

CONCORDIA UNIVERSITY  
DEPARTMENT OF ACCOUNTANCY

FINANCIAL ACCOUNTING  
COMM 217 ALL SECTIONS

MID-TERM EXAMINATION  
Winter 2012

Duration: 3 hours

Name: \_\_\_\_\_

**Instructions:**

1. This examination paper consists of **9 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. You are expected to write your answers in the examinations booklet in **ink**.
4. Read the questions carefully and budget your time wisely. Show all calculations.
5. This is a closed book examination. However, a silent hand-held (not graphical) calculator and one standard language (not electronic) dictionary are permitted.
6. Show your calculations on the examination booklet.
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 booklets when you have finished. Write your name on both the examination paper and the examination booklet.

Question	Topic	Total Marks
1	Multiple choice	18
2	Preparation of journal entries	17
3	Preparation of adjusting entries, income statement and statement of financial position	26
4	Accounting for receivables and bad debts	20
5	Accounting for inventory and cost of sales	19
	Total	100

**QUESTION 1 (18 marks; 31 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 only**. Each correct answer is worth 1.5 marks.

1. Revenues can be defined as
  - a. Increases in owners' equity as a result of cash contributions by owners.
  - b. Decreases in liabilities resulting from the payment of bank loans.
  - c. Increases in retained earnings as a result of selling goods or performing services.
  - d. Only a and c.
  
2. SLH, Inc. reported the following information:

	<b>December 31, 2011</b>	<b>December 31, 2010</b>
Total assets	\$150,000	\$104,000
Total liabilities	60,000	40,000

SLH did not have any transactions affecting share capital in 2011. It declared dividends of \$10,000 during 2011. Based on these details, SLH's profit for 2011 should be:

- a. \$20,000
  - b. \$36,000
  - c. \$26,000
  - d. Cannot be determined without knowing the revenues and expenses for 2011.
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3. The recording of depreciation expense will have the following effects:
 

	<b>Assets</b>	<b>Profit</b>	<b>Shareholders' Equity</b>
a.	Decrease	Decrease	Decrease
b.	Decrease	No effect	No effect
c.	Decrease	No effect	Decrease
d.	Decrease	Decrease	No effect

4. For a merchandising company, the cost of inventory becomes an expense when
  - a. inventory is purchased from a supplier.
  - b. payment is made to the supplier.
  - c. inventory is sold to a customer.
  - d. cash is received from the customer.

5. Verna Ltd. reported the following information for 2011:

Beginning inventory	\$10,000	Purchase returns	\$ 1,200
Ending inventory	8,000	Sales revenue	98,000
Purchases	41,000	Sales returns	2,000
Purchase discounts	800		

Verna's gross profit percentage is:

- a. 56.1%
- b. 55.2%
- c. 57.3%
- d. None of these values are correct. The correct percentage is: \_\_\_\_\_

6. The usefulness of the debt-to-equity ratio is that it allows interested parties to assess
- how the company finances its assets.
  - the relative risk assumed by the company because of debt financing.
  - whether the company should expand its use of debt to finance assets.
  - all of the above.
7. Which of the following statements is true?
- Only permanent accounts are closed at the end of the accounting period.
  - Only temporary accounts are closed at the end of the accounting period.
  - All accounts are closed at the end of the accounting period.
  - Only the retained earnings account is closed at the end of the accounting period.
8. Which of the following statements best describes the matching process?
- Total assets should equal total liabilities and owners' equity.
  - Revenues should be recognized when they are earned and realized.
  - Revenue and the expenses that were incurred to earn that revenue should be reported in the same accounting period.
  - Debits should always be equal to credits.
9. International Financial Reporting Standards (IFRS) were developed over time because
- New accounting concepts have been introduced.
  - Corporations wanted to change the way they reported their financial results.
  - Comparison of financial statements of different international companies could not be made when countries used different generally accepted accounting principles (GAAP).
  - Canadian GAAP became outdated over time.
10. Which of the following is not an objective of internal control?
- Maximizing profit
  - Ensuring the accuracy and reliability of accounting records
  - Safeguarding assets
  - Complying with legal requirements
11. Which are two of the most common adjustments made to the bank statement balance during the bank reconciliation process?
- Deducting customer NSF cheques and adding bank service charge fees.
  - Deducting deposits in transit and adding outstanding cheques.
  - Adding NSF cheques and deducting service charge fees.
  - Adding deposits in transit and deducting outstanding cheques.
12. The cash records and the bank statement of Mezza Company showed the following at the end of January 2012:

Outstanding cheques, December 31, 2011	\$ 8,000
Cheques written by Mezza Company during January 2012	50,000
Cheques cleared by the bank during January 2012	54,000

Therefore, the amount of outstanding cheques at the end of January 2012 should be

- a. \$2,000.      b. \$4,000.      c. \$6,000.      d. \$8,000.

