Financial Accounting Exam 3.3 Solution

Question 1

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

Part 1(a)

MaryEllen's Camping and Equipment Company (MEC) manufactures and sells state of the art camping equipment. MEC sells its products to retail companies on account and expects them to pay the full amounts they owe within 20 days. On December 1, 2014 MEC sold products valued at $25 thousand to a retailer, Tim's. On December 20, 2014, Tim's paid MEC the $25 thousand outstanding balance.

Record MEC's December 20, 2014 entry.

	Debit	Credit
Cash	$25	
Accounts receivable - gross		$25

Part 1(b)

On December 31, 2014, MEC's accountants were preparing the adjusting entries for the end of the fiscal year. They determined that the company owes the sales staff $10 thousand and owes the manufacturing employees $15 thousand for the month of December 2014. The company policy is to pay employees on the 1st of each month. No earlier related entry has been recorded.

Record an adjusting journal entry for the December 2014 employee compensation.

	Debit	Credit
Sales, general & administrative expense	$10	
Inventories - WIP	$15	
Accrued liabilities		$25

Part 1(c)

On January 1, 2014, MEC's paid $24 thousand rent for the right to use an office building for the company's sales department during 2014. On December 31, 2014, MEC's accountants prepared a month-end adjusting entry to recognize the office's usage during December.

Record the December 31 adjusting entry to record usage of the rental property.

	Debit	Credit
Sales, general & administrative	$2	
Prepaid expenses		$2

Part 1(d)

On December 20, 2014, new manufacturing equipment leased by MEC was installed, ready to use, and put into production. The company concluded the lease met the criteria for a capital lease. The estimated present value of the $3 thousand monthly future minimum payments of the non-cancelable lease was $50 thousand, with the first payment due January 20, 2015. MEC's policy is to record transfers from non-current liabilities to current liabilities in separate month-end adjusting entries.

Record a journal entry for the commencement of the new lease on December 20, 2014.

	Debit	Credit
PP&E [fixed assets] at historical cost	$50	
Long-term debt		$50

Question 2

Elizabeth's Dance Apparel
LIFO Perpetual

	Units	$50 Layer	$55 Layer	$60 Layer	$65 Layer	$70 Layer	$75 Layer		Total
		Input Costs Layers							
2013									
Year-end balance	20	5 @ $50	5 @ $55	5 @ $60	5 @ $65			=	$1,150
2014									
Purchase on January 1	70					70 @ $70		=	$4,900
Sales for January 1 - June 30	(90)	(5) @ $50	(5) @ $55	(5) @ $60	(5) @ $65	(70) @ $70		=	($6,050)
Purchase on July 1	100						100 @ $75	=	$7,500
Sales for July 1 - December 31	(95)						(95) @ $75	=	($7,125)
Pre-impairment balance	**5**						**5 @ $75**	=	**$375**
LCM impairment: market = $65	5						5 @ ($10)	=	($50)
Year-end balance	**5**						**5 @ $65**	=	**$325**

LIFO Summary

	Cost of Sales	Ending Inventory
2014	$13,225	$325

Fill in the two boxes in the above template.
(1 point each, for a total of 2 points)

Question 3

Aanza, Inc. issued bonds on December 31, 2013. The stated interest was payable at the end of each year. The face value, market rate at issuance, and proceeds at issuance are presented in the incomplete bond attribute table below.

No credit for completing the bond attributes and amortization tables below. However, the related data is needed for the entries below.

Aanza Inc.

Computing the stated interest and stated interest rate

Present value of face value: $6,139.13 = $10,000 * 0.6139, where 0.6139 is the present value of $1 discounted at 5% for 10 periods

Present value of stated interest payments: $5,405.21 = $11,544 - $6,139.13

Stated interest payments: $700.00 = $5,405.21/7.7217, where 7.7217 is the present value of an annuity of $1 discounted at 5% for 10 years

Stated interest rate: 7% = ($700.00/$10,000) * 100%

Issuance Date: December 31, 2013				Contractual Future Cash Flows									
Stated rate	Face value	Market rate at issuance	Proceeds at issuance	31-Dec-14	31-Dec-15	30-Dec-16	30-Dec-17	31-Dec-18	31-Dec-19	30-Dec-20	30-Dec-21	31-Dec-22	31-Dec-23
7.00%	$10,000	5.00%	$11,544	($700)	($700)	($700)	($700)	($700)	($700)	($700)	($700)	($700)	($10,700)

Amortization Table Through End of 2014

Year	Cash paid during year	Interest expense during year	Discount or premium amortized during year	Debt carrying value at year end
2013				$11,544.35
2014	$700	$577.22	$122.78	$11,421.56

(2 points each, for a total of 4 points)

Part 3(a)

Record Aanza's journal entry to recognize the issuance of the bonds on December 31, 2013.

