



**COMM 457**  
**Suggested Solution**  
**Midterm #1- Section 101**  
**October 15, 2012**

**Multiple choice – circle the best answer- 1 mark each (11 marks)**

- 1) If the bookkeeper mistakenly records a deposit of \$630 as \$360, the error would be shown on the bank reconciliation statement as a:
- A) \$270 deduction from the bank balance
  - B) \$270 deduction from the book balance
  - C) \$270 addition to the book balance
  - D) \$270 addition to the bank balance
- 2) Under the revenue principle, a business should record revenue when the business:
- A) receives an order from a customer for goods or services
  - B) prepares the invoice (bill) for goods or services
  - C) delivers goods or services to a customer
  - D) receives payment from a customer for goods or services.
- 3) To maintain effective controls over cash, who should be the first person to handle cash received through the mail?
- A) the accounts receivable clerk
  - B) a mailroom employee
  - C) the controller
  - D) the bookkeeper
- 4) If assets increase \$120,000 during a given period and liabilities decrease \$25,000 during the same period, shareholders' equity must:
- A) increase \$95,000
  - B) decrease \$145,000
  - C) decrease \$95,000
  - D) increase \$145,000
- 5) According to the Generally Accepted Accounting Principles (GAAP), the primary objective of financial reporting is to provide information:
- A) to the federal government about income tax matters
  - B) about the fair market value of the company's assets
  - C) about the effectiveness of the business
  - D) about the efficiency of the company's operations
  - E) None of the above

6) Which of the following is not a qualitative characteristic of financial information.

- A) Understandability.
- B) Historical cost.**
- C) Faithful representation.
- D) Comparability.

7) Which statement best explains the qualitative characteristic of "relevance"?

- A) Financial reports should be understandable to the users of the information.
- B) Omitting information would influence a user's economic decision.**
- C) Information should influence a user's economic decisions.
- D) Financial reports should be accurate and complete.

8) The stable-monetary-unit assumption is the basis for ignoring:

- A) the possibility that the value of inventory might drop below its historical cost
- B) fluctuations in the value of the Canadian dollar relative to foreign currencies
- C) the effect of inflation in the accounting records**
- D) the difference between the appraised value and the actual cost when recording an asset at its historical cost

9) Cash for services to be performed by a company in 2012 is received in 2011. Using the accrual basis of accounting, the revenue should appear on:

- A) the 2012 income statement**
- B) both the 2011 and 2012 income statements
- C) neither the 2011 nor 2012 income statement
- D) the 2011 income statement

10) On December 1, 2012, Cream Ale Ltd. receives \$2,400 in advance for an agreement to brew beer during the months of December, January, February and March. As of December 31, 2012, Cream Ale Ltd:

- A) would have a \$1,200 liability to its client under accrual accounting, and would have a \$1,800 liability to its client under cash-basis accounting
- B) would have recognized \$600 revenue under accrual accounting, and would have recognized \$1,800 revenue under cash-basis accounting
- C) would have a \$600 liability to its client under accrual accounting, and would have a \$1,800 liability to its client under cash-basis accounting
- D) would have recognized \$600 cash under accrual accounting, and would have recognized \$2,400 cash under cash-basis accounting**

11) What will be the result if the adjusting entry to accrue revenue at the end of a company's year-end is not prepared and recorded?

- A) The net income for the period will be understated.**
- B) The net income for the period will be overstated.
- C) The net income for the period will not be affected.
- D) The assets for the period will be understated.

## Problems

### Problem 1 Accounting and Internal Control (8 marks)

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a) Define internal control. Who is responsible for establishing an effective system of internal control? **(4 marks)**

*Internal control is the organizational plan and all the related measures adopted by an entity to safeguard its assets, encourage adherence to company policies, promote operational efficiency, and ensure accurate and reliable accounting records.*

*It is the responsibility of accountants and managers alike, and it is only as effective as the quality of the people in the organization.*

b) Even if internal control is well designed it is not an absolute guarantee that fraud and or error will not occur? List two reasons why internal control cannot be expected to be perfect. **(2 marks)**

**Collusion** Systems designed to thwart one person's fraud can be beaten by two or more employees working together and colluding to defraud the firm.

**Human error** As employees are human, errors/mistakes are bound to occur.

**Unusual transactions** System may not have considered all types of transactions which might occur.

**Volume of transactions** System was designed for a certain level of transactions which may be exceeded at certain times during the year.

c) A friend explains that he is getting unearned revenue and accrued revenue mixed up. Help your friend understand the difference. **(2 marks)**

**Unearned revenue** represents funds received in advance of the revenue being earned (services being performed).

**Accrued revenue** is revenue which has been earned (i.e. services performed) but has not yet been recorded or paid for.

## Problem 2 Bank Reconciliation (15 marks)

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On May 31, 2012 the Cash account of Parker Supply Company (Parker) had a balance of \$43,820. On that date, the bank statement indicated a balance of \$54,600.

