

UTS BUSINESS SCHOOL – ACCOUNTING UNIVERSITY OF TECHNOLOGY SYDNEY

22107 ACCOUNTING FOR BUSINESS DECISIONS A AUTUMN SESSION 2016

SAMPLE MID-SEMESTER EXAMINATION

Released in Teaching Week 4 on UTSONline

The examination will be held during your tutorial in the week commencing Monday 16th May 2016. Students will be given ONE HOUR to complete the examination. Please note that the exam is closed book.

Two questions will be asked in the mid-semester examination. The first question will be an extended response question, similar in style to questions 1-4 in Part A (Theory) of this sample exam. It is not advisable to memorise word for word answers to questions 1-4 because while the style of the question in the mid-semester exam will be similar, the content will be different and could be combined or different elements of two or more of questions 1-4. The second question will be similar in style to the questions in Part B (Practical – Questions 5-10) of this sample exam. It is important to note that while the style of the exam question will be similar to questions in part B, the numbers in the question and information provided will differ. Accordingly, it is important to understand the process of completing the practical questions, because memorised answers will be of no value. Both in this sample exam and the actual exam, both questions (theory and practical) are of equal value - plan to devote equal time to the theory question and to the practical question. Therefore, the theory question should be 30 minutes of thoughtful writing, not a set number of words or pages. Remember to explicitly answer the question asked in your exam.

Students are permitted to bring writing implements and a non-data storage/retrieval calculator to the exam. No notes, textbooks, notebooks, laptops, personal organisers, mobile phones, electronic, transmitting or receiving equipment will be permitted.

The examination requires the knowledge of material covered in lectures 1-6 and tutorials 1-7. Students should be cautious of material placed on UTSONline by fellow students. Any information to be officially provided will be put on the “Announcement” page. Separate discussion boards for each question from this sample exam have been setup on UTSONline. **Students are to use the correct folder when posting questions or comments and make sure they read the previous postings before asking a question.**

The mid-semester exam is compulsory for all students regardless of the assessment option chosen.

Any questions of clarification should be asked on the Discussion Boards on UTSONline or in lectures. Only questions about student personal matters should be emailed directly to the Subject Coordinator, James Wakefield.

Good Luck!

Carin, Cheryl, Chris, Don, Ella, Fernando, James, Jon, Khalil, Kristina, Raechel, Stephen, Tia

PART A - THEORY

Address all of the following points using examples where appropriate. Please make sure your answer is logically structured.

Question 1

Financial statements are prepared for a range of different business entities.

1. Identify the different entities financial statements can be prepared for.
2. Identify the different financial statements and explain the type of information contained within each of the financial statements.
3. Explain the purpose of accounting information and how this purpose is linked to the needs of stakeholders involved with different entities.

Question 2

Accounting information is guided by various principles, assumptions and qualitative characteristics.

1. Describe the process of generating accounting information.
2. Identify and describe the assumptions, qualitative characteristics and framework which guide the preparation of accounting information.
3. Explain why accountants have flexibility in accounting choices.
4. Explain how the assumptions and qualitative characteristics of accounting guide the choice of the following accounting methods.
 - a. Revenue recognition
 - b. Accounting for bad debts

Question 3

Accountants have the ability to choose different ways to report accounting information, and this choice can have an impact on the reported financial performance and position of an entity.

1. Identify and describe in detail the different methods available when making reporting decisions for:
 - a. Revenue recognition
 - b. Accounting for uncollectible receivables (bad debts)
2. Explain the advantages and disadvantages of each method you have just described in part one of this question.
3. Explain why accountants are able to choose different ways to report accounting information. In your answer you may like to discuss the advantages and disadvantages of being able to make different accounting choices with brief reference to the article Gowthorpe and Amat (2005), Creative Accounting: Some Ethical Issues of Macro- and Micro-Manipulation.
4. Explain how the choice of these accounting methods can be used by managers for earnings management. In your answer you may like to refer to how the assumptions and qualitative characteristics of accounting reduce earnings management.

Question 4

Predicting future cash flows is important to determine the viability and value of a company.

