

MIDTERM EXAMINATION (REGULAR)
FALL 2012

Name: _____ ID: _____

Duration: 3 hours

Instructions (very important):

1. This examination paper consists of **9 pages including** this page. Please make sure your copy has all pages before commencing to write.
2. Make sure that your FULL name (last name first), Student ID and Section Letter are on the three documents: computer input sheet, answer booklet and examination paper.
3. You must answer the multiple choice questions by using the **computer input sheet**; darken the letter you choose **in pencil** on the computer input sheet. Write all your answers to the other questions in the **examination answer booklet in ink**. You may answer the questions in any order you prefer. **Only the answers on the computer input sheet and in the examination booklet will be graded.**
4. Read the questions carefully and budget your time wisely.
5. Show all calculations on the examination booklet, and omit narratives for journal entries. Using abbreviated account names, headings, subheadings, totals and subtotals is not recommended. **If you choose to use abbreviations, then a nominal deduction of 1 mark will be made per examination question.**
6. This is a closed book examination. However, a silent hand-held (not graphical or programmable) calculator and one standard language (not electronic) dictionary are permitted.
7. **Invigilators will not answer questions** (unless you think there is an **error** in the question).
8. Return the exam along with the computer input sheet and answer booklet(s) when you have finished.

Question	Topic	Total Marks
1	Multiple choice	24
2	Preparation of journal entries	13
3	Preparation of adjusting entries, financial statements, and selected calculations	41
4	Accounting for receivables and bad debts	22
	Total	100

Question 1 (24 marks; 40 minutes)

Multiple choice

For each of the following, choose the letter that corresponds to the **best** answer, and **show your answer on the computer input sheet**. Each correct answer is worth 1.5 marks.

1. Which of the following is a potential cost of the public disclosure of accounting information?
 - a. Loss of competitive advantage caused by revealing information to competitors.
 - b. Potential increased regulation and taxes due to reporting excessive profits in politically sensitive industries.
 - c. Raising and then failing to meet the expectations of investors.
 - d. All of the above are potential costs of disclosure.

2. Which of the following conditions must exist for an item to be recorded as an asset?
 - a. The item is not owned or controlled by the company.
 - b. Future benefits from the item cannot be reliably measured.
 - c. The item must be a tangible asset.
 - d. The item must be expected to provide future benefits.

3. Which of the following options accurately identifies the effects a cash sale of an iPhone by Apple Inc.?
 - a. Trade receivables increases, sales revenue increases, cost of sales increases, and inventory decreases.
 - b. Cash increases, sales revenue increases, cost of sales decreases, and inventory decreases.
 - c. Trade receivables increases, sales revenue increases, cost of sales decreases, and inventory decreases.
 - d. Cash increases, sales revenue increases, cost of sales increases, and inventory decreases.

4. When a customer places an order, Tasty Cakes requires a deposit equal to the full purchase price. However, Tasty Cakes does not recognize revenue until the completed cake is delivered. During the month of September 2012, Tasty Cakes received \$24,000 in customer deposits. The balance in its Deferred Revenue account was \$4,000 at September 1, 2012 and \$6,000 at September 30, 2012. How much revenue did Tasty Cakes recognize during the month of September 2012?
 - a. \$26,000
 - b. \$24,000
 - c. \$22,000
 - d. \$4,000

5. Which of the following events appears in the cash flows from financing activities section of the statement of cash flows?
 - a. Cash purchase of equipment
 - b. Loan to another company
 - c. Receipt of cash for funds loaned to employees
 - d. Repurchase of shares for cash

6. If bad debt expense is determined by estimating uncollectible trade accounts receivable, the entry to record the write-off of a specific uncollectible account would decrease
- The allowance for doubtful accounts.
 - Profit.
 - The carrying amount of trade receivables
 - Bad debt expense.
7. An underestimation of bad debt expense has the following effects on profit and assets:

