

MIDTERM EXAMINATION (REGULAR)
FALL 2014

Name: _____ ID: _____ Section: _____

Duration: 3 hours

Instructions (very important):

1. This examination paper consists of **7 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	21
2	Journal Entries and Financial Statement Preparation	42
3	Accounting for Receivables and Bad Debt Expense	21
4	Accounting for Inventories and Cost of Sales	16
Total		100

Question 1 (21 marks; 38 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 would appear in a closing entry?
 - a. Salaries Payable
 - b. Trade Accounts Receivable
 - c. Retained Earnings
 - d. Accumulated Depreciation
2. On June 1, 2013, Windall Inc. signed a note for \$10,000, payable in three years. Annual interest of 9 percent is payable on June 1 of each year, beginning in 2014. What amount of interest expense should be reported on Windall's statement of earnings for its fiscal year ended December 31, 2014?
 - a. \$900
 - b. \$1,350
 - c. \$450
 - d. \$2,700
3. Failure to make an adjusting entry to recognize accrued salaries payable would cause the following:
 - a. An understatement of expenses, liabilities, and shareholders' equity.
 - b. An overstatement of shareholders' equity, and an understatement of both expenses and liabilities.
 - c. An overstatement of both assets and shareholders' equity.
 - d. An overstatement of both assets and liabilities.
4. Bianca Corp. reduced its selling and administrative expenses while maintaining sales volume and the sales price of its products. How will this affect the net profit margin ratio?
 - a. The ratio will decrease.
 - b. The ratio will not change.
 - c. The ratio will increase.
 - d. The ratio will either increase or decrease depending on the amount of the reduction in the selling and administrative expenses.
5. The dual effects concept can best be described as follows:
 - a. Recording a transaction in the accounting system will have at least two effects on the basic accounting equation.
 - b. When an exchange takes place between two parties, both parties must record the transaction.
 - c. When a transaction is recorded, both the statement of financial position and the statement of earnings will be affected.
 - d. When a transaction is recorded, one account will always increase and one account will always decrease.
6. When using the allowance method, as bad debt expense is recorded,
 - a. Total assets remain the same and shareholders' equity remains the same.
 - b. Total assets decrease and shareholders' equity decreases.
 - c. Total assets increase and shareholders' equity decreases.
 - d. Total liabilities increase and shareholders' equity decreases.
7. The inventory costing method selected by a company will affect
 - a. The statement of financial position.
 - b. The statement of earnings.
 - c. The statement of retained earnings.
 - d. All of the above.

8. Which of the following is *not* a financing activity on the statement of cash flows?
 - a. Lending money to a shareholder.
 - b. Borrowing money from a local bank.
 - c. Paying dividends to shareholders.
 - d. Issuing shares to shareholders.

9. If a company reported the following items on its statement of earnings (cost of sales \$100,000, income tax expense \$40,000, interest expense \$10,000, operating expenses \$70,000, sales revenue \$280,000), what amount would be reported for the subtotal “earnings from operations”?
 - a. \$180,000
 - b. \$60,000
 - c. \$100,000
 - d. \$110,000

10. Bueno Corp. reported gross sales of \$500,000, one-half of which were sales on account. Customers used their credit cards to pay for \$200,000 of sales. The credit card company charges 3% for payments made by a credit card. Sales on account for \$30,000 were returned to Bueno Corp., and sales discounts of 2% were taken on the net credit sales. What is the amount of net sales?
 - a. \$454,000
 - b. \$460,600
 - c. \$459,600
 - d. \$459,000

11. Which of the following would normally **not** be found in the notes to the financial statements?
 - a. Accounting rules applied in the company’s financial statements.
 - b. A description of the company’s products and services.
 - c. Additional detail supporting numbers reported in the company’s financial statements.
 - d. Relevant financial information not presented in the company’s financial statements.

12. At the end of a recent year, The Gap, Inc., reported total assets of \$7,564 million, current assets of \$4,005 million, total liabilities of \$3,177 million, current liabilities of \$2,158 million, and shareholders’ equity of \$4,387 million. What is its current ratio and what does this suggest about the company?
 - a. The ratio of 2.38 suggests that The Gap has liquidity problems.
 - b. The ratio of 1.86 suggests that The Gap has sufficient liquidity.
 - c. The ratio of 2.38 suggests that The Gap has greater current assets than current liabilities.
 - d. The ratio of 1.86 suggests that The Gap is not able to pay its short-term obligations with current assets.

