CITY UNIVERSITY OF HONG KONG

Course code & title : CB2100 Introduction to Financial Accounting

Time allowed : Three hours

This paper has **Fifteen** pages (including this cover page).

1. This paper consists of **20** Multiple Choice questions (20 marks) in **SECTION A** and **7** written questions (80 marks) in **SECTION B**. Answer **ALL** questions.
2. Write your student number on the cover page of answer book.
3. Put your answers on the answer book (including the Multiple Choice questions).
4. Observe all rules and regulations stipulated in the City University's Student website regarding assessment policies.
5. Start each question on a new page.
6. **DO NOT** use **Pencils**. If pencils are used, 10% of the total marks will be deducted.
7. Budget your time by referring to allocated marks.
8. Show your supporting calculations wherever appropriate.
9. Approved calculators by University (basic, financial or scientific) are allowed.

*This is a **closed-book** examination.*

Candidates are allowed to use the following materials/aids:

A Maximum of 10 pages of own notes (back-to-back page is allowed)

Materials/aids other than those stated above are not permitted. Candidates will be subject to disciplinary action if any unauthorized materials or aids are found on them.

The examination paper is strictly confidential.
You must not share it with anyone.

Section A (MC Questions, 20 marks, 1 mark each)

Write your answer on the answer book.

1.

On December 2, Coley Corp. acquired 1,000 shares of its $2 par value common stock for $27 each.
On December 20, Coley Corp. resold 400 shares for $15 each. Which of the following is correct regarding the journal entry for the resold shares?

A. Debit Cash $15,000.

B. Credit Treasury Stock $10,800.

C. Credit Additional Paid in Capital $5,200.

D. Credit Treasury Stock $6,000.

2.

Which of the following is correct with respect to a bank reconciliation?

A. Subtract interest earned from the bank's balance.

B. Add service charge to the company's balance.

C. Subtract NSF checks from the company's balance.

D. Add deposits outstanding to the company's balance.

3.

Following are transactions of Gotebo Tanners, Inc., a new company, during the month of January:

1. Issued 10,000 shares of common stock for $15,000 cash.
2. Purchased land for $12,000, signing a note payable for the full amount.
3. Purchased office equipment for $1,200 cash.
4. Received cash of $14,000 for services provided to customers during the month.
5. Purchased $300 of office supplies on account.
6. Paid employees $10,000 for their first month's salaries.

What was the balance of Gotebo's Cash account following these six transactions?

A. $29,800.

B. $19,300.

C. $17,800.

D. $22,400.

4.

A company purchases a piece of equipment on January 1, 2021, for $70,000 and the equipment has an expected useful life of five years. Its residual value is estimated to be $10,000. Assuming the company uses the straight-line depreciation method, what should be the balance in accumulated depreciation for the equipment as of December 31, 2023 (three years later)?

A. $44,000.

B. $32,000.

C. $36,000.

D. $42,000.

5.

Brady's Inflation Needle Co. reports accounts receivable of $100,000 in 2020 and $250,000 in 2021. Using horizontal analysis, what would be the percentage increase or decrease in accounts receivable?

A. 60% decrease

B. 60% increase

C. 150% decrease

D. 150% increase

6.

Given the information below, what is the gross profit?

Sales revenue	$320,000
Accounts receivable	50,000
Ending inventory	100,000
Cost of goods sold	250,000
Sales returns	20,000

A. $250,000.

B. $70,000.

C. $220,000.

D. $50,000.

7.
While providing services to Palmer Co., Raider Group caused damages of $125,000. As of the end of the year, both parties agree that it is probable that Raider will pay Palmer the full amount of the damages within the next two months. How would Raider and Palmer report the lawsuit at the end of the year?

A. Raider reports a loss; Palmer reports nothing.

B. Raider reports nothing; Palmer reports nothing.

C. Raider reports nothing; Palmer reports a gain.

D. Raider reports a loss; Palmer reports a gain.

8.
How many of the following transactions increase a company's liquidity?

- Provide services on account.
- Pay workers' salaries in the current period.
- Purchase office supplies with cash.
- Pay dividends to stockholders.

A. 0.

B. 1.

C. 2.

D. 3.

9.

