2024-07-26 Cousins Exam Prep (Refine)

Financial Accounting II, Term 4

- Term 4 April 2024
- Final Exam, Date 26 July 2024
- 100 marks in total

I. Ideal Questions (5 marks per item of the ideal questions)

(1) What are the advantages and disadvantages account receivables to a firm?

Advantages:

- Increased sales: Offering credit terms can attract customers and increase sales.
- Improved cash flow: While not immediate, accounts receivable contribute to overall cash flow.

- Competitive advantage: Credit terms can give a company a competitive edge.

Disadvantages:

- Credit risk: There's a risk of customers defaulting on their payments.

- Tied-up capital: Money invested in accounts receivable is unavailable for other uses.

- Administrative costs: Managing accounts receivable requires time and resources.
- Potential for bad debts: Some customers may not pay, resulting in losses.

(2) What are the differences between Allowance Method and Direct Write-off Method for uncollectible account receivable?

Allowance Method:

- **Matching principle:** Expenses (bad debts) are matched with related revenues.
- **Estimate of uncollectible accounts:** A company estimates the amount of bad debts and creates an allowance for doubtful accounts.
- **Matching principle:** Better reflects the true income of the period.
- **Generally Accepted Accounting Principles (GAAP) compliant.**

Direct Write-Off Method:

- **No allowance:** Bad debts are only recorded when a specific account is deemed uncollectible.
- **Mismatching of revenue and expenses:** Violates the matching principle.
- **Overstates assets:** Accounts receivable are overstated until written off.
- **Generally not accepted under GAAP.**

(3) What is the definition of a plant asset? What is different type of plant assets? How different between a plant asset and a current asset?

Types of plant assets:

- **Land:** The earth's surface and anything permanently attached to it.
- **Buildings:** Structures used for business operations.
- **Equipment:** Machinery, furniture, and other assets used in operations.
- **Vehicles:** Cars, trucks, and other transportation assets.

Difference between plant and current assets:

- **Plant assets:** Have a long useful life, are not readily converted to cash, and are used in operations.
- **Current assets:** Expected to be converted to cash within one year, are more liquid.

(4) How to allocate cost of a plant asset into an expense? Give your explanations to each method of the cost allocation of a plant asset.

- **Straight-line method:** Allocates equal amounts of depreciation expense each year.

$$\frac{\text{Cost} - \text{Salvage Value}}{\text{Useful Life}} = \text{Annual Depreciation}$$

- **Units-of-production method:** Allocates depreciation based on the asset's usage.

$$\frac{\text{Cost} - \text{Salvage Value}}{\text{Total Estimated Units of Production}} = \text{Depreciation per Unit}$$

- **Declining-balance method:** Allocates a higher amount of depreciation in the early years and lower amounts in later years.

$$\text{Book value at beginning of year} \times \text{Depreciation rate} = \text{Depreciation expense}$$

The choice of each methods depend on factors like asset usage, company policy, and tax implications.

(5) How many forms of business company are there in general?

Generally, there are three primary forms of business companies:

- **Sole proprietorship**
- **Partnership**
- **Corporation**

(6) Give the definition of partnership. How many forms of partnership are there? Give your explanation to each form of partnership.

A **partnership** is a business owned by two or more people who share profits, losses, and control.

**Types of Partnerships:

- **General Partnership:** All partners share in management, profits, and liabilities.
- **Limited Partnership:** At least one general partner manages the business and assumes unlimited liability, while limited partners contribute capital but have limited liability.
- **Limited Liability Partnership (LLP):** Similar to a general partnership, but partners have limited personal liability for the debts and actions of other partners.

(7) What are the advantages and disadvantages of each form of the partnership?

General Partnership:

- **Advantages:** Easy to form, shared decision-making, tax advantages.
- **Disadvantages:** Unlimited liability, potential for disagreements, lack of continuity.

Limited Partnership:

- **Advantages:** Limited liability for limited partners, ability to raise capital.
- **Disadvantages:** Requires at least one general partner with unlimited liability, complex structure.

Limited Liability Partnership:

- **Advantages:** Limited liability for partners, tax advantages.
- **Disadvantages:** More complex to form than a general partnership, potential for higher fees.

(8) What is corporation? How many forms of corporation are there?

A **corporation** is a legal entity separate from its owners (shareholders). It has the right to enter into contracts, own property, and sue or be sued.

Forms of Corporations:

- **C Corporation:** The most common type, subject to corporate income tax.
- **S Corporation:** A pass-through entity, meaning profits and losses pass through to shareholders' personal tax returns.
- **LLC (Limited Liability Company):** Hybrid structure combining characteristics of partnerships and corporations.

(9) How different between corporation and partnership? Give your explanation and characteristics of corporation.

