Practice Quiz 1 | Prepared by Dr. Richard M. Crowley

Name: _______________________________ | Section: G___ Score: ____ / 100

This quiz is worth 7.5% of the overall course grade and should take up to 75 minutes to complete. The quiz will be graded out of a total of 100 points. Read each question carefully, and do your best to answer it. Make sure to show your work when answering questions, as partial credit will be awarded for work that, while not leading to the correct answer, shows significant progress towards it.

Question 1 (**24 points**):
A new coffee shop has arrived in town! After 3 months of operations, they realize that they should probably have an accountant. As part of the terms of their venture capital equity funding they received to start up, they are required to provide an IFRS compliant set of financial statements to their investors. They have asked you to write out journal entries for the last month's transactions. Please record the journal entries as they should have been recorded at the time that the transactions occurred (ignore any potentially needed adjusting entries for now):

1) Purchased $20,000 worth of coffee beans on account. All the coffee beans have been received.
2) Made $50,000 in sales, using $8,000 of inventory, all paid at the time of the transaction.
3) Prepaid rent expense of $10,000, covering half of the current month and half of the next month.
4) Bought back 100 common shares for $5,000 from an investor the venture capitalist didn't like.
5) Paid a typical electricity bill of $4,000 halfway through the month.
6) In the process of shipping $5,000 worth of coffee beans to a specialty grocery store in Dempsey at a price of $20,000. The business paid in cash already, but the beans haven't all shipped yet.

NUMBER	ACCOUNTS	DR	CR
1	Inventory	20,000	
	A/P		20,000
2	Cash	50,000	
	COGS	8,000	
	Revenue		50,000
	Inventory		8,000
3	Prepaid Rent	10,000	
	Cash		10,000
4	Treasury Stock	5,000	
	Cash		5,000
5	Utilities Expense	4,000	
	Cash		4,000
6	Cash	20,000	
	Unearned Revenue		20,000

Commented [RC1]: Grading: 3 points per entry (number 2 counts as 2 entries). 1 point allocated to each account name, 1 point allocated to the values.

Commented [RC2]: We mark this all as unearned as we cannot gauge how much is completed thus far.

(*Question 1 continued*) Next, prepare a simple income statement, listing each expense separately. Include gross profit and operating profit. Tax expense is $0.

Commented [RC3]: Grading: 1 point for having correct gross profit, 1 point for the correct net income, and 1 point for general format. Correct values based on the values in the journal entries

Income Statement as of Month End
For Coffee Company

Revenue	50,000
COGS	(8,000)
Gross Profit	42,000
Utilities Expense	4,000
Operating Profit	38,000
Tax Expense	0
Net Income	38000

Question 2 (**22 points**):
The same coffee company needs more help. They just realized that, under IFRS, they need to book adjusting entries before making their financial statements. The CFO made the following notes that he thinks will be helpful:

- Half of the beans have been shipped to the grocer in Dempsey
- Next month's electricity bill is expected to be average
- They have a big coffee roaster that cost $12,000. They expect it to last around 5 years, and can sell it off for around $2,000 after that. Straight line depreciation is preferred.
- The venture capitalist said they do *not* need to worry about taxes for this process

Using both the CFO's notes and the information from question 1, determine the **four** needed adjusting entries, and write out the journal entries for them.

NUMBER	ACCOUNT	DR	CR
1	Unearned Revenue	10,000	
	COGS	2,500	
	Revenue		10,000
	Inventory		2,500
2	Utilities Expense	2,000	
	Utilities Payable		2,000
3	Depreciation Expense	500	
	Accumulated Depreciation		500
	166.67 or 2000 also accepted		
4	Rent Expense	5,000	
	Prepaid Rent		5,000

Commented [RC4]: 4 points per entry, allocated at 2 points for account names, and 2 points for correct values

Commented [RC5]: This is to match our usage of inventory with the revenue. Half of the 5,000 total inventory is $2,500.

