

ADM 1340
MID TERM EXAM
Introductory Financial Accounting
Winter 2014
SOLUTIONS

Time: 2 hours

Student Name: _____

Student #: _____

Section: **M (Prof. Chourou)** _____ **N (Prof. Ghandi)** _____
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READ CAREFULLY

Instructions

1. This examination comprises 5 questions over 15 pages. Page 15 is a page for rough work and will not be marked. Answer Question No. 1 (multiple choice) directly on the Scantron Sheet provided and the rest of the questions directly in the exam booklet. The exam is **not** to be removed from the examination room.
2. Limit your answer to the space provided. Blank sheets for rough work and supporting calculations are given at the end of each question. You must show, where appropriate, supporting calculations.
3. This exam is out of 66 marks and is 2 hours long. You should budget approximately 1.8 minutes per mark.
4. Please do **not** ask the invigilator or the professor any questions, as they will not be answered. State reasonable assumptions, if you feel they are necessary. Language dictionaries (non-electronic) are allowed if approved by the professor.
5. The use of electronic communication devices such as cell phones is strictly prohibited during the exam. YOU **MUST** BRING PHOTO ID WITH YOU. No photo ID means no exam.

Q1	/ 33
Q2	/ 8
Q3	/8
Q4	/ 9
Q5	/ 8
TOTAL	/ 66

Statement of Academic Integrity:

The School of Management does not condone academic fraud, an act by a student that may result in a false academic evaluation of that student or of another student. Without limiting the generality of this definition, academic fraud occurs when a student commits any of the following offences: plagiarism or cheating of any kind, use of books, notes, mathematical tables, dictionaries or other study aid unless an explicit written note to the contrary appears on the exam, to have in his/her possession cameras, radios (radios with headsets), tape recorders, pagers, cell phones, or any other communication device which has not been previously authorized in writing.

Statement to be signed by the student:

I have read the text on academic integrity and I pledge not to have committed or attempted to commit academic fraud in this examination.

Signed: _____

Note:

An examination without this signed statement will not be graded and will receive a final exam grade of zero.

Question No. 1 (33 marks)

Select the best answer for each of the following multiple-choice items and enter your answer on the Scantron Sheet provided. Failure to use the Scantron Sheet will result in zero marks for Question No. 1. Only one answer will be accepted for each question. There is no penalty for guessing. No account will be taken of any explanations provided.

Items 1 to 11 are each worth one mark.

1. In order for accounting information to be relevant, it must
 - a. have very little cost.
 - b. help predict future events or confirm prior expectations.**
 - c. be verifiable.
 - d. be used by a lot of different organizations.

2. Working capital is a measure of
 - a. comparability.
 - b. liquidity.**
 - c. profitability.
 - d. solvency.

3. A liquidity ratio measures the
 - a. profit or operating success of a company over a period of time.
 - b. ability of a company to survive over a long period of time.
 - c. short-term ability of a company to pay its maturing obligations and to meet unexpected needs for cash.**
 - d. percentage of total financing provided by creditors.

4. A weakness of the current ratio is
 - a. the difficulty of the calculation.
 - b. that it doesn't take into account the composition of the current assets.**
 - c. that it is rarely used by sophisticated analysts.
 - d. that it can be expressed as a percentage, as a rate, or as a proportion.

5. Which one of the following is a fundamental qualitative characteristic?
 - a. Relevance**
 - b. Timeliness
 - c. Understandability
 - d. Comparability

6. Accounting information should be neutral in order to enhance
 - a. faithful representation**
 - b. materiality.
 - c. comparability.
 - d. understandability.

7. On a classified statement of financial position, current assets are often listed
 - a. in alphabetical order.
 - b. with the largest dollar amounts first.
 - c. in the order in which they are expected to be converted into cash.**
 - d. in the order of acquisition.

8. Long-lived assets without physical substance are
 - a. listed directly under current assets on the statement of financial position.
 - b. not listed on the statement of financial position because they do not have physical substance.
 - c. intangible assets.**
 - d. listed as a long-term investment on the statement of financial position.

9. The classification and normal balance of the unearned revenue account is
 - a. asset, debit
 - b. liability, credit.**
 - c. revenues, credit.
 - d. shareholders' equity, credit.

10. In general, revenue recognition occurs

- a. when cash is received
- b. when it is earned.**
- c. when expenses are incurred.
- d. in the period that income taxes are paid.

11. Recording transactions that affect a company's financial statements in the periods in which they occur rather than when cash is received or paid is called

- a. time period accounting
- b. the cash basis of accounting.
- c. monetary accounting.
- d. the accrual basis of accounting.**

Items 12 to 22 are each worth two marks.

