

CONCORDIA UNIVERSITY
DEPARTMENT OF ACCOUNTANCY

FINANCIAL ACCOUNTING
COMM 217 ALL SECTIONS

MID-TERM EXAMINATION
Fall 2011

Duration: 3 hours

Name: _____

Instructions:

1. This examination paper consists of **8 pages** including this page. Please make sure your paper has all pages before commencing to write.
2. 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.**
3. Read the questions carefully and budget your time wisely.
4. This is a closed book examination. However, a silent hand-held (not graphical) calculator and one standard language (not electronic) dictionary are permitted.
5. Show your calculations on the examination booklet.
6. **Invigilators will not answer questions** (unless you think there is an **error** in the question).
7. Return the exam along with the computer input sheet and answer booklets when you have finished. Write your name on both the examination paper and the examination booklet.

Question	Topic	Total Marks
1	Multiple choice	21
2	Preparation of journal entries	16
3	Preparation of adjusting entries, income statement and statement of financial position	28
4	Accounting for receivables and bad debts	20
5	Accounting for inventory and cost of sales	15
	Total	100

QUESTION 1 (21 marks; 38 minutes)**Multiple choice**

For each of the following, 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. XYZ Company showed total assets of \$150,000 and total liabilities of \$60,000 as at December 31, 2010. During 2011, if total assets increased by \$60,500 and total liabilities decreased by \$42,000, then shareholders' equity
 - a. increased by \$60,500.
 - b. increased by \$18,500.
 - c. increased by \$102,500.
 - d. cannot be determined from the given information.

2. Current assets are listed on a statement of financial position
 - a. by order of liquidity.
 - b. by size, with smaller amounts shown before larger amounts.
 - c. by alphabetical order.
 - d. in any order the accountant chooses.

3. 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.

4. Which account is least likely to appear in an adjusting journal entry?
 - a. Cash
 - b. Property Tax Expense
 - c. Interest Receivable
 - d. Salaries Payable

5. Which of the following statements regarding depreciation of a building is **incorrect**?
 - a. Depreciation represents the decline in the value of the building over time.
 - b. Depreciation is an estimated expense to be recorded over the building's estimated useful life.
 - c. As depreciation is recorded, shareholders' equity is reduced.
 - d. As depreciation is recorded, assets are reduced.

6. Which of the following statements best describes the **matching process**?
 - a. Total assets should equal total liabilities and shareholders' equity.
 - b. Revenues should be recognized when they are earned and realized.
 - c. Revenue and the expenses that were incurred to earn that revenue should be reported in the same accounting period.
 - d. Debits should always be equal to credits.

7. Which of the following statements is true?
 - a. Only permanent accounts are closed at the end of the accounting period.
 - b. Only temporary accounts are closed at the end of the accounting period.
 - c. All accounts are closed at the end of the accounting period.
 - d. Only the retained earnings account is closed at the end of the accounting period.

8. A good system of internal control for cash should include a number of procedures that would facilitate the discovery of mishandling of cash by employees. Which of the following statements reflects a weak internal control procedure?
- All cash receipts should be deposited in a bank on a daily basis.
 - All major disbursements should be made by issuing serially numbered cheques.
 - Only one person should handle cash receipts and cash disbursements so as to reduce labour costs and limit access to cash.
 - The function of receiving cash should be separated from the function of disbursing cash.

9. The cash records and the bank statement of Mezza Company showed the following at the end of September 2011:

Outstanding cheques, August 31, 2011	\$ 8,000
Cheques written by Mezza Company during September 2011	50,000
Cheques cleared by the bank during September 2011	54,000

Therefore, the amount of outstanding cheques at the end of September 2011 should be

- \$2,000.
 - \$4,000.
 - \$6,000.
 - \$8,000.
10. The primary reason for establishing an allowance account (rather than writing off uncollectible accounts to bad debt expense) is that the allowance method:
- conforms to the matching process.
 - ensures that overdue trade receivables are not overlooked.
 - results in more accurate reporting of revenues on the income statement.
 - simplifies the bookkeeping effort.
11. In 2011, Cyros Corp. reported net sales revenues of \$18,800 and cost of goods sold of \$5,600 while Qing Ltd. reported net sales revenue of \$22,300 and cost of goods sold of \$9,300. Which of the following statements is correct?
- Qing Ltd. did a better job of controlling product costs as a percentage of sales than did Cyros Corp. as evidenced by its gross profit of \$13,000.
 - Cyros Corp. generated a lower gross profit percentage than Qing Ltd. because its sales revenue was lower than Qing's.
 - Qing Ltd. generated more revenue than Cyros Corp., but it has a lower gross profit percentage.
 - None of these statements is correct.
12. Which of the following statements is true about earnings per share?
- It is the only ratio required to be disclosed on the income statement.
 - It assesses the ability of the firm to pay its bills as they come due.
 - It evaluates the efficiency with which the company uses its assets to generate sales revenue.
 - None of the statements is true.