13. Which of the following statements are true regarding the statement of financial position?
 1. One cannot determine the true fair market value of a company by reviewing its statement of financial position.
 2. Certain internally generated assets, such as a trademark, are not reported on a company’s statement of financial position.
 3. A statement of financial position shows only the ending balances, in a summarized format, of all statement of financial position accounts in the accounting system as of a particular date.
 - a. None of these statements is true.
 - b. Statements 1 and 2 only are true.
 - c. Statements 2 and 3 only are true.
 - d. All statements are true.

14. Upon review of the most recent bank statement, you discover that you recently received a “not sufficient funds” cheque from a customer. Which of the following describes the actions to be taken when preparing your bank reconciliation?

	Balance per Books	Balance per Bank Statement
a.	No change	Decrease
b.	Decrease	Increase
c.	Decrease	No change
d.	Increase	Decrease

QUESTION 2 (42 marks; 75 minutes): *Journal Entries and Financial Statement Preparation*

The Green Glass Corp. is a local company that sells a wide variety of imported glass products. The Company’s unadjusted trial balance at December 30, 2013 is presented below. The accounts below are listed in alphabetic order, and each account has a "normal" debit or credit balance, as the term is defined in the textbook. The Company’s fiscal year ends on December 31.

Accounts	Balance (\$)
Accumulated depreciation	24,000
Allowance for doubtful accounts (credit balance)	400
Cash	33,600
Common shares (<i>11,610 shares issued and outstanding</i>)	116,100
Cost of sales	86,400
Deferred revenue	14,700
Insurance expense	4,900
Interest receivable	2,500
Loss on sale of trucks	2,960
Merchandise inventory	56,600
Miscellaneous expenses	390
Notes payable (<i>8%, due on September 30, 2019</i>)	37,000
Notes receivable (<i>10%, due on March 1, 2015</i>)	30,000
Prepaid insurance	9,000
Rent expense	17,800
Retained earnings	27,200
Sales revenue	156,450
Supplies on hand	6,000
Trade payables	10,000
Trade receivables	32,700
Trucks	70,000
Wages expense	33,000

Green Glass had the following transactions on December 31:

1. Paid \$12,000 to its supplier, of which \$2,000 was for merchandise received on that day and \$10,000 was for merchandise received on December 1, 2013.
2. Discovered that it recorded cheque #23 as \$390 miscellaneous expense, but the correct amount that cleared the bank account was \$930.
3. Declared dividends of \$0.30 per share, payable on January 15, 2014.
4. Hired a new employee to start working on January 1, 2014. The employee will be paid an annual salary of \$30,000.

Below is additional information available to you at December 31, 2013.

- a) The balance in prepaid insurance represents the cost of a one-year insurance policy purchased on August 1. The policy was effective on that date.
- b) The company currently owns two trucks, including a new truck purchased on July 1, 2013. The annual depreciation for each truck is estimated to be \$4,000 per year.
- c) The Company delivered all the merchandise for which customers paid in advance. Green Glass uses a perpetual inventory system and its gross profit percentage on the merchandise delivered was 40 percent.
- d) A cheque received from a customer for \$156 on November 28 did not appear on the bank statement at November 30, 2013.
- e) Workers are paid \$1,500 at the end of two weeks of work; the next pay-day is on January 7, 2014.
- f) The allowance for doubtful accounts must be adjusted to an amount of \$3,000 based on an analysis of trade receivables as at December 31, 2013.
- g) Green Glass signed on September 30, 2013 a note, payable in six years. The note and interest at 8% will be paid at maturity.
- h) A 3-year note receivable was issued on March 1, 2012, and has an interest rate of 10% per year. Interest on the note will be received at maturity.
- i) A physical count of the supplies on hand on December 31 indicated that \$3,000 worth of supplies had not been used.