Issue bond on December 31, 2013

	Debit	Credit
Cash	$11,544.35	
Bond unamortized premium		$1,544.35
Bond face value		$10,000.00

Part 3(b)

Record Aanza's journal entry to recognize the first-year interest expense on December 31, 2014, including any amortization of a premium or discount and accrue the interest payment that is due. Assume the related unamortized discount or premium is classified as non-current.

Record first-year interest expense on December 31, 2014

	Debit	Credit
Finance (interest) expense	$577.22	
Bond unamortized premium	$122.78	
Accrued liabilities: other		$700.00

Question 4

Part 4(a)

Record the entry Cisco recorded in 2014 to replenish the Allowance for doubtful accounts related to Accounts receivable. (1 point)

	Debit	Credit
Provision for bad debt	$65	
Allowance for bad debts (contra asset)		$65

Part 4(b)

Identify the Cisco Systems financial-statement line items that were affected by the journal entries Cisco recorded during fiscal 2014 to replenish the Allowance for doubtful accounts related to Accounts receivable in Part 4(a) and the direction of these effects (as indicated below). (1/2 point per statement, for a total of 2 points.)

Cisco Systems Financial Statements

Balance Sheet

Line Items	Increases	Decreases
Accounts receivable, net of allowance …		x
Retained earnings		x

Statement of Stockholders' Equity

Line Items	Increases	Decreases
Net income		x

Income Statement

Line Items	Increases	Decreases
General and administrative	x	

Statement of Cash Flows

Line Items	Increases	Decreases
Net income		x
Provision for receivables	x	

Part 4(c)

Determine the direct effect(s) on the following Cisco System metrics, everything else equal (ignore taxes) from replenishing its allowance for doubtful accounts receivable recorded in Part 4(a) during fiscal 2014. (1/4 point per ratio, for a total of 1 point.)

	Increases	Decreases	No Effect
Working capital (current assets - current liabilities)		x	
Financial leverage (liabilities / assets)	x		
Receivables turnover (revenues /average gross receivables)			x
Allowance coverage (bad debts allowance/gross receivables)	x		

Part 4(d)

Record the entry Cisco recorded in 2014 to write-off uncollectible accounts recivables (net of recoveries). (1 point)

	Debit	Credit
Allowance for bad debts (contra asset)	$28	
Accounts receivable - gross		$28

Question 5

Part 5(a)

Record an entry that summarizes the entries Steelcase recorded during year ended February 28, 2014 to replenish its warranty allowance. Combine the current and noncurrent allowance.
(1 point)

	Debit	Credit
Cost of sales	$20.8	
Accrued warranty allowance (current and noncurrent)		$20.8

Part 5(b)

Identify the Steelcase financial-statement line items that were affected by the journal entries Steelcase recorded during fiscal 2014 to replenish its warranty allowance in Part 5(a) and the direction of these effects.

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

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

Steelcase Financial Statements

Balance Sheet

Line Items	Increases	Decreases
Product warranties	x	
Other long-term liabilities	x	
Retained earnings		x

Statement of Stockholders' Equity

Line Items	Increases	Decreases
Net Income		x

Income Statement

Line Items	Increases	Decreases
Cost of sales	x	

Statement of Cash Flows

Line Items	Increases	Decreases
Net Income		x
Accrued expenses and other liabilities	x	

Part 5(c)

Record an entry that summarizes the entries Steelcase recorded during year ended February 28, 2014 to settle warranty claims. (1 point)

	Debit	Credit
Accrued warranty allowance (current and noncurrent)	$14.90	
Inventories - raw materials and parts		$8.94
Accrued liabilities		$5.96

Part 5(d)

Identify the Steelcase financial-statement line items that were affected by the journal entries Steelcase recorded during fiscal 2014 to settle warranty claims in Part 5(c) and the direction of these effects.