1. Describe the different components of the cash flow statement and the information it provides to users.
2. Explain the relation between the following accruals and future cash flow as suggested by Barth, Cram and Nelson (2001).
 - a. Accounts receivable
 - b. Accounts payable
 - c. Inventory
 - d. Depreciation and amortization

PART B – PRACTICAL

Question 5

The comparative income statement for the financial year ended June 30 for Fiona Flamingo Farms is as follows:

Fiona Flamingo Farms
Comparative statement of comprehensive income
For the years ended 30 June

| | 2016 | 2015 |
|----------------------------------|----------------|----------------|
| | \$ | \$ |
| Sales Revenue | 770,000 | 690,000 |
| Less: Cost of Goods Sold | <u>487,000</u> | <u>345,000</u> |
| Gross Profit | 283,000 | 345,000 |
| | | |
| Selling Expenses | 97,000 | 82,000 |
| Administrative expenses | 71,000 | 79,000 |
| Finance Expenses | <u>9,000</u> | <u>3,000</u> |
| Profit before income tax expense | 106,000 | 181,000 |
| Income tax expense | <u>31,800</u> | <u>54,300</u> |
| Profit after income tax expense | 74,200 | 126,700 |

Required:

- A.** Perform **horizontal analysis** and **vertical analysis (for 2016 only)** on the income statement. In your answer please remember to indicate if it is an INCREASE or (DECREASE) and round your findings to ONE decimal place [e.g. -32.996% is -33.0% or minus 33.0% or (33.0%).
- B.** Comment on the significant changes disclosed by the comparative statement of comprehensive income.
- C.** Prepare a statement of retained earnings for the year ended June 30, 2016. (Retained earnings at July 1, 2015 were \$58,000, dividends declared and paid during the financial year were \$37,000.
- D.** Explain how profits for the year ended June 30, 2015 were \$126,700 yet Retained Earnings at July 1, 2015 were only \$58,000.

Question 6

The comparative balance sheet for the financial year ended June 30 for Radical Road Trips is as follows:

| Radical Road Trips Ltd. | | |
|---|-------------------------|-------------------------|
| Comparative Statements of Financial Position | | |
| | As at 30/06/2016 | As at 30/06/2015 |
| | \$ | \$ |
| Current Assets | | |
| Cash | 90,000 | 85,000 |
| Accounts Receivable | 30,000 | 40,000 |
| Less: Allowance for Bad Debts | 3,900 | 2,400 |
| Supplies | 200 | 300 |
| Prepaid Insurance | 1,320 | 1,200 |
| Total Current Assets | 117,620 | 124,100 |
| Non-current Assets | | |
| Vehicles | 60,000 | 40,000 |
| Less: Accumulated Depreciation - Vehicles | 10,000 | 4,000 |
| Total Non-current Assets | 50,000 | 36,000 |
| TOTAL ASSETS | 167,620 | 160,100 |
| Current Liabilities | | |
| Accounts Payable | 15,000 | 20,000 |
| Unearned Revenue | 9,000 | 7,000 |
| Total Current Liabilities | 24,000 | 27,000 |
| Non-current Liabilities | | |
| Long Term Loan | 25,000 | 5,000 |
| Total Non-current Liabilities | 25,000 | 5,000 |
| TOTAL LIABILITIES | 49,000 | 32,000 |
| Shareholders' Equity | | |
| Contributed Capital | 50,000 | 40,000 |
| Retained Earnings | 68,620 | 88,100 |
| Total Shareholders' Equity | 118,620 | 128,100 |
| Total Liabilities & Shareholders' Equity | 167,620 | 160,100 |

Required:

- A. Perform **horizontal analysis** and **vertical analysis (for 2016 only)** on the comparative balance sheet. In your answer please remember to indicate if it is an INCREASE or (DECREASE) and round your findings to ONE decimal place [e.g. -32.996% is -33.0% or minus 33.0% or (33.0%).
- B. Calculate the **current ratio** for 2016.
- C. Assuming credit sales for 2016 were \$300,000 calculate the **receivables turnover ratio** for 2016.
- D. Calculate the **days in receivables** ratio for 2016.
- E. Calculate the **allowance ratio** for 2016.
- F. Comment on the significant changes disclosed by the comparative balance sheet. In your analysis include:
 - a. The main findings from the **horizontal analysis** and **vertical analysis**
 - b. An interpretation of what each of the ratios mean for Radical Road Trips.
 - c. The advantages and limitations of each of the ratios.

Question 7

Carin owns and operates the Carin Consulting business. On August 1, 2016 her ledger showed the following account balances (Ignore GST).

