

**Suggested Solution**  
**Midterm Examination (Regular)**  
**Winter 2013**

**Question 1**

1. C
2. C
3. D
4. C
5. D
6. D
7. C
8. D
9. A
10. D
11. D
12. D
13. A
14. C
15. C
16. D

**Question 2:**

**Requirement 1**

a.	Cash (\$8,000 * .98) .....	7,840	
	Credit Card Discounts .....	160	
	Sales Revenues .....		8,000
b.	Allowance for doubtful accounts .....	7,200	
	Trade receivables .....		7,200
c.	Wages Expense .....	1,000	
	Wages Payable .....	200	
	Cash .....		1,200

d. Cash .....	12,000	
Deferred revenue .....		12,000
e. Trade Payable.....	20,000	
Cash.....		20,000
f. Machinery .....	30,000	
Cash.....		10,000
Notes Payable.....		20,000
g. Prepaid Insurance.....	7,000	
Cash.....		7,000
h. No entry is required, because revenue cannot be recognized and no cash is received.		
i. Trade receivable (\$400 + \$5) .....	405	
Cash .....		405
Or		
Trade receivables .....	400	
Bank service charges .....	5	
Cash .....		405
j. Cash .....	40,000	
Land.....	10,000	
Share Capital .....		50,000

### Question 3

**Req. 1**-- Adjusting journal entries, October 31, 2012

a) Depreciation expense .....	23,500	
Accumulated depreciation – building .....		16,250
Accumulated depreciation - equipment .....		7,250
( $\$700,000 - \$50,000$ ) / 40 = \$16,250		
( $\$150,000 - \$5,000$ ) / 20 = \$7,250		
(b) Dividends (or, Retained earnings) .....	1,400	
Dividends payable .....		1,400
\$.07 x 20,000 = \$1,400		

(c) Insurance expense (or, General & administrative expenses)	8,750	
Prepaid insurance .....		8,750
$\$21,000 \times 5/12 = \$8,750$		
(d) Interest expense .....	2,000	
Interest payable .....		2,000
$\$400,000 \times 6\% \times 1/12 = \$2,000$		
(e) Unearned rent revenue	7,200	
Rent revenue		7,200
$\$8,400 \times 6/7 = \$7,200$		
(f) Bad debts expense	18,000	
Allowance for doubtful accounts		18,000
$\$2,000,000 \times .90 \times .01 = \$18,000$		
(g) Income tax expense .....	76,190	
Income tax payable .....		76,190
See the income statement for calculation.		

**Req. 2**

Xavier Ltd.  
Income Statement  
For the Year Ended October 31, 2012

Sales revenue	\$2,000,000	
Less: sales returns and allowances	<u>20,000</u>	
Net sales	1,980,000	
Cost of goods sold	<u>980,000</u>	
Gross margin/profit	<u>1,000,000</u>	
Operating expenses		
General and administrative expenses	424,000	
Selling expenses	130,000	
Depreciation expense	23,500	(See comment below.)
Bad debts expense	18,000	(See comment below.)
Insurance expense	<u>8,750</u>	(See comment below.)
Total operating expenses	<u>604,250</u>	
Operating income	395,750	

Other revenues and expenses		
Rent revenue	7,200	
Profit before interest and income taxes	<u>402,950</u>	
Interest expense	<u>(22,000)</u>	(\$20,000 + \$2,000)
Profit before income taxes	380,950	
Income tax expense	<u>76,190</u>	(\$380,950 x .20)
Profit	<u>\$304,760</u>	

Earnings per share (EPS) \$15.24 per share.                    (\$304,760 / 20,000)

(Comment: some students may have used General and administrative expenses or Selling expenses for certain of the adjusting entries -- adapt marking key accordingly.)

**Req. 3**

Xavier Ltd.  
Statement of Financial Position (partial)  
As at October 31, 2012

Liabilities and Shareholders' Equity	
Current Liabilities	
Trade payables	\$ 22,600
Income taxes payable	76,190
Dividends payable	1,400
Interest payable	2,000
Unearned rent revenue (See below.)	<u>1,200</u>
Total current liabilities	103,390
Note payable, 6%, due December 1, 2013	<u>400,000</u>
Total liabilities	503,390
Shareholders' Equity	
Common shares (20,000 shares outstanding)	600,000
Retained earnings (See below.)	<u>423,360</u>
Total shareholders' equity	<u>1,023,360</u>
Total Liabilities and Shareholders' Equity	<u>\$1,526,750</u>

Unearned rent revenue = \$8,400 - \$7,200 = \$1,200.