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

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

Steelcase Financial Statements

Balance Sheet

Line Items	Increases	Decreases
Inventories		x
Product warranties		x
Employee compensation	x	
Other long-term liabilities		x

Statement of Stockholders' Equity

Line Items	Increases	Decreases
NONE		

Income Statement

Line Items	Increases	Decreases
NONE		

Statement of Cash Flows

Line Items	Increases	Decreases
Inventories	x	
Employee compensation liabilities	x	
Accrued expenses and other liabilities		x

An acceptable alternative for the balance sheet effects is to assume the company transfers allowance from non-current to current liabilities prior to settlements and thus settlements decrease Product warranties but don't affect Other long-term liabilities.

Per Management's discussion and Analysis of Financial Condition and Results of Operations in the company's 10K report, **Steelcase's tax rate for the year ended February 28, 2014 is 40.4%**

Part 5(e)

For the year ended February 28, 2014, what was Steelcase's FIFO cost of sales?
(1.5 points)

Write your answer in this box: $2,046.40

Part 5(f)

For the year ended February 28, 2014, what was Steelcase's tax savings from using LIFO? (round to 2 decimal places)
(1 point)

Write your answer in this box: $0.04

Part 5(g)

For the year ended February 28, 2014, what was Steelcase's FIFO retained earnings? (round to 2 decimal places)
(1.5 points)

Write your answer in this box: $689.11

Steelcase	**2014**
FIFO cost of sales:	
LIFO cost of sales	2,046.50
Less increase in LIFO reserve	0.10
	2,046.40

Steelcase	**2014**
Tax Saving from LIFO	
Tax rate	40.4%
Increase in LIFO reserve	0.1
	0.04

Steelcase	**2014**
FIFO retained earnings	
LIFO retained earnings	676.30
LIFO reserve	21.50
Less cummulative tax savings	8.69
	689.11

Question 6

Part 6(a)

Record an entry that summarizes the entries Starbucks recorded during year ended September 28, 2014 for depreciation and amortization.
(2 points)

	Debit	Credit
Depreciation & amortization expense	$709.6	
Inventories - WIP	$38.8	
Accumulated depreciation & amortization (contra asset)		$748.4

Part 6(b)

Identify the Starbucks financial-statement line items that were affected by the journal entries Starbucks recorded during fiscal 2014 for depreciation and amortization in Part 6(a) and the direction of these effects.

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

Starbucks Financial Statements

Balance Sheet

Line Items	Increases	Decreases
Inventories	x	
Property, plant and equipment, net		x
Retained earnings		x

Statement of Stockholders' Equity

Line Items	Increases	Decreases
Net earnings		x

Income Statement

Line Items	Increases	Decreases
Depreciation and amortization expenses	x	

Statement of Cash Flows

Line Items	Increases	Decreases
Net earnings including noncontrolling interests		x
Depreciation and amortization	x	
Inventories		x

Question 7

Part 7(a)

Record an entry that summarizes the entries Loblaw recorded when it disposed of fixed assets during fiscal 2013. (2 points)

	Debit	Credit
Cash	$26	
Accumulated depreciation & amortization (contra asset)	$108	
Gain on sale of fixed assets		$11
PP&E [fixed assets] at historical cost		$123

Part 7(b)

Identify the Loblaw financial-statement line items that were affected by the journal entries Loblaw recorded during fiscal 2013 when it disposed of fixed assets in Part 7(a) and the direction of these effects.

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

Loblaw Financial Statements

Balance Sheet

Line Items	Increases	Decreases
Cash and cash equivalents	x	
Fixed assets		x
Retained earnings	x	

Statement of Stockholders' Equity

Line Items	Increases	Decreases
Net earnings	x	

Income Statement

Line Items	Increases	Decreases
Selling, general and adminstrative expenses		x

Statement of Cash Flows

Line Items	Increases	Decreases
Net earnings	x	
Gain on disposal of assets		x
Proceeds from fixed asset sales	x	

Part 7(c)

Record an entry that summarizes the entries Loblaw recorded when it impaired fixed assets during fiscal 2013. (2 points)

	Debit	Credit
Impairment charges	$52	
Accumulated fixed asset impairments (contra asset)		$52

Question 8

Jeni's Dream House

Jeni has always wanted to live in one particular house in Brookfield, WI. On her wedding day, October 1, 2014, she received $200,00 from her parents to put a down payment on the house. Jeni decided she would repay her parents with interest based on a market rate of 3.5% per year, compounded annually. She plans to make her first of 20 equal annual payments on October 1, 2015. She will begin accruing interest on the unpaid balance starting on October 1, 2014, when she receives the $200,000.