A company has the following information:

Total revenues	$860,000
Sales returns and allowances	$ 50,000
Sales discounts	$ 30,000
Ending inventory	$100,000

What is the amount of net revenues for the company?

A. $330,000.

B. $230,000.

C. $680,000.

D. $780,000.

10.

Curry Footwear reports net income of $500,000, earnings per share of $1.50, and has a stock price of $45.00 at the end of the year. What is Curry Footwear's price-earnings ratio?

A.30.0

B. 11,111.1

C. 67.5

D. 46.5

11.

Why doesn't stockholders' equity equal the market value of equity?

A. Stockholders' equity usually does equal the market value of equity.

B. Investors tend to incorrectly price the market value of equity.

C. It's related to the use of historical cost to report many long-term assets and the expensing of value generating costs such as research and development and advertising.

D. It's due to incorrect entries prepared by accountants.

12.

When an investment is made in another corporation’s common stock, what is the effect on total stockholders' equity?

A. Decrease.

B. Increase.

C. No effect.

D. Cannot determine from the given information.

13.

On January 1, Gucci Brothers Inc. started the year with a $492,000 balance in Retained Earnings and a $605,000 balance in Common Stock. During the year, the company reported net income of $92,000, paid a dividend of $15,200, and issued more common stock for $27,500. What is total stockholders' equity at the end of the year?

A. $1,231,700.

B. $1,097,000.

C. $1,201,300.

D. $1,588,300.

14.
Oregon Adventures purchased equipment for $80,000. They sold the equipment at the end of three years for $45,000. If the expected useful life of the equipment was seven years with a residual value of $10,000, and they use straight-line depreciation, which of the following is true regarding the entry to record the sale of the equipment?

A. Debit Loss $5,000.

B. Credit Gain $5,000.

C. Credit Accumulated Depreciation $40,000.

D. Credit Equipment $5,000.

15.

On October 1, 2021, a company purchases equipment for $72,000. The equipment is expected to be used for the next four years (48 months). What adjusting entry should the company record on December 31, 2022?

A. Debit Depreciation Expense and credit Accumulated Depreciation for $13,500.

B. Debit Depreciation Expense and credit Accumulated Depreciation for $18,000.

C. Debit Depreciation Expense and credit Accumulated Depreciation for $22,500.

D. Debit Depreciation Expense and credit Accumulated Depreciation for $4,500.

16.

The following information pertains to Julia & Company:

March 1 Beginning inventory = 30 units @ $5

March 3 Purchased 15 units @ $4

March 9 Sold 25 units @ $8

What is the ending inventory balance for Julia & Company assuming that it uses FIFO?

A. $125.

B. $100.

C. $110.

D. $85.

17.

At the end of the year, Mark Inc. estimates future bad debts to be $6,500. The Allowance for Uncollectible Accounts has a credit balance of $2,500 before any year-end adjustment. What adjustment should Mark Inc. record for the estimated bad debts at the end of the year?

A. Debit Bad Debt Expense, $6,500; credit Allowance for Uncollectible Accounts, $6,500.

B. Debit Bad Debt Expense, $4,000; credit Allowance for Uncollectible Accounts $4,000.

C. Debit Allowance for Uncollectible Accounts, $9,000; credit Bad Debt Expense, $9,000.

D. Debit Bad Debt Expense, $9,000; credit Allowance for Uncollectible Accounts, $9,000.

18.

On November 1, 2021, a company signed a $100,000, 6%, six-month note payable with the amount borrowed plus accrued interest due six months later on May 1, 2022. The company records the appropriate adjusting entry for the note on December 31, 2021. In recording the payment of the note plus accrued interest at maturity on May 1, 2022, the company would:

A. Debit Interest Expense, $2,000.

B. Debit Interest Expense, $1,000.

C. Debit Interest Payable, $2,000.

D. Debit Interest Expense, $3,000.

19.

A company has four types of products in its inventory. The company applies the rules under lower of cost and net realizable value to its inventory at the end of each year as shown below:

Product	Quantity	Cost	Net Realizable Value
A	15	$ 7	$ 8
B	10	15	14
C	20	8	6
D	15	11	10

The year-end adjustment based upon the information above would include a:

A. Debit to Cost of Goods Sold $65.

B. Credit to Inventory $50.

C. Debit to Inventory $65.

D. Debit to Cost of Goods Sold $50.

20.

