

SOLUTION KEY

CONCORDIA UNIVERSITY
DEPARTMENT OF ACCOUNTANCY

FINANCIAL ACCOUNTING
COMM 217 ALL SECTIONS

MIDTERM EXAMINATION (REGULAR) Winter 2016

Name: _____ ID: _____ Section: _____

Duration: 3 hours

Instructions (very important):

1. This examination paper consists of **13 pages including this page**. Please make sure your copy has all pages before commencing to write.
2. Write your FULL name (last name & first), Student ID and Section Letter on all three examination 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. **Professors and invigilators will not answer questions unless if you think there is an error in the exam.**
8. Return the exam along with the computer input sheet and answer booklet(s) when you have finished.

Question	Topic	Marks
1	Multiple Choice	22.5
2 (a & b)	Journal Entries	26
2 (c & d)	Financial Statement Preparation	26
2 (e)	Closing Entries	4.5
2 (f)	Ratio Analyses	8
3	Accounting for Inventories and Cost of Sales	13
Total		100

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I. Multiple choice Questions: (1.5 each; Total of 22.5 marks)

- 1) For a business organized as a general partnership, which statement is true?
 - a) The owners and the business are separate legal entities.
 - b) **Each partner is potentially responsible for the debts of the business.**
 - c) Formation of a partnership requires getting a charter from the province of incorporation.
 - d) A partnership is not considered to be separate from its creditors.

- 2) Which of the following situations would cause investors to overpay for the acquisition of a company from its current owners?
 - a) **Understated trade payables and overstated inventory.**
 - b) Understated revenues and overstated expenses.
 - c) Understated assets and overstated expenses.
 - d) Understated assets and overstated revenues.

- 3) Vida Corporation gathered the following reconciling information in preparing its July bank reconciliation:

Cash balance per books, July 31	\$3,500
Deposits in transit	150
Electronic collection of account receivable	850
Bank charge for cheque printing	20
Outstanding cheques	2,000
NSF cheque	170

The adjusted cash balance per books at July 31 is

- a) **\$4,160.**
- b) \$4,010.
- c) \$2,460.
- d) \$2,310.

Calculation: $\$3,500 + \$850 - \$20 - \$170 = \$4,160$

- 4) In 2013, G CO. reported product sales of \$717.8 million and trade receivables of \$79.4 million. In 2012, product sales were \$584.9 million and trade receivables were \$71.4 million. What was its receivables turnover ratio for 2013?
 - a) 8.19
 - b) 8.64
 - c) 9.04
 - d) **9.52**

Calculation: $\$717.8 \div \{(\$79.4 + \$71.4) \div 2\} = 9.52$

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- 5) The WD Co. reported revenue of \$23,402 million for 2013. Their trade receivables balance was \$3,999 million in 2013 and \$3,633 million in 2012. How much cash was collected from customers?

- a) \$23,036
- b) \$23,306
- c) \$23,402
- d) \$23,768

Calculation: $\$23,402 - (\$3,999 - \$3,633) = \$23,036$

- 6) The books of Tweed Company provided the following information:

Beginning balances:

Trade receivables	\$30,000
Allowances for doubtful accounts (a credit)	2,000

Transactions during the year:

Sales revenue (of which 1/3 were on credit)	1,800,000
Collections on trade receivables	590,000
Accounts written off as uncollectible	2,500

Past collection experience has indicated that 1% of credit sales normally is not collected. Therefore, an adjusting entry for bad debt expense should be made in the amount of which of the following?

- a) \$500.
- b) \$2,500.
- c) \$6,000.
- d) \$6,500.

Calculation: $(\$1,800,000 \times 1/3) \times 1\% = \$6,000$

- 7) In applying the revenue principle to a given transaction, the most important moment or period in time is when

- a) The related cash inflows occur.
- b) The related expenses are incurred.
- c) Ownership is transferred or services are rendered.
- d) The service contract is signed regarding service to be performed.

