Part 1(a)

Complete the following income statement for Carly's Candies:

Carly's Candies Income Statement	
January 1 - January 31, 2016	
Operating profit	
Revenues	_____
Cost of sales	_____
Marketing general and administrative	_____
Income from operations	_____
Non-operating profit	
Interest income	_____
Profit before taxes	_____
Income tax expense	_____
Net profit	_____
Other comprehensive income	_____ 0
Comprehensive income	=====

Part 1(b)

Complete the following statement of changes in owners' equity for Carly's Candies:

Carly's Candies				
STATEMENT OF OWNERS' EQUITY				
	Common stock	Retained earnings	Reserves	Total
December 31, 2015	_____	_____	_____	_____
Comprehensive income				
Net profit	_____	_____	_____	_____
Other comprehensive income	_____	_____	_____	_____
Total	_____	_____	_____	_____
Dividends declared	_____	_____	_____	_____
January 31, 2016	=====	=====	=====	=====

Part 1(c)

Complete the following direct cash flow statement for Carly's Candies:

Carly's Candies	
DIRECT CASH FLOW STATEMENT	
January 1 - January 31, 2016	
Operating Activities	
Sales collections	_____
Supplier payments	_____
Compensation payments	_____
Other	_____
Net cash from operations	_____
Investing Activities	
Sell debt securities	_____
Net cash (used) for investing	_____
Financing Activities	
Declare and pay dividends	_____
Net cash from financing	_____
Change in cash	_____
Beginning cash balance	_____
Ending cash balance	=====

Part 1(d)

Complete the following indirect cash flow statement for Carly's Candies:

Carly's Candies	
INDIRECT CASH FLOW STATEMENT	
January 1 - January 31, 2016	
Operating Activities	
Net profit	_____
Receivables	_____
Inventories	_____
Accounts payable	_____
Accrued compensation & benefits	_____
Taxes payable	_____
Net cash from operations	_____
Investing Activities	
Sell debt securities	_____
Net cash (used) for investing	_____
Financing Activities	
Declare and pay dividends	_____
Net cash from financing	_____
Change in cash	_____
Beginning cash balance	_____
Ending cash balance	=====

Question 2

For parts (a) - (j) you are to record journal entries for Jennifer’s Fabulous Cakes and Cookies (JFCC) in the spaces provided **using accounts from the chart of accounts in the supplement**. JFCC is a manufacturing company that produces cakes and cookies in state of the art facilities located close to large cities and delivers some of them the same day to up-scale restaurants. The rest are frozen and stored in freezer warehouses until they are sold to distributors and grocery stores, typically within 60 days. *Check your work carefully, no partial credit.*

(4 points for each part, for a total of 40 points)

Part 2(a)

On January 1, 2015, JFCC paid \$48 thousand cash to rent a building during 2015 that would be suitable for producing cakes and cookies.

Record the \$48 thousand rental payment on January 1, 2015.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Part 2(b)

The rental contract for the production facility rented in part 2(a) did not include the cost of manufacturing equipment. JFCC purchased these items on January 1, 2015 for \$120 thousand cash, expecting to use them for 10 years.

Record a journal entry for the \$120 thousand payment on January 1, 2015.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Part 2(c)

On January 1, 2015 JFCC purchased and received \$20 thousand worth of flour, baking soda, chocolate and other ingredients that would be used to produce cakes and cookies. JFCC also received the invoice for this delivery on January 1, 2015, requiring JFCC to pay the supplier \$20 thousand by February 15, 2015. The supplier guaranteed these ingredients would stay fresh for at least two months.

Record a journal entry for the \$20 thousand of ingredients purchased on January 1, 2015.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Part 2(d)

On January 1, 2015 JFCC purchased cars for \$200 thousand that would be used by the sales staff and corporate executives. JFCC gave the car dealer a \$20 thousand cash down payment and promised to pay the remaining \$180 thousand plus interest to the dealer starting January 15th, 2017. Thus, JFCC paid \$20 thousand cash and issued \$180 thousand of debt on January 1, 2015 to acquire the cars.

JFCC expected to use the cars for 5 years, at which time they expected them to have \$20 thousand of trade-in value. As a result, JFCC estimated the cost to use the cars for the five years would be \$180 thousand (\$200 - \$20), or \$3 thousand per month.