Best Construction purchased a delivery truck on June 1, 2021. The following information is available:

Cost = $90,000
Estimated service life = 5 years
Estimated residual value = $15,000

Calculate the balance of accumulated depreciation for the year ended December 31, 2022, using straight-line depreciation.

A. $21,250.

B. $17,500.

C. $23,750.

D. $30,000.

SECTION B

Question 1 [13 marks]

Alice Stone is the CEO of Outlet Flooring, a discount provider of carpet, tile, wood, and laminate flooring. At the end of the year, the company's accountant provides Alice with the following information, before any adjustment.

Accounts receivable	$11,000,000
Estimated percentage uncollectible	4%
Allowance for uncollectible accounts	$110,000 (credit)
Operating income	$2,900,000

Alice has significant stock ownership in the company and, therefore, would like to keep the stock price high. Analysts on Wall Street expect the company to have operating income of $2,200,000. The fact that actual operating income is well above this amount will make investors happy and help maintain a high stock price. Meeting analysts' expectations will also help Alice keep her job.

Required:

(a). Record the adjustment for uncollectible accounts using the accountant's estimate of 4% of accounts receivable. **(3 marks)**

(b). After the adjustment is recorded in Requirement 1, what is the revised amount of operating income? Will Outlet Flooring still meet analysts' expectations? **(3 marks)**

(c). Alice instructs the accountant to instead record $700,000 as bad debt expense so that operating income will exactly meet analysts' expectations. By how much would total assets and operating income be misstated if the accountant records this amount? **(3 marks)**

(d). Why would Alice be motivated to manage operating income in this way? **(4 marks)**

Question 2 [16 marks]

Richard has two classes of stock authorized: $10 par preferred, and $1 par value common. As of the beginning of 2021, 125 shares of preferred stock and 3,000 shares of common stock have been issued. The following transactions affect stockholders' equity during 2018:

March	1	Issue 3,000 additional shares of common stock for $10 per share.
April	1	Issue 175 additional shares of preferred stock for $40 per share.
June	1	Declare a cash dividend on both common and preferred stock of $0.25 per share to all stockholders of record on June 15.
June	30	Pay the cash dividends declared on June 1.
August	1	Purchase 175 shares of common treasury stock for $7 per share.
October	1	Reissue 125 shares of treasury stock purchased on August 1 for $9 per share.

Richard has the following beginning balances in its stockholders' equity accounts on January 1, 2021: Preferred Stock, $1,250; Common Stock, $3,000; Additional Paid-in Capital, $19,500; and Retained Earnings, $11,500. Net income for the year ended December 31, 2021, is $7,650.

Required:

(a) Record each of these transactions. **(10 marks)**

(b) Indicate whether each of these transactions would increase (+), decrease (−), or have no effect (NE) on total assets, total liabilities, and total stockholders' equity by completing the following chart. Put down your answer in the answer book provided. **(6 marks)**

	Transaction	**Total Assets**	**Total liabilities**	**Total Stockholders' Equity**
(i)	Issue common stock			
(ii)	Issue preferred stock			
(iii)	Declare cash dividends			
(iv)	Pay cash dividends			
(v)	Purchase treasury stock			
(vi)	Reissue treasury stock			

<u>Question 3</u> [6 marks]

Strawberry Fields purchased a tractor at a cost of $38,000 and sold it two years later for $25,000. Strawberry Fields recorded depreciation using the straight-line method, a five-year service life, and an $8,000 residual value.

(i) What was the gain or loss on the sale?

(ii) Record the journal entries for the sale.

<u>Question 4</u> [6 marks]

ABC Ltd. exchanges long-term assets with XYZ Ltd. ABC receives a delivery truck and gives up a piece of machinery. The fair value and book value of the machinery were $27,000 and $25,000 (original cost of $35,000 less accumulated depreciation of $10,000), respectively. Since the delivery truck was worth $32,000, ABC paid an additional $5,000 in cash to XYZ.

Record the journal entries for the exchange for ABC Ltd.