Required

1. Prepare journal entries to record the transactions that occurred on December 31, 2013. If an event does not require a journal entry, state "No entry" and provide an explanation. **(5 marks)**
2. Prepare all adjusting journal entries at December 31, 2013. If an event does not require a journal entry, state "No entry" and provide an explanation. **(13 marks)**
3. Prepare, in proper form, a multi-step statement of earnings for the year ended on December 31, 2013. The company is subject to a 30% income tax rate. Income tax will be paid in January 2014. **(13 marks)**
4. Prepare, in proper form, the **Assets** section (only) of a classified statement of financial position as at December 31, 2013. **(11 marks)**

QUESTION 3 (21 marks; 38 minutes): *Accounting for Receivables and Bad Debts Expense*

This problem consists of two (2) independent parts. Show details of all calculations.

Part A

The December 31, 2012 statement of financial position of Howson Limited reported Trade Accounts Receivable of \$450,000 and a credit balance in Allowance for Doubtful Accounts of \$45,000. During 2013, the following transactions occurred:

- Service revenue billed on account, \$1,500,000 (terms, net/60)
- Collections from customers, \$1,300,000
- Accounts written off as uncollectible, \$37,000
- Collection of accounts previously written off, \$4,000.

Required

1. Record the 2013 transactions in journal entry form. **(5 marks)**
2. The company uses the aging of receivables method to estimate bad debts expense and determined that uncollectible accounts are expected to be 5% of the balance of trade accounts receivable. Show the adjusting journal entry at December 31, 2013. **(6 marks)**
3. Show, in proper form, how trade accounts receivable would be presented on the company's comparative statement of financial position as at December 31, 2013. **(4 marks)**

Part B

During 2013, Lau Inc. recorded sales of \$2,600,000, sales returns and allowances of \$80,000 and salespersons' commissions amounting to 4% of total sales. Forty-percent (40%) of sales are for cash. However, only 25% of sales returns and allowances are from cash sales. Based on aging of trade receivables, bad debts expense for the fiscal year is \$15,000. The net realizable value of trade receivables was \$100,000 at January 1, 2013 and \$125,000 at December 31, 2013 before write-offs (see below) and bad debts expense were recorded.

Required

(Journal entries are not required.)

1. Assume that on December 31, 2013, \$10,900 of trade receivables are written off and the appropriate adjusting entry for bad debts expense is also made. How much was the trade receivables turnover ratio for 2013? Round your calculation to two decimal places. **(4 marks)**
2. Assume that on December 31, 2013 only \$2,900 of trade receivables are written off and the appropriate adjusting entry for bad debts expense is also made. Does the change in the amount of trade receivables written off affect the trade receivables turnover ratio for 2013? Explain. **(2 marks)**

QUESTION 4 (16 marks; 29 minutes): *Accounting for Inventories and Cost of Sales*

Tuggers Corporation sells one product. Transactions related to this product during September 2014 are summarized below.

Date	Description	Units	Dollar Amount per Unit
Sept. 1	Inventory	100	15.00
Sept. 4	Sale	80	18.00
Sept. 11	Purchase	150	16.50
Sept. 13	Sale	120	18.75
Sept. 20	Purchase	160	17.00
Sept. 27	Sale	100	20.00

Tuggers pays 40% of its inventory purchases with cash and the rest on account. It uses the FIFO inventory costing method, and its fiscal year ends on September 30 each year. All sales are on account.

Required

1. Assume Tuggers uses a periodic inventory system.
 - a. Prepare journal entries to record the transactions on September 4 and 11. **(2.5 marks)**
 - b. Calculate the cost of sales for the month of September 2014. **(3.5 marks)**
 - c. Prepare the journal entry or entries to record the cost of sales at September 30, 2014. **(3.5 marks)**
2. What would you do differently for items a, b, and c of requirement 1 if Tuggers used the perpetual inventory method. There is no need to prepare journal entries or do any calculations. Simply explain what would be different. **(3 marks)**
3. Tuggers uses the lower of FIFO cost and net realizable value rule on an individual item basis. The net realizable value at the product is \$15 per unit at September 30, 2014.
 - a. Prepare the adjusting entry to reflect the application of the LCNRV rule. If no journal entry is needed, explain why. **(1.5 marks)**
 - b. Assume that the Company's accountant ignored the LCNRV rule. How would this error affect the Company's inventory turnover ratio, and its current ratio? Be specific in your answers, no calculations are required. **(2 marks)**