Record a journal entry for the January 1, 2015 cars purchase.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Part 2(e)

On January 22, 2015 JFCC paid employees \$30 thousand cash for services rendered from January 1 to January 21. No entries related to these employees January service had been recorded earlier, including no prepayments. \$20 thousand was paid to employees who worked in production and the remaining \$10 thousand to employees who were not associated with production

Record a journal entry for the \$30 thousand payment to employees on January 22, 2015.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Part 2(f)

All of JFCC's sales to restaurants are on account, with customers required to pay within 60 days of delivery. Historically, some of JFCC's customers have declared bankruptcy, forcing JFCC to write-off trade receivables. In anticipation of these write-offs, JFCC maintains an allowance for doubtful accounts, which had a \$12 thousand balance on January 1, 2015.

On January 24, 2015 JFCC wrote off a \$7 trade receivable.

Record a journal entry for the \$7 thousand write-off on January 24, 2015.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Part 2(g)

Assuming JFCC plans to prepare financial statements at the end of each month, should the company record an adjusting entry on January 31, 2015 for one month's usage of the building it rented on January 1, 2015 to produce cakes and cookies (see entry 2(a))? **If not, write "no entry required"** in the first row of the space allotted below for the entry. Assume no entry has been recorded earlier for January usage of the rented production facility and that this usage is valued at 1/12 of the \$48 thousand rental payment made on January 1, 2015, or \$4 thousand.

Record a journal entry for the January usage of the rental property or state no entry required.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Part 2(h)

Assuming JFCC plans to prepare financial statements at the end of each month, should the company record an adjusting entry on January 31, 2015 for one month's usage of both: (i) the production equipment purchased on January 1, 2015 to produce cakes and cookies (see 2(b)) and (ii) the cars purchased on January 1, 2015 for use by the sales staff and corporate executives (see 2(d))? **If not, write "no entry required"** in the first row of the space allotted below for the entry. Assume no entries have been recorded earlier for January usage of these items and that this usage is valued at \$1 thousand for the production equipment and \$3 thousand for the cars.

Record a journal entry for the January usage of these items or state no entry required.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Part 2(i)

On January 31, 2015 JFCC records an adjusting entry that recognizes January usage of \$12 thousand of the ingredients purchased on January 1, 2015 to produce cakes and cookies. (See 2(c))

Record a journal entry for the \$12 thousand January usage of ingredients.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Part 2(j)

All of JFCC's sales to restaurants are on account, with customers required to pay within 60 days of delivery. Historically, some of JFCC's customers have declared bankruptcy, forcing JFCC to write-off trade receivables. In anticipation of these write-offs, JFCC maintains an allowance for doubtful accounts, which had a \$12 thousand balance on January 1, 2015. The \$7 write-off on January 24 was the only write-off during January. On January 31, 2015 JFCC recorded an adjusting entry to replenish the allowance. JFCC determined that the allowance ending balance needed to be \$13, so an \$8 adjustment was needed (= \$13 - (\$12-\$7)).

Record a journal entry to recognize the \$8 thousand allowance replenishment on January 31, 2015.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Question 3

Questions 3(a)-3(k) pertain to IBM's financial statements and footnote excerpts in the Exam Supplement. (4 points for each part, for a total of 44 points)

Question 3(a)

CIRCLE the letter associated with the best response.

If you circle more than one letter, you will not get credit.

Based on the information in the Exam Supplement, it is reasonable to conclude:

- (a) IBM expected to collect \$8,754 million of the "Notes and accounts receivable - trade" owed the company on December 31, 2014. ($\$8,754 = \$9,090 - \$336$)
- (b) IBM recognized \$1,609 million of depreciation on Property, plant and equipment during 2014. ($\$1,609 = \$28,263 - \$26,654$)
- (c) At the end of 2014, IBM was expecting to recognize \$11,877 million of previously deferred income during 2015.
- (d) (a) and (b)
- (e) (b) and (c)
- (f) (a) and (c)
- (g) (a), (b) and (c)
- (h) None of the above

Question 3(b)

CIRCLE the letter associated with the best response.

If you circle more than one letter, you will not get credit.