Corporation:

- Separate legal entity
- Limited liability for shareholders
- Continuous life
- Double taxation (corporate and shareholder level)
- Complex formation and regulation

Partnership:

- Not a separate legal entity
- Partners have personal liability (except for LLP)
- Limited life
- Pass-through taxation
- Easier to form and manage

(10) What are the advantages and disadvantages of each form of corporation?

C Corporation:

- **Advantages:** Limited liability, ability to raise capital, continuous life.
- **Disadvantages:** Double taxation, complex formation and regulation.

S Corporation:

- **Advantages:** Limited liability, pass-through taxation, easier to manage than a C Corporation.
- **Disadvantages:** Restrictions on shareholders, eligibility requirements.

LLC:

- **Advantages:** Limited liability, pass-through taxation, flexibility in management structure.
- **Disadvantages:** State-specific regulations, potential for double taxation in some cases.

II. Problems (10 marks per item of the problems)

Problem 1

Gomez Corp. uses the allowance method to account for un-collectibles. On January 31, it wrote off an $800 account of a customer, C. Green. On March 9, it receives a $300 payment from Green.

> 1) Prepare the journal entry or entries for January 31.
> 2) Prepare the journal entry or entries for March 9; assume no additional money is expected from Green.

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1. Prepare the journal entries for January 31

Date	Account Title	Debit	Credit
Jan 31	Allowance for Doubtful Accounts	800	
	Accounts Receivable - C. Green		800

2. Prepare the journal entries for March 9

Date	Account Title	Debit	Credit
Mar 9	Accounts Receivable - C. Green	800	
	Allowance for Doubtful Accounts		800
Mar 9	Cash	300	
	Accounts Receivable - C. Green		300

Problem 2

The following monthly data are taken from Ramirez Company at July 31: sales salaries, $200,000; office salaries, $160,000; federal income taxes withheld, $90,000; state income taxes withheld, $20,000; Social Security taxes withheld, $22,320; Medicare taxes withheld, $5,220; medical insurance premiums, $7,000; life insurance premiums, $4,000; union dues deducted, $1,000; and salaries subject to unemployment taxes, $50,000. The employee pays 40% of medical and life insurance premiums.

Required:

Prepare journal entries to record:

1. accrued payroll, including employee deductions, for July;
2. cash payment of the net payroll (salaries payable) for July;
3. accrued employer payroll taxes, and other related employment expenses, for July—assume that FICA taxes are identical to those on employees and that SUTA taxes are 5.4% and FUTA taxes are 0.6%; and
4. cash payment of all liabilities related to the July payroll.

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1. Accrued Payroll

Account Title	Debit	Credit
Salaries Expense	360,000	
Social Security Tax Payable	22,320	
Medicare Tax Payable	5,220	
Federal Income Tax Payable	90,000	
State Income Tax Payable	20,000	
Union Dues Payable	1,000	
Medical Insurance Expense	4,200	
Life Insurance Expense	2,400	
Salaries Payable		217,060
Cash Payable		142,940

2. Cash Payment of Net Payroll

Account Title	Debit	Credit
Salaries Payable	217,060	
Cash Payable	142,940	
Cash		217,060

3. Accrued Employer Payroll Taxes

Account Title	Debit	Credit
Social Security Tax Payable	2,754,000	
Medicare Tax Payable	1,377,000	
SUTA Tax Payable	19,440	
FUTA Tax Payable	2,160	
Salaries Expense		2,754,000

4. Cash Payment of All Liabilities

Account Title	Debit	Credit
Social Security Tax Payable	2,754,000	
Medicare Tax Payable	1,377,000	
SUTA Tax Payable	19,440	
FUTA Tax Payable	2,160	
Federal Income Tax Payable	90,000	
State Income Tax Payable	20,000	
Union Dues Payable	1,000	
Medical Insurance Expense	4,200	
Life Insurance Expense	2,400	
Cash		3,135,600

Problem 3

Martinez Company owns a building that appears on its prior year-end balance sheet at its original $572,000 cost less $429,000 accumulated depreciation. The building is depreciated on a straight-line basis assuming a 20-year life and no salvage value. During the first week in January of the current calendar year, major structural repairs are completed on the building at a $68,350 cost. The repairs extend its useful life for 5 years beyond the 20 years originally estimated.

a) Determine the building's age (plant asset age) as of the prior year-end balance
sheet date.

b. Prepare the entry to record the cost of the structural repairs that are paid in cash.

c. Determine the book value of the building immediately after the repairs are recorded.

d. Prepare the entry to record the current calendar year's depreciation.

a. Determine the building’s age (plant asset age) as of the prior year-end balance sheet date.