	Profit	Assets
a.	Overstated	Understated
b.	Understated	Overstated
c.	Understated	Understated
d.	Overstated	Overstated

8. The Cash in Bank account for Mannix Inc. shows an ending balance of \$1,540 at September 30, 2012. The bank statement for September has a balance of \$1,600 at September 30, 2012, and the statement shows service charges of \$40 and a Not Sufficient Funds (NSF) cheque for \$200. A deposit of \$500 made on September 30 was still in transit and outstanding cheques totalled \$800. What is Mannix's adjusted book balance at September 30, 2012?
- a. \$1,060 b. \$1,300 c. \$1,280 d. \$2,100

9. Assume that ADX, Inc. pays its employees \$3,500 for a 5-day work week and follows accrual accounting in all respects. The end of the year, December 31, fell on Tuesday, but the company does not pay employees until Friday, the usual payday for the week. What journal entry should ADX record on Friday, January 3, the next pay day, knowing that both January 1 and January 2 are paid holidays?

a.	Salary expense	3,500	
	Cash		3,500
b.	Salary expense	2,100	
	Salary payable	1,400	
	Cash		3,500
c.	Salary payable	3,500	
	Cash		3,500
d.	Salary payable	2,100	
	Salary expense	1,400	
	Cash		3,500

10. The bookkeeper of Restaurant Chu Fu recorded a cash collection on account by debiting Cash and crediting Accounts Payable. As a result of this error,
- Total liabilities will be overstated on the trial balance.
 - Total assets will be overstated on the trial balance.
 - The trial balance will not balance.
 - Both statements in a and b are correct.

11. Home Furnishings, Inc. sold a bedroom set to Bianca Laporte for \$4,000 on account and paid \$100 for delivery of the bedroom set to Bianca's house. Bianca returned a defective lamp and received credit for \$200 on her account with Home Furnishings. She paid the amount due within the discount period and benefitted from a discount of 1 percent. The amount of net sales that results from these transactions is
 - a. \$3,662.
 - b. \$3,663.
 - c. \$3,762.
 - d. impossible to determine without knowing the cost of the bedroom set to Home Furnishings.

12. Which of the following transactions increases profit under the accrual basis but does not increase profit under the cash basis?
 - a. The sale of merchandise inventory for cash at a price in excess of the inventory's cost.
 - b. Collection from a customer on account.
 - c. Receipt of cash in advance for renting excess space in the next few months.
 - d. The sale of merchandise inventory on account at a price in excess of cost.

13. Accounting information is considered to be relevant when
 - a. it represents the economic conditions and events that it is intended to represent.
 - b. it is capable of making a difference in a decision.
 - c. it is understandable by reasonably informed users.
 - d. it is verifiable and neutral.

14. A good system of internal control for cash should include a number of procedures that would facilitate the discovery of mishandling of cash by employees. Which of the following statements reflects a weak internal control procedure?
 - a. All cash receipts should be deposited in a bank on a daily basis.
 - b. All major disbursements should be made by issuing serially numbered cheques.
 - c. Only one person should handle cash receipts and cash disbursements in order to save reduce salaries expense and limit access to cash.
 - d. The function of receiving cash should be separated from the function of disbursing cash.

15. One of the main reasons why most companies report property, plant and equipment on their statement of financial position at historical cost adjusted for accumulated depreciation is that:
 - a. historical costs are more easily verifiable than current market values.
 - b. Except in unusual cases, historical costs generally represent the current market values of assets at the time a statement of financial position is prepared.
 - c. Historical costs make the accounting process easier.
 - d. Most companies do not wish to disclose the market value of their assets.

16. A gain is recorded when:
- Inventory held for resale is sold at more than its cost.
 - Inventory held for resale is sold for less than its cost.
 - Land is sold for more than its original cost.
 - Land is sold for less than its original cost.

Question 2 (13 marks; 24 minutes): *Preparation of journal entries*

Beaver Inc. provides interior design services and sells merchandises for home and office decor. The following information relate to selected transactions that occurred at Beaver during the second quarter of 2012.

