

UNIVERSITY OF WATERLOO
School of Accountancy

AFM 101

Mid-Term Examination

Date & Time: June 13, 2005 1.5 hours
Pages: 15, including cover

Spring 2005
Professor: G. Stremlaw

Name: _____ **ID#** _____

Instructions:

- 1) Cordless calculators may be used. The calculator must be standalone with no other communications or data storage features.
- 2) Answer all the questions in the space provided in the exam.
- 3) Hand in the entire examination paper.
- 4) For all multiple choice questions, there is no mark penalty for incorrect responses.
- 5) Show details of all calculations you perform.
- 6) Please verify that this examination paper has the appropriate number of pages.

Question	Maximum Marks	Mark Awarded
1	35	
2	10	
3	6	
4	16	
5	8	
6	10	
Total	85	

Ratios

Price-Earnings Ratio

$$\frac{\text{Market Price}}{\text{Net Income}}$$

Financial Leverage Ratio

$$\frac{\text{Average Total Assets}}{\text{Average Shareholders' Equity}}$$

Total Asset Turnover Ratio

$$\frac{\text{Net Sales}}{\text{Average Total Assets}}$$

Earnings per Share

$$\frac{\text{Net Income Available to Common Shareholders}}{\text{Weighted-Average Number of Common Shares Outstanding during the Period}}$$

Net Profit Margin

$$\frac{\text{Net Income}}{\text{Net Sales}}$$

Quality of Income Ratio

$$\frac{\text{Cash Flow from Operating Activities}}{\text{Net Income}}$$

Capital Acquisition Ratio

$$\frac{\text{Cash Flow from Operating Activities}}{\text{Cash Paid for Property, Plant and Equipment}}$$

Return on Equity

$$\frac{\text{Net Income}}{\text{Average Shareholders' Equity}}$$

Question 1 (35 marks, 45 minutes)

Choose the correct response from the answers provided. **There is not a mark penalty for incorrect responses.** Please circle the correct response for each question clearly. If more than one answer is selected or your selection is unclear, you will receive no marks for that applicable question.

1. Identify the potential economic consequences of not following generally accepted accounting principles (GAAP).
 - A) It could affect the stock price of the company.
 - B) It could affect management and employee bonuses.
 - C) It could lead to a loss of competitive advantage over other companies.
 - D) All of these are potential consequences.

2. The purpose of an audit is to
 - A) prove the accuracy of an entity's financial statements.
 - B) lend credibility to an entity's financial statements.
 - C) endorse the quality of leadership that managers provide for a corporation.
 - D) establish that a corporation's stock is a sound investment.

3. The principle that requires us to record a transaction when we provide service to a client and bill them is
 - A) cost-benefit.
 - B) cost principle.
 - C) full disclosure.
 - D) revenue recognition.

4. An example of an external exchange would be
 - A) the purchase of inventory on credit from a supplier
 - B) cash received from a credit customer
 - C) cash dividend paid to stockholders
 - D) A, B and C are external exchanges

5. Rarro Corporation received \$50,000 cash invested by its owners. The effect on the fundamental accounting model was
 - A) assets and liabilities each increased by \$50,000.
 - B) assets and revenues each increased by \$50,000.
 - C) shareholders' equity and revenues each increased by \$50,000.
 - D) shareholders' equity and assets each increased by \$50,000.

