

MIDTERM EXAMINATION (REGULAR)  
WINTER 2014

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

**Duration: 3 hours**

**Instructions (very important):**

1. This examination paper consists of **8 pages including this page**. Please make sure your copy has all pages before commencing to write.
2. Make sure that your FULL name (last name first), Student ID and Section Letter are on the three documents: computer input sheet, answer booklet and examination paper.
3. 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.**
4. Read the questions carefully and budget your time wisely.
5. Show all calculations on the examination booklet, and omit narratives for journal entries. Using abbreviated account names, headings, subheadings, totals and subtotals is not recommended, and it may be subject to mark deduction.
6. This is a closed book examination. However, a silent hand-held (not graphical or programmable) calculator and one standard language (not electronic) dictionary are permitted.
7. **Invigilators will not answer questions.** If you think there is an **error** in the question, ask your instructor when he/she visits the exam room.
8. Return the exam along with the computer input sheet and answer booklet(s) when you have finished.

Question	Topic	Total Marks
1	Multiple choice	30
2	Journal entries and financial statement preparations	50
3	Accounting for receivables and bad debts	20
	Total	100

**Question 1 (30 marks; 45 minutes):**

**Multiple Choice**

For each of the following multiple choice question, 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. Which of the following accounts is least likely to appear in an adjusting journal entry?
  - a. Sales Revenue
  - b. Wages payable
  - c. Cash
  - d. Interest expense
  
2. Which of the following is a temporary account:
  - a. Retained earnings
  - b. Deferred revenue
  - c. Accumulated depreciation
  - d. Interest expense
  
3. Which of the following transactions will cause an increase on both sides (left and right) of the basic accounting equation?
  - a. Recording depreciation expense.
  - b. Making payment to a supplier for inventory purchased on account.
  - c. Borrowing money from a bank.
  - d. Purchasing equipment in cash.
  
4. Kam Company Ltd.'s bad debt expense is understated by \$4,000. The effects of this error on the current year's balance of Total Liabilities and Profit, respectively, are:

<u>Total Liabilities</u>	<u>Profit</u>
a. Understated	Overstated
b. Overstated	Understated
c. Understated	Understated
d. No impact	Overstated
  
5. Which of the following statements is incorrect about earnings per share?
  - a. It is required to be disclosed on the income statement.
  - b. It equals Retained Earnings divided by the number of shares outstanding.
  - c. A steady increase in earnings per share is a signal of good management.
  - d. It is used to evaluate a company's profitability.
  
6. An adjustment to a company's reported cash balance is needed if:
  - a. a cheque made to a supplier has not yet been received by its bank.
  - b. its bank has incorrectly recorded a cheque in the company's bank account.
  - c. a notice of a bank service charge is received along with the bank statement.
  - d. a deposit was in transit at the end of the period.
  
7. Rogers Corporation reported the following amounts at the end of its first year of operations, December 31, 2013: contributed capital \$120,000; sales revenue \$480,000; total assets \$400,000; and total liabilities \$250,000. Its total expenses for 2013 would be:
  - a. 150,000
  - b. 130,000
  - c. 360,000
  - d. 450,000

8. On April 1, 2013, Gecko Company borrowed \$48,000 from a local bank at an annual interest rate of 8 percent, and signed a note, payable on April 1, 2014. Interest on this note is also payable at that date. Which of the following amounts should be reported as interest expense related to this note on Gecko's for the year ended December 31, 2013?
- a. \$0.
  - b. \$2,560.
  - c. \$2,880.
  - d. \$3,840.
9. The usefulness of the debt-to-equity ratio is that it allows interested parties to assess
- a. how the company finances its assets.
  - b. the relative risk assumed by the company because of debt financing.
  - c. whether the company should expand its use of debt to finance assets.
  - d. All of the above.
10. Which of the following statements regarding depreciation of a building is incorrect?
- a. As depreciation is recorded, the balance of total assets is reduced.
  - b. Depreciation is an estimated expense to be recorded over the building's estimated useful life.
  - c. As depreciation is recorded, the balance of shareholders' equity is reduced.
  - d. As depreciation is recorded, the balance of total liabilities is increased.
11. Which of the following statements best describes the matching process?
- a. Total assets should equal the sum of total liabilities and shareholders' equity.
  - b. Revenues should be recognized when they are earned, instead of when cash is received.
  - c. Revenue and the expenses that were incurred to earn that revenue should be reported in the same accounting period.
  - d. The total amount of debits should always equal the total amount of credits.
12. Which of the following conditions must exist for an item to be recorded as an asset?
- a. The item is not owned or controlled by the company.
  - b. Future benefits from the item cannot be reliably measured.
  - c. The item must be a tangible asset.
  - d. The item must be expected to provide future benefits.
13. The time it takes for a company to pay cash to suppliers, sell goods and services to customers, and collect cash from customers is called:
- a. Revenue cycle
  - b. Life cycle
  - c. Operating cycle
  - d. Cash cycle
14. Which of the following is not a contra-revenue account?
- a. Credit card discounts
  - b. Sales discounts
  - c. Sales returns and allowances
  - d. Allowance for doubtful accounts