13. Which of the following determines when revenues and expenses should be recorded under accrual accounting?
- the revenue principle and the matching process
 - relevance and representational faithfulness.
 - the cost principle and the matching process
 - the revenue principle and the periodicity assumption.
14. If the inventory at the end of 2010 is understated and the error is never detected, what would be the effect on the 2010 and 2011 financial statements, respectively?
- Profit will be overstated in 2010 and understated in 2011.
 - Profit will be understated in 2010 and overstated in 2011.
 - Retained earnings will be understated at the end of 2010 and overstated at the end of 2011.
 - Cost of goods sold will be overstated in 2010 but will not be affected in 2011.

QUESTION 2 (16 marks; 29 minutes) *Preparation of journal entries*

Trevor Yardhagi opened a legal practice on January 1, 2011. During the first months of operations, the following transactions occurred (ignore income taxes):

- Purchased computer equipment on January 1 for \$8,400, paying \$2,000 in cash and signing a one-year note for \$6,400, payable on January 1, 2012. Interest on the note is \$600, payable also on January 1, 2012. The equipment depreciation is \$350 per month.
- Purchased a one-year malpractice insurance policy on January 1 for \$12,000 cash. Coverage of the insurance policy started on that date.
- Purchased \$3,800 of office supplies on credit. On January 31, it was determined that \$500 of supplies had not been used.
- Trevor is a member of the Law Society and is required to pay annual membership fees of \$720. He received the invoice from the Law Society on January 31 and will pay the full amount in February 2011. The membership period coincides with the calendar year.
- Performed services for clients represented by insurance companies. At January 31, \$6,000 of such services were earned but not yet billed to the insurance companies.

Required:

- Prepare in proper format the journal entries needed to record the transactions that occurred in January 2011 as well as any adjustments to the accounts as at January 31, 2011. Label your adjusting journal entries beginning with the letter "F". If an event does not require a journal entry, explain the reason. *Please skip a line between journal entries, and omit narratives.* Also omit closing entries. **(11.5 marks)**
- Show the effects of each of the journal entries (including adjusting entries) you recorded in requirement 1 on profit and total assets, respectively (+ for increase, – for decrease, and 0 for no effect). Use the following format:

<u>Transaction/Journal Entry</u>	<u>Effect on Profit</u>	<u>Effect on Total Assets</u>	(4.5 marks)
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QUESTION 3 (28 marks; 50 minutes) *Preparation of adjusting journal entries and financial statements*

LTU Inc. provides you with the following unadjusted trial balance as at December 31, 2010. The accounts are listed in alphabetic order.

	<u>Debit</u>	<u>Credit</u>
Accumulated depreciation, equipment		\$ 4,500
Allowance for doubtful accounts		900
Cash	\$ 5,300	
Cost of goods sold	64,500	
Deferred revenue		5,620
Equipment, at cost	30,000	
Merchandise inventory	8,000	
Miscellaneous operating expenses	700	
Note receivable, due December 31, 2011	12,000	
Prepaid income taxes	520	
Prepaid rent	8,400	
Rent expense	5,500	
Retained earnings, December 31, 2009		35,000
Sales returns and allowances	2,200	
Sales revenue		150,500
Share capital (15,000 shares)		30,000
Trade payables		16,500
Trade receivables	50,000	
Wages expense	55,900	
Totals	<u>\$243,020</u>	<u>\$243,020</u>

Assume that total assets were \$100,000 as at December 31, 2009 and that no shares were issued or redeemed (repurchased) during 2010. Also assume that the company uses a perpetual inventory system.

Information required for adjustment purposes:

- As at December 31, 2010, \$4,000 of wages was owed to employees. No entry has been made for the unpaid wages.
- The note receivable was obtained by LTU on September 1, 2010. The note carries a 5% annual interest rate, payable to LTU at maturity only. No entry has been made for interest.
- The balance in Prepaid rent represents the payment for twelve months' rent beginning August 1, 2010.
- The equipment has a useful life of twenty years, with no residual value. The bookkeeper did not record the depreciation for 2010. Assume that straight-line depreciation is used.
- Cash dividends of 50 cents per share were declared on December 31, 2010, and will be paid on January 25, 2011. The bookkeeper did not record the dividend.
- The allowance for doubtful accounts must be increased to an amount of \$1,200 based on an aged analysis of trade receivables as at December 31, 2010. The bookkeeper did not adjust the accounts.
- The company is subject to an income tax rate of 20%. Income taxes are due March 15, 2011. (*Hint: complete required 2 before making this adjusting entry.*)

Required:

1. Prepare in proper form the adjusting journal entries as at December 31, 2010 for items (a) to (g) above. Create new accounts, if necessary. Also omit narratives for the adjusting journal entries, and skip a line between journal entries. Omit closing entries, too. **(10 marks)**
2. Prepare in proper form a multi-step (classified) income statement for the year ended December 31, 2010. **(8 marks)**
3. Prepare in proper form the **Assets section (only)** of a classified statement of financial position as at December 31, 2010. *A complete statement of financial position is not required.* **(5 marks)**
4. How much is the approximate remaining life of the equipment as at December 31, 2010? **(1 mark)**
5. Calculate the following ratios based on your answers to requirements 2 and 3, and briefly explain the meaning of each ratio:
 - Net profit margin ratio
 - Total asset turnover ratio **(4 marks)**

QUESTION 4 (20 marks; 36 minutes)*Accounting for receivables and bad debts*

The following events occurred at Pete Boilermaker Inc. (hereafter, Pete) from October 1 to December 31, 2011.