Retained earnings = \$120,000 + \$304,760 - \$1,400 = \$423,360.

**Req. 4** -- Closing journal entries, October 31, 2012

(Note: some students may have debited Retained Earnings immediately for Dividends -- adapt marking key accordingly.)

Sales revenue	2,000,000	
Rent revenue	7,200	
Income summary		2,007,200
Income summary	1,702,440	
Sales returns and allowances		20,000
Cost of goods sold		980,000
General and administrative expenses		424,000
Selling expenses		130,000
Depreciation expense		23,500
Bad debts expense		18,000
Insurance expense		8,750
Interest expense		22,000
Income tax expense		76,190
Income summary	304,760	
Retained earnings		304,760
(\$2,007,200 - \$1,702,440 = \$304,760)		
Retained earnings	1,400	
Dividends		1,400

**Req. 5** -- Age of building, October 31, 2012

$\$138,125 / \$16,250 = 8.5$  years (102 months).

**Req. 6**

a) Debt-to-equity ratio:

$\$503,390 / \$1,023,360 = 49.2\%$ .

The debt-to-equity ratio measures the proportion of financing provided by debt compared to equity. It is a basic measure of risk, and in this case it is relatively low since only about one-third of assets are financed by debt.

b) Return on assets ratio, fiscal year 2012:

First, calculate total assets at the end of fiscal 2011 using the balance sheet equation,

Assets = Liabilities + Shareholders' Equity.

Fiscal 2011: Assets = (\$503,390 - \$100,000) + (\$600,000 + \$120,000)

Assets = \$403,390 + \$720,000 = \$1,123,390

ROA, fiscal 2012

= [ $\$304,760 + \$22,000 (1 - .20)$ ] / [  $(\$1,123,390 + \$1,526,750) / 2$  ]

= [ $\$304,760 + \$17,600$ ] /  $\$1,325,070 = 24.3\%$ .

The return on assets ratio measures how effectively management has used assets to generate profit during the period. It is a basic measure of profitability, and in this case it appears to be good.

#### Question 4

##### Req. 1

(b) Oct. 11	Trade receivables	72,000	
	Sales revenues		72,000
(c) Oct. 14	Trade receivables	36,000	
	Sales revenues		36,000
(d) Oct. 16	Cash	71,280	
	Sales discounts (72,000 * 1%)	720	
	Trade receivables		72,000
(f) Nov. 27	Cash	30,000	
	Sales returns and allowances	6,000	
	Trade receivables		36,000
(h) Dec. 16	Allowance for doubtful accounts	12,000	
	Trade receivables		12,000

(i) Dec. 29	Trade Receivables	1,000	
	Allowance for doubtful accounts		1,000
	Cash	1,000	
	Trade Receivables		1,000

**Req. 2**

	Amount Receivable	Estimated Percent Uncollectible	Estimated Amount Uncollectible
Not yet due	\$30,000	1%	\$ 300
1-30 days past due	nil	5%	nil
31-60 days past due	48,000	10%	4,800
More than 60 days past due	23,000*	20%	4,600
	\$101,000		\$9,700

\* \$111,000-75,000-13,000+1,000-1,000 = 23,000

Bad debts expense	5,700*	
Allowance for doubtful accounts		5,700

\* \$9,700 – [16,000 – (13,000-1,000) ] = \$5,700

**Req. 3**

Credit sales = \$500,000 + 186,000 – 720– 6,000 = \$679,280

Bad debt expense = \$679,280 \* 2% = \$13,586

**Req. 4**

TR Turnover = Net credit sales/Average net trade receivable

TR Turnover, 2011 = \$600,000/[(88,000-8,000+100,000-10,000)/2] = 7.06

TR Turnover, 2012 = \$679,280/[(90,000+101,000-9,700)/2] = 7.49

TR Turnover, per stated credit terms = 365/30 = 12.17

The trade receivables turnover has improved slightly. However, it is much worse than stated credit terms. B3O should increase its efforts to collect cash from its customers.