6. The collection of an account receivable from a customer would
- A) Increase liabilities.
 - B) Decrease liabilities.
 - C) Not affect liabilities.
 - D) Decrease stockholders' equity.
7. The BAT Corporation had 20B revenues of \$100,000, expenses of \$75,000, and an income tax rate of 20 percent. Net income after taxes would be
- A) \$25,000.
 - B) \$20,000.
 - C) \$15,000.
 - D) \$ 5,000.
8. Jet Corporation was organized on March 1, 20B. Jet Corporation issued shares of capital stock to each of the six owners who paid in a total of \$3,000 cash. On the basis of transaction analysis, the following entry should be recorded in the accounts (dr = debit and cr = credit)
- A) Cash (dr), \$3,000; Revenue (cr), \$3,000.
 - B) Cash (cr), \$3,000; Stockholders' equity (dr), \$3,000.
 - C) Cash (dr), \$3,000; Contributed Capital (cr), \$3,000.
 - D) Cash (cr), \$3,000; Contributed Capital (dr), \$3,000.
9. The advantage of shortening the length of the operating cycle is
- A) reduction of operating costs
 - B) increased cash inflow
 - C) increased profits
 - D) A, B, and C are advantages
 - E) None of these is an advantage
10. Which of the following activities will most likely result in a reported **loss** on the income statement?
- A) The sale of inventory to customers
 - B) The sale of old equipment
 - C) The wages and benefits paid to employees
 - D) None of these would result in a loss

11. Two basic accounting principles determine when revenues and expenses are to be recorded under accrual basis accounting. They are
- A) recognition and measurement
 - B) revenue and matching
 - C) cost and matching
 - D) None of the responses listed.
12. Which of the following is not an example of the application of the revenue principle?
- A) Recording the sale of merchandise on credit in sales revenue.
 - B) Recording rent received in advance on unearned rent revenue.
 - C) Recording interest collected on unearned rent revenue.
 - D) Reducing the service revenue account for service revenue collected but not yet performed at the end of the accounting period.

13. During the accounting period, Luxor Company had the following data:

Sales of products:	
Cash received	\$70,000
On credit (not yet received)	\$10,000

Expenses:	
Cash paid	\$35,000
On credit (not yet paid)	3,000

This is the first year of business.

Therefore, sales revenue and expenses were

	Sales Revenue	Expenses
A)	\$80,000	\$35,000
B)	\$80,000	\$38,000
C)	\$70,000	\$35,000
D)	\$60,000	\$32,000

14. Which group of accounts contains only those that normally have a debit balance?
- A) Accounts receivable; Accumulated depreciation; Fees earned.
 - B) Bond investment; Cash; Contributed capital.
 - C) Cash; Inventory; Prepaid insurance.
 - D) Notes receivable; Wages payable; Operating expenses.
 - E) None of these is correct.

15. If Golden Corporation declared a dividend to its stockholders which has not been paid, this would
- A) increase liabilities.
 - B) increase stockholders' equity.
 - C) decrease liabilities.
 - D) increase assets.
16. Which of the following is not a correct statement about the unadjusted trial balance?
- A) It provides a listing of the accounts for the balance sheet only.
 - B) It provides data in a convenient form for the development of the financial statements.
 - C) It provides a check on the equality of the debits and credits of the ledger accounts.
 - D) All of the statements are correct.
 - E) None of the statements is correct.
17. On July 1, 20A, Bill Company signed a two-year \$8,000 note payable with 9 percent interest. At due date, July 1, 20C, the principal and interest will be paid in full. Interest expense should be reported on the income statement for the year ended December 31, 20A, in the amount of
- A) \$ 1,440.
 - B) \$ 720.
 - C) \$ 420.
 - D) \$ 360.
 - E) None of the above is correct.
18. On January 1, 20B, the ledger of Global Corporation correctly showed supplies inventory of \$500. During 20B, supplies purchases amounted to \$700. A count (inventory) of supplies on hand at December 31, 20B, showed \$400. The 20B income statement should report supplies expense amounting to
- A) \$ 1,200.
 - B) \$ 1,100.
 - C) \$ 800.
 - D) \$ 700.
 - E) None of the amounts is correct.
19. Which of the following statements best describes the relationship between net income for the period and the ending balance in retained earnings?
- A) Net income for the period increases the ending balance of retained earnings.
 - B) Retained earnings at the end of the period increases the amount of net income.
 - C) Net income for the period reduces the ending balance of retained earnings.
 - D) Net income for the period has no effect on the ending balance of retained earnings.
 - E) Beginning retained earnings plus net income always equals ending retained earnings.