| | Debit \$ | Credit \$ |
|---|---------------------|----------------------|
| Cash | 20,000 | |
| Accounts Receivable | 16,000 | |
| Inventory | 18,000 | |
| Supplies | 1,000 | |
| Prepaid Insurance | 0 | |
| Computer | 0 | |
| Accumulated Depreciation— Computer | | 0 |
| Equipment | 10,000 | |
| Accumulated Depreciation— Equipment | | 5,000 |
| Motor Vehicle | 0 | |
| Accumulated Depreciation— Motor Vehicle | | 0 |
| Land | 0 | |
| Accounts Payable | | 4,000 |
| Unearned Revenue | | 700 |
| Telephone Payable | | 150 |
| Notes Payable | | 0 |
| Mortgage Payable | | 0 |
| Contributed Capital | | 25,000 |
| Retained Earnings | | 30,150 |
| Consulting Service Revenue | | 0 |
| Sales Revenue | | 0 |
| Cost of Goods Sold | 0 | |
| Supplies Expense | 0 | |
| Advertising Expense | 0 | |
| Insurance Expense | 0 | |
| Telephone Expense | 0 | |
| Rent Expense | 0 | |
| Depreciation Expense | 0 | |
| Dividends | 0 | |
| TOTAL | 65,000 | 65,000 |

The following transactions occurred during August 2016:

1. The owner contributed an additional \$2,000 cash and equipment valued at \$5,000 to the business.
2. Purchased land for \$260,000 by arranging a mortgage with the bank.
3. Paid \$1,500 cash to purchase a computer for the business.
4. Purchased a motor vehicle for \$36,000 by arranging a promissory note with a lender.
5. Paid \$3,000 to creditor (Accounts Payable) for goods previously purchased in July.

6. Paid \$150 for a telephone bill that related to charges incurred during July. An adjusting entry for \$150 was made at the end of July to accrue this telephone expense.
7. Performed consulting services for a customer and received \$6,000 cash.
8. Billed (invoiced) a client \$9,000 for consulting services performed during August.
9. Received \$4,000 cash from customers who had previously been billed (invoiced) for services performed during July.
10. Received and paid an invoice for \$2,000 relating to August's advertising expense.
11. Distributed \$7,000 cash dividends to the owner of the business.
12. Sold inventory on credit to a customer for \$5,000. The inventory cost \$3,000 and was recorded using the **perpetual** inventory system.
13. Received \$1,000 cash for consulting services to be performed in September. The cash receipt was recorded as a **liability**.
14. Received \$2,000 cash for consulting services to be performed in September. The cash receipt was recorded as **revenue**.
15. Purchased supplies on credit \$700. The supplies purchased were recorded as an **asset**.
16. Paid \$1,200 for a 12-month insurance policy. The insurance was recorded as an **asset**.
17. Paid \$6,000 cash for rent for August, September and October. The business recorded the rent as an **expense**.

Required:

- A. Record the above transactions in a general journal using only the ledger accounts given.
- B. Post to the ledger, (remembering first to enter the opening balances).

Question 8

For each of the following **independent** situations and from the information below **record the adjusting entry (and only the adjusting entry – do not record the original transaction or opening balance)** in the General Journal, being as precise with your account titles as possible, e.g. not using “supplies” but “supplies expense” or “supplies on hand”. Please ignore GST. All calculations are to be worked out on a monthly (not daily) basis.

Note: alternative versions of some of the questions are included. You are expected to know how to record both as you may be examined on either the question or the alternative version.

Required: Record the Adjusting Entries

- i. **Ella Auditors** is conducting the audit on Swan Productions. It is normal practice not bill or invoice the client until the audit is completed. By the end of the financial year 43 hours have been spent on the audit. The average rate is \$370 per hour. Record the adjusting entry for Ella Auditors.
(*Alternative:* record the adjusting entry for *Swan Productions*)
- ii. Jon Ltd. invested \$40,000 in a term deposit at Murray River Bank on **1 May 2016**. Interest is received after one year and interest rates are 6%. Record the adjusting entry for Jon Ltd. when their financial year ends on **30 November 2016**.
(*Alternative:* record the adjusting entry for *Murray River Bank*)
- iii. **On 1 March 2016**, Martin Ltd. accepts a \$15,000, five percent, ten month note receivable. Record the adjusting entry for Martin Ltd. when their financial year ends on **30 June 2016**.
- iv. At Ian Industries salaries are paid and recorded weekly at the end of the week late on a **Saturday** evening for all work performed up to and including **Saturday** evening. The weekly salary bill is \$36,000 for a **six-day** working week (Mon – Sat). Ian’s accounting period ends on **Tuesday** evening. Record the adjusting entry.
- v. Jenny borrowed \$120,000 from Eastpac Bank on **1 February 2016**. Interest is paid after six months and interest rates are 8%. Record the adjusting entry for Jenny on 30 April 2016.
(*Alternative:* record the adjusting entry for *Eastpac Bank* on 30 April)
- vi. Electricity expenses average \$2,400 **per year**. The Electricity meter was last read exactly **three months ago**. The bill was received 2 months ago and paid last month. The financial year ends today. Record the adjusting entry for the three months ended today.
- vii. Chang Ltd. records uncollectible receivables using the allowance method, calculating the amount of the adjustment using the **percentage of receivables** approach. At the end of the financial year the balance of the Accounts Receivable account of Chang Ltd. is \$78,000 **debit**, the balance of the Allowance for Bad Debts account is \$1,000 **credit** and estimates that 2% of its receivables balance will be uncollectible. Record the adjusting entry.
(*Alternative:* record the adjusting entry assuming the balance of the Allowance for Bad Debts account is \$1,000 *debit*)
(*Alternative:* record the adjusting entry using the *percentage of sales approach*, assuming net credit Sales Revenue was \$78,000 and 2% of credit sales revenue will not be collected)