**QUESTION 2 (17 marks; 32 minutes)** *Preparation of journal entries*

The following information relates to selected transactions that occurred at Oscar Company during the last three months of 2011:

- October 2: Issued 1,200 shares to three investors who contributed a total amount of \$10,000 in cash, as well as a piece of equipment valued at \$5,000.
- October 7: Purchased equipment for use in the business at a cost of \$20,000; one-half was paid in cash, and the company signed a note for the balance, payable in three years, with interest at the rate of 6% per year.
- November 15: Merchandise that cost \$7,500 was sold to Bing, Inc. on account for \$10,000, with credit terms of 2/10, n/30. The Company uses a perpetual inventory system.
- November 18: Bing, Inc. returned to the Company \$1,000 of merchandise purchased on November 15.
- November 20: Ordered \$600 in office supplies.
- November 22: Received cash payment from Bing, Inc. for the amount due.
- December 1: Paid \$18,000 in advance for a one-year lease starting from this date.
- December 20: Received \$20,000 in advance from a new client for services that had not yet been started. As at December 31, 2011, it was estimated that 40% of the services had been completed.
- December 24: Paid \$6,000 in salaries to employees who worked during the past 12 days, including Saturday, December 24. Employees work six days per week, and are paid every other Saturday for the previous 12 work days.

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

1. Prepare the journal entries to record the transactions that occurred from October 2 to December 24, inclusive. If an event does not require a journal entry, explain the reason. **(12.5 marks)**
2. Prepare the necessary adjusting entries related to the transactions that occurred in **December** only. **(4.5 marks)**

**QUESTION 3 (26 marks; 47 minutes)** *Preparation of adjusting journal entries and financial statements*

Presented below is the unadjusted trial balance for Charmar Inc. as at December 31, 2011.

	Debit	Credit
Cash	\$247,000	
Trade receivables	485,000	
Note receivable, due March 15, 2013	60,000	
Building	500,000	
Accumulated depreciation – building		\$140,625
Trade payables		70,400
Note payable, due December 31, 2012		30,000
Deferred rent revenue		6,000
Share capital (100,000 shares)		620,000*
Retained earnings – December 31, 2010		165,000
Sales revenue		999,000
Sales returns and allowances	12,000	
Cost of goods sold	490,000	
Salaries expense	222,000	
Other operating expenses	15,025	
	<u>\$2,031,025</u>	<u>\$2,031,025</u>

\*Original investment by shareholders for 100,000 shares issued on the date of incorporation.

Information for adjustment purposes as at December 31, 2011:

- a) The company lent \$60,000 to an employee on October 1, 2011 and recorded the note receivable. The note bears interest of 5% per year. According to the terms of the note, all interest will be paid as one lump sum when the note matures.
- b) The company borrowed \$30,000 on December 1, 2011 and recorded the note payable. The note bears interest of 4% per year. According to the terms of the note, interest is payable at the beginning of each month, commencing January 1, 2012.
- c) A portion of the building was rented to Amleg Corp. on November 1, 2011 for three months. Charmar received \$6,000 cash from Amleg for the three months and recorded this amount as Deferred rent revenue.
- d) The building was acquired January 1, 2002. Depreciation on the building for 2011 has not been recorded. The building is being depreciated on a straight-line basis over its estimated useful life, no residual value. (Note: the amount of depreciation for 2011 *can* be computed.)
- e) Dividends of sixty cents per share were declared in December 2011, payable January 15, 2012. The dividend was not recorded.
- f) No entry has yet been made for income taxes. Assume an income tax rate of 30%, and that income taxes will be paid March 15, 2012. (Hint: determine the correct amount for *Profit before income taxes*, then make the adjusting entry for income taxes.)

**Required:**

1. Prepare in proper form the adjusting journal entries for items (a) to (f) above as at December 31, 2011. Omit narratives, but show details of calculations where applicable. Create new accounts, as needed. **(9 marks)**
2. Prepare in proper form a multi-step income statement for the year ended December 31, 2011. **(7 marks)**
3. Prepare in proper form the Liabilities and Shareholders' Equity section ONLY of the classified statement of financial position as at December 31, 2011. **(6 marks)**
4. Calculate the following ratios for 2011 and provide a brief meaningful definition in each case:
  - a. Profit margin ratio.
  - b. Return on equity ratio. **(4 marks)**

**QUESTION 4 (20 marks; 36 minutes)***Accounting for receivables and bad debts*

Wolverine Inc. specializes in manufacturing small machinery. Below is Wolverine's Trade Receivables ledger from October 1 to December 31, 2011.