20. Time Corporation reported the following for 20A:

Capital stock.....	5,000 shares outstanding
Revenues	\$100,000
Expenses	\$ 95,000

What was the amount of earnings per share?

- A) \$20.00.
 - B) \$19.00.
 - C) \$ 2.00.
 - D) \$ 1.00.
 - E) None of the amounts is correct.
21. Closing entries
- A) are required to reduce the balances in the nominal accounts to zero at the end of each period.
 - B) transfer the components of net income to a stockholders' equity account each period.
 - C) establish a zero balance in all revenue and expense accounts at the end of each period.
 - D) are required so that the income statement accounts will be prepared to collect revenue and expense amounts for the subsequent period.
 - E) All of the responses are correct.
22. The net profit margin is calculated by taking:
- A) net income divided by the number of common shares outstanding
 - B) gross profit divided by net sales
 - C) net income divided by net sales
 - D) None of the responses is the correct calculation of net profit margin
23. In what order are current assets usually reported on the balance sheet?
- A) From the most liquid to the least liquid.
 - B) From the least liquid to the most liquid.
 - C) In alphabetical order of accounts.
 - D) From the largest balance to the smallest balance.
 - E) In no particular order.

24. Discontinued operations are
- A) the amount reflected on the income statement for adjustments made to balance sheet accounts when applying different accounting principles.
 - B) the result of the disposal of a major segment of the business.
 - C) a gain or loss that is both unusual in nature and infrequent in occurrence.
 - D) a prediction of earnings for future accounting periods.
 - E) None of these statements is correct.
25. Libbyway, Inc., paid cash dividends of \$20,000 during 20A. In its statement of cash flows, the dividends would be shown as cash flow used in
- A) Operating activities.
 - B) Financing activities.
 - C) Investing activities.
 - D) Distributing activities.
 - E) None of these activities is correct.
26. Return on equity (ROE) primarily measures
- A) the ability to generate revenue while holding assets steady
 - B) the ability to generate sufficient profit on total assets
 - C) the ability to earn income for the common stockholders
 - D) None of these abilities
27. A company that sells magazines collects subscription fees prior to the publication and distribution of the magazine. As the cash is received in advance from the customers, the company should record a debit to Cash and a credit to
- A) Sales revenue.
 - B) Prepaid expenses.
 - C) Unearned revenue.
 - D) Accounts payable.
 - E) None of these is correct.
28. Credit terms of 2/10, n/30 indicate that a
- A) two percent discount for early payment is available if the invoice is paid before the tenth day of the month following the month the sale.
 - B) two percent discount for early payment is available within ten days of the invoice date.
 - C) ten percent discount for early payment is available if the invoice is paid within two days of the date of the invoice.
 - D) two percent discount for early payment is available if the invoice is paid after the tenth day, but before the thirtieth day of the invoice date.
 - E) None of these responses is correct.

29. Many businesses offer a sales discount to their business customers to
- A) provide an incentive to pay their bills early
 - B) reduce the likelihood the customer will not pay them
 - C) speed up the collection of cash so less borrowing is need for operations
 - D) encourage all of the responses listed
 - E) encourage none of the responses listed
30. T Co's gross profit percentage has been increasing in the three years from 1999 through 2001 from 36.5% to 39.8%. This change has most likely been caused by
- A) higher product costs
 - B) selling products with lower margins
 - C) selling products for higher prices
 - D) none of these responses
 - E) all of these responses
31. Which of the following is a benefit of increasing the receivables turnover ratio?
- A) Improved cash flow
 - B) Reduced level of receivables as a percentage of net credit sales
 - C) Reduced need for borrowing to support operations
 - D) All of these are benefits
 - E) None of these is a benefit
32. For accounting purposes, cash includes
- A) IOU's received from employees.
 - B) postage stamps accompanying an order received from a customer.
 - C) balances on deposit in banks.
 - D) a note received from a customer in settlement of an overdue account receivable.
 - E) a post-dated check received from a customer.
33. When preparing the monthly bank reconciliation, the accountant for Tiffany Toys noted that a check received from a customer last month for \$89 was marked NSF and returned along with the bank statement. In reconciling the bank balance with the company's cash account, the \$89 should be
- A) deducted from the bank balance.
 - B) added to the bank balance.
 - C) deducted from the company's cash balance.
 - D) added to the company's cash balance.

