Midterm 17 September 2014, questions and answers

Financial Accounting (Concordia University)

CONCORDIA UNIVERSITY
DEPARTMENT OF ACCOUNTANCY

FINANCIAL ACCOUNTING
COMM 217 ALL SECTIONS

MIDTERM EXAMINATION (ALTERNATE)
FALL 2014

Name: ____________________________ ID: _____________ Section: _____

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	21
2	Journal Entries and Financial Statement Preparation	39
3	Accounting for Receivables and Bad Debt Expense	21
4	Accounting for Inventories and Cost of Sales	19
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. At the beginning of 2014, Dong Company had $1,000 of supplies on hand. During 2014, the company purchased supplies amounting to $6,400 (paid for in cash and debited to Supplies Expense). At December 31, 2014, the Company had only $2,600 worth of supplies on hand. The adjusting entry Dong Company would record on December 31, 2014, to adjust the Supplies Inventory account would include a
   a. Debit to Supplies Inventory for $2,600.
   b. Credit to Supplies Expense for $1,600.
   c. Credit to Supplies Inventory for $4,800.
   d. Debit to Supplies Expense for $4,800.

2. 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.

3. 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

4. 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

5. 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.

6. 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.

7. The bookkeeper of Bernier Ltd. prepared the adjusted trial balance at September 30, 2014, the end of the Company's first year of operations and determined the following amounts:

Total liabilities, September 30	$150,000
Sales revenue for the year	300,000
Total expenses for the year	240,000
Contributed capital, September 30	40,000
Dividends declared during the year	20,000

The Company did not declare any dividends. What amount of total assets would be reported on the statement of financial position as at September 30, 2014?

a. $190,000 b. $230,000 c. $250,000
d. Total assets cannot be determined without having a complete list of the Company's assets and their ending balances.

8. A company has been successful in reducing the costs of its manufacturing process by relocating the factory to another locale. What effect will this factor have on the company's gross profit percentage, all other things equal?
a. The ratio will not change.
b. The ratio will decrease.
c. The ratio will increase.
d. The effect cannot be determined without additional information.

9. Which of the following is **not** a step toward effective internal control over cash?
a. Require signatures from a manager and one financial officer on all cheques.
b. Require that cash be deposited daily at the bank.
c. Require that the person responsible for removing the cash from the register have no access to the accounting records.
d. Require that the same person be responsible for removing the cash from the register and recording the transaction in order to reduce salaries expenses.

10. If the ending balance in Trade Payable decreases from one period to the next, which of the following is true?
a. Cash payments to suppliers exceeded current period purchases.
b. Cash payments to suppliers were less than current period purchases.
c. Cash receipts from customers exceeded cash payments to suppliers.
d. Cash receipts from customers exceeded current period purchases.

11. Which of the following is <u>false</u> regarding a perpetual inventory system?
a. Physical counts are not needed since records are maintained on a transaction-by-transaction basis.
b. The balance in the Inventory account is updated with each inventory purchase and sale transaction.
c. Cost of sales is increased as sales are recorded.
d. The account Purchases is not used as inventory is acquired.

12. Consider the following information: ending inventory, $24,000; sales, $250,000; beginning inventory, $20,000; selling and administrative expenses, $70,000; and purchases, $90,000. The cost of sales would equal:

a. $86,000   b. $16,000   c. $94,000   d. $84,000

13. An increasing inventory turnover ratio
   a. Indicates a longer time span between the ordering and receiving of inventory.
   b. Indicates a shorter time span between the ordering and receiving of inventory.
   c. Indicates a shorter time span between the purchase and sale of inventory.
   d. Indicates a longer time span between the purchase and sale of inventory.

14. Which of the following statements regarding the lower of cost or net realizable value rule for inventory are true?
   1. The lower of cost or net realizable rule is consistent with the historical cost principle.
   2. When the net realizable value of inventory drops below the cost shown in the financial records, net earnings is reduced.
   3. When the net realizable value of inventory drops below the cost shown in the financial records total assets are reduced.

   a. 1   b. 2 and 3   c. 2   d. 1, 2 and 3

QUESTION 2 (39 marks; 70 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 (debit balance)	400
Cash	48,600
Common shares *(11,690 shares)*	116,900
Cost of sales	86,400
Deferred revenue	10,700
Insurance expense	4,900
Interest receivable	2,500
Gain on sale of land	5,900
Merchandise inventory	52,600
Miscellaneous expenses	450
Notes payable *(4%, due on September 30, 2019)*	37,000
Notes receivable *(5%, due on March 1, 2015)*	30,000
Prepaid insurance	9,000
Rent expense	17,800
Retained earnings	27,200
Sales revenue	156,450
Supplies expense	6,000
Trade payables	25,000
Trade receivables	35,700
Trucks	70,000
Wages expense	38,800

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 $450 miscellaneous expense, but the correct amount that cleared the bank account was $540.
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 4% will be paid at maturity.

h) A 3-year note receivable was issued on March 1, 2012, and has an interest rate of 5% 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 **Liabilities and Shareholders' Equity** section (only) of a classified statement of financial position as at December 31, 2013. **(8 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 $45,000 and a credit balance in Allowance for Doubtful Accounts of $4,500. During 2013, the following transactions occurred:

– Service revenue billed on account, $150,000 (terms, net/60)
– Collections from customers, $130,000
– Accounts written off as uncollectible, $3,700
– Collection of accounts previously written off, $400.

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. had the following summary transactions:

- Sales revenue, $2,600,000. Forty percent (40%) of sales are for cash.
- Sales returns and allowances, $80,000. Twenty five percent (25%) of sales returns and allowances are from cash sales.
- Salespersons' commissions, 4% of total sales.
- Bad debts expense for the fiscal year, $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 debt expense were recorded.

Required

(Journal entries are not required.)

1. Assume that on December 31, 2013, $1,090 of trade receivables are written off and the appropriate adjusting entry for bad debt 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 $290 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 (19 marks; 34 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 20 percent of its inventory purchases with cash and the rest on account. It uses a perpetual inventory system, and its fiscal year ends on September 30 each year. All sales are on account.

Required

1. Assume that Tuggers uses the weighted-average cost method. Prepare journal entries to record the transactions on September 11 and 13. Round your calculations to two decimal places. **(6.5 marks)**

2. What would you do differently for requirement 1 if Tuggers used the periodic inventory method. There is no need to prepare journal entries or do any calculations. Simply explain what would be different. **(2 marks)**

3. For this requirement, assume that Tuggers uses the FIFO costing method.
   a. Calculate the gross profit for September 2014. **(4 marks)**
   b. Will the gross profit increase, decrease or remain unchanged if the weighted-average cost method is used instead of the FIFO costing method? Explain. **(2 marks)**
   c. 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.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 return on assets ratio? Be specific in your answers, no calculations are required. **(3 marks)**