15. Which of the following statements reflects a weak internal control procedure for cash?
- At the end of a business day, the person who handles cash disbursement is allowed to keep no more than \$1,000 cash in his safe.
  - All cash receipts should be deposited in a bank on a daily basis.
  - For payment larger than \$10,000, signatures from two authorized personnel are required.
  - Only one person should handle cash receipts and cash disbursements so as to reduce labour costs and limit access to cash.

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

Outstanding cheques:	\$ 500
Bank service charges	50
Deposits in transit	1,500
Customer note receivable collected by bank	975
Cash balance per bank statement	1,265

Assuming there is no error on bank statement, the cash balance on M&M's book before the reconciliation should be:

- \$1,840.
  - \$1,400.
  - \$1,340.
  - \$1,290.
17. Which of the following statement regarding returns of sales on account is incorrect?
- The sales returns decrease shareholders' equity
  - The sales returns decrease the balance of net sales
  - The sales returns increase cost of goods sold
  - The sales returns decrease the balance of total assets.

18. Accounting information is considered to be relevant when
- it represents the economic conditions and events that it is intended to represent.
  - it is capable of making a difference in a decision.
  - it is understandable by reasonably informed users.
  - it is verifiable and neutral.

19. Master Bakery is specialized in making wedding cakes. Customers are always required to pay a deposit equal to the full purchase price, when they place orders. During the month of September 2013, Master Bakery received \$34,000 in customer deposits. The balance in its Deferred Revenue account was \$14,000 at September 1, 2013 and \$16,000 at September 30, 2013. How much revenue did Master Bakery recognize during the month of September 2013?

- \$30,000
- \$32,000
- \$34,000
- \$36,000

20. The bookkeeper of Giants Co. recorded a cash collection on account by debiting Cash and crediting Trades Payable. As a result of this error,
- The trial balance will still balance.
  - Total liabilities will be overstated on the trial balance.
  - Total assets will be overstated on the trial balance.
  - All statements above are correct.

**Question 2 (50 marks; 90 minutes):*****Journal Entries and Financial Statements***

**Note: There is no penalty for “carry-over” errors. Budget your time wise.**

As at December 1, 2013, Oshawa Ltd.’s trial balance shows the following. The accounts are listed in alphabetical order.

	<u>Debit</u>	<u>Credit</u>
Accumulated depreciation, building		\$22,500
Accumulated depreciation, equipment		11,250
Allowance for doubtful accounts		2,250
Building	\$300,000	
Cash	62,290	
Cost of goods sold	161,250	
Deferred revenue		14,050
Equipment	75,000	
Membership Expense	880	
Merchandise inventory	20,000	
Miscellaneous operating expenses	1,750	
Note receivable, due June 1, 2014	30,000	
Prepaid income taxes	1,300	
Prepaid Membership	80	
Rent expense	13,750	
Retained earnings, Dec. 31, 2012		219,000
Sales returns and allowances	5,500	
Sales revenue		376,250
Share capital (10,000 shares)		250,000
Trade payables		41,250
Trade receivables	125,000	
Wages expense	139,750	
<b>Totals</b>	<b><u>\$ 936,550</u></b>	<b><u>\$ 936,550</u></b>

During the month of December, the following transactions occurred:

Dec. 1: Agreed to rent a warehouse, starting from the same day, for two years. Paid \$12,000 cash in advance for the first year.

Dec. 1: Purchased equipment at a cost of \$45,000; the company paid one third of the cost in cash and signed a note payable in three years for the remaining balance. The annual interest rate on the note payable is 6%.

Dec. 3: Ordered \$500 office supplies.

Dec. 6: Purchased an insurance policy, and made full cash payment of \$3,600 on the same day.  
The insurance policy would cover the company for one year from December 1.

Dec. 12: Sold merchandise for \$30,000 on account. The cost of products sold was \$12,000.

Dec. 16: Paid \$8,000 in salaries to employees who worked for the first half of December.

Dec. 18: Received an order from a client worth \$21,000.