- 8) On January 1, 2015, Green Inc., started the year with a \$22,000 credit balance in its retained earnings account. During 2015, the company earned profit of \$40,000 and declared and paid dividends of \$10,000. Also, the company received cash of \$15,000 as an additional investment by its owners and \$20,000 as a collection of receivables. Therefore, the balance in retained earnings on December 31, 2015, would equal

- a) \$8,000.
- b) \$52,000.
- c) \$67,000.
- d) \$87,000.

Calculation: $\$22,000 + \$40,000 - \$10,000 = \$52,000$

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- 9) Which statement is *false* regarding the financial statements?
- a) Current assets reported in the statement of financial position are generally reported in order of their liquidity.
 - b) Distributions to owners (dividends) are reported in the statement of earnings.**
 - c) Expenses on the statement of earnings are reported as incurred, not as paid.
 - d) The statement of cash flows reports the sources and uses of cash during the accounting period.
- 10) In order for accounting information to be relevant, it must
- a) Have very little cost.
 - b) Help predict future economic events or confirm prior expectations.**
 - c) Be verifiable.
 - d) Be used by a lot of different organizations.
- 11) Which of the following would most likely increase net profit margin?
- a) Decreasing selling price
 - b) Increasing sales volume**
 - c) Increasing expenses
 - d) Decreasing sales volume
- 12) When the auditors give an unqualified opinion, it means the company's financial statements do not conform to international financial reporting standards.
- a) True
 - b) False**
- 13) The balance in Allowance for Doubtful Accounts would have a debit balance when
- a) The percentage of receivables basis is used.
 - b) An uncollectible account is later recovered.
 - c) Write-offs during the year have been less than previous estimates.
 - d) Write-offs during the year have exceeded previous estimates.**
- 14) If an account is collected after having been previously written off,
- a) The allowance account should be debited.
 - b) Only the cash account needs to be credited.
 - c) Both statement of earnings and balance sheet accounts will be affected.
 - d) There will be both a debit and a credit to trade accounts receivable.**
- 15) If a cheque correctly written and paid by the bank for \$521 is incorrectly recorded on the company's books for \$251, the appropriate treatment on the bank reconciliation would be to
- a) Add \$270 to the balance per bank.
 - b) Add \$270 to the balance per books.
 - c) Deduct \$270 from the balance per books.**
 - d) Deduct \$270 from the balance per bank.

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II. Journal Entries and Financial Statements:

On January 1, 2015, Carly and Carl formed ABC Company, a computer sales and service company, by investing \$90,000 in cash. A total of 1,800 shares in ABC were issued and the shares were split equally among Carly and Carl. ABC also borrowed \$10,000 from the local bank; the loan is to be paid in 2018. The interest on the loan is due every 6 months. ABC had the following transactions in January 2015:

- 1) January 1: Paid \$6,000 in advance for three months' rent of space for its store.
- 2) January 1: Purchased office equipment (desks and chairs) for \$5,000 in cash.
- 3) January 1: Purchased 50 personal computers at a cost of \$1,500 each. The computers were purchased from supplier A and were paid for in cash.
- 4) January 4: Purchased from Supplier B, on account, 50 printers at a cost of \$450 each. The terms of the purchase were 2/10, n/30.
- 5) January 5: Sold 40 personal computers for \$2,550 each to a local university. The terms of the sale were 2/10, n/30.
- 6) January 14: Sold on account 39 printers for \$750 each to a copy/printing store.
- 7) January 14: The local university paid its outstanding balance in full.
- 8) January 14: Paid Supplier B the full balance due.
- 9) January 16: Issued 1,000 shares for \$50 a share. Carly and Carl purchased the shares in equal quantities and they paid for the shares in cash.
- 10) January 31: Employees had earned \$12,600 in salaries. A portion was paid on January 31, 2015 and the remaining \$3,000 is to be paid during February, 2015.
- 11) January 31: A total of \$20,000 was still outstanding in accounts receivable.
- 12) January 31: Dividends of \$2,000 were declared.
- 13) Other operating expenses of \$8,400 were incurred and paid for during January.
- 14) Depreciation expense for the period amounted to \$1,500.

