

Midterm Examination

ADM 1340

Financial Accounting

Spring/Summer 2012

SOLUTIONS

Time: 2 hours

Student Name: _____

Student #: _____

Section: ☐ X (Professor Shujun Ding)
☐ Y (Professor Robert Collier)

Instructions:

1. Answer all questions in this booklet. The booklet is **not** to be removed from the examination room. You may separate the pages but ensure that you put them back together and staple before handing in. **Ensure that you show all supporting calculations.**
2. Limit your answer to the space provided. Indicate if you use the back of a page.
3. The use of standard abbreviations (for example, A/R for Accounts Receivable and COGS for Cost of Goods Sold) is quite acceptable.
4. Budget about 1.5 minutes per mark. **Please do not ask the invigilators questions. Make reasonable assumptions where necessary.**
5. Language dictionaries and scientific calculators are allowed.
6. The use of electronic communication devices such as cell phones is strictly prohibited during the exam. Sharing of calculators is also strictly prohibited. Use of a programmable calculator is not allowed.
7. **You must sign page 2 of this exam.**
8. It is highly recommended that you use blue or black ink for your answers. **If you do use pencil, you will not be able to submit your midterm for re-appraisal should you believe that the marking key was not applied appropriately to your answers.**

Multiple Choice (Q1-28)	40/
Problem 1	10/
Problem 2	15/
TOTAL	/65

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 head sets), 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 an exam grade of zero.

Multiple Choice (40 marks – 72 minutes)

Select the best answer for each of the following multiple-choice questions and enter your answer in the table box below. Only one answer will be accepted for each question. There is no penalty for guessing. No account will be taken of any explanations provided.

Question Nos. 1 to 16 are each worth 1 mark. Question Nos. 17 to 28 are each worth 2 marks.

#	Answer
1	
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#	Answer
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Multiple Choice (40 marks – 72 minutes)

Questions 1 to 18 are each worth one mark.

1. Which of the following regarding retained earnings is false?
 - a. Retained earnings is increased by net income.
 - b. Retained earnings is a component of shareholders' equity on the balance sheet.
 - c. *Retained earnings is an asset on the balance sheet.*
 - d. Retained earnings represents earnings not distributed to shareholders in the form of dividends.

2. If cost of goods sold is not debited at the time of a sale, which inventory control method is being used?
 - a. Perpetual
 - b. *Periodic*
 - c. Retail
 - d. Cost of goods sold is never debited at the time of a sale

3. Which of the following is not classified as an asset?
 - a. Goodwill
 - b. Prepaid Expense
 - c. Equipment
 - d. *Unearned Revenues*

4. Total assets on a balance sheet prepared on a given date must agree with which of the following?
 - a. The sum of total liabilities and net income as shown on the income statement.
 - b. The sum of total liabilities and share capital.
 - c. The sum of total liabilities and retained earnings.
 - d. *The sum of total liabilities and share capital and retained earnings.*

5. When a periodic inventory system is used
 - a. Timely data is of utmost importance.
 - b. *Inventory shrinkage is impossible to calculate.*
 - c. Cost of goods sold is always known.
 - d. Each inventory purchase and sale is reflected in the inventory control account.

6. All of the following are examples of internal control over cash except:
 - a. Depositing cash in the bank regularly.
 - b. Ensuring different people are responsible for receiving and depositing cash.
 - c. Ensuring a bank reconciliation is done regularly.
 - d. *Maintaining a separate facility for the storage of perishable goods.*

Multiple Choice (continued) (40 marks – 72 minutes)

7. Which of the following items is not a permanent account in a company's chart of accounts?
- a. *Cost of goods sold*
 - b. Retained Earnings
 - c. Revenue
 - d. Unearned revenue
8. Who of the following has primary responsibility for the accuracy of the financial statements of a company?
- a. Bookkeeper
 - b. *Management*
 - c. External Auditor
 - d. Internal Auditor
9. The matching principle controls
- a. Where on the income statement expenses should be presented.
 - b. How costs are allocated between Cost of Goods Sold and general and administrative expenses.
 - c. The ordering of current assets and current liabilities on the balance sheet.
 - d. *When costs are recognized as expenses on the Income Statement.*
10. Which of the following would not be considered a recurring item on the income statement?
- a. Administrative expenses
 - b. Sales revenues
 - c. Selling expenses
 - d. *Loss on disposal of a business division*
11. If a company decided to record a cash outlay as an asset rather than as an expense, how will this decision affect net income in the current period?
- a. *Net income will be higher.*
 - b. Net income will be lower.
 - c. Net income will not be affected by this decision.
 - d. Both assets and liabilities would be overstated.
12. Which of the following is the entry to be recorded by a law firm when it receives a retainer (deposit) from a new client that will be earned when services are provided in the future?
- a. Debit to Accounts Receivable; credit to Legal Services Revenue.
 - b. Debit to Unearned Revenue; credit to Legal Services Revenue.
 - c. *Debit to Cash; credit to Unearned Revenue.*
 - d. Debit to unearned Revenue; credit to Cash.