It is also OK to leave this off along with inventory, assuming that the COGS was recorded when the inventory was shipped. As such, no points would be marked off if this was missing.

Commented [RC6]: Assuming 3 months. 2,000 if 1 year; 166.67 if 1 month. Each could be a reasonable assumption, but 500 is preferred as question 1 said "3 months"

Commented [RC7]: The information from this journal entry comes from question 1, #3, as it stated "Prepaid rent expense of $10,000, covering half of the current month and half of the next month."

What is the effect of these entries on the firm's profit – that is, has it gone up or down, and by how much?

Commented [RC8]: 6 points: 3 points for the correct assertion on if profit went up or down, 3 points for the correct value of the change. Partial credit awarded. Based on the answers in the above section.

Answer:

If you do not include COGS in #1:
Revenue increased by 10,000
Expenses increased by 2,000 + 500 + 5,000 = 7,500
Net Income **increased** by 10,000 - 7,500 = **2,500**.

If you include COGS in #1:
Revenue increased by 10,000
Expenses increased by 7,500 + 2,500
Net income **did not change**, 10,000 - 10,000 = **0**

<u>Question 3</u> (**26 points**)

A few months later, the CFO summons you again. This time, he is trying to figure out how to deal with some of the venture capitalist's complicated equity transactions. As you may recall, the company previously bought back 100 shares for $5,000. This is the only source of treasury shares for the firm. The venture capitalist has started using this for a mix of employee compensation and investment. The following transactions have since occurred, in order:

1) Allowed the CEO and CFO to purchase 20 shares <u>each</u> at half the historical cost of the shares for incentive purposes.
2) Convinced another venture capital fund to buy 50 shares at $100 each.
3) Declared a $1 dividend per share. There were originally 1,000 shares issued, but treasury shares do not receive dividends.
4) Dividends were paid.
5) Gave you the option to purchase the remaining 10 shares for a total of $200, for helping out so much.

The CFO would greatly appreciate it if you could determine what the journal entries should be for these five actions.

NUMBER	ACCOUNT	DR	CR
1	Cash	1,000	
	Retained Earnings	1,000	
	Treasury Shares		2,000
2	Cash	5,000	
	Retained Earnings		1,000
	Additional Paid-in Capital (APIC)		1,500
	Treasury Shares		2,500
3	Dividends	990	
	Dividends Payable		990
	990 as 10 shares are held as treasury shares		
4	Dividends Payable	990	
	Cash		990
5	Cash	200	
	APIC	300	
	Treasury Shares		500
	**Did not accept* is also a valid answer		

Commented [RC9]: 6 points each for 1, 2, and 5, allocated at 1 point per account name, 2 points for correct values (partial credit awarded) and 1 point for having a balancing entry.

4 points each for 3 and 4, allocated at 1 point per account name and 2 points for values. No points off for carryforward value errors in question 4. Only -1 instead of -2 if the values were 1000 or 900 for question 3.

Commented [RC10]: As we presumably have no APIC here, this must be retained earnings.

Note that the question says the CEO and CFO **each** purchase 20 shares, so there are 40 shares in this journal entry.

Commented [RC11]: Can omit and credit APIC for $2,500 instead

Commented [RC12]: As we have APIC from #2, this must be APIC, not retained earnings.

Question 4 (**16 points**)

After a large marketing campaign, the company has really expanded its business-to-business sales. These transactions have almost all been on account rather than in cash. No one thought much of it until one of them clients wrote them a letter stating that they were going bankrupt and that their outstanding debt of $2,000 would not be payable. The coffee company, at the moment, does not have any allowance for uncollectible accounts set up, i.e., it has a zero balance. They have requested your expertise on this topic to help them book the loss on this transaction and to set up a proper allowance.

First, what is the journal entry for the $2,000 uncollectible account, assuming none will ever be collected? The CFO would like you to use the “allowance for uncollectible accounts” account in this transaction.