34. Under the completed-contract method, revenue is recognized
- A) when construction begins on the project.
 - B) when the project is complete.
 - C) throughout the project as cash payments are received from the customer.
 - D) throughout the project as bills are sent to the customer.
35. In the article “Companies Curbing Reliance On Pro Forma Figures-Survey”, Phyllis Plitch documented
- A) that pre-tax income needs to be scrutinized
 - B) amalgamation is an increasing trend
 - C) companies are relying more heavily on GAAP to adhere to SEC regulations
 - D) Hudson’s Bay Company’s profitability levels are skeptical

Question 2 (10 marks, 10 minutes)

Match the following terms with their definitions by placing the letter that identifies the best definition in the blank next to the term.

- A. Current assets divided by current liabilities.
- B. Accumulated earnings minus accumulated dividends.
- C. A gain or loss that is unusual in nature and infrequent in occurrence.
- D. Total assets minus total liabilities.
- E. Government agency which regulates financial disclosures for publicly traded companies.
- F. Information that is accurate, unbiased, and verifiable.
- G. Obligations to be paid with current assets normally within one year.
- H. Results from the disposal of a major segment of a business and is reported net of tax effects.
- I. Amount reflected on the income statement for adjustments made to balance sheet accounts when applying different accounting methods.
- J. Information that can influence a user's decision.
- K. Auditors' statement that the financial statements are fair presentations in all material respects in conformity with GAAP.

- ___ 1. Cumulative effect of changes in accounting methods
- ___ 2. Discontinued operations
- ___ 3. OSC
- ___ 4. Current ratio
- ___ 5. Stockholders' equity
- ___ 6. Reliable information
- ___ 7. Current liabilities
- ___ 8. Extraordinary item
- ___ 9. Retained earnings
- ___ 10. Unqualified audit report (clean opinion)

Question 3 (6 marks, 7 minutes)

Near the end of 20B, the ledger of Dice Company included the following accounts and balances:

Allowance for Doubtful Accts \$800 credit balance
Bad Debt Expense 0 balance
Accounts Receivable 50,000 debit balance

Cash collections on Accounts receivable during 20B amounted to \$148,500. Sales revenue during 20B amounted to \$200,000, of which 75% was on credit, and it was estimated that 2% of the credit sales made in 20B would ultimately become uncollectible. Before adjusting entries were made for 20B, (a) a \$600 account was determined to be uncollectible and written off by Dice and (b) bad debt expense was recorded to 20B. These adjustments are not reflected in the account balances above.

After the above entries were posted to the ledger, the account balances were as follows (give the amount under the appropriate debit or credit column):

	Transaction	Debit	Credit
A.	Allowance for doubtful accounts		
B.	Bad debt expense		
C.	Accounts receivable		

Question 4 (16 marks, 10 minutes)

For each of the following accounts, complete the chart below by indicating whether the account is an asset (A), liability (L), or shareholders' equity (SE) and whether the account usually has a debit (Dr) or credit (Cr) balance.

	Account	Balance Sheet Category	Debit or Credit
1.	Retained earnings		
2.	Office supplies		
3.	Contributed capital		
4.	Income taxes payable		
5.	Accounts receivable		
6.	Marketable securities		
7.	Dividends payable		
8.	Prepaid expenses		

Question 5 (8 marks, 8 minutes)

(A) Complete the following schedule for Gold Eye Company.

