

**EXAM 1 (REGULAR) - DURATION: 2 HOURS
FALL 2020**

Name: _____ ID: _____ Section: _____

Instructions (very important):

1. All questions must be answered in a word document (.doc or .docx). You may answer the questions in any order you prefer, make sure to identify the question you are answering. You should name the file as follows: Familyname_Firstname_StudentID#.
2. Write your FULL name (last name & first) and Student ID on top of the first page of the document carrying your answers.
3. If an answer to a question requires calculations, show the details to earn the allocated marks. Omit narrative explanations for journal entries.
4. Abbreviating any names (for example: account names, headings, subheadings, totals, subtotals, etc.) may be subject to mark deduction.
5. 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.

GOOD LUCK!

Question	Topic	Total Marks
1	Multiple Choice Questions	20
2	Journal Entries and Adjusting Entries	16
3	Journal Entries, Adjusting Entries and Financial Statements	34
	Total	70

QUESTION 1: Multiple Choice Questions (2 marks each; 20 marks in total)

For each of the following multiple-choice question, choose the letter that corresponds to the **best** answer. For each question, write the letter of your answer in the Word document.

1. Which of the following statements is incorrect?
 - A. Retained earnings is increased by net earnings and decreased by a net loss.
 - B. Retained earnings is a component of shareholders' equity on the statement of financial position.
 - C. Retained earnings is reported on the statement of earnings.
 - D. Retained earnings represent earnings not distributed to shareholders in the form of dividends.

2. The primary purpose of hiring a public accounting firm to examine the financial statements of the company is
 - A. to assure that no fraud has been committed by the company's management.
 - B. to provide credibility that the financial information conforms to international financial reporting standards in all material respects.
 - C. to detect all accounting errors made by the accounting system and employees.
 - D. not reflected in any of the other statements.

3. SLH, Inc. reported the following information:

	December 31, 2020	December 31, 2019
Total assets	\$150,000	\$104,000
Total liabilities	60,000	40,000

SLH did not have any transactions affecting contributed capital in 2020. It declared dividends of \$10,000 during 2020. Based on these details, SLH's net earnings for 2020 should be:

- A. \$20,000
 - B. \$36,000
 - C. \$26,000
 - D. Cannot be determined without knowing the revenues and expenses for 2020.

4. An assumption inherent in the preparation of financial statements under the accrual basis of accounting holds that a business organization must associate its expenses for a period with the revenues it generates during the same period. What is the concept called?
 - A. Verifiability.
 - B. Accounting entity.
 - C. Continuity.
 - D. Matching.

5. The qualitative characteristic comparability means that the usefulness of accounting information is enhanced if
- A. the same accounting procedures should not be applied from year to year.
 - B. accounting data are supported by documents when possible.
 - C. accounting data are based on objective data and transactions
 - D. similar accounting methods are applied across businesses and over time.
6. If a company is successful in reducing selling and administrative expenses while maintaining sales volume and the sales price of its product, then the net profit margin ratio
- A. will not change.
 - B. will increase.
 - C. will decrease.
 - D. will either decrease or remain unchanged.
7. On October 10, MFP Co. paid \$7,000 in employee salaries, including \$1,000 it owed to its employees for work done in September. What are the effects of this transaction?
- A. Expenses increased, liabilities increased, and assets increased.
 - B. Assets decreased, liabilities decreased, and expenses increased.
 - C. Assets decreased, expenses decreased, and liabilities increased.
 - D. Expenses decreased, liabilities decreased, and assets decreased.
8. Which of the following would not affect a company's net earnings?
- A. A change in the company's income tax rate.
 - B. A change in the selling price of a company's product.
 - C. Paying a dividend to shareholders.
 - D. Advertising a new product.
9. An accrued liability results from an expense that is
- A. incurred but not yet paid.
 - B. incurred and paid.
 - C. paid but not yet incurred.
 - D. neither incurred nor paid.
10. Which of the following determines when revenues and expenses should be recorded under accrual accounting?
- A. relevance and representational faithfulness
 - B. the cost principle and the matching process
 - C. the revenue principle and the matching process
 - D. the revenue principle and the periodicity assumption.

QUESTION 2 (16 marks; 26 minutes)*Preparation of journal entries***Part A (5 marks):**

The following selected events occurred at Rex Corporation during the fiscal year, ending on September 30, 2020.

- a. Sold merchandise that cost \$2,400 for \$3,200 cash.
- b. Declared a cash dividend of \$30,000 on September 1, 2020 payable on October 1, 2020.
- c. Issued 12,000 shares at \$13 per share for cash.
- d. Determined that the income tax expense for fiscal year 2020 is \$25,000, to be paid on November 1, 2020. No entry has been recorded yet.