Additional Information:

- i. ABC's tax rate is 30%.
- ii. Estimated uncollectible receivables are 10% of the outstanding balance.
- iii. Interest on the loan for the month of January amounted to \$25.
- iv. ABC closes its books on a monthly basis and uses a perpetual inventory system and the FIFO inventory costing method.

Continued 

Required:

- a) Record all of the journal entries for the transactions that occurred in January 2015.
(21 marks)

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- b) Record any adjusting entries at January 31, 2015. (5 marks)
- c) Prepare the Statement of Earnings for January 2015. (10 marks)
- d) Prepare the Statement of Financial Position as at January 31, 2015. (16 marks)
- e) Record the closing entries at January 31, 2015. (4.5 marks)
- f) Compute the Current Ratio, Net Profit Margin and Return on Equity ratios. What do the results you arrive at tell you about ABC Company? (11 marks)

Solution (? min) (64.5 Marks)

a) JOURNAL ENTRIES (21 Marks):

Dr. Cash	90,000	
Cr. Contributed Capital		90,000
Dr. Cash	10,000	
Cr. Bank Loan		10,000
1) Dr. Prepaid Rent	6,000	
Cr. Cash		6,000
2) Dr. Office Equipment	5,000	
Cr. Cash		5,000
3) Dr. Inventory (Personal Comp)	75,000	
Cr. Cash		75,000
	<i>(Calculation: $50 \times 1,500 = 75,000$)</i>	
4) Dr. Inventory (Printers)	22,500	
Cr. Accounts/Trade Payable		22,500
	<i>(Calculation: $50 \times 450 = 22,500$)</i>	
5) Dr. Accounts Receivable (University)	102,000	
Cr. Sales Revenue		102,000
	<i>(Calculation: $40 \times 2,550 = 102,000$)</i>	
Dr. COGS	60,000	
Cr. Inventory (Personal Computers)		60,000
	<i>(Calculation: $40 \times 1,500 = 60,000$)</i>	
6) Dr. Accounts Receivable (Printing)	29,250	
Cr. Sales Revenue		29,250
	<i>(Calculation: $39 \times 750 = 29,250$)</i>	
Dr. COGS	17,550	
Cr. Inventory (Printers)		17,550
	<i>(Calculation: $39 \times 450 = 17,550$)</i>	

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7) Dr. Cash	99,960	
Dr. Sales Discount*	2,040	
Cr. Accounts Receivable (local university)		102,000
<i>(*Calculation: $102,000 \times 0.02 = 2,040$)</i>		
8) Dr. Accounts Payable	22,500	
Cr. Cash		22,050
Cr. Printer Inventory		450
9) Dr. Cash	50,000	
Cr. Contributed Capital		50,000
<i>(Calculation: $50 \times 1,000 = 50,000$)</i>		
10) Dr. Salaries Expense	12,600	
Cr. Salaries Payable		12,600
Dr. Salaries Payable	9,600	
Cr. Cash		9,600
11) Dr. Cash	9,250	
Cr. Accounts Receivable		9,250
<i>(Calculation: $29,250 - 20,000 = 9,250$)</i>		
12) Dr. Other Operating Expenses	8,400	
Cr. Cash		8,400
13) Dr. Depreciation Expense	1,500	
Cr. Accumulated Depreciation		1,500
14) Dr. Declared Dividends	2,000	
Cr. Dividends Payable		2,000

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b) ADJUSTING ENTRIES: (5 Marks)

Dr. Rent Expense	2,000	
Cr. Prepaid Rent		2,000

Dr. Bad debt expense	2,000	
Cr. Allowance for Doubtful Accounts		2,000

(Calculation: 20,000 x 10% = \$2,000)

Dr. Interest Expense	25	
Cr. Interest Payable		25

Dr. Tax Expense	7,540.50	
Cr. Tax Payable		7,540.50

(Calculation: 25,135 x 30% = \$7,540.50)
(\$25,135 is from calculating the income before taxes, check (c) below)

c) Statement of Earnings: (10 marks)

ABC Company
Statement of Earnings (or Income Statement)
For the Month (or Period) Ended 31 January 2015