12. What is the total amount of working capital?

Current assets	\$ 9,000	Net sales	\$ 20,000
Current liabilities	4,000	Total liabilities	5,000
Average assets	40,000	Shareholders' equity	25,000
Total assets	30,000	Market price of shares	\$2
Profit	9,000	Weighted average number of common shares	18,000

- a. \$2,000
- b. \$4,000
- c. \$5,000**
- d. \$7,000

13. What are the earning per share?

Current assets	\$ 9,000	Net sales	\$ 20,000
Current liabilities	4,000	Total liabilities	5,000
Average assets	40,000	Shareholders' equity	25,000
Total assets	30,000	Market price of shares	\$2
Profit	9,000	Weighted average number of common shares	18,000

- a. \$0.36
- b. \$0.50**
- c. \$0.80
- d. \$1.11

14. What is the debt to total assets?

Current assets	\$ 9,000	Net sales	\$ 20,000
Current liabilities	4,000	Total liabilities	5,000
Average assets	40,000	Shareholders' equity	25,000
Total assets	30,000	Market price of shares	\$2
Profit	9,000	Weighted average number of common shares	18,000

- a. 12.5%
- b. 20.0%
- c. 75.0%
- d. 16.7%**

15. The current assets of Key Corporation are \$360,000. The current liabilities are \$240,000. The current ratio expressed as a ratio is
- 150%
 - 1.5:1**
 - 0.7:1
 - $\$360,000 \div \$240,000$

16.

Operating expenses	\$ 45,000
Sales returns and allowances	25,000
Sales discounts	16,000
Sales	210,000
Cost of goods sold	79,000
Income tax expense	11,000

The profit margin would be

- 16.2%.
- 20.1%.**
- 26.6%.
- 41.0%.

17. If a company has net sales of \$500,000 and cost of goods sold of \$350,000, the gross profit margin is
- 15%.
 - 30%.**
 - 70%.
 - 100%.

18. Aye Corp sells \$10,000 of goods on account in the current year and collects \$7,500 of this. It incurs \$6,000 in expenses on account during the current year and pays \$4,000 of them. Aye would report what amount of profit under the cash and accrual bases of accounting, respectively?
- \$4,000 on the cash basis and \$3,500 on the accrual basis
 - \$3,500 on the cash basis and \$4,000 on the accrual basis**
 - \$6,000 on the cash basis and \$3,500 on the accrual basis
 - \$1,500 on the cash basis and \$6,000 on the accrual basis

19. Benz Inc. shows the following account balances for last month:

Purchases	\$28,000
Sales Returns and Allowances	4,000
Purchase Discounts	2,500
Freight In	1,875
Freight Out	2,500

The cost of goods purchased for last month is

- \$25,875
- \$27,375**
- \$29,875
- \$30,500

20. Stylish Shoe Store reported beginning merchandise inventory of \$15,000. During the period, purchases were \$70,000; purchase returns, \$2,000; and freight in \$5,000. A physical count of inventory at the end of the period revealed that \$10,000 was still on hand. The cost of goods available for sale was

- a. \$78,000
- b. \$82,000
- c. **\$88,000**
- d. \$92,000

21. For last month, the following data were taken from the ledger of Shanghai Inc:

Purchases	\$ 100,000
Purchase Returns and Allowances	1,200
Purchase Discounts	600
Freight In	3,000
Beginning Inventory	18,000
Ending Inventory	19,200

What was the cost of goods sold?

- a. \$ 19,200
- b. **\$100,000**
- c. \$101,200
- d. \$119,200

22. Westcom Corporation's goods in transit at December 31 include (1) sales made FOB destination, (2) sales made FOB shipping point, (3) purchases made FOB destination, and (4) purchases made FOB shipping point. Which items should be included in Westcom's inventory at December 31?

- a. (2) and (3)
- b. **(1) and (4)**
- c. (1) and (3)
- d. (2) and (4)

**** END OF MULTIPLE CHOICE ****

Question No. 2 (8 marks)

FINEP Manufacturing produces and sells cars. The company adjusts its accounts annually. On December 31, 2013 the FINEP's unadjusted trial balance was as follows.