NUMBER	ACCOUNT	DR	CR
1	Allowance for Uncollectible Accounts	2,000	
	A/R		2,000

Commented [RC13]: 4 points, allocated at 1 point per account name and 2 points for correct values.

Bad Debt Expense accepted as the debit account as well, though this changes the correct answer for the third part.

Second, using the below information on remaining A/R and allowance schedule, please calculate what the amount should be in the allowance account.

1) Dempsey Grocer with $5,000 outstanding for 65 days
2) CBD Grocer with $7,000 outstanding for 25 days
3) Tanglin café with $3,000 outstanding for 32 days
4) Serangoon café with $3,000 outstanding for 4 days
5) Sentosa café with $2,000 outstanding for 45 days

DAYS	0-30	31-60	61-90
PERCENT UNCOLLECTIBLE	2%	10%	50%

Answer:

Commented [RC14]: 8 points. Full credit if the answer is correcting. If incorrect, partial credit awarded at 1 point per A/R item categorized correctly, 1 point for presenting an accurate total based on the allowance amounts obtained.

-2 if the 2,000 from the first part was included.
6/8 if Net A/R was calculated instead of the allowance amount.

PERCENT	AMOUNT	VALUE
50%	5,000	2,500
10%	5,000	500
2%	10,000	200

Total = 2,500 + 500 + 200 = **3,200**

(*Question 4 continued*) Third, the CFO would like to know what journal entry should be recorded to adjust the allowance account to the proper value.

NUMBER	ACCOUNT	DR	CR
1	Bad Debt Expense	5,200	
	Allowance for Uncollectible Accounts		5,200

Commented [RC15]: 4 points: 1 point per account name, and 2 points for correct values, conditional on the values from parts 1 and 2 of the question.

5,200 since we need to reverse the previous DR balance of 2,000 in the allowance account.

<u>Question 5</u> (**12 points**): Read the below mini-case and answer the questions that follow.

Uber for Travelling Salesmen*

Traditionally, in-person business sales has been both time and capital intensive, with companies needing to either hire a workforce in each target city, or fly out trained employees weekly. Consequently, it has been reserved for only high value targets – those companies that can purchase in large quantities or that can purchase high value products.

In an effort to open up in-person business sales to more businesses, Universal Avenue, a Swedish startup, is attempting to build up an Uber-like base of young salespeople all over the globe. Instead of companies training their own salespeople and maintaining their own offices abroad, Universal Avenue envisions a world where well trained salespeople are hired on demand. All a company has to do is send a job description and training materials to Universal Avenue, and they automatically match salespeople to the company and train them. Companies then pay Universal Avenue (who in turn pays the sales people) based on performance – if there are no sales, then there's no cost. Likewise, salespeople working for Universal Avenue receive no payment unless they make a sale.

*Based on *Coming Next: The On-Demand Sales Force*, WSJ, May 31, 2015.

Questions on next page

Case questions:

1) What is a potential risk that might affect the success of the sales campaign, based on how Universal Avenue is set up? Consider the following three situations, and come up with 1 risk for each, briefly explaining your reasoning for the risk:
    a. Multiple salespeople working for the same client in the same location.
    b. A salesperson working for multiple companies simultaneously.
    c. Sales are done via cash as opposed to electronically.
2) How might Universal Avenue provide direction to their salespeople to fix each of the issues identified above?

Issue a: Inefficient use of personnel, potential for infighting.

Commented [RC16]: 2 points per issue, 2 points per solution.

No credit awarded for issue a if the identified issue would be identical if there was only 1 salesperson.

Other solutions are possible.

Partial credit awarded.

Issue b: Salespeople may slack off and focus only on one company

Issue c: Potential for fraud by skimming money off the top.

Solution to a: Assign fewer salespeople to each individual location, or specify different jobs for the salespeople

Solution to b: Assign salespeople to just 1 company at a time.

Solution to c: Switch to electronic transactions.

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