- (a) Oct. 10: Anthony, Inc. called Pete and placed an order to purchase 15 boilers.
- (b) Oct. 30: Pete sold 15 boilers to Bianca Corp. on credit.
- (c) Nov. 1: The purchasing manager of Anthony, Inc. visited Pete and purchased 12 boilers instead of the 15 boilers that were previously ordered.
- (d) Nov. 5: Bianca Corp. paid for the boilers purchased on October 30 in full.
- (e) Nov. 7: Pete sold 10 boilers to Cheng Ltd. on credit.
- (f) Nov. 15: Anthony, Inc. returned two defective boilers, and paid the amount due to Pete.
- (g) Dec. 1: Cheng Ltd. paid \$80,000 to Pete on account.
- (h) Dec. 5: After a thorough review of its trade receivables, Pete determined that receivables totalling \$12,000 were not collectible. These receivables relate to sales made prior to October 1, 2011. A write-off was recorded on the same day.
- (i) Dec. 30: Pete recovered \$3,000 from the receivables that were written off on December 5.

Additional Information:

- Pete sold all boilers at \$10,000 per unit.
- All of Pete's sales were on credit with terms 3/10, n/30.
- Pete's records included the following items and their balances as at September 30, 2011:

Trade receivables.....	\$ 60,000
Allowance of doubtful accounts (credit balance).....	15,000
Net sales.....	600,000

- Pete had not yet recorded any amount for bad debt expense in 2011.
- Pete uses the periodic inventory method.

Required:

1. Prepare the journal entries to record the transactions in (d), (f), (h), and (i). **(6 marks)**
2. Pete uses the *Aging of Trade Receivables* method to determine the amount of bad debt expense according to the following schedule:

	Estimated Uncollectible Rate
Not yet due.....	5%
1-30 days past due	10%
31-60 days past due	15%
More than 60 days overdue	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, 2011. Show your calculations. (Hint: You may wish to use a time line to keep track of trade receivables in order to determine the age of these receivables.) **(6 marks)**

3. Assume for this part only that Pete uses the *Percentage of Credit Sales* method to determine bad debt expense. Based on past experience, Pete estimated the bad debt rate to be 1% of net credit sales. Determine the amount of bad debt expense for 2011. A journal entry is not required. **(3 marks)**
 4. Pete's *Net Trade Receivables* were \$62,000 at December 31, 2010. Calculate Pete's *Average Collection Period* for the year of 2011 and explain what it means. Assume that Pete uses the *Aging of Trade Receivables* method for this requirement. **(3 marks)**
 5. Evaluate Pete's *Average Collection Period* knowing that two major competitors, Spartans Corp. and Hossiers Ltd. reported average collection periods of 20.3 days and 30.7 days, respectively for 2011. **(2 marks)**
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QUESTION 5 (15 marks; 27 minutes)*Accounting for inventory and cost of sales*

Yuki Company sells school supplies, including backpacks. It reported the following information related to purchases and sales of backpacks for the first quarter of 2011:

		<u>Units</u>	<u>Unit Cost</u>
January 1:	Beginning inventory	100	\$7
January 18:	Purchase	700	10
January 30:	Sale (at \$15 per unit)	400	
February 23:	Purchase	200	12
March 24:	Sale (at \$20 per unit)	400	

All purchase and sale transactions are on account. The company uses a periodic inventory system and the FIFO inventory costing method. Round your calculations to two decimal places.

Required:

1. Calculate the cost of ending inventory, cost of goods sold, and gross profit for the quarter ending March 31, 2011. An income statement, or portion thereof, is not required. **(4 marks)**
2. Prepare the journal entries to record the transactions that occurred on January 18 and January 30. **(3 marks)**
3. If the company determines on March 31 that the net realizable value of its inventory is \$11 per unit, what journal entry should it record on that date? If no entry is needed, explain why. **(2 marks)**
4. Would the Company's gross profit increase or decrease if it used the weighted-average cost method instead of FIFO. You simply need to explain the direction of the change in gross profit. No calculations are required. **(2 marks)**
5. If the Company used a perpetual inventory system and the weighted-average cost method, what would be the cost of the 400 units sold on March 24? Show your detailed calculations. A journal entry is not required. **(4 marks)**