How much total interest will Jeni pay to her parents? (round to 2 decimal places)
(3 points)

Write your answer in this box: $81,445.02

Jeni's House	
Outstanding amount of loan immediately prior to first payment	
Original amount of loan	$200,000
Future value of $1 after 1 year, discounted at 3.5%	1.035
Outstanding amount of loan immediately prior to first payment	$207,000
Monthly payment	
Present value of an annuity of $1 for 20 periods, discounted at 3.5% (payments at the start)	14.70980
Yearly payments: 207,000/14.70980	$14,072.25
Total paid to parents: $14,072.25 * 20	$281,445.02
Total interest paid: $281,445.02- $200,000	**$81,445.02**

Question 9

The following questions pertain to **Target's operating lease note** in the Exam Supplement. The format for parts (i)-(ii) is the same as the format for clicker questions discussed during class. **You MUST CIRCLE the letter associated with the best response to receive credit.**
(1 point each for a total of 2 points)

Question 9(i)

CIRCLE the letter associated with the best response.
Assumption:
If Target had capitalized its operating leases at the end of fiscal 2013 (2/1/2014) using a 5% discount rate (as indicated in the exam supplement information), the depreciation expense would have been $93.57 in future years.

Based on the available information in **Target's operating lease note** in the exam supplement, it is reasonable to conclude:

(a) The fiscal 2014 interest expense associated with the newly capitalized leases would have been $70.54.

(b) The fiscal 2014 interest expense associated with the newly capitalized leases would have been $116.97.

(c) The fiscal 2014 total expense associated with the newly capitalized leases would have exceeded the $187 minimum operating lease expense anticipated for 2014 (assuming the leases are not capitalized).

(d) (a) and (c)

(e) (b) and (c)

Question 9(ii)

CIRCLE the letter associated with the best response.
Assumption:
If Target had capitalized its operating leases at the end of fiscal 2013 (2/1/2014) using a 5% discount rate (as indicated in the exam supplement information), the depreciation expense would have been $93.57 in future years.

Based on the available information in **Target's operating lease note** in the exam supplement, it is reasonable to conclude:

(a) Fiscal 2014 gross margin percent would not have changed, where gross margin percent = (revenues - cost of sales)/revenues.

(b) Financial leverage at the end of fiscal 2013 would have increased, where financial leverage = (total liabilities)/(total assets).

(c) Fiscal 2013 return on equity would not have changed, where return on equity = (net income)/(average owners' equity).

(d) (a) and (b)

(e) (a), (b) and (c)

Question 10

Part 10(a)

As reported in *The Wall Street Journal*, November 21, 2014:
Alibaba's Gift Keeps Giving:
$8 Billion Debt Sales Make Company Wall Street's Top Underwriting Customer

"Wall Street has a new favorite customer: Alibaba Group Holding Ltd.

The Chinese e-commerce company has emerged as this year's biggest source of fees for banks working on capital-markets deals. After its $25 billion initial public offering in September, the largest in history, the Chinese Internet company on Thursday sold $8 billion in bonds, one of the largest corporate-bond deals of the year. ..."

Determine the direct effect(s) on the following Alibaba's metrics, everything else equal (ignore taxes) when Alibaba recorded the journal entries to recognize issuing $25 billion of new shares and $8 billion in bonds. Ignore transaction costs. (1/4 point per ratio, for a total of 1 point.)

	Increases	Decreases	No Effect
Working capital (current assets - current liabilities)	x		
Return on equity (ROE) (net profit / average owners' equity)		x	
Net cash from operations			x
Net cash from financing	x		

Part 10(b)

As reported in *The Wall Street Journal*, January 6, 2014:
FedEx to Offer $2 Billion in Notes to Repurchase Shares:
Expects to Buy Back 11.4 Million Shares....

"FedEx Corp. plans to offer $2 billion in senior unsecured notes to fund the repurchase of the package-delivery company's shares from Goldman Sachs Group Inc. and J.P. Morgan Chase & Co. ...

FedEx plans to repurchase a combined $2 billion of its stock before the end of its current fiscal year..."

Determine the *combined* direct effect(s) on the following FedEx's metrics, everything else equal (ignore taxes) when FedEx recorded the journal entries to recognize the $2 billion in notes [assuming this is long-term debt] and $2 billion to repurchase shares. (1/4 point per ratio, for a total of 1 point.)

	Increases	Decreases	No Effect
Financial leverage (liabilities / assets)	x		
Return on equity (ROE) (net profit / average owners' equity)	x		
Net cash from investing			x
Net cash from financing			x