

MIDTERM EXAMINATION (REGULAR)
WINTER 2013

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	24
2	Preparation of journal entries	13
3	Preparation of adjusting entries, financial statements, and selected calculations	41
4	Accounting for receivables and bad debts	22
	Total	100

Question 1 (24 marks; 40 minutes)***Multiple choice***

1. A company makes an adjusting entry to reduce a liability. This adjustment would:
 - A. decrease an asset account by the same amount.
 - B. increase an expense account by the same amount.
 - C. increase a revenue account by the same amount.
 - D. decrease a liability account by the same amount.

2. On October 31, 2012, BBB Inc.'s cash account had a balance of \$16,451.03. After reviewing the bank statement, BBB found it had three outstanding cheques totalling \$5,643.01. Its bank account was credited for \$12.19 of interest earned on the account balance, and it was charged \$9.00 of service fees. BBB's bank statement dated October 31, 2012 would report a balance of:

A. \$ 22,090.85. B. \$ 10,811.21. C. \$ 22,097.23. D. \$ 16,454.22.

3. Atlantic Inc. reported the following amounts at the end of its first year of operations, December 31, 2012: share capital \$120,000; sales revenue \$400,000; total assets \$340,000; dividends \$20,000; and total liabilities \$200,000. Its total expenses for 2012 would be:

A. \$340,000. B. \$320,000. C. \$ 300,000. D. \$360,000.

4. Company A has a receivables turnover ratio of 5.6 in 2012, which is lower than in 2011. Company B has a receivables turnover ratio of 11.3 in 2012, which is higher than in 2011. All other things equal:
 - A. Company A appears to better manage its receivables than Company B.
 - B. In 2012, Company A has a lower average collection period than Company B.
 - C. Company B appears to better manage its receivables than Company A.
 - D. Company B's average collection period is rising.

5. Which of the following transactions does not involve an accrual?
 - A. Recording interest earned that will be received in the next period.
 - B. Recording operating expense incurred but not yet paid.
 - C. Recording salary expense incurred but not yet paid.
 - D. Recording the pre-payment of two years' worth of insurance.

6. Mackie Company provided \$25,500 of services on account, and collected \$18,000 from customers during the year. The company also incurred \$17,000 of expenses on account, and paid \$15,400 to suppliers for goods and services. As a result of these events:
 - A. Total assets would increase
 - B. Total liabilities would increase
 - C. Total equity would increase
 - D. All the elements of the accounting equation would increase.

7. The operating activities section is often believed to be the most important part of a statement of cash flows because?

- A. it gives the most information about how operations have been financed.
- B. it shows the dividends that have been paid to shareholders.
- C. it indicates a company's ability to generate cash from sales to meet current cash needs.
- D. it shows the net increase or decrease in cash during the period.

8. The omission of preparing an adjusting entry to record depreciation expense at the end of the period will cause:

- A. an overstatement of expenses.
- B. an overstatement of revenues.
- C. an overstatement of liabilities.
- D. an overstatement of assets.

9. Which of the following procedures is not consistent with good control of cash receipts?

- A. Assignment of cash custody and reconciliation to the same individual.
- B. Separate responsibilities for cash-handling and cash-recording functions
- C. Assignment of responsibilities to ensure a continuous and uninterrupted flow of cash from initial receipt to deposit in a bank account
- D. Continuous and close supervision of all cash-handling and cash-recording functions

10. Which of the following businesses would most likely report a deferred revenue account on its' statement of financial position?

- | | |
|---------------------------------------|---------------------------|
| A. Coffee shop | B. Women's clothing store |
| C. Manufacturer of computer equipment | D. Airline |

11. Which of the following statements is true about assets?

- A. They are the properties or economic resources owned by the business.
- B. They are available to provide future benefits to the business.
- C. They are generally classified into current assets and non-current assets.
- D. All of these statements are correct.

12. Examples of internal transactions include all of the following except:

- A. writing off an uncollectible account.
- B. recording the expiration of prepaid insurance.
- C. recording unpaid wages.
- D. paying wages to company employees.

13. Permanent accounts would not include:

- | | |
|----------------------|-----------------------|
| A. Interest expense. | B. Wages payable. |
| C. Prepaid rent. | D. Deferred revenues. |

14. Corporations provide shareholders with quarterly and annual financial statements. This is an example of the following concept:

- A. Going Concern
- B. Monetary Unit.
- C. Periodicity
- D. Relevance

15. On November 1, 2012, Tim's Toys borrows \$30,000,000 at 9% to finance the holiday sales season. The note is for a six-month term and both principal and interest are payable at maturity. What should be the balance of interest payable for the loan as at December 31, 2012?