Sales Revenue (or Revenue; or Sales)	\$131,250
Less: Sales Discount	2,040
Net Revenue	129,210
Cost of Sales (or Cost of Goods Sold)	77,550
Gross Profit	51,660
Operating Expenses	
Salaries Expense	12,600
Other Operating Expenses	8,400
Depreciation Expense	1,500
Rent Expense	2,000
Bad Debt Expense	2,000
<i>Total Operating Expenses</i>	26,500
Earnings from Operations	25,160
Non-Operating Expenses	
Interest Expense	25
Earnings before taxes	25,135.00
Income Tax Expense (30%)	7,540.50
Net Earnings (or Net Income)	\$17,594.50

Earnings per share \$7.65
[Calculation of EPS = \$17,594.50 / ((1800 + 2800)/2)]

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d) Statement of Financial Position: (16 Marks)

ABC Company

Statement of Financial Position (or Balance Sheet)

As at 31 January 2015

Assets		
Current Assets		
Cash		\$133,160
Accounts Receivable	20,000	
Less: Allowance for doubtful accounts	<u>2,000</u>	
Net Accounts Receivable		18,000
Prepaid Rent		4,000
Inventory (Printers)		4,500
Inventory (Computers)		<u>15,000</u>
Total Current Assets		174,660
Non-Current (or Long-term) Assets		
Office Equipment	5,000	
Less: Accumulated Depreciation	<u>1,500</u>	
Net Office Equipment		<u>3,500</u>
Total Assets		<u><u>178,160</u></u>
Liabilities and Shareholders' Equity		
Current Liabilities		
Salaries Payable		3,000
Interest Payable		25
Dividends Payable		2,000
Income Tax Payable		<u>7,540.50</u>
Total Current Liabilities		12,565.50
Non-Current (or Long-term) Liabilities		
Bank Loan		<u>10,000</u>
Total Liabilities		22,565.50
Shareholders' Equity		
Common Shares (or Contributed Capital)	140,000	
Retained Earnings	<u>15,594.50</u>	
Total Shareholders' Equity		<u><u>155,594.50</u></u>
Total Liabilities and Shareholders' Equity		<u><u>178,160</u></u>

[Calculation of Retained Earnings: Net Income - Declared Dividends]

[Calculation of Retained Earnings = 17,594.50 – 2,000 = 15,594.50]

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e) Closing Entries: (4.5 marks):

Dr. Sales Revenue	131,250	
Cr. Income Summary		131,250
Dr. Income Summary	113,655.5	
Cr. Sales Discount		2,040
Cr. Cost of Sales		77,550
Cr. Other Operating Expenses		8,400
Cr. Salaries Expense		12,600
Cr. Depreciation Expense		1,500
Cr. Rent Expense		2,000
Cr. Interest Expense		25
Cr. Bad Debt Expense		2,000
Cr. Income Tax Expense		7,540.5

[Balance in Income Summary = a Credit balance of \$17,594.50]

Dr. Income Summary	17,594.5	
Cr. Retained Earnings		17,594.5
Dr. Retained Earnings	2,000	
Cr. Declared Dividends		2,000

f) Ratio Analyses: 8 Marks

$$\begin{aligned}\text{Current ratio} &= \text{Current Assets} / \text{Current Liabilities} \\ &= 174,660 / 12,565.50 = 13.90\end{aligned}$$

- The ratio shows that the company is liquid.
- Its current assets are 13.9 times the current liabilities.
- ABC can cover its current obligations through its current assets.
- The ratio seems quite high (due to cash), perhaps ABC could use its current assets in a more efficient manner.

$$\begin{aligned}\text{Net Profit Margin} &= \text{Net Earnings} / \text{Net Sales} \\ &= 17,594.50 / 129,210 = 0.1362 = 13.62\%\end{aligned}$$

- This shows that net earnings is only 13.62% of net sales.
- This tells us that expenses for ABC might be too high.
- Perhaps ABC should check if it could be more efficient with its expenses or Cost of sales; it could also be due to the industry that ABC is in.