General Ledger		Trade Receivables		
Date	Explanation	Debit	Credit	Balance
Oct. 1	Balance			9,500
Oct. 8	Wrote-off uncollectible accounts.		1,500	8,000
Oct. 15	Sold 10 units to Allen.	5,000		13,000
Oct. 31	Sold 15 units to Bill.	7,500		20,500
Nov. 5	Bill paid the amount due for units purchased on October 31.		7,500	13,000
Nov. 7	Sold 20 units to Cindy.	10,000		23,000
Nov. 16	Allen returned 2 units and paid the amount due for the remaining units purchased on October 15.		5,000	18,000
Nov. 25	Cindy returned 2 units purchased on November 7.		1,000	17,000
Nov. 29	Cindy made a partial payment on the units purchased on November 7.		5,000	12,000
Dec. 20	Recovered \$500 that was written off on October 8.	500	500	12,000

**Additional Information:**

- Wolverine sold its small machinery at \$500 each.
- All sales were on credit with terms 2/10, n/30.
- Wolverine's records included the following items and their balances as at September 30, 2011:
 

Trade receivables .....	\$ 9,500
Allowance for doubtful accounts (credit balance).....	1,300
Net sales.....	100,000
- Wolverine had not yet recorded any bad debt expense in 2011.
- Wolverine uses the periodic inventory method.

**Required:**

1. Prepare the journal entries to record the transactions on October 8, November 5, November 16, and December 20. **(6 marks)**
2. Wolverine uses the *Aging of Trade Receivables* method to determine the amount of receivables that may not be collectible in the future according to the following schedule:

	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%

Determine the amount of receivables that may not be collectible in the future, and prepare the journal entry to record bad debt expense on December 31, 2011. Show your calculations. (Hint: You may wish to keep track of trade receivables in order to determine the age of these receivables.) **(6 marks)**

3. Assume for this part only that Wolverine uses the *Percentage of Credit Sales* method to determine bad debt expense. Based on past experience, Wolverine estimated the bad debt rate to be 1% of net credit sales. Show, in good form, how trade receivables would be presented on Wolverine's statement of financial position as at December 31, 2011. (Hint: you may want to use T-accounts to keep track of the effects of specific transactions.) **(5 marks)**
  4. Wolverine's *Cost of Goods Sold* is \$60,000 for 2011. Calculate and evaluate Wolverine's *Gross Profit Percentage* for 2011. Wolverine's *Gross Profit Percentage* was 35% and 40% for the years 2009 and 2010, respectively. Round your calculations to two decimal places. **(3 marks)**
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**QUESTION 5 (19 marks; 34 minutes)***Accounting for inventory and cost of sales*

This question consists of three independent parts.

**Part A (13 marks)**

Kruger Corp. reported the following sale and purchase transactions in January 2012:

<b>Table 1</b>		
Jan. 1	Beginning inventory	5 units at \$90 each
Jan. 3	Sale on account	3 units at \$120 each
Jan. 6	Purchase on account	11 units at \$95 each
Jan. 8	Sale on account	4 units at \$120 each
Jan. 9	Sale on account	5 units at \$120 each
Jan. 15	Sales returned due to damage, \$240 (two units that were sold on January 9). The units were in very poor condition and were destroyed.	

Kruger Corp. uses a periodic inventory system, and the FIFO inventory costing method.

**Required:**

1. Calculate net sales and gross profit for January 2012. **(5 marks)**
2. Prepare the journal entries to record the purchase transaction on January 6, the sale transaction on January 8, and the sales return on January 15. **(4 marks)**
3. Calculate cost of goods sold for January 2012, assuming for this part only that Kruger uses a perpetual inventory system and the weighted-average cost method. **(4 marks)**

**Part B (4 marks)**

The following data are available for two products of the Classic Company:

	<b>A</b>	<b>B</b>
Beginning inventory	\$20,000	\$15,000
Purchases	65,000	62,000
Ending inventory	13,000	9,000
Cost of goods sold	72,000	68,000

You discover the following errors:

- A. Ending inventory for product A was understated by \$5,000.
- B. Beginning inventory for product B was overstated by \$3,000.

**Required:**

1. Recalculate the cost of goods sold for each product. **(2 marks)**
2. By how much would profit increase or decrease after correcting these errors? Assume that Classic Company is subject to an income tax rate of 30 percent. **(2 marks)**

**Part C (2 marks)**

Which inventory costing method (Specific Identification, FIFO or Weighted Average Cost) best fits each of the independent descriptions below? Specify the appropriate method for each description separately.

- A. It provides the same cost of ending inventory in a periodic or a perpetual inventory system.
- B. It results in a cost of ending inventory that is close to the current cost of replacing it.
- C. It maximizes reported profit when inventory purchase prices are falling.
- D. It is used to record the cost of automobiles, jewellery, and art objects.