Multiple Choice (continued) (40 marks – 72 minutes)

13. Company A owns a building. Which of the following statements regarding depreciation is false from an accounting perspective?
- a. *As the value of the building decreases over time, it depreciates.*
 - b. Depreciation is an estimated expense to be recorded each period during the building's life.
 - c. As depreciation is recorded, shareholders' equity is reduced.
 - d. As depreciation is recorded, total assets are reduced.
14. Generally, what will be the result if no adjusting entry is made to record revenue earned during the current period when cash was received during the last accounting period?
- a. The assets will be understated.
 - b. The liabilities will be understated.
 - c. *The liabilities will be overstated.*
 - d. Both the revenues and the liabilities will be correctly stated in the current period.
15. Which of the following transactions would involve a debit to an asset account?
- a. Recording depreciation expense on a capital asset.
 - b. Payment of an accounts payable.
 - c. Payment of a dividend.
 - d. *Collection of an accounts receivable.*
16. Which of the following items is not a reconciling item when preparing a bank reconciliation?
- a. Bank service charges not recorded by the corporation
 - b. Outstanding cheques
 - c. *Interest collected by the bank on a note receivable and recorded by the corporation*
 - d. Outstanding deposits

Questions 17 to 28 are each worth two marks.

17. Abalone Corp. uses a periodic inventory system. The following information pertains to July, 2011:

July 1	Beginning inventory	20 units @ \$19	\$ 380
7	Purchases	70 units @ \$20	1,400
22	Purchases	10 units @ \$22	220
			<u>\$2,000</u>

A physical count of merchandise inventory on July 31 shows that 25 units are on hand.

Under the FIFO cost formula, ending inventory at July 31 was

- a. \$1,500
 - b. \$1,480
 - c. **\$520**
 - d. \$500
18. On July 1, 2011 Martell Company signed a 1-year, 8%, \$40,000 note payable from First National Bank. The loan plus all accrued interest is to be repaid on June 30, 2012. Martell's year-end is September 30. In its 2011 financial statements Martell Company will record interest expense of:
- a. \$1,600
 - b. \$3,200
 - c. **\$800**
 - d. \$400
19. Data for Krebs TV Limited for the year ended December 31, 2011 are as follows:
- | | |
|---------------------|-----------|
| Sales revenue | \$130,000 |
| Beginning inventory | 34,000 |
| Ending inventory | 40,000 |
- If Krebs' gross profit ratio is 32%, the inventory turnover for 2011 is (rounded to three decimal places):
- a. 2.210
 - b. **2.389**
 - c. 1.124
 - d. 3.514

Use the following information to answer questions 20, 21 and 22.

Jordan Company has \$50,000 in cash, \$85,000 in short-term investments, \$12,000 in net current receivables, \$145,000 in inventory, and \$10,000 in prepaid expenses. Total non-current assets are \$525,000. Total liabilities of the company are \$404,000 of which \$136,000 represents current liabilities and the balance is non-current liabilities.

20. The acid-test ratio is (rounded to three decimal places):
- a. 0.748
 - b. **1.081**
 - c. 1.124
 - d. 0.575

Multiple Choice (continued) (40 marks – 72 minutes)

21. The debt ratio is (rounded to three decimal places):
- a. 2.047
 - b. 0.575
 - c. 1.739
 - d. **0.489**
22. The current ratio is (rounded to three decimal places):
- a. 1.566
 - b. 1.955
 - c. 1.127
 - d. **2.221**
23. Chu Limited recorded cost of goods sold on its Income Statement in the amount of \$510,000. The gross profit was \$340,000. If Chu showed a beginning balance and an ending balance in its net receivables account in the amount of \$230,000 and \$190,000 respectively, the ratio showing days' sales in receivables is (rounded up to the nearest day):
- a. 99 days
 - b. 95 days
 - c. **91 days**
 - d. 83 days
24. Ealing Company began operations and purchased \$15,900 of office supplies. By year-end, \$8,800 of supplies were still on hand. The adjusting entry to be recorded at year-end would include a:
- a. **Credit to supplies for \$7,100**
 - b. Debit to supplies for \$15,900
 - c. Credit to supplies expense for \$7,100
 - d. Debit to supplies expense for \$8,800
25. On June 1, 2011 Destry Limited received \$4,500 for services to be performed evenly over the next twelve months. The amount received was credited to Unearned Revenue. The adjusting entry recorded on December 31, 2011 included a:
- a. Debit to Service Revenue for \$1,875
 - b. Credit to Service Revenue for \$1,875
 - c. **Debit to Unearned Service Revenue for \$2,625**
 - d. Credit to Unearned Service Revenue for \$2,625
26. Given the following data, what is the cost of inventory purchases?
- | | |
|---------------------|-----------|
| Sales revenue | \$725,000 |
| Cost of goods sold | 345,000 |
| Ending inventory | 250,000 |
| Beginning inventory | 120,000 |
- a. \$370,000
 - b. \$465,000
 - c. **\$475,000**
 - d. \$595,000