- A. \$ 112,500.
- B. \$ 225,000.
- C. \$ 450,000.
- D. \$1,350,000.

16. Which of the following statements is correct?

- A. Adjusting entries to decrease prepaid expenses involve previously recorded assets.
- B. Adjusting entries to record accrued revenues involve assets that have not yet been recorded.
- C. Adjusting entries to decrease deferred revenues involve previously recorded liabilities.
- D. All of these statements are correct.

Question 2 (13 marks; 24 minutes): *Preparation of journal entries*

Megalo Corporation uses accrual accounting to record revenues and expenses. During September 2012, Megalo had the following transactions during September 2012:

- a. Sold goods to Tina who charged the purchase price, \$8,000, on her Visa Card; Visa charges a 2% fee.
- b. Wrote-off a customer's account balance of \$7,200.
- c. Paid employee wages of \$1,200. Of this amount, \$200 had been earned and recorded in the prior month.
- d. Negotiated a contract to deliver \$40,000 of goods to Tom by December 2012. Tom gave Megalo an advance deposit of \$12,000 in September 2012.
- e. Paid Sherbrooke Inc., Megalo's main supplier, \$20,000 for a purchase made in August.
- f. Purchased machinery to be used in the business at a cost of \$30,000. One third was paid in cash; the company signed a note for the balance, payable in three years, with an annual interest rate of 12%.
- g. Purchased a two-year insurance plan which became effective starting from October 1, 2012. The annual insurance premium costs are \$3,500.
- h. Received an order from Wolverine Corp. worth \$10,000.
- i. A cheque of \$400 from Philip Rivers, a customer of Megalo was returned from the bank and marked NSF (Not Sufficient Funds). Megalo was also charged a service fee of \$5 because of this returned cheque.
- j. Issued 50,000 shares to three investors who contributed a total amount of \$40,000 in cash, as well as a piece of land valued at \$10,000.

Required:

Prepare journal entries in the proper format for the above transactions. *Please skip a line between journal entries and omit narratives.* If the event does not require a transaction, indicate “no transaction required” and briefly explain the reason.

Question 3 (41 marks; 72minutes): *Preparation of adjusting entries, financial statements, and selected calculations.*

Xavier Ltd. sells widgets. Xavier's inexperienced bookkeeper has supplied you with the following list of accounts and their unadjusted balances as at October 31, 2012 -- the company's fiscal yearend. Each account has a "normal" debit or credit balance, as the term is defined in the textbook.

Accumulated depreciation – building	\$121,875
Accumulated depreciation – equipment.....	43,500
Allowance for doubtful accounts.....	14,000
Building, at cost.....	700,000
Cash.....	90,000
Common shares (20,000 shares outstanding)....	600,000
Cost of goods sold.....	980,000
Deferred rent revenue.....	8,400
Equipment, at cost.....	150,000
General and administrative expenses	424,000
Interest expense.....	20,000
Land, at cost.....	460,000
Merchandise inventory.....	33,375
Note payable, due December 1, 2013.....	400,000
Prepaid insurance.....	21,000
Retained earnings, October 31, 2011.....	120,000
Sales revenue.....	2,000,000
Sales returns and allowances.....	20,000
Selling expenses.....	130,000
Trade receivables.....	302,000
Trade payables.....	22,600

You have obtained the following information for adjustment purposes.

- Buildings are depreciated over 40 years on a straight-line basis with salvage value of \$50,000. Equipment is depreciated over 20 years on a straight-line basis with salvage value of \$5,000. The bookkeeper did not record any depreciation in fiscal year 2012.
- Dividends of 7 cents (\$0.07) per common share were declared on October 31, 2012 (payable on November 20, 2012). The bookkeeper did not record the dividend.

- c) The balance in the prepaid insurance account represents the cost of a new policy covering the period June 1, 2012 to May 31, 2013.
- d) Interest on the note payable, at an annual rate of 6 %, is due on the first of each month. The company has always made interest payments on time, including on October 1, 2012.
- e) The company leases a very small part of its building to a tenant in an unrelated field of business. The balance in the deferred rent revenue account represents the payment for rent covering the period May 1, 2012 to November 30, 2012.
- f) The company uses the percentage of credit sales to estimate bad debts. Although the bookkeeper knew that 90% of sales were on credit and that the bad debt rate was 1% of net credit sales, he did not make the adjusting entry. In fiscal year 2012, all sales returns and allowances are related to cash sales only.
- g) The company is subject to an income tax rate of 20%.

