

UNIVERSITY OF WATERLOO
School of Accounting and Finance

AFM 101
Professor Duane Kennedy
Professor Mindy Wolfe
Professor Catherine Wong

Mid-Term Examination
Fall 2009

Date and Time: October 22, 2009, 7:15 – 8:45pm

Pages: 16, including cover

Name: _____

Student Number: _____

Instructions:

- 1) Cordless calculators may be used. The calculator must be standalone with no other communication or data storage features.
- 2) Answers for the multiple-choice questions must be recorded on the UW answer card. All other questions must be answered in the space provided on the examination paper. Answers written outside of the provided space will not be graded. You must submit both this examination paper and the UW answer card.
- 3) Show details of all calculations.
- 4) The final page of the examination contains a list of ratios. For your convenience, this page may be detached from the examination paper.
- 5) Please verify that this examination paper has the appropriate number of pages.

Question	Maximum Marks	Mark Awarded
1	12	
2	14	
3	14	
4	8	
5	27	
Total	75	

Question 1 (12 Marks)

Wier Corporation provides catering services for small businesses. The following alphabetical listing shows all of the account balances taken from the unadjusted trial balance at the end of the fiscal year. All account balances have the usual sign (i.e., debit or credit).

Wier Corporation
Unadjusted Trial Balance
December 31, 2009

Accounts Payable	\$ 4,600
Accounts Receivable	7,800
Accumulated Amortization, Building	24,000
Accumulated Amortization, Equipment	16,700
Advertising Expense	22,200
Building	180,000
Capital Stock	110,000
Cash	15,100
Equipment	56,500
Interest Expense	8,250
Inventory	42,700
Land	198,900
Mortgage Payable	150,000
Operating Expenses	57,700
Retained Earnings (as at Dec 31, 2008)	130,150
Revenue	260,500
Salaries Expense	121,900
Unearned Revenue	15,100

Required:

Provide the adjusting journal entries required at December 31, 2009. You do not need to include explanations. Answers must appear in the space provided.

- A) The mortgage payable was borrowed on September 1, 2005 and must be repaid in ten years. The note has an 8% interest rate and interest is paid in equal amounts on February 28 and August 31.

- B) The equipment has an estimated life of 10 years with an expected salvage value of \$5,000. The company uses straight-line amortization.
- C) Wier Corporation provided catering services during the last week of December to customers who had paid in advance. The customers payments had been recorded as Unearned Revenue. These catering services had an invoice price of \$1,500.
- D) Salaries earned during the last week of December were \$1,800. These salaries will be paid on January 5, 2010.
- E) Wier Corporation has not recorded or sent invoices to customers for catering services provided during December. The invoices for a total of \$12,100 will be sent on January 3, 2010.
- F) The company had \$1,500 of inventory on hand on December 31, 2008. The company purchased \$41,200 of inventory during the year and debited the Inventory account. The manager counted the inventory on December 31, 2009 and found that inventory costing \$1,800 remained on hand.

Question 2 (14 marks)

Huson Limited is a small corporation which develops specialized business software. The company has been in business for a number of years and has net assets of \$350,000 and net liabilities of \$110,000 at the end of 2008. The company's fiscal year is December 31. All appropriate adjusting entries and closing entries were made at the end of December 2008.

Required:

Provide the journal entries required to record the following transactions that occurred in January 2009. You do not need to include explanations. Answers must appear in the space provided.

- A) The company issued 10,000 shares to new investors and received \$140,000 in cash.
- B) Huson Limited purchased new office furniture with a cost of \$9,500 from Thompson Ltd. Huson Limited paid \$1,500 in cash and signed a note promising payment of the remainder, including interest at an 8% annual rate, in six months.
- C) Huson Limited signed a contract with a customer for the development of new software. The software has a selling price of \$150,000. The customer paid a \$25,000 deposit and will pay the remaining \$125,000 when the software is delivered in April.

D) The company sold old computer equipment which had an original cost of \$40,000. The accumulated amortization on the equipment at December 31, 2008 is \$30,000. Huson Limited received \$8,000 in cash for the equipment.

E) The electric utility bill of \$780 for January was paid.

F) Dividends of \$5,000 were declared and paid on January 15.

G) Purchased \$1,200 of office supplies on account. Huson Limited expects to pay for supplies in February.