- April 1 Beaver agreed to provide interior design services to a client. The project will cover the period from April 1 to July 31. The client paid the full fee of \$12,000 on April 1.
- April 2 Received the bank statement which included a cheque stamped NSF (Not Sufficient Funds). The cheque was from a customer, Philip Co., for \$300. The bank statement also included a debit memorandum for \$5 as a service charge related to this cheque.
- April 20 Sold 20 units of merchandise (unit price, \$50) to Benoit Inc. on account. The credit terms were 2/10, n/30. Beaver purchased the merchandise in January for \$30 per unit.
- April 28 Received the amount due from Benoit Inc.
- May 1 Purchased store equipment for \$5,000. Beaver paid \$1,500 in cash and signed a note for \$3,500, payable in two years, plus interest at an annual rate of 12 percent. The interest will be paid as a lump sum when the note payable is due.
- May 10 Issued 1,000 shares at \$120 per share in exchange for a building.
- June 15 Anthony, Inc. called Beaver and placed an order to purchase merchandise for \$20,000.

Required:

- Prepare journal entries for the above transactions. If there is no journal entry required, then simply write “no entry” next to the date. Please *skip a line* between journal entries, and omit narrative explanations (10 marks).
- Prepare the adjusting journal entries (if any) at June 30, 2012, the end of the second quarter (3 marks).

Question 3 (41 marks; 72minutes): *Preparation of adjusting entries, financial statements, and selected calculations.*

Jones and Smith Ltd. has been operating for many years. You have been presented with the following *unadjusted* amounts as at December 31, 2012. Each account balance has a "normal" balance, as the term is defined in the textbook. The accounts are not arranged in any particular order. (The unadjusted trial balance does balance, so don't lose time checking that it does.)

Account Title	Balance
Cost of goods sold	\$ 720,000
Cash	150,000
Building	720,000
Accumulated depreciation – equipment	48,000
Land	114,100
Accumulated depreciation – building	120,000
Note receivable	60,000
Sales revenue	1,983,000
Share capital (20,000 shares)	100,000
Advertising expense	76,000
Dividends declared	36,000
Sales returns and allowances	20,000
Trade payables	150,000
Equipment	240,000
Merchandise inventory	140,000
Trade receivables	168,600
Deferred rent revenue	16,000
Interest receivable	4,900
Salaries expense	220,000
Note payable	80,000
Office supplies inventory	9,400
Retained earnings, Dec. 31, 2011	180,000
Insurance expense	14,000
Gain on sale of long-term investments	16,000

Jones and Smith Ltd. adjusts its accounts *annually*. The following information is available for adjustment purposes for 2012:

- The amount shown as insurance expense includes coverage for January and February of 2013, the monthly premium is \$1,800.
- The note receivable is dated November 1, 2010 and carries an interest rate of 7 percent per year. Interest on the note will be received by Jones and Smith when the note becomes due on February 28, 2013.
- The building is depreciated over forty years on a straight-line basis, with no salvage (residual) value. The equipment is depreciated over twenty years on a straight-line basis, with no salvage value.

- d) Management bonuses totalling \$50,000 for the year 2012 have not been recorded.
- e) The cost of office supplies still on hand (in stock) on December 31, 2012 is \$8,000.
- f) The company rented surplus space in its building to a tenant on March 1, 2012 for \$1,000 per month, payable in advance for sixteen months. The entire amount received was credited to Deferred rent revenue.
- g) The note payable is dated November 1, 2012 and carries an interest rate of 6 percent per year. Interest on the note will be paid by Jones and Smith when the note becomes due on February 28, 2013.
- h) The company is subject to an income tax rate of 20 percent. Income taxes for the year 2012 will be paid on March 15, 2013.