<u>Question 5</u> [16 marks]

Income statement and balance sheet data for The Sports Shack are provided below.

The Sports Shack Income Statements For the years ended December 31		
	2021	**2020**
Sales revenue	$8,200,000	$6,600,000
Cost of goods sold	6,100,000	4,700,000
Gross profit	2,100,000	1,900,000
Expenses:		
Operating expenses	1,450,000	1,400,000
Depreciation expense	90,000	100,000
Interest expense	25,000	50,000
Income tax expense	95,000	80,000
Total expenses	1,660,000	1,630,000
Net income	$440,000	$270,000

The Sports Shack Balance Sheets December 31			
Assets	**2021**	**2020**	**2019**
Current assets:			
Cash	$290,000	$218,000	$196,000
Accounts receivable	1,050,000	680,000	880,000
Inventory	919,000	1,250,000	1,100,000
Supplies	80,000	90,000	65,000
Long-term assets:			
Equipment	1,100,000	1,200,000	900,000
Accumulated depreciation	(440,000)	(350,000)	(250,000)
Total assets	$2,999,000	$3,088,000	$2,891,000
Liabilities and Stockholders' Equity			
Current liabilities:			
Accounts payable	$50,000	$65,000	$55,000
Interest payable	2,000	4,000	6,000
Income tax payable	38,000	40,000	30,000
Long-term liabilities:			
Notes payable	200,000	400,000	300,000
Stockholders' equity:			
Common stock	900,000	900,000	900,000
Retained earnings	1,809,000	1,679,000	1,600,000
Total liabilities and equity	$2,999,000	$3,088,000	$2,891,000

Required:
(a). Calculate the following risk ratios for **2020** and **2021**. **(4 marks)**

(i) Receivables turnover ratio

(ii) Inventory turnover ratio

(iii) Current ratio

(iv) Debt to equity ratio

(b). Calculate the following profitability ratios for **2020** and **2021**. **(4 marks)**

(i) Gross profit ratio

(ii) Profit margin

(iii) Return on assets

(iv) Asset turnover

(c). Based on the ratios calculated, determine whether overall risk and profitability improved from 2020 to 2021. **(8 marks)**

Question 6 [12 marks]

Part A (6 marks)

Below are several scenarios related to control activities of a company.

(i). A manufacturing company compares total sales in the current year to those in the previous year but does not compare the cost of production.

(ii). So that employees can have easy access to office supplies, a company keeps supplies in unlocked cabinets in multiple locations.

(iii). At the end of each day, a single employee collects all cash received from customers, records the total, and makes the deposit at the bank.

(iv). At the end of the year only, the company compares its cash records to the bank's records of cash deposited and withdrawn during the year.

(v). A company encourages employees to call an anonymous hotline if they believe other employees are circumventing internal control features.

(vi). All employees have the authority to refund a customer's money.

Required:

For each scenario, determine which control activity is violated. Control activities include separation of duties, physical controls, proper authorization, employee management, reconciliations, and performance reviews. If no control activity is violated, state "none."

Part B (6 marks)

The following selected transactions relate to liabilities of Food Emporium whose fiscal year ends on December 31.

Jan. 26	Negotiated a line of credit with City Bank that can be renewed annually upon bank approval. The amount available under the line of credit is $1 million at the bank's prime rate.
March 1	Arranged a six-month bank loan of $400,000 with City Bank under the line of credit agreement. Interest at the prime rate of 8% is payable at maturity.
September 1	Paid the 8% note at maturity.

Required:

Record the appropriate entries, if any, on January 26, March 1, and September 1. If no entry is required, please state "no entry".

Question 7 [11 marks]

Part A (6 marks)

A company understated its ending inventory balance by $5,000 in 2020. What impact will this error have on total assets and retained earnings in 2020 and 2021 (ignoring tax effects)?

Part B (5 marks)

A company reports inventory using lower of cost and net realizable value. Below is information related to its inventory at the year-end date:

Inventory	Quantity	Book Value	Market Value
Unit A	10	$30	$32
Unit B	18	$43	$40
Unit C	12	$23	$27
Unit D	15	$18	$17

Required:

Calculate ending inventory under lower of cost and net realizable value, and record any necessary adjustment to inventory.

----E N D----