

MID-TERM EXAMINATION
Winter 2011

Duration: 3 hours

Instructions:

1. This examination paper consists of **8 pages** including this page. Please make sure your paper has all pages before commencing to write.
2. 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**. 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.**
3. Read the questions carefully and budget your time wisely. Show all calculations.
4. This is a closed book examination. However, a silent hand-held (not graphical) calculator and one standard language (not electronic) dictionary are permitted.
5. **Invigilators will not answer questions** (unless you think there is an **error** in the question).
6. Return the exam along with the computer input sheet and answer booklets when you have finished.

Question	Topic	Total Marks
1	Multiple choice	24
2	Preparation of journal entries	12
3	Preparation of adjusting entries, income statement and statement of financial position	34
4	Accounting for receivables and bad debts	16
5	Accounting for inventory and cost of sales	14
	Total	100

Question 1 (24 marks; 43 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. Pacific Corporation reported the following amounts at the end of its first year of operations, December 31, 2010: contributed capital \$100,000; sales revenue \$380,000; total assets \$300,000; dividends \$20,000; and total liabilities \$180,000. Its retained earnings at December 31, 2010 and its total expenses for 2010 would be

	Retained earnings	Total expenses
A)	\$20,000	\$340,000
B)	20,000	320,000
C)	40,000	340,000
D)	40,000	360,000

2. At January 1, 2010, Fungo Corporation had assets of \$560,000 and liabilities of \$360,000. During the year, assets increased by \$50,000 and liabilities decreased by \$20,000. What was the total amount of shareholders' equity at December 31, 2010?

A) \$870,000 B) \$270,000 C) \$850,000 D) \$170,000

3. Niko Corporation purchased factory equipment for \$42,000 cash. Which of the following statements regarding this purchase is incorrect?

A) The profit for Niko will be reduced by the factory equipment expense of \$42,000.
 B) Total assets on Niko's statement of financial position will not change.
 C) Total liabilities will not change.
 D) Total shareholders' equity on Niko's statement of financial position will not change.

4. Which of the following qualitative characteristic indicates that accounting information can influence users' decisions?

A) Comparability. B) Materiality. C) Relevance. D) Reliability.

5. What is the primary purpose of hiring a public accounting firm to examine the financial statements of a company?

A) to assure no fraud has been committed by the company's management
 B) to provide credibility that the financial information conforms with applicable financial reporting standards in all material respects
 C) to detect all accounting errors made by the accounting system and employees
 D) to detect fraud committed by employees

6. Which of the following is false?

A) Relevance of accounting information means that the information would make a difference in a user's decision.
 B) Trade receivables is normally classified as a current asset.
 C) Accumulated depreciation normally appears in the income statement.
 D) The matching process holds that all expenses incurred in the earning of revenue should be recognized in the same period as the revenue earned.

7. Which statement is incorrect regarding the financial statements?
- A) Current assets reported in the statement of financial position are generally reported in order of their liquidity.
- B) Dividends declared is an expense reported in the income statement.
- C) Expenses on the income statement are reported as incurred, not as paid.
- D) The statement of cash flows reports the sources and uses of cash during the accounting period.
8. During 2010, Cinse Corporation incurred operating expenses amounting to \$105,000 of which \$70,000 was paid in cash; the balance will be paid in January 2011. The transaction effects on the accounting equation are as follows:

	Assets	Liabilities	Shareholders' equity
A)	Decrease by \$70,000	No effect	Decrease by \$70,000
B)	Decrease by \$105,000	No effect	Decrease by \$105,000
C)	Decrease by \$105,000	Increase by \$35,000	Decrease by \$105,000
D)	Decrease by \$70,000	Increase by \$35,000	Decrease by \$105,000

9. In 2010, Whoobie Company reported total assets of \$55,000 and net sales of \$43,000. In 2009, they reported total assets of \$51,000 and net sales of \$45,000. The company's 2010 asset turnover ratio (rounded to the nearest hundredth) was
- A) 0.81 B) 0.83 C) 1.20 D) 1.28
10. On October 1, 2010, Jayhawk Company paid \$9,600 for a two-year insurance policy on its building. Jayhawk's fiscal year ends on December 31. Which amounts should the Company report for Prepaid Insurance and Insurance Expense on its financial statements for 2010?

	Prepaid insurance	Insurance expense
A)	\$9,600	\$0
B)	\$0	\$9,600
C)	\$8,400	\$1,200
D)	\$1,200	\$8,400

11. Which of the following statements describes the conservatism constraint?
- A) Avoid overstating assets and revenues and avoid understating expenses and liabilities.
- B) The benefits of recording and reporting accounting information should outweigh the related costs.
- C) Relatively small amounts that do not influence users' decisions should not be reported on the financial statements.
- D) Differences due to long-standing and accepted accounting and reporting practices in a particular industry.
12. During the audit of Takedown Company's 2010 financial statements, the auditors discovered that the 2009 ending inventory had been overstated by \$11,000 and that the 2010 ending inventory had been overstated by \$8,000. Before the effect of these errors, 2010 pretax profit had been computed as \$90,000. What should be reported as the correct 2010 profit before taxes?
- A) \$90,000. B) \$87,000. C) \$93,000. D) \$109,000.