Dec. 23: Received an invoice of \$960 for renewing 2014 membership fees, but decided to pay it  
in early January, 2014.

Below is additional information available to Oshawa's accountants on December 31, 2013, the  
end of Oshawa's fiscal year. No journal entry has been made, however.

- a) Prepaid Membership refers to the membership fee of an institution that Oshawa joined in  
November. Oshawa started its membership on December 1, 2013.
- b) The note receivable was obtained by Oshawa on July 1, 2013 and carries an annual  
interest rate of 4%. The interest is paid to Oshawa at maturity only.
- c) For 2013, depreciation expense of the building was \$7,500, and depreciation expense of  
the equipment (both the old and the newly acquired ones) was \$3,750.
- d) Oshawa's employees get paid bi-weekly on the 1<sup>st</sup> and the 16<sup>th</sup> of every month, for a total  
amount of \$8,000. The next pay day is January 1<sup>st</sup> 2014.
- e) Cash dividends of \$1.75 per share were declared on December 31, 2013 and would be  
paid on January 25, 2014.
- f) The allowance for doubtful accounts must be increased to an amount of \$3,000 based on  
an analysis of trade receivables as at December 31, 2013.
- g) The company is subject to an income tax of 25%. Income taxes are due March 15, 2014.  
(Hint: Complete requirement 3 before making this adjusting entry)

**Required 1:**

Prepare the journal entries needed to record the above transactions that occurred in December,  
2013. If an event does not require a journal entry, please write "No Entry" and explain the reason  
why. Skip a line between entries, and omit narratives. **(9 marks)**

**Required 2:**

Prepare the adjusting journal entries as at December 31, 2013 (**Note, in addition to items (a) to  
(g) above, transactions from Requirement 1 may also need additional adjusting entries**).  
Create new accounts if necessary. Skip a line between entries, and omit narratives.

**(13 marks)**

**Required 3:**

Prepare, in proper form, a multi-step classified income statement for the year ended December 31, 2013. **(11 marks)**

**Required 4:**

Prepare, in proper form, the **Liability and Shareholders' Equity section** (only) of a classified statement of financial position as at December 31, 2013. *A complete statement of financial position is not required.* **(10 marks)**

**Required 5:**

Assume that total assets were \$550,000 as at December 31, 2012. Calculate the following ratios based on your prior answers and briefly explain the meaning of each ratio:

- a. Net profit margin (%)
- b. Total Asset Turnover
- c. Return on Equity (%)

When applicable, round your answer to two decimal places.

**(7 marks)**

**Question 3 (20 marks; 45 minutes):**      *Accounting for receivables and bad debts*

During December 2013, Gateway Inc. had the following transactions:

- a) *December 2*, sold merchandise worth of \$15,000 to Tom, 80% of which were on account.
- b) *December 4*, Tom returned merchandise worth of \$500 – 10% related to cash sales, and 90% related to sales on account.
- c) *December 12*, Tom paid off the purchase made on December 2.
- d) *December 17*, wrote off \$1,000 trade receivables deemed uncollectible.
- e) *December 20*, sold merchandise worth of \$ 5,400 to Danielle. Danielle paid the merchandise on her VISA Credit Card. The Credit Card charge was 3%.
- f) *December 27*, received cash payment of \$600 for trade receivable previously written off.

Additional information

- Credit sales term:                      2/15, n/30.
- Sales Revenue as at November 30, 2013:  
    Cash Sales:                      \$37,000;                      Net Credit Sales:                      \$328,000
- The balance of Trade Receivable  
    As at December 31, 2012:    \$55,000;                      As at November 30, 2013:    \$51,000.
- Estimated uncollectible rate applicable to all receivables, regardless of the age:  
    As at December 31, 2012:    3.0%;                      As at December 31, 2013:    3.5%.

**Required 1:**

Prepare journal entries for transactions a) to f), above. **(6 marks)**

**Required 2:**

What is the amount of bad debt expense should Gateway record at the fiscal year-end, December 31, 2013? Show your calculations. **(4 marks)**

**Required 3:**

Calculate the trade receivable turnover ratio for 2013 (round your answer to two decimal places). What does your result suggest about Gateway's ability to manage trade receivable during 2013? Be specific. **(5 marks)**

**Required 4:**

Assume, starting from 2013, Gateway follows the *Percentage of Credit Sales* method to determine bad debt expense. Based on past experience, Gateway estimates the bad debt rate to be 1% of net credit sales. Show, in proper form, how trade receivable would be presented on the company's Statement of Financial Position as at December 31, 2013. **(5 marks)**