Question 3 (14 marks)

The following information and financial statements relate to Dunmore Limited for 2009:

- a) Purchased equipment for \$35,000 cash.
- b) Sold the long-term investment on January 1, 2009 for \$37,000.
- c) Sold equipment for \$14,000 that had originally cost \$43,000 and had \$29,000 of accumulated amortization.
- d) Issued \$44,000 of bonds payable at face value.
- e) Dividends were paid in cash.

Comparative Balance Sheet Information

	December 31	
Assets	<u>2009</u>	<u>2008</u>
Cash	\$376,700	\$195,000
Accounts receivable	123,900	85,000
Inventories	13,200	27,000
Long term investment	0	37,000
Equipment	272,000	280,000
Accumulated amortization, equipment	<u>(154,000)</u>	<u>(135,000)</u>
Total assets	<u>\$631,800</u>	<u>\$489,000</u>
Liabilities and Shareholders' Equity		
Accounts payable	\$94,100	\$63,000
Bonds payable	44,000	0
Capital stock	96,000	96,000
Retained earnings	<u>397,700</u>	<u>330,000</u>
Total liabilities and shareholders' equity	<u>\$631,800</u>	<u>\$498,000</u>

Income Statement

For the Year Ended December 31, 2009

Revenues (including gains)		\$162,000
Amortization expense	\$48,000	
Other expenses (including losses)	<u>29,000</u>	<u>77,000</u>
Income before taxes		\$85,000
Income tax expense		8,300
Net income		<u>\$76,700</u>

Required:

Prepare the statement of cash flows for Dunmore Limited for 2009 using the indirect method. *Please use the table on the following page to complete this question.* Be sure to prepare a schedule for any non-cash items for disclosure, if appropriate.

Dunmore Limited
Statement of Cash Flows

Operating Activities:

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<hr/>	<hr/>	
Net cash flow from operating activities		<hr/>

Investing Activities:

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Net cash flow from investing activities		<hr/>

Financing Activities

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<hr/>	<hr/>	
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Net cash flow from financing activities		<hr/>
<hr/>		<hr/>
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Non-cash Investing and Financing Activities

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Question 5 (27 marks)

Choose the correct response from the answers provided. There is no mark penalty for incorrect responses. Mark the correct responses by completing the University of Waterloo answer card, using a black lead HB pencil only. Write your name and student number on the answer card and **mark your student number in the appropriate ovals**. You **do not** need to complete the section number and card number. **Answers recorded on the following pages will not be marked.**

1. On January 1, 2009, Grover Inc., started the year with a \$22,000 credit balance in its retained earnings account. During 2009, the company earned net income of \$40,000 and declared and paid dividends of \$10,000. Also, the company received cash of \$15,000 as an additional investment by its owners. Therefore, the balance in retained earnings on December 31, 2009, would be which of the following?
 - A) \$42,000.
 - B) \$52,000.
 - C) \$57,000.
 - D) \$67,000.

2. Winn Company's 2009 income statement reported total revenues, \$110,000, and total expenses (including \$10,000 amortization), \$70,000 (i.e., a net income of \$40,000). The 2009 balance sheet reported the following: accounts receivable--beginning balance, \$16,000 and ending balance, \$14,000; wages payable--beginning balance, \$2,000 and ending balance, \$1,500. Therefore, based only on this information, the 2009 net cash inflow from operating activities was which of the following?
 - A) \$48,500.
 - B) \$50,000.
 - C) \$51,500.
 - D) \$59,500.

3. During 2009, Blue Corporation incurred operating expenses amounting to \$100,000, of which \$75,000 were paid in cash; the balance will be paid in January 2010. Transaction analysis of operating expenses for 2009, should reflect which of the following?
 - A) decrease shareholders' equity, \$75,000; decrease assets, \$75,000.
 - B) decrease assets, \$100,000; decrease shareholders' equity, \$100,000.
 - C) decrease assets, \$100,000; increase liabilities, \$25,000; decrease shareholders' equity, \$100,000.
 - D) decrease shareholders' equity, \$100,000; decrease assets, \$75,000; increase liabilities, \$25,000.