- viii. When supplies are purchased by Andrea they were recorded as an **asset**. Calculations after an end of period stock-take revealed a closing stock (balance) of \$2,000. There was an opening balance of \$3,000 and during the period \$8,000 of supplies were purchased. Record the adjusting entry.
(*Alternative:* record the adjusting entry assuming the supplies were recorded as an *expense* when purchased.)
- ix. Raechel pays her insurance of \$24,000 annually in early September. The insurance policy covers all her claims from 12.01 a.m. on September 1. Insurance is recorded as an **expense** when paid and the financial year ends on December 31. Record Raechel's adjusting entry for the four months ended December 31.
(*Alternative:* record the adjusting entry assuming the insurance was recorded as a *prepayment (asset)* when paid.)
(*Alternative:* record the adjusting entry *from the perspective of the insurance company* assuming the insurance was recorded as a *liability* when received.)
(*Alternative:* record the adjusting entry *from the perspective of the insurance company* assuming the insurance was recorded as *revenue* when received.)
- x. On 1 March, Ryan Rockclimbing paid \$1,200 to the local rockclimbing magazine for a one-page advertisement for Ryan's rockclimbing skills courses. The advertisements will run each month for the next 12 months. Ryan initially recorded the advertising as a **prepayment (asset)**. Record the adjusting entry for Ryan for the month of March.
(*Alternative:* record the adjusting entry assuming the advertising was recorded as an *expense* when paid.)
(*Alternative:* record the adjusting entry *from the perspective of the magazine company* assuming the advertising was recorded as a *liability* when received.)
(*Alternative:* record the adjusting entry *from the perspective of the magazine company* assuming the advertising was recorded as *revenue* when received.)
- xi. When office photocopying paper is purchased it is recorded as an **expense**. An end of period stock-take (count) revealed a closing balance of \$3,000. There was an opening balance of \$1,000 and during the period \$5,000 of photocopying paper was purchased. Record the adjusting entry.
(*Alternative:* record the adjusting entry assuming the photocopying paper was recorded as an *asset* when purchased.)
- xii. James Limited received rent on the first day of November **2015**, a total of \$70,200 in advance for twelve months commencing on that day and records it as **revenue**. Record the adjusting entry for the year ending June 30, 2016 for James Limited.
(*Alternative:* record the adjusting entry assuming the rent was recorded as a *liability* when received.)
(*Alternative:* record the adjusting entry *from the perspective of the tenant* assuming the rent was recorded as an *asset* when paid.)
(*Alternative:* record the adjusting entry *from the perspective of the tenant* assuming the rent was recorded as an *expense* when paid.)
- xiii. Adriel Construction received \$500,000 in August 2015 for a new building project and recorded this initial cash receipt as a **liability**. The project is 75% complete at financial year-end. Record the adjusting entry for financial year ending June 30, 2016 for Adriel.
(*Alternative:* record the adjusting entry assuming the initial cash receipt was recorded as *revenue* when received.)

- xiv. A tennis club offered a special rate for upfront **annual** memberships at the start of the season. If patrons paid their 12 months' fees in advance they only had to pay \$1,200. The tennis club recorded the fees received as "Membership **Revenue**", and 300 people signed up. At the end of the financial year the tennis club had been operational for **3 months**. Record the adjusting entry for the **tennis club**.
(*Alternative:* record the adjusting entry assuming the initial cash receipt was recorded as a *liability* when received.)
- xv. Nelson owns a cruise ship and leased it for 8 years receiving \$9.6 million (the entire lease amount) at the commencement of the lease. Nelson recorded the receipt of the money as **Unearned Rent Revenue**. Record the adjusting entry when his first financial year ends **two months after** the lease commenced.
(*Alternative:* record the adjusting entry assuming the initial cash receipt was recorded as *revenue* when received.)
- xvi. **On 1 September 2013**, Stephen Services purchased a new digital SLR camera for \$18,500. The depreciation charge for the camera is \$3,000 **per year**. Record the adjusting entry for depreciation for the **financial year** ending 30 June **2016**.
(*Alternative:* record the adjusting entry assuming the camera was purchased on 1 September **2015**.)
(*Alternative:* record the adjusting entry assuming the depreciation charge was \$350 **per month** and the camera was purchased on 1 September **2013**.)
(*Alternative:* record the adjusting entry assuming the depreciation charge was \$350 **per month** and the camera was purchased on 1 September **2015**.)