Required:

Prepare all necessary journal entries during fiscal year 2020 only (omit narrative explanations).

(5 marks)**Part B (11 marks):**

Zalpha Company, a clothing retailer, reports prepaid expenses and deferred revenues on its statement of financial position. The following information concerns adjusting entries that need to be recorded on December 31, 2019 for the year just ended. Assume no adjusting entries were recorded before December 31, 2019.

- a. The office supplies account had a balance of \$500 at the start of the fiscal year. During the year, the company purchased supplies at a cost of \$3,650, which was added to the Office Supplies account. The inventory of supplies on hand (in stock) at December 31 had a cost of \$700.
- b. The company has 10 employees who earn a total of \$2,000 per work day (i.e., 10 employees @ \$200). They are paid each Monday for their work in the five-day workweek ending on the preceding Friday. December 31, 2019 falls on Tuesday, and all 10 employees worked the first two days of the week. They were paid their salaries for five full days on Monday, January 6, 2020.
- c. Because the company is not large enough to occupy the entire building, it arranged to rent some space to a tenant at \$600 per month, starting on October 1, 2019. The rents for October and November *were* paid by the tenant on October 1, 2019, but the tenant has not paid the rent for December. However, he promised to pay the rent for both December and January in full on January 31, 2020.
- d. On October 31, 2019, the company renewed its insurance policy for five months at a cost of \$525 per month, effective November 1, 2019. Zalpha paid on October 31 the entire insurance premium for the next five months.

Required:

1. Use the information above to prepare adjusting journal entries at December 31, 2019. Omit narratives. **(7 marks)**
2. Prepare journal entries to record the subsequent cash transactions in January 2020. Omit narrative explanations. **(4 marks)**

QUESTION 3 (34 marks; 53 minutes) *Preparation of journal entries and financial statements*

Mitka Inc. reported the following accounts and balances in its unadjusted trial balance as at December 31, 2019. Note that the accounts are listed in alphabetic order.

Accounts payable	\$ 57,000
Accounts receivable	52,600
Accumulated depreciation – Equipment	12,000
Cash	168,000
Cost of sales	205,000
Deferred sales revenue	10,000
Dividends declared	20,000
Equipment, at cost	60,000
Interest expense	600
Merchandise inventory	17,000
Note payable, due June 1, 2021	30,000
Operating expenses	163,000
Prepaid expenses	4,800
Retained earnings, Jan. 1, 2019	43,000
Sales revenue	450,000
Contributed capital (990 common shares)	99,000
Supplies on hand	10,000

All of the above accounts have “normal” debit and credit balances, as defined in the textbook.

Additional information:

- Management estimates that 20 percent of the balance in Deferred sales revenue had actually been earned by December 31, 2019. Assume that the normal gross profit is 60% of the sales revenue.
- The balance in Prepaid expenses represents the premium for a one-year insurance policy, effective December 1, 2019.
- Mitka Inc. acquired the equipment on January 1, 2017. Depreciation expense for 2019 was determined to be \$6,000.
- A count of supplies as at December 31, 2019 showed that the cost of supplies that remained in stock was \$2,000.
- Interest on the note payable is 4 percent per year, payable monthly at the beginning of the following month. Interest was last paid on December 1, 2019 and was recorded properly at that time. The company signed the note on June 1, 2019.
- The company is subject to a 40% income tax rate. No amount has yet been recorded for income taxes in 2019.
- The company issued 90 shares throughout the year 2019.

Required:

1. Prepare in good form any necessary adjusting journal entries as at December 31, 2019 for events (a) to (g) above. You may omit narrative explanations, but be sure to show all calculations. Also, use “Operating expenses” in your journal entries for items (b), (c) and (d). This will save you time and space when you prepare the statement of earnings for requirement 2 below. **(10 marks)**
2. Prepare, in good form, a multiple-step statement of earnings for the year ended December 31, 2019. **(6 marks)**
3. Prepare, in good form, the liabilities and shareholders’ equity section of the classified statement of financial position as at December 31, 2019. **(9.5 marks)**
4. Calculate the total assets turnover ratio, the return on assets ratio and the return on equity ratio based on your answers to the previous requirements. Briefly explain and interpret the result of each ratio (provide one statement per ratio). Assume that at December 31, 2018 the balance in Contributed capital was \$95,000 and the balance in total assets equalled \$268,000. **(8.5 marks)**