- The bank reported the collection of a note receivable for Parker of \$6,100 plus \$300 of interest.
- The \$1,200 cheque of a customer, Raymond Frank, was returned by the bank because of insufficient funds.
- The bank charged Parker \$160 for services.
- The bank erroneously failed to credit a \$4,000 deposit to Parkers' account.
- It was determined that the bank statement did not include a deposit of \$4,700 made by Parker on May 31 and that cheques totaling \$13,000 issued by Parker had not cleared the bank.
- Parker incorrectly recorded an insurance expense payment of \$160 as \$1,600.

### Required:

- a) Prepare in good format the bank reconciliation as of May 31, 2012. **(8 marks)**

Parker Supply Company  
Bank Reconciliation  
May 31, 2012

Bank Statement		\$54,600	Book Balance		\$43,820
Add:			Add:		
Deposits	\$4,000		Note proceeds	\$6,100	
	4,700		Interest earned	300	
		8,700	Recording error	1,440	
Deduct:					7,840
O/S cheques		13,000	Deduct:		
			NSF Cheque	\$1,200	
			Service charge	160	1,360
<b>Adjusted Bank Balance</b>		<b>\$50,300</b>	<b>Adjusted Cash Balance</b>		<b>\$50,300</b>

b) Prepare all journal entries that result from your reconciliation in part a) **(4 marks)**

Cash	7,840	
Notes receivable		6,100
Interest revenue		300
Insurance expense		1,440
Accounts Receivable	1,200	
Bank service charge expense	160	
Cash		1,360

### Problem 3 Adjusting journal entries (13 marks)

Below is an alphabetical list of Scott's Consulting Limited's accounts at its fiscal year end of June 30, 2012, **prior to adjustments**:

Accounts Payable	\$ 1,476
Accounts Receivable	2,485
Accumulated Depreciation- Computer Equipment	2,545
Accumulated Depreciation- Furniture	964
Cash	3,795
Common Shares	18,752
Computer Equipment	7,635
Consulting Fees Earned	117,350
Furniture	9,640
Note Receivable	6,500
Prepaid Insurance	1,872
Rent Expense	10,120
Retained Earnings (deficit)	(66,850)
Salaries Expense	32,950
Supplies	2,960
Telephone Expense	1,560
Unearned Consulting Fees	5,280

All accounts are in their normal balance except RE which is negative due to heavy losses in previous years.

Other data:

1. A one-year insurance policy was purchased on November 1, 2011.
2. On June 30, 2011, there was \$555 of supplies on hand. During the year, \$2,405 of additional supplies was purchased. A count of supplies on June 20, 2012 revealed \$905 of supplies on hand.
3. The furniture has an estimated useful life of 10 years with a residual value of \$1,640.
4. As at June 30, 2012, an analysis revealed that \$1,550 of the unearned consulting fees were still unearned.
5. The note receivable, issued on April 1, 2012, bears an annual interest rate of 8.25%. Interest and principal are receivable in full on the December 1, 2012 maturity date.
6. Salaries accrued and unpaid to June 30, 2012 total \$3,980.
7. On May 21, the company signed a contract to provide consulting services to Henry Inc. commencing July 1, 2012. The contract is for three months at a rate of \$4,600 per month. Payments are due at the beginning of each month.

#### REQUIRED:

Prepare all adjusting journal entries at June 30, 2012. Place entries and supporting calculations on the next page. Explanations are not required.

### Response to problem 3

	Debit	Credit
1. Insurance expense	1,248	
Prepaid Insurance		1,248
=1,872/12*8months (Nov- June)		
2. Supplies expense	2,055	
Supplies		2,055
=555+2,405-905		
3. Depreciation expense	800	
Accumulated depreciation - Furniture		800
(9,640-1,640)/10=800		
4. Unearned Revenue	3,730	
Revenue		3,730
5,280-1,550= amount earned		
5. Interest receivable	134	
Interest revenue		134
6,500*.0825*3/12		
6. Salary expense	3,980	
Salary payable		3,980
7. No transaction		

## Problem 5 Financial Statements and analysis continued

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**Based solely on the information provided,** address each of the following independent situations:

- a) You are the controller of a potential supplier for Lululemon. Briefly discuss with support whether you would agree to grant credit to Lululemon? **(3 marks)**

*Need to address the current ratio which addresses an entity's ability to pay its short-term liabilities. Current ratio is calculated as Current Assets/Current Liabilities. As comparative figures are provided, it should be calculated for 2012 and 2011. A conclusion should be presented.*

- b) You are the Chair of the Board of Directors of Lululemon and have just received the balance sheet on page 10. Discuss with support whether you believe the shareholders will be pleased with the company's performance in 2012. **(3 marks)**

*Focus could be on the **profitability** of the company – comparison of income amounts and EPS between the two years. Consider calculating the Return on Sales (Net income/Sales) or Return on Assets (Net income /Average total assets) to support your response.*

*Consider addressing the **debt ratio** of the company which is calculated as Total liabilities/Total Assets. Important to **make the calculations** and **discuss** whether they have improved or deteriorated*

*Strong cash position will allow the company to grow*

**Other valid responses accepted.**