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$$\text{Return on Equity} = \text{Net Earnings} / \text{Average Shareholders' Equity} \\ = 17,594.50 / ((90,000 + 155,594.50)/2) = 0.1433 = 14.33\%$$

-This ratio shows that for every dollar invested by shareholders, the return is 11.31 cents (or 11.31%).

-While this does not seem high it could be normal for the industry that ABC is in.

Comparing the 3 ratios with ABC's competitors and the industry average would provide us with a better picture of how ABC is doing.

III. Inventory (FIFO & Weighted Average Cost Method) (13 marks)

Company Ltd, which uses a perpetual inventory system, recorded the following inventory transactions during the year 2015:

			Number of	
			Units	Unit Cost
October	1	Beginning Inventory	45	\$8
	25	Purchase	150	9
November	4	Purchase	65	10
	16	Sale	120	16
December	4	Purchase	50	12
	20	Sale	150	19

Instructions:

- Using the FIFO cost method, calculate the cost of sales for the period ended December 31 and ending inventory at December 31. Show your calculations. (5.5 marks)
- Using the weighted average cost method, calculate the cost of sales for the period ended December 31 and ending inventory at December 31. Show your calculations. Round your calculations to two decimal places. (6 marks)
- Company Ltd is interested in having the highest possible earnings per share. If it were to use the periodic inventory system, would the choice of FIFO or Weighted Average have an effect on earnings per share? If it would have an effect, which method would be better and why? If it wouldn't have an effect, explain why. (2.5 marks)

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Solution (13 Marks Total)

(a) Total of 5 Marks

		Purchases	COGS	Balance
October	1			(45@8) \$360
	25	(150 @ \$9) \$1,350		(45@8) \$360 (150 @ \$9) \$1,350 \$1,710
November	4	(65 @ \$10) \$650		(45@8) \$360 (150 @ \$9) \$1,350 (65 @ \$10) \$650 \$2,360
	16		120 units sold 45 @ \$8 \$360 75 @ \$9 675 \$1,035	(75 @ \$9) 675 (65 @ \$10) \$650 \$1,325
December	4	(50 @ \$12) \$600		(75 @ \$9) 675 (65 @ \$10) \$650 (50 @ \$12) \$600 \$1,925
	20		150 units sold 75 @ \$9 675 65 @ \$10 650 10 @ \$12 120 \$1,445	(40 @ \$12) \$480

COGS = \$1,035 + \$1,445 = \$2,480

Ending Inventory = \$480

Check: Beg + Purch – End = COGS: 360 + (1,350+ 650 + 600) – 480 = 2,480, correct!

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(b) Total of 5.5 points

		Purchases	COGS	Balance
October	1			(45@ \$8) \$360
				(45@ \$8) \$360
	25	(150 @ \$9) \$1,350		(150 @ \$9) \$1,350
				195 \$1,710 Per Unit: \$8.77
November	4	(65 @ \$10) \$650		(195 @ \$8.77) \$1,710 (65 @ \$10) \$650
				260 \$2,360 Per Unit \$9.08
	16		120 units sold	
			120 @ 9.08 \$1,089	Per Unit \$9.08 # of Units: 140
December	4	(50 @ \$12) \$600		(140 @ \$9.08) \$1,270.85 (50 @ \$12) \$600
				190 \$1,871 Per Unit \$9.85
	20		150 units sold	
			150 @ 9.85 \$1,476.99	Per Unit \$9.85 # of Units: 40

COGS: $\$1,089.30 + 1,476.99 = \underline{\underline{\$2,566.29}}$

Ending Inventory: **\$394** or 393.27 (calculated as $1,871 - 1,476.99$; or $\$9.85 \times 40$)

Check: Beg + Purch – End = COGS: $360 + (1,350 + 650 + 600) - 394 = 2,566$, correct!

c) Periodic: FIFO or Weighted Average? (2.5 Marks)

- a. Yes, the choice of FIFO or Weighted Average would have an effect on EPS.
- b. FIFO would provide lower COGS, thus higher net earnings and higher EPS.
- c. This is because the cost of inventory is increasing and Weighted Average takes the average of all prices thus including the higher prices in its calculations.