FINEP manufacturing Unadjusted Trial Balance December 31, 2013		
	Debits	Credits
Cash	20,000	
Accounts receivable	15,000	
Supplies	6,000	
Prepaid insurance	6,000	
Equipment	30,000	
Accumulated depreciation—equipment		15,000
Accounts payable		3,000
Salaries payable		2,000
Unearned revenue		5,000
Bank Loan (due May 2018)		20,000
Common shares		12,000
Retained earnings		40,000
Revenues		43,000
Salary expense	32,000	
Rent Expense	10,000	
Interest expense	9,000	
Advertising expense	12,000	
	140,000	140,000

Additional information:

- 1) The insurance, which has a one-year term, was signed and effective on August 1, 2013. The company paid \$6,000 for the insurance.
- 2) The company performs a count on December 31, 2013 and it reveals that the company has \$200 worth of supplies on hand.
- 3) The bank loan signed on December 1, 2013 has an interest rate of 9% per year. That interest is payable at the beginning of each month.
- 4) The company uses straight line depreciation to depreciate its assets and the equipment has a useful life of 6 years and a residual value of zero.

Required:

Prepare the adjustment entries required at December 31, 2013 (show your calculations):

Suggested Solution

1) Insurance expense calculation for 5 months (August-December) = $\$6,000/12\text{months} \times 5$ months = \$2,500 (1 point)

Insurance expense	\$2,500	(0.5 points)
Prepaid insurance	\$2,500	(0.5 points)

2) Supplies expenses: $\$6,000 - \$200 = \$5,800$ (1 point)

Supplies expenses	\$5,800	(0.5 points)
Supplies	\$5,800	(0.5 points)

3) Interest payable: $\$20,000 \times 9\% \times 1/12$ months = \$150 (1 point)

Interest expense	\$150	(0.5 points)
Interest payable	\$150	(0.5 points)

4) Annual depreciation expense: $\$30,000/6$ years = \$5,000 per year (1 point)

Depreciation expense	\$5,000	(0.5 points)
Accumulated depreciation expense – equipment	\$5,000	(0.5 points)

Question No. 3 (8 marks)

On September 1, Wilderness Inc had an inventory of 18 backpacks at a cost of \$30 each. The company uses a perpetual inventory system. During September, the following transactions occurred.

- Sept. 4 Purchased 35 backpacks at \$30 each from Back Packs Unlimited, terms 3/10, n/30.
- 6 Received credit of \$150 for the return of 5 backpacks purchased on Sept. 4 that were defective.
- 9 Sold 20 backpacks for \$50 each to University Supply, terms 2/10, n/30.
- 14 Paid Back Packs Unlimited in full.
- 18 Received payment from University Supply.

Instructions

Record the September transactions for Wilderness Inc.

Suggested Solution

Sept. 4	Merchandise Inventory (\$30 x 35)	(0.5 points)	1,050	
	Accounts Payable	(0.5 points)		1,050
6	Accounts Payable	(0.5 points)	150	
	Merchandise Inventory	(0.5 points)	150	
9	Accounts Receivable (\$50 x 20)	(0.5 points)	1,000	
	Sales	(0.5 points)	1,000	
	Cost of Goods Sold (\$30 x 20)	(0.5 points)	600	
	Merchandise Inventory	(0.5 points)	600	
14	Accounts Payable (\$1,050 – \$150)	(0.5 points)	900	
	Cash (\$900 × 97%)	(0.5 points)	873	
	Merchandise Inventory (\$900 × 3%)	(1 point)	27	
18	Cash (\$1,000 x 98%)	(0.5 points)	980	
	Sales Discounts (\$1,000 x 2%)	(1 point)	20	
	Accounts Receivable	(0.5 points)	1,000	

Question No. 4 (9 marks)

Safety Helmets has the following inventory records for February 2014

Date	Description	Units	Cost
Feb 1	Beginning inventory	100	\$8
5	Purchase	60	9
22	Purchase	150	9
24	Sales	(300)	
28	Purchase	90	10

- The 300 units sold on February 24 generated sales revenue of \$6,770
- The company is considering the following three combinations to use for its inventory costing:
 1. FIFO –perpetual
 2. Average- perpetual
 3. Average- periodic

Required:

- a) Which one of the three combinations will enable the company to report the **highest** gross profit for the month? Provide a brief logical explanation for your answer using no numerical calculations (1 point).
- b) Calculate the gross profit based on your answer in part (a) above (3 points).
- c) Which one of the three combinations will enable the company to report the **lowest** gross profit for the month? Calculate the amount of this gross profit (3 points).
- d) Will the amount of gross profit reported under the FIFO-Periodic combination (not listed in the three combinations being considered) equal the amount of the gross profit in part (b) above? Answer Yes or No with a brief logical explanation for your answer, using no numerical calculations (2 points).