Required

Note 1: Show all calculations when necessary.

Note 2: This entire problem can be solved -- there is no "missing" information.

1. Prepare in proper form the adjusting journal entries for items (a) to (g) above. Establish new accounts, as needed. Please skip a line between journal entries. Narratives are not required. (Hint: it may be helpful to use T-accounts for the accounts affected by the adjusting entries.)

(11.5 marks)

2. Prepare in proper form a classified ("multi-step") income statement for fiscal year 2012.

(10 marks)

3. Prepare in proper form the **Liabilities and Shareholders' Equity section ONLY** of the classified statement of financial position (balance sheet) as at October 31, 2012.

(8 marks)

4. Prepare in proper form the closing entries as at October 31, 2012. Please skip a line between journal entries. Narratives are not required.

(4 marks)

5. What is the age, to the nearest month, of the building as at October 31, 2012? **(1.5 marks)**

6. Xavier's accounting records indicate that its total liabilities at the end of fiscal year 2012 were \$100,000 higher compared to the end of fiscal year 2011. Also, no common shares were issued or repurchased during fiscal year 2012. Using the financial statements you prepared, calculate the following ratios for fiscal year 2012. Briefly explain and comment in each case.

(6 marks)

- a) Debt-to-equity ratio.
- b) Return on assets ratio.

Question 4 (22 marks; 44 minutes) *Accounting for receivables and bad debts*

B3O Inc. sells high-performance commercial ovens at \$6,000 per unit. Ovens are sold either for cash or on account with terms 1/10, n/30. The following transactions occurred during the quarter ended December 31, 2012.

- (a) Oct. 5: Collected \$75,000 cash from customers for credit sales made in earlier quarters.
- (b) Oct. 11: Sold 12 ovens to Goldilocks Ltd. on account.
- (c) Oct. 14: Sold 6 ovens to H&G Co. on account.
- (d) Oct. 16: Goldilocks paid for its ovens in full.
- (e) Oct. 25: Sold 8 ovens to CMC Corp. on account.
- (f) Nov. 27: H&G returned an oven and paid the rest of its account in full.
- (g) Dec. 14: Sold 5 ovens to SCA Inc. on account.
- (h) Dec. 16: After reviewing the trade receivables and deciding that it would never be collected, B3O wrote off an old account for \$13,000 from the previous quarter.
- (i) Dec. 29: Recovered \$1,000 from the receivables that were written off on December 16.

B3O's records show the following account balances at these dates:

	<u>Sept. 30, 2012</u>	<u>Dec. 31, 2011</u>
Trade receivables.....	\$111,000	\$100,000
Allowance for doubtful accounts (credit balance).....	16,000	10,000
Cash sales.....	300,000	400,000
Net Credit sales	500,000	600,000

Required

1. Prepare the journal entries to record transactions (b), (c), (d), (f), (h), and (i). Note: Do not prepare journal entries to record cost of sales.

(8.5 marks)

2. The Company uses the Aging of Trade Receivables method to determine the amount of bad debt expense. The estimated uncollectible rates for the various age groups are:

	<u>Age of trade receivables</u>			
	<u>Not yet due</u>	<u>1-30 days past due</u>	<u>31-60 days past due</u>	<u>Over 60 days past due</u>
Estimated % uncollectible	1%	5%	10%	20%

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, 2012. Show your calculations.

(6.5 marks)

3. Assume for this part only that B3O uses the *Percentage of Credit Sales* method to determine bad debt expense. Based on past experience, B3O estimated the bad debt rate to be 2% of net credit sales. Determine the amount of bad debt expense for 2012. Round your answer to the nearest dollar. A journal entry is not required. **(2.5 marks)**

4. B3O's Trade Receivables and Allowance for Doubtful Accounts have a balance of \$88,000 and \$8,000 respectively on January 1, 2011. Calculate B3O's Trade Receivables Turnover ratio for 2011 and 2012, and comment on B3O's management of trade receivables in 2012. Round your calculation to two decimal places. **(4.5 marks)**