Based on the information in the Exam Supplement, it is reasonable to conclude:

- (a) IBM paid \$5,437 million cash for research, development and engineering during 2014.
- (b) The \$12,022 of net income IBM recognized for 2014 was associated with a \$12,022 increase in net assets during 2014.
- (c) IBM declared the same amount of dividends it paid to shareholders of IBM stock during 2014.
- (d) (a) and (b)
- (e) (b) and (c)
- (f) (a) and (c)
- (g) (a), (b) and (c)
- (h) None of the above

Question 3(c)

CIRCLE the letter associated with the best response.

If you circle more than one letter, you will not get credit.

Based on the information in the Exam Supplement, it is reasonable to conclude:

- (a) IBM paid \$3,740 million cash to purchase PP&E during 2014.
- (b) Depreciation increased IBM's net cash from operations by \$3,145 during 2014.
- (c) The net effect of operating entries on inventories during 2014 was a \$39 increase.
- (d) (a) and (b)
- (e) (b) and (c)
- (f) (a) and (c)
- (g) (a), (b) and (c)
- (h) None of the above

Question 3(d)

CIRCLE the letter associated with the best response.

If you circle more than one letter, you will not get credit.

Based on the information in the Exam Supplement, it is reasonable to conclude:

- (a) IBM's accounts payable decreased by \$597 million during 2014.
- (b) The net effect of operating entries on IBM's accounts payable during 2014 was a \$456 decrease.
- (c) The net effect of non-operating entries on IBM's accounts payable during 2014 was a \$141 decrease.
- (d) (a) and (b)
- (e) (b) and (c)
- (f) (a) and (c)
- (g) (a), (b) and (c)
- (h) None of the above

Part 3(e)

Record a journal entry that summarizes the entries IBM recorded during 2014 to write-off long-term financing receivables.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Part 3(f)

Record a journal entry that summarizes the entries IBM recorded during 2014 to replenish its current and noncurrent allowances for doubtful accounts.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Part 3(g)

Assumption

For the purpose of this exam, assume:

- “Net (gain)/loss on asset sales and other” in the operating section of IBM’s cash flow statement is completely attributable to the disposal of property, plant and equipment during **2013** (note year).

Definition of book value of property, plant, and equipment

- The book value of property plant and equipment, also called its carrying value, is its historical cost less its accumulated depreciation and accumulated impairments.

Required

Estimate the book value of the property, plant and equipment IBM disposed of during **2013** (note year) immediately before these disposals occurred.

Write your answer in this box:

Part 3(h)

Assumptions

For the purpose of this exam, assume:

- “Net (gain)/loss on asset sales and other” in the operating section of IBM’s cash flow statement is completely attributable to the disposal of property, plant and equipment during **2013**. (This is the same assumption as in 3(g).)
- The historical cost of the property, plant and equipment disposed of during **2013** was \$1,000 and there were no accumulated impairments associated with these assets.

Record a journal entry that summarizes the 2013 disposals of property, plant and equipment.

Note: Four rows have been provided, but you may not need them all.

	Debit	Credit

Part 3(i)**Background**

This question centers on the extended warranties discussed in the second paragraph of the Product Warranties footnote excerpt in the Exam Supplement and with the second table in the same footnote, “Extended Warranty Liability (Deferred Income).” The remainder of this footnote deals with standard warranties. You will need this information for the bonus question, if you elect to respond to this question.

While we haven’t studied extended warranties, we’ve studied the concepts needed to record related entries in other contexts: an extended warranty is a service contract the customer pays for before receiving the related benefits. For example, if you purchase an iPhone from Apple, you are given an opportunity to purchase Apple Care Protection, which (among other things) extends the periods you will receive technical support and hardware repair coverage (beyond the periods your entitled to under the standard protection plan, having purchased the iPhone).

Record a journal entry that summarizes the 2014 entries IBM recorded to recognize revenue associated with extended warranties that had previously been deferred.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

RELEVANT INFORMATION for QUESTIONS 3(j) and 3(k)

The following quotes are from IBM’s 2014 Annual Report:

“The loss from discontinued operations, net of tax, was \$3.7 billion in 2014 and \$0.4 billion in 2013. The loss in 2014 included a non-recurring pre-tax charge of \$4.7 billion, or \$3.4 billion, net of tax.”