13. Jefferson Company had the following account balances on February 15, 2011:

Trade receivables	\$6,000
Allowance for doubtful accounts	550

On February 16, a bad debt of \$80 was written off. What is the net realizable value of the receivables before and after the write-off?

	<u>Before</u>	<u>After</u>
A)	\$5,450	\$5,450
B)	\$5,450	\$5,370
C)	\$6,470	\$6,470
D)	\$5,370	\$5,450

14. On July 1, 2010, Gecko Company borrowed \$48,000 from a local bank at an annual interest rate of 8 percent, and signed a note, payable on July 1, 2012. Interest on this note is also payable at that date. Which of the following amounts should be reported on the income statement for the year ended December 31, 2010?

A) \$1,920. B) \$3,840. C) \$7,680. D) \$0.

15. The following information is available to the accountant of M&M Company when preparing the monthly bank reconciliation:

Outstanding cheques:	#1249 for	\$ 525
	#1261 for	70
Bank service charges		50
Deposits in transit		1,500
Customer note receivable collected by bank		975
Cash balance per bank statement		1,265
Cash balance per books (prior to reconciliation)		1,245

The corrected cash balance following completion of the reconciliation is

A) \$1,575. B) \$2,765. C) \$2,170. D) \$2,120.

16. Campbell Company purchased 100 units of Product A at \$21 per unit for resale to customers at \$30. At year end, it was determined that the net realizable value of Product A is \$20 per unit. At what value (per unit) should Product A be reported on the statement of financial position at year end?

A) \$20. B) \$21. C) \$30. D) None of these amounts.

Question 2 (12 marks; 22 minutes) *Preparation of journal entries*

The following information relates to selected transactions that occurred at McCord Company during the month ending January 31, 2011 (McCord follows accrual accounting practices in all respects):

- January 1: Purchased equipment for use in the business at a cost of \$24,000; one-third was paid in cash, and the company signed a note for the balance, payable in two years. Interest on the note is 6 percent per year, payable at the end of each month.
- January 5: Paid \$6,000 in salaries to employees who worked during the past two weeks. Two-thirds of this amount was earned by employees in December 2010.
- January 15: Rented a warehouse for one year, starting on that date and paid \$18,000 in advance. The company's bookkeeper debited Rent Expense and credited Cash for this payment.
- January 31: The Company sold merchandise for \$100,000 during January. Customers paid for these purchases as follows: \$30,000 in cash, \$70,000 using a credit card issued by the Company. Customers are sent their monthly statements at the beginning of the following month. Myra Frinkle who purchased merchandise for \$500 in cash returned the purchased items to the Company and received a cash refund of \$500. The merchandise was in excellent condition and was returned to stock immediately. The company uses a perpetual inventory system and has a gross profit percentage of 0.4 (or 40 percent).
- January 31: Included with the bank statement was a cheque from a customer, Fred Cooper, for \$300 stamped NSF (Not Sufficient Funds). The bank statement also included a debit memorandum for \$5 as a service charge related to this cheque.

Required: *Please skip a line between journal entries. (Omit narratives and show calculations.)*

1. Prepare the journal entries to record the following transactions: (If an event does not require a journal entry, explain the reason.)
 - a. Payment of interest on the note payable on January 31.
 - b. Payment of salaries on January 5.
 - c. Sale of merchandise during the month, and subsequent return of merchandise by Myra Frinkle.
 - d. The return of Fred Cooper's cheque and related service charges.
2. Determine the amount of rent expense that should be included in an income statement for January 2011.

Question 3 (34 marks; 61 minutes) *Preparation of adjusting entries, income statement and statement of financial position*

Infometrix Inc. completed its fourth year of operations on December 31, 2010. A student working in the company's office on a part-time basis assembled the following list of accounts and their related balances. The accounts are not arranged in any particular order.