- **Annual depreciation:** $572,000 / 20 years = $28,600
- **Building age:** $429,000 accumulated depreciation / $28,600 annual depreciation = 15 years

Therefore, the building's age as of the prior year-end balance sheet date is 15 years.

b. Prepare the entry to record the cost of the structural repairs that are paid in cash.

Date	Account Title	Debit	Credit
Jan	Building	68,350	
	Cash		68,350

c. Determine the book value of the building immediately after the repairs are recorded.

- **Original cost:** $572,000
- **Accumulated depreciation:** $429,000
- **Building cost after repairs:** $572,000 + $68,350 = $640,350
- **Book value:** $640,350 - $429,000 = $211,350

Therefore, the book value of the building immediately after the repairs is $211,350.

d. Prepare the entry to record the current calendar year’s depreciation.

- **New total life:** 20 years + 5 years = 25 years
- **Remaining life:** 25 years - 15 years = 10 years
- **New depreciable base:** $640,350
- **Annual depreciation:** $640,350 / 10 years = $64,035
- **Debit:** Depreciation Expense ($64,035)
- **Credit:** Accumulated Depreciation - Building ($64,035)

Date	Account Title	Debit	Credit
Dec 31	Depreciation Expense	64,035	
	Accumulated Depreciation - Building		64,035

Problem 4

Diaz Company owns a milling machine that cost $250,000 and has accumulated depreciation of $182,000. Prepare the entry to record the disposal of the milling machine on January 3 under each of the following independent situations.

a. The machine needed extensive repairs, and it was not worth repairing. Diaz disposed of the machine, receiving nothing in return.

b. Diaz sold the machine for $35,000 cash.

c. Diaz sold the machine for $68,000 cash.

d. Diaz sold the machine for $80,000 cash.

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a. Machine disposed of with no return

Date	Account Title	Debit	Credit
Jan 3	Accumulated Depreciation - Milling Machine	182,000	
	Loss on Disposal of Milling Machine	68,000	
	Milling Machine		250,000

b. Machine sold for $35,000 cash

Date	Account Title	Debit	Credit
Jan 3	Accumulated Depreciation - Milling Machine	182,000	
	Loss on Disposal of Milling Machine	33,000	
	Cash		35,000
	Milling Machine		250,000

c. Machine sold for $68,000 cash

Date	Account Title	Debit	Credit
Jan 3	Accumulated Depreciation - Milling Machine	182,000	

Date	Account Title	Debit	Credit
	Cash		68,000
	Milling Machine		250,000

d. Machine sold for $80,000 cash

Date	Account Title	Debit	Credit
Jan 3	Accumulated Depreciation - Milling Machine	182,000	
	Cash		80,000
	Milling Machine		250,000
	Gain on Disposal of Milling Machine		12,000

Problem 5

Timberly Construction negotiates a lump-sum purchase of several assets from a company that is going out of business. The purchase is completed on January 1, 2015, at a total cash price of $900,000 for a building, land, land improvements, and four vehicles. The estimated market values of the assets are building, $508,800; land, $297,600; land improvements, $28,800; and four vehicles, $124,800. The company’s fiscal year ends on December 31.

Required

a. Prepare a table to allocate the lump-sum purchase price to the separate assets
purchased (round per- cents to the nearest 1%). Prepare the journal entry to record the purchase.

b. Compute the depreciation expense for year 2015 on the building using the straight-line method, assuming a 15-year life and a $27,000 salvage value.

c. Compute the depreciation expense for year 2015 on the land improvements assuming a five-year life and double-declining-balance depreciation.

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a. Allocation Table

Asset	Fair Market Value	Percentage	Allocated Cost
Building	$508,800	56%	$504,000
Land	$297,600	33%	$297,000
Land Improvements	$28,800	3%	$27,000

Asset	Fair Market Value	Percentage	Allocated Cost
Vehicles	$124,800	8%	$72,000
Total	$960,000	100%	$900,000

b. Journal Entry to Record Purchase

Date	Account Title	Debit	Credit
Jan 1, 2015	Building	$504,000	
	Land	$297,000	
	Land Improvements	$27,000	
	Vehicles	$72,000	
	Cash		$900,000

Depreciation Expense

b. Depreciation Expense for Building

- **Cost:** $504,000
- **Salvage value:** $27,000
- **Depreciable base:** $504,000 - $27,000 = $477,000
- **Annual depreciation:** $477,000 / 15 years = $31,800

Depreciation expense for year 2015 on the building is **$31,800**.

c. Depreciation Expense for Land Improvements

- **Cost:** $27,000
- **Salvage value:** Assumed to be $0 (common for land improvements)
- **Depreciable base:** $27,000
- **Depreciation rate:** 2 / 5 = 40% (double-declining-balance)

Depreciation expense for year 2015: $27,000 * 40% = $10,800
Depreciation expense for year 2015 on land improvements is **$10,800**.