Transaction	Assets	Liabilities	Stockholders' Equity
Beginning financial position	\$75,000	\$25,000	\$50,000
Borrowed \$20,000 cash using a note payable, face amount \$20,000.			
Collected accounts receivable for cash, \$5,000.			
Paid accounts payable, \$1,000 cash.			
Purchased office supplies on credit, \$1,000.			
Sold stock to new investors for \$5,000 of cash.			
Paid a \$10,000 note payable.			
Ending financial position.			

(B) How much did cash change during the period?

Question 6 (10 marks, 10 minutes)

Plants Supreme, Inc., a small retail store which sells house plants, started business on January 1, 20A. At the end of January, 20A, the following information was available:

Sales of plants for cash	\$50,000
Sales of plants for credit	3,000
Cost of plants which were sold and paid for during January	30,000
Cash expenditures during January:	
Salaries	4,500
Telephone	100
Office Supplies (all used)	100
Electricity	200
Rent on the store for January, 20A	800
(will not be paid until February, 20A)	

A. Using the above information, prepare the income statement for Plants Supreme for the month ended January 31, 20A.

B. What is the amount of cash flows provided by operating activities to be presented on the statement of cash flows?

Answer Key

Question 1 (35 Marks)

1. D
2. B
3. D
4. D
5. D
6. C
7. B
8. C
9. D
10. B
11. B
12. C
13. B
14. C
15. A
16. A
17. D
18. C
19. A
20. D
21. E
22. C
23. A
24. B
25. B
26. C
27. C
28. B
29. D
30. C
31. D
32. C
33. C
34. B
35. C

(Question 6)

Question 2 (10 Marks)**(Question 5)**

1. I; 2. H; 3. E; 4. A; 5. D; 6. F; 7. G; 8. C; 9. B; 10. K

Question 3 (6 Marks)**(Question 3)**

	Transaction	Debit	Credit
A.	Allowance for doubtful accounts $800 + 3,000 - 600$		\$3,200
B.	Bad debt expense $150,000 \times 2\%$	\$ 3,000	
C.	Accounts receivable $50,000 - 148,500 + (200,000 \times 75\%) - 600$	\$50,900	

Question 4 (16 Marks)**(Question 4)**

1. SE, Cr
2. A, Dr
3. SE, Cr
4. L, Cr
5. A, Dr
6. A, Dr
7. L, Cr
8. A, Dr

Question 5 (8 Marks)

(Question 2)

(A)

Transaction	Assets	Liabilities	Stockholders' Equity
Beginning financial position	\$75,000	\$25,000	\$50,000
Borrowed \$20,000 cash using a note payable, face amount \$20,000.	+20,000	+20,000	
Collected accounts receivable for cash, \$5,000.	+5,000 -5,000		
Paid accounts payable, \$1,000 cash.	-1,000	-1,000	
Purchased office supplies on credit, \$1,000.	+1,000	+1,000	
Sold stock to new investors for \$5,000 of cash.	+5,000		+5,000
Paid a \$10,000 note payable.	-10,000	-10,000	
Ending financial position.	\$90,000	\$35,000	\$55,000

(B) Cash increase, \$19,000
 (+ 20,000 + 5,000 – 1,000 + 5,000 – 10,000)

Question 6 (10 Marks)

(Question 1)

A.

Plants Supreme, Inc.
 Income Statement
 For the Month Ended January 1, 20A

Revenue (\$50,000 + \$3,000).....	\$53,000
Expenses:	
Cost of goods sold.....	\$30,000
Salaries.....	4,500
Telephone.....	100
Office supplies used.....	100
Electricity.....	200
Rent.....	800
	35,700
Net income.....	\$17,300

B. $17,300 - 3,000 + 800 = \$15,100$ **OR** $\$50,000 - 30,000 - 4,500 - 100 - 100 - 200 = \$15,100$