Account Title	Balance	Account Title	Balance
Cost of goods sold	\$590,000	Trade receivables	\$150,000
Merchandise inventory	140,000	Cash	54,000
Equipment	200,000	Building	320,000
Accumulated depreciation – equipment	20,000	Trade payables	68,600
Retained earnings, January 1, 2010	177,000	Deferred rent revenue	6,000
Accumulated depreciation – building	40,000	Credit card discounts	5,000
Note payable	30,000	Salaries expense	120,000
Sales revenue	983,000	Note receivable	30,000
Interest expense	2,400	Share capital (10,000 shares)	570,000
Advertising expense	76,000	Land	160,000
Insurance expense	6,300	Dividends declared	12,000
Sales returns and allowances	20,000	Office supplies inventory	8,900

Each of the account balances above has a "normal" balance, as the term is defined in the textbook. The following additional information was not taken into consideration in determining the account balances:

- The amount shown as insurance expense includes \$900 for coverage during the first two months of 2011.
- The note receivable was received on September 1, 2010 and carries an interest rate of 10 percent per year. Interest on the note will be received by the company when the note becomes due on February 28, 2011.
- The building is depreciated over 40 years on a straight-line basis with no salvage value. Depreciation on the equipment was determined to be \$10,000 per year.
- Additional dividends of \$50,000 were declared in December 2010, but will not be paid until January 2011.
- The cost of office supplies still on hand at December 31, 2010 is \$600.
- The company rented surplus space in its building to a tenant on November 1, 2010 for \$1,000 per month, payable in advance for six months. The entire amount received was credited to Deferred rent revenue.
- Employees earned \$3,000 of salaries in December 2010 that will be paid on the first pay day in January 2011.
- The company is subject to an income tax rate of 30 percent. Income taxes for the year 2010 will be paid on March 15, 2011.

Required *(show all calculations):*

- Prepare the necessary adjusting journal entries as at December 31, 2010 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.) **(11 marks)**

2. Prepare, in proper form, a classified ("multi-step") income statement for Infometrix Inc. for the year ended December 31, 2010. **(9 marks)**
3. Prepare in proper form the Assets section of a classified statement of financial position for Infometrix Inc. as at December 31, 2010. *A complete statement of financial position is not required.* **(7 marks)**
4. Calculate the following amounts or ratios, as applicable. **(7 marks):**
 - a. Age of the building as at December 31, 2010.
 - b. Balance of retained earnings at December 31, 2010.
 - c. Net profit margin for 2010. Explain the meaning of this ratio.
 - d. Return on equity for 2010. Assume that the balance of the share capital account did not change during 2010. How would you interpret this ratio?

QUESTION 4 (16 marks; 29 minutes)

Accounting for receivables and bad debts

During 2010 the following selected summary transactions occurred for Zoftad Ltd:

- a) Sales, \$50,000,000 – of which 90% were on account, terms net 30.
- b) Sales returns and allowances, \$500,000 – 10% related to cash sales, and 90% related to sales on account.
- c) Cash collections of \$42,000,000 from trade receivable customers.
- d) Write-offs of trade receivable deemed uncollectible, \$1,100,000.
- e) Cash recoveries of trade receivable previously written off, \$60,000.

Additional information

- Trade receivable balance, December 31, 2009: \$7,000,000.
- Estimated uncollectible accounts as a percentage of trade receivable:
 - As at December 31, 2009... 2.0% (two percent);
 - As at December 31, 2010... 2.5% (two-and-one-half percent).

Required (Hint: answer in the order shown.)

1. Prepare journal entries for summary transactions a) to e), above. **(6 marks)**
2. Show, in good form, how trade receivable would be presented on the company's comparative statement of financial position as at December 31, 2010. **(3 marks)**
3. Prepare the adjusting journal entry to record bad debts expense for 2010. **(2 marks)**
4. Calculate the trade receivables turnover ratio for 2010. What does your result suggest about the firm's ability to manage trade receivables during 2010? Be specific. **(3 marks)**
5. If cost of goods sold averages 40% of net sales, how much was the gross profit dollar amount for 2010? An income statement is not required. **(2 marks)**

QUESTION 5 (14 marks; 25 minutes)*Accounting for inventory and cost of sales*

The following table is from Amelie Ltd.'s perpetual inventory record for item A by the end of November 2010.

Date	Quantity	Unit Cost	Unit Sale Price
Beginning inventory, January 1	300	\$ 90	
Purchase, February 5	400	\$100	
Sale, May 23	300	\$ 90	\$150
Purchase, September 15	300	\$110	
Sale, November 26	350	\$100	\$160

On December 1, 2010, Amelie sold 200 units to a customer at a unit sale price of \$180. The company's fiscal year ends on December 31, 2010.

Required:

1. Which inventory costing method does Amelie Ltd. use? Explain. **(2 marks)**
2. Prepare the journal entries to record the purchase transaction on September 15 and the sale transaction on December 1, assuming both are cash transactions. **(5 marks)**
3. Compute the inventory turnover ratio during 2010, and briefly explain what the amount means. **(5 marks)**
4. Assume for this part that the demand for item A slowed down during December 2010, and its net realizable value dropped to \$95 per unit at December 31, 2010. Amelie Ltd. reports its ending inventory at the Lower of Cost and Net Realizable Value (LCNRV). Prepare the journal entry that should be recorded at December 31, 2010. If no journal entry is required, please explain why. **(2 marks)**