Suggested Solution

(a) 1 point

With inventory costs increasing (as per the record provided), FIFO cost of goods sold (COGS) will be highest because it is based on the oldest costs, which are low. Gross profit will therefore be the highest. Hence, the correct answer to the question asked is FIFO-Perpetual combination.

(b) 3 points

$$\begin{aligned}\text{FIFO-Perpetual: Gross Profit} \\ \text{COGS} &= (100 \times \$8) + (60 \times \$9) + (140 \times \$9) \\ &= \$2,600 \\ \text{Gross profit} &= \$6,770 \text{ (sales revenue)} - \$2,600 \\ &= \mathbf{\$4,170}\end{aligned}$$

(c) 3 points

In a perpetual system the calculation of average cost is done after each purchase but in the periodic system it is done only at the **end** of the period. Since the inventory costs are rising over the entire period, average-periodic COGS will be higher (and therefore gross profit lower) than under the average-perpetual combination. This is confirmed by the calculations below:

(i) Average Perpetual:

$$\begin{aligned}\text{Average cost per unit with the three purchases prior to the January sale} &= \\ \frac{100 \times \$8 + 60 \times \$9 + 150 \times \$9}{100 + 60 + 150} &= \$8.677\end{aligned}$$

$$\begin{aligned}\text{Cost of 300 units sold (COGS)} &= 300 \times \$8.677 \\ &= \$2,603\end{aligned}$$

$$\begin{aligned}\text{Gross Profit} &= \$6,770 \text{ (Sale revenue)} - \$2,603 \\ &= \mathbf{\$4,167}\end{aligned}$$

(ii) Average Periodic:

Here the COGS is to be calculated at one period. Thus:

$$\begin{aligned}\text{The average cost per unit equals:} \\ \frac{100 \times \$8 + 60 \times \$9 + 150 \times \$9 + 90 \times \$10}{100 + 60 + 150 + 90} &= \$8.975\end{aligned}$$

$$\begin{aligned}\text{COGS} &= 300 \times \$8.975 \\ &= \$2,693 \text{ (rounded)}\end{aligned}$$

$$\begin{aligned}\text{Gross Profit} &= \$6,770 \text{ (Sales Revenue)} - \$2,693 \\ &= \mathbf{\$4,077}\end{aligned}$$

From the foregoing calculations the \$4,077 gross profit under the average-periodic combination is the lowest, and this is the correct answer to the question asked in part c.

(d) 2 points

Yes, because under both FIFO-Perpetual and FIFO-Periodic combinations the first (oldest) costs in inventory will be assigned to the COGS. Hence the COGS amount and therefore gross profits will be equal.

Question No. 5 (8 marks)

Prince Inc. generated \$2.5 million in credit sales during the current year. Based on past experience, it is estimated that 1.5% of all credit sales will prove to be uncollectible. The balance of the allowance for doubtful accounts at December 31 is \$6,900 credit before the year end adjustment for uncollectible accounts. Accounts receivable at December 31 consists of the following:

<u>Account Classification</u>	<u>Amount</u>
Current	\$1,900,000
1-30 days past due	150,000
31-60 days past due	90,000
61-90 days past due	50,000
Over 90 days past due	20,000

Required:

- a. Calculate bad debts expense and record the related journal entry for the current year using the percentage of credit sales method. (2 points)
- b. Prince has decided to write off all the accounts that were over 90 days past due. Record the journal entry. (2 points)
- c. Show how Accounts Receivable will be presented on the December 31 balance sheet, with appropriate account balances, following the above adjustments. (2 points)
- d. One of the customers whose \$3,000 account was written off paid in full. Record the journal entry. (2 points)

Suggested Solution

a.	Bad debt expense = $\$2,500,000 \times .015 = \$37,500$		1 pt
	Bad debt expense (SE) 37,500		0.5 pt
	Allowance for doubtful accounts (XA) 37,500		0.5 pt
b.	Allowance for doubtful accounts (XA) 20,000		1 pt
	Accounts Receivable (A) 20,000		1 pt
c.	Accounts Receivable (2,210,000 – 20,000)	2,190,000	0.5 pt
	less Allowance for doubtful accounts	<u>24,400</u>	1 pt
	(6,900 + 37,500 – 20,000)		
	Net A/R	2,165,600	0.5 pt
d.	Accounts Receivable (A) 3,000		0.5 pt
	Allowance for doubtful accounts (XA) 3,000		0.5 pt
	Cash (A) 3,000		0.5 pt
	Accounts Receivable (A) 3,000		0.5 pt