Question 9

Eric Enterprises has asked for your assistance in preparing their financial statements. Eric has provided you with the following list of accounts and their account balances. Eric advises you that all accounts have a normal balance and that the balance of the Retained Earnings account reflects the net profit that has been retained in the business.

| | \$ | Debit | Credit |
|---|---------|-------|--------|
| Accounts Payable | 1,200 | | |
| Accounts Receivable | 12,000 | | |
| Accumulated Depreciation - Delivery Van | 12,000 | | |
| Advertising Expense | 10,000 | | |
| Bad Debts Expense | 3,600 | | |
| Bank Loan | 50,000 | | |
| Cash | 28,000 | | |
| Contributed Capital | 13,000 | | |
| Cost of Goods Sold | 55,000 | | |
| Delivery Van | 36,000 | | |
| Depreciation Expense | 3,600 | | |
| Dividends | 10,000 | | |
| Electricity Expense | 800 | | |
| Electricity Payable | 240 | | |
| Insurance Expense | 6,000 | | |
| Interest Expense | 5,000 | | |
| Interest Payable | 100 | | |
| Interest Receivable | 840 | | |
| Inventory | 25,000 | | |
| Prepaid Insurance | 8,000 | | |
| Prepaid Rent | 2,000 | | |
| Rent Expense | 20,000 | | |
| Retained Earnings, <i>April 1</i> | 40,000 | | |
| Salaries Expense | 15,000 | | |
| Salaries Payable | 1,500 | | |
| Sales Revenue | 120,000 | | |
| Supplies | 400 | | |
| Supplies Expense | 1,300 | | |
| Unearned Revenue | 4,500 | | |

Required:

- A. Identify the normal balance of each account by transferring the dollar amount into the correct debit or credit column.
- B. Prepare the following financial statements:
 - a. Income Statement
 - b. Statement of Changes in Equity (Retained Earnings)
 - c. Balance sheet
- C. Record the closing entries in a general journal using only the ledger accounts given.

Question 10

Tim Textile Company (TTC) prepares monthly bank reconciliations of the company's cheque account balance. An extract of the **bank statement** of TTC showing the last entries for for May 2016 indicated the following:

| | | Withdrawals | Deposits | Balance |
|--------|---------------------------|-------------|----------|---------|
| May 28 | NSF - cheque No. 399 | 1,000 | | 6,767 |
| May 29 | DEPOSIT – Franc's Fabrics | | 2,700 | 9,467 |
| May 31 | Service Charges | 30 | | 9,437 |
| May 31 | Interest | | 40 | 9,477 |

On investigation it was found that:

- The NSF cheque No. 399 was a customer's cheque previously deposited into the bank account that bounced due to insufficient funds in the customer's bank account.
- The deposit from Franc's Fabrics related to the collection of a note (\$2,500) and the related interest (\$200). A previous adjusting entry had recorded the interest revenue as a receivable at the time it was earned. This \$2,700 cash deposit had not been recorded in the accounting records of TTC.
- The May 31 Interest deposit had not been recorded in the accounting records of TTC.

An analysis of TTC's accounting records revealed the following items that appeared in the accounts of TTC but did not appear in the bank statement for May:

- Cheque number #5489 for \$650 paid to Electric Energy for an electricity bill and cheque number #5490 for \$230 paid to Officegear Supplies for stationery.
- A cheque for \$1,780 received from Ben Robbins and a cheque for \$1,560 received from GeoTex. Both were for textile designing services and were deposited into the bank on May 30.

Additionally, it was found that cheque #5488 correctly appeared as a withdrawal of **\$780** in the bank statement but was incorrectly recorded as a cash disbursement of **\$870** in the accounting records of TTC. The cheque was to pay an open account payable.

The closing balance of the cheque account per TTC's accounting records on May 31 was \$10,137

Required:

- A) Prepare a bank reconciliation in proper form for May 31, 2016.
- B) Record the transactions (adjustments) Tim Textile Company will need as a result of this bank reconciliation process?
- C) What amount would Tim Textile Company report as the cash balance in the statement of financial position (balance sheet) at May 31, 2016?
- D) How does the preparation of bank reconciliations aid in internal control?

THE END