Required:

1. Prepare the necessary adjusting journal entries as at December 31, 2012 for events (a) to (h) above. You may wish to complete requirement 2 (below) before recording the journal entry for item (h). Please skip a line between journal entries, and omit narrative explanations. Set up new accounts if needed. (Hint: using T-accounts for the accounts affected by the adjusting entries may be helpful in keeping track of account balances.) (12 marks)
2. Prepare, in proper form, a classified ("multi-step") income statement for Jones and Smith Ltd. for the year ended December 31, 2012. (9 marks)
3. Prepare in proper form a classified statement of financial position (balance sheet) for Jones and Smith Ltd. as at December 31, 2012. (14 marks)
4. Calculate the following amounts or ratios. (6 marks):
 - a. Age of the building at December 31, 2012, rounded to the nearest year.
 - b. Net profit margin ratio for 2012. Briefly explain the meaning of this ratio.
 - c. Return on equity ratio for 2012. Assume that the balance of the share capital account did not change during 2012. How would you interpret this ratio?

Question 4 (22 marks; 44 minutes) Accounting for receivables and bad debts

This question consists of two independent parts.

Part A (12 marks):

Mountaineer Inc. started its business in 2010, and its fiscal year ends on December 31. The following table provides information regarding Mountaineer’s “Trade Receivables”:

Trade Receivables					
Date	Total balance	Age			
		Not yet Due	1-30 days past due	31-60 days past due	Over 60 days past due
December 31, 2010	\$300,000	230,000	40,000	30,000	
December 31, 2011	\$400,000	300,000	50,000	40,000	10,000

Additional Information:

- All sales were on credit with terms 2/10, n/30.
- Mountaineer used the **Aging of Trade Receivables** method to determine the amount of receivables that may not be collectible in the future, and it recorded bad debt expense only at fiscal year-end.
- After a thorough review of its trade receivables, Mountaineer determined that receivables totaling \$5,000 were not collectible on May 5, 2011. A write-off was recorded on the same day. On Oct 10, 2011, Mountaineer recovered and recorded \$1,000 from the receivables that were written off earlier.

Required:

1. Prepare the journal entries to record the transactions on May 5, 2011 and October 10, 2011 respectively. (3 marks)
2. Calculate the amount of receivables that may not be collectible in the future using the aging schedule below, and prepare the journal entry to record bad debt expense on December 31, 2011. Show your calculations. (Hint: You may want to start your work from 2010). (7 marks)

	Estimated Uncollectible Rate
Not yet Due.....	1%
1-30 days past due	5%
31-60 days past due	10%
More than 60 days overdue	15%
3. Show (in proper form) how trade receivables would be presented on Mountaineer's statement of financial position as at December 31, 2011. (2 marks)

Part B (10 marks):

Buckeye Co. produces outdoor gear, and its fiscal year ends on December 31.
The following information is available from Buckeye's annual report for fiscal year 2011.

Net Trade Receivables	\$160,000
Bad Debt Expense	2,100

Additional Information:

- All sales were on credit with terms 2/10, n/30.
- Buckeye used the **Percentage of Credit Sales** method to determine bad debt expense, and it records bad debt expense only at fiscal year-end. Based on past experience, Buckeye estimated the bad debt rate to be 0.2% of net credit sales.

Required:

1. If cost of goods sold averages 40% of net sales, how much was Buckeye's *Gross Profit* (dollar amount) in 2011? Show your calculations. (2 marks)
2. Buckeye's net trade receivables were \$140,000 at December 31, 2010. Calculate Buckeye's *Receivables Turnover Ratio* for fiscal year 2011 and explain what it means. (3 marks)
3. Evaluate Buckeye's *Receivables Turnover Ratio* knowing that two major competitors, Bruins Corp. and Huskies Ltd. reported receivables turnover ratios of 7.5 and 6.5, respectively for 2011. (1 mark)
4. If Buckeye wrote-off uncollectible receivables totaling \$1,000 on August 31, 2011, would the *Gross Profit* and *Receivables Turnover Ratio* you calculated in Requirements 1 and 2 be different? Explain your answers (no calculation is required). (4 marks)