Multiple Choice (continued) (40 marks – 72 minutes)

27. If a bank statement included an NSF cheque for \$450, the journal entry to record this reconciling item would include a:
- a. Debit to Cash for \$450
 - b. Credit to Accounts Receivable for \$450
 - c. Debit to Accounts Payable for \$450
 - d. *None of the above*
28. Under the allowance method, if actual bad debts expense during the year exceeds the allowance amount, the balance in the allowance for doubtful accounts at year-end prior to any adjustment:
- a. should be deducted from gross Accounts Receivable on the Balance Sheet
 - b. must be adjusted by debiting it to bring the balance back to zero
 - c. *will be a debit*
 - d. will equal zero

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

Problem 1 (15 marks)

Norman Rae Ltd. is a service business; the items listed below are for the month of October, 2012.

Retained earnings, October 1	\$15,000
Common shares	28,000
Accounts payable	10,000
Office equipment	30,000
Service revenue	29,000
Dividends paid	6,000
Office supplies expense	3,500
Cash	16,000
Utilities expense	700
Office supplies	2,800
Salaries expense	7,000
Accounts receivable	14,000
Rent expense	3,000
Income tax expense	4,500
Accumulated depreciation-office equipment	6,000
Depreciation expense	500

Required:

Prepare a single-step Income Statement, and a classified Balance Sheet

SUGGESTED SOLUTIONS:

NORMAN RAE LTD.
Income Statement
Month Ended October 31, 2012

Revenues	
Service revenue	\$29,000
Expenses	
Depreciation expense	500
Salaries expense	\$7,000
Office supplies expense	3,500
Rent expense	3,000
Utilities expense	700
Total expenses	<u>14,700</u>
Income before tax	14,300
Income tax expense	<u>4,500</u>
Net income	<u>\$9,800</u>

NORMAN RAE LTD.
Balance Sheet
October 31, 2012

Assets		
Current Assets		
Cash		\$16,000
Accounts receivable		14,000
Office supplies.....		<u>2,800</u>
Total Current Assets:.....		32,800
Office equipment	<u>30,000</u>	
Less: Accumulated depreciation.....	6,000	<u>24,000</u>
Total assets		<u>\$56,800</u>
Liabilities and Shareholders' Equity		
Liabilities		
Accounts payable		\$10,000
Shareholders' equity		
Common shares	\$28,000	
Retained earnings	<u>18,800*</u>	
Total shareholders' equity.....		<u>46,800</u>
Total liabilities and shareholders' equity.....		<u>\$56,800</u>

Ending Retained Earnings = 15,000 + 9,800 – 6,000 = 18,800

Problem 2 (10 marks)

Broadway Limited had an \$800 credit balance in the Allowance for Doubtful Accounts at December 31, 2011, before the current year's provision for uncollectible accounts. An aging of the accounts receivable revealed the following:

		Estimated Percentage Uncollectible
Current Accounts	\$150,000	1%
1-30 days past due	15,000	3%
31-60 days past due	8,000	6%
61-90 days past due	5,000	12%
Over 90 days past due	<u>6,000</u>	30%
Total Accounts Receivable	<u>\$184,000</u>	

Instructions

(a) Prepare the adjusting entry at December 31, 2011, to recognize bad debts expense, assuming Broadway uses the aging method. (4 marks)

(b) Assume the same facts as above except that the Allowance for Doubtful Accounts had an \$800 debit balance before the current year's provision for uncollectible accounts. Prepare the adjusting entry for the current year's bad debts, assuming Broadway uses the aging method. (2 marks)

(c) Broadway sold merchandise to Amy Ward in January 2011 for \$1,000, which is included in the balance over 90 days past due. Prepare journal entries to record the following transactions in January 2012. (4 marks)

January 5
Wrote off as uncollectible the balance of the Amy Ward account when she declared bankruptcy.

January 20
Received a cheque for \$350 from Amy Ward. No further collections are expected.

SUGGESTED SOLUTIONS:

(a) Bad Debts Expense 4,030
 Allowance for Doubtful Accounts (\$4,830 – \$800) 4,030
 (To adjust the allowance account to total estimated uncollectible)

Current	\$150,000 x 1% = \$1,500
1-30 days past due	15,000 x 3% = 450
31-60 days past due	8,000 x 6% = 480
61-90 days past due	5,000 x 12% = 600
Over 90 days past due	6,000 x 30% = <u>1,800</u>
	<u>\$4,830</u>

(b) Bad Debts Expense 5,630
 Allowance for Doubtful Accounts (\$4,830 + \$800) 5,630
 (To adjust the allowance account to total estimated uncollectible)

(c) Journal Entries:
January 5 Allowance for Doubtful Accounts..... 1,000
 Accounts Receivable—A. Ward..... 1,000

January 20 Accounts Receivable—A. Ward 350
 Allowance for Doubtful Accounts 350
 Cash 350
 Accounts Receivable—A. Ward..... 350