4. What are the primary qualities of accounting information that increase the usefulness to decision makers?
- A) relevance and cost-benefit.
 - B) reliability and comparability.
 - C) reliability and relevance.
 - D) materiality and relevance.
5. Hill's Copy Service performed photocopy services during December, 2009, but had not collected any cash (or other assets) from its customers by the end of the accounting period, December 31, 2009. What effect did performing these services have on the fundamental accounting model?
- A) Increased assets and increased liabilities.
 - B) Increased assets and increased shareholders' equity.
 - C) Increased assets and decreased shareholders' equity.
 - D) Decreased liabilities and decreased shareholders' equity.
6. Brooks Company sold equipment for \$100,000, purchased a building for \$80,000, sold long-term investments for \$20,000 and repaid a note payable for \$25,000 plus \$1,500 of interest. What was the net cash flow from investing activities (parentheses indicate an outflow)?
- A) (\$45,000).
 - B) \$13,500.
 - C) \$15,000.
 - D) \$40,000.
7. At the end of December, the owner of an apartment complex realized that the December rent had not been collected from one of the tenants. December 31 was the end of the accounting year; therefore, the owner made the appropriate adjusting entry at that time. When the December rent was collected in January of the following year, the entry made by the apartment owner should include which of the following?
- A) debit to Rent revenue receivable.
 - B) credit to Rent revenue receivable.
 - C) debit to Rent revenue collected in advance.
 - D) credit to Rent revenue.

8. The financial statements for Ozzie Company show the following:

Cost of Goods sold \$121,000

	Beginning Balance	Ending Balance
Merchandise inventory	\$25,000	\$26,000
Accounts Receivable	35,000	33,000
Accounts Payable	18,000	21,000

How much cash was paid for merchandise?

- A) \$117,000.
- B) \$119,000.
- C) \$121,000.
- D) \$124,000.

9. Assume a company's January 1, 2009, financial position was: Assets, \$40,000 and Liabilities, \$15,000. During January 2009, the company completed the following transactions: (a) paid on a note payable, \$4,000 (no interest); (b) collected accounts receivable, \$4,000; (c) paid accounts payable, \$2,000; and (d) purchased a truck, \$1,000 cash, and \$8,000 notes payable. What is the company's January 31, 2009, financial position?

	Assets	Liabilities	Shareholders' Equity
A)	\$42,000	\$ 9,000	\$33,000
B)	\$44,000	\$17,000	\$27,000
C)	\$43,000	\$18,000	\$25,000
D)	\$42,000	\$17,000	\$25,000

10. At the end of its accounting period, December 31, 2009, May Corporation owed \$1,000 for property taxes which had not been recorded nor paid. Therefore, the 2009 adjusting entry should be which of the following?

- A) \$1,000 credited to an expense account and debited to a liability account.
- B) \$1,000 debited to an expense account and credited to an asset account.
- C) \$1,000 credited to a liability account and debited to an expense account.
- D) \$1,000 debited to a liability account and credited to an asset account.

11. At the end of 2008, Libby Company reported an ending balance for retained earnings of \$50,000. During 2009, the company reported the following amounts: Dividends declared and paid, \$30,000 and net income, \$40,000. The 2009 statement of Retained Earnings should report an ending balance for retained earnings of which of the following?
- A) \$ 60,000.
 - B) \$ 80,000.
 - C) \$ 90,000.
 - D) \$100,000.
12. The debt-to-equity ratio does which of the following?
- A) assesses solvency or the relative proportion of the company financed by debt as opposed to equity financing
 - B) assesses the liquidity or ability to pay current obligations as they come due
 - C) assesses the profitable operations of the company
 - D) All of these are correct
13. Two basic accounting principles determine when revenues and expenses are to be recorded under accrual basis accounting. What are they?
- A) recognition and measurement
 - B) revenue and matching
 - C) cost and matching
 - D) cost and revenue
14. Abe Cox is the sole owner and manager of Cox Auto Repair Shop. In 2009, Cox purchased a new automobile for personal use and continued to use an old truck in the business. Which of the following fundamentals prevents Cox from recording the cost of the new automobile as an asset to the business?
- A) Separate-entity assumption.
 - B) Revenue principle.
 - C) Full disclosure.
 - D) Cost principle.
15. Which of the following statements about cash flows from operating activities, in a cash flow statement prepared under the indirect method, is correct?
- A) An increase in accounts receivable would be subtracted from net income.
 - B) An increase in salaries payable would be subtracted from net income.
 - C) An increase in inventory would be added to net income.
 - D) Depreciation expense would be subtracted from net income.