IBM’s 2014 Annual Report, Page 43

“In the third quarter of 2014, the company recorded a pre-tax charge of \$4.7 billion related to the expected sale of the Microelectronics disposal group, which was part of the Systems and Technology reportable segment. The pre-tax charge reflected the fair value less the estimated cost of selling the disposal group including an impairment to the semiconductor long-lived assets of \$2.4 billion, \$1.5 billion representing the cash consideration expected to be transferred to GLOBALFOUNDRIES and \$0.8 billion of other related costs. The asset impairment was reflected in property, plant and equipment, net and the other estimated costs of disposal were reflected in other accrued expenses and liabilities and other liabilities in the Consolidated Statement of Financial Position.”

IBM’s 2014 Annual Report, Page 100

Discontinued operations are those the company plans to divest [sell] in the near future. Reporting the performance of discontinued operations separately helps investors predict future performance.

Assumptions

For the purpose of this exam, assume:

- IBM recognized a \$1,319 million tax benefit associated with the \$4,700 million pre-tax charge discussed above and thus the charge net of taxes was \$3,381. Note: you need not be concerned about taxes. The purpose of this assumption is to help you identify the financial-statement consequences of the pre-tax entry.
- IBM recorded the following entry to recognize the pre-tax charge:

	Debit	Credit
Pretax loss related to anticipated divestiture	\$4,700	
PP&E accumulated impairments		\$2,400
Accrued liabilities: other		\$2,300

Part 3(j)

Determine the direct effect(s) on the following IBM metrics, everything else equal (ignore taxes) from recognizing the \$4,700 pre-tax charge.

Guidance

Include the direct affects, including the effect(s) of closing entries for events affecting income.

You must put an “X” in the appropriate box to receive credit. You will not receive credit if you put an X in more than one box per metric.

	Increases	Decreases	No Effect
Current ratio (current assets / current liabilities)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Financial leverage (liabilities / assets)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Return on equity (ROE) (net profit / average owners' equity)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Net cash from operations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Part 3(k)

Identify the IBM financial-statement line items that were affected by the recognizing the \$4,700 pre-tax charge related to the expected sale of the Microelectronics business. (See the entry on the previous page.)

Guidance:

- (1) Determine the appropriate line item(s) affected using IBM’s statements. For example, write “cash and cash equivalents” rather than “cash” because this is on IBM’s balance sheet. Thus, **write the line-item caption reported on the financial statement (verbatim) rather than the account name.**
- (2) Include line item(s) directly affected, including the effect(s) of closing entries for events affecting income. Ignore taxes.
- (3) Don’t include totals or sub-totals indirectly affected by the entry. For example, don’t report “net income” on the income statement. However, net income is NOT a total on the statement of changes in shareholders’ equity.
- (4) Three lines were included below for each statement, but you may need none or more than one line. For full credit, **write “NONE” if no line item is effected on the statement.**
- (5) Indicate if the effect(s) of the entries associated with the above event increased or decreased the number reported for the line item. Put an X in the appropriate column if the above event increases or decreases the number reported for that line item. For full credit, be sure to mark only one box in each statement’s row. **NOTE: If a reported negative number changes from -2 to -3, it decreases; if it changes from -2 to -1, it increases.**
- (6) You won’t receive credit for a statement if you list line items not affected by the entry: don’t guess!

IBM Financial Statements					
Balance Sheet			Statement of Stockholders' Equity		
Line Items	Increases	Decreases	Line Items	Increases	Decreases
	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Income Statement			Statement of Cash Flows		
Line Items	Increases	Decreases	Line Items	Increases	Decreases
	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>

Bonus Question

This question centers on the standard warranties discussed in the first paragraph of the Product Warranties footnote excerpt in the Exam Supplement and with the first table in the same footnote, “Standard Warranty Liability.” (4 points)

Record a journal entry that summarizes the 2014 entries IBM recorded to ensure the December 31, 2014 balance in the Standard Warranty Liability (allowance) would reflect the expected future claims associated with outstanding warranties at that date.

Hint: To record this entry, you will need to combine two numbers in the Standard Warranty Liability table in the supplement.

Note: Four rows have been provided, but you may not need them all.

	<u>Debit</u>	<u>Credit</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____