

COMM 217 – Financial Accounting
Solution to Exam 1 – Fall 2020

QUESTION 1 – MCQs

1. C
2. B
3. B [Increase in SE = (\$150,000 – 60,000) – (104,000 – 40,000) = \$26,000. This increase is due to the increase in retained earnings = Net earnings – Dividends; NE – 10,000 = \$26,000 → NE = \$36,000]
4. D
5. D
6. B
7. B
8. C
9. A
10. C

QUESTION 2 (16 marks; 27 minutes)

Part A (5 marks):

a.	Cash	3,200	
	Sales revenue		3,200
	Cost of sales	2,400	
	Inventory		2,400
b.	Dividends declared	30,000	
	Dividends payable		30,000
c.	Cash	156,000	
	Contributed capital (or Common shares)		156,000
d.	Income tax expense	25,000	
	Income tax payable		25,000

Part B (11 marks):

Requirement 1 (7 marks)

a.	Dec. 31	Office supplies expense	3,450	
		Office supplies		3,450
		<i>Cost of supplies used = \$500 + \$3,650 – \$700 = \$3,450</i>		
b.	Dec. 31	Salaries expense (\$2,000 x 2 days)	4,000	
		Salaries payable		4,000

c. Dec. 31	Deferred rent revenue	1,200	
	Rent receivable	600	
	Rent revenue		1,800

Note that Rent revenue could be two entries, one for \$1,200 with a debit to the deferred rent revenue, and one for rent receivable of \$600.

d. Dec. 31	Insurance expense (\$525 x 2 months)	1,050	
	Prepaid insurance (or prepaid insurance expense) ..		1,050

Requirement 2 (4 marks)

Jan. 6	Salaries payable	4,000	
	Salaries expense	6,000	
	Cash		10,000

Jan. 31	Cash	1,200	
	Rent receivable		600
	Rent revenue		600

QUESTION 3 (34 marks; 58 minutes)

Req. 1 (10 marks)

a)	Deferred sales revenue	2,000	
	Sales revenue		2,000
	<i>Calculation: \$10,000 x 20% = \$2,000</i>		
	Cost of sales	800	
	Merchandise inventory		800
	<i>Calculation: \$2,000 x (1 - .60) = \$800</i>		
(b)	Operating expenses	400	
	Prepaid expenses		400
	<i>Calculation: \$4,800 x 1/12 = \$400</i>		
(c)	Operating expenses	6,000	
	Accumulated depreciation		6,000
(d)	Operating expenses	8,000	
	Supplies on hand		8,000
	<i>Calculation: \$10,000 - \$2,000 = \$8,000</i>		
(e)	Interest expense	100	
	Interest payable		100
	<i>Calculation: \$30,000 x 4% x 1/12 = \$100</i>		

(f) Income tax expense	27,240	
Income tax payable		27,240

Calculation (could be shown here or in the statement of earnings):
 $\$69,100 \times 40\% = \$27,240$ as per statement of earnings, Req. 2

- (g) No entry at December 31 because this transaction was recorded during the year. This information is needed for the calculation of earnings per share.

Req. 2 (6 marks)

Mitka Inc.
Statement of earnings
For the Year Ended December 31, 2019

Sales revenue	\$452,000
Cost of sales	<u>205,800</u>
Gross profit	246,200
Operating expenses	<u>177,400</u>
Earnings from operations	68,800
Interest expense	<u>700</u>
Earnings before income taxes	68,100
Income tax expense	<u>27,240</u>
Net earnings	<u>\$ 40,860</u>
 Earnings per share	 <u>\$43.24</u>

Calculation: $EPS = \$40,860 / ((900 + 990)/2) = \$40,860 / 945 = \$43.238 = \43.24 (rounded)

Req. 3 (9.5 marks)

Mitka Inc.
Statement of financial position
As at December 31, 2019

Liabilities and Shareholders' Equity

Current Liabilities

Accounts payable	\$ 57,000
Interest payable	100
Deferred revenue	8,000
Income taxes payable	<u>27,240</u>
Total current liabilities	92,340

Non-Current Liabilities

Note payable	<u>30,000</u>
Total liabilities	<u>122,340</u>

Shareholders' Equity

Contributed capital	99,000	
Retained earnings	<u>63,860</u>	(\$43,000 + \$40,860 – \$20,000)
Total shareholders' equity	<u>162,860</u>	
Total liabilities and shareholders' equity	<u>\$285,200</u>	

Req. 4 (8.5 marks)

- (a) Total asset turnover ratio = Sales revenue / Average total assets
= \$452,000 / [(\$268,000 + \$285,200) / 2] = \$452,000 / \$276,600 = 1.6377 = 1.64 (rounded)

Mitka generates \$1.64 in sales revenue for every \$1 of total assets.

- (b) Return on assets = Net earnings + Interest expense (net of tax) / Average total assets
= \$40,860 + (\$700 × 0.6) / [(\$268,000 + \$285,200) / 2]
= (\$40,860 + \$420) / \$276,600 = \$41,280 / \$276,600 = 0.1492 = 14.92%

For each dollar of total assets (or for each dollar invested by creditors and shareholders), the company generates \$0.1492 in return.

- (c) Return on equity = Net earnings / Average shareholders' equity
= \$40,860 / {[(\$95,000 + \$43,000) + \$162,860] / 2}
= \$40,860 / [(\$138,000 + \$162,860) / 2] = \$40,860 / \$150,430 = \$0.2716 = 27.16%

For each dollar invested by shareholders, the company generates \$0.2716 (or 27.16%) in return (or profit).