16. The owner of an office building should report rent collected in advance as a debit to cash and a credit to which of the following?
- A) a revenue.
 - B) an asset other than cash.
 - C) a liability.
 - D) an expense.
17. On July 1, 2009, Childe Company paid the premium in advance of \$2,400 for a two-year fire insurance policy on machinery. At that time, the full amount paid was recorded as prepaid insurance. On December 31, 2009, the end of the accounting year, the required adjusting entry should include which of the following?
- A) a \$600 debit to prepaid insurance.
 - B) a \$600 debit to insurance expense.
 - C) a \$2,400 credit to prepaid insurance.
 - D) a \$2,400 debit to insurance expense.
18. What is the primary difference between revenues and gains?
- A) Gains are increases in net assets from peripheral activities while revenues are increases from ongoing activities.
 - B) Generally accepted accounting principles makes no distinction between them since they both increase income.
 - C) Revenues cause increases in net assets as a result of peripheral activities and gains cause increases through ongoing activities.
 - D) Both revenues and gains cause a decrease in net assets from ongoing and peripheral transactions respectively.
19. On January 1, 2009, Milburn Corporation had the following balances in its shareholders' equity accounts: Common shares - \$100,000 (10,000 shares) and Retained earnings - \$30,000. During 2009, the company issued 1,000 additional shares of common shares for \$10 per share, reported net income of \$40,000, and paid cash dividends of \$20,000. What amount of total shareholders' equity would the company report in its December 31, 2009, balance sheet?
- A) \$120,000.
 - B) \$140,000.
 - C) \$160,000.
 - D) \$180,000.

20. Lori Company sold an operational asset, a machine, for cash. It originally cost \$20,000. The accumulated amortization at the date of disposal was \$15,000. A gain on the disposal of \$2,000 was reported. What was the cash inflow from this transaction?
- A) \$3,000.
 - B) \$4,000.
 - C) \$5,000.
 - D) \$7,000.
21. A company reports sales revenue of \$120 million this year and \$110 million last year. Their total assets in the current year are \$80 million and last year's total assets were \$75 million. What is the current year's asset turnover ratio?
- A) 1.46
 - B) 1.50
 - C) 1.55
 - D) 1.61
22. Operating cash inflows and outflows are primarily connected to which of the following?
- A) acquisitions and sale of long lived assets
 - B) the sale of goods and services to customers and costs incurred to operate the business
 - C) issuance of shares, bank borrowings and repayments, and dividend payments
 - D) purchase and sale of long-term investments
23. On July 1, 2007, Bill Company signed a two-year \$8,000 note payable with 9 percent interest. At due date, July 1, 2009, the principal and interest will be paid in full. Interest expense should be reported on the income statement for the year ended December 31, 2007, in the amount of which of the following?
- A) \$ 360.
 - B) \$ 420.
 - C) \$ 720.
 - D) \$ 1,440.
24. Espresso Company purchased a machine that cost \$28,000 and had an estimated useful life of 7 years (no residual value) on January 1, 2008. The company uses the straight-line method of amortization. The net book value at the end of 2009, would be which of the following?
- A) \$16,000.
 - B) \$20,000.
 - C) \$24,000.
 - D) \$28,000.

25. The asset turnover ratio is used to assess which of the following?
- A) whether the company can pay their bills currently due with their existing cash and receivables
 - B) whether the company can borrow money from the bank
 - C) whether the company is using its assets effectively in generating sales revenue
 - D) whether the company is collecting cash from credit customers in a timely manner
26. Failure to make an adjusting entry to recognize accrued salaries payable would cause which of the following?
- A) an understatement of expenses and liabilities and an overstatement of shareholders' equity.
 - B) an overstatement of expenses and liabilities.
 - C) an understatement of expenses, liabilities and shareholders' equity.
 - D) an understatement of assets and shareholders' equity.
27. The operating cycle of a business is best defined as which of the following?
- A) the period of time for which we prepare our financial statements
 - B) the length of time over which our plant and equipment assets are expected to be used by the company in generating revenues
 - C) the time it takes for a company to purchase and pay for goods or services from suppliers, sell those goods or services to customers and collect cash from the customers
 - D) one year

Ratios

Price- Earnings Ratio	$\frac{\text{Market Price}}{\text{Net Income}}$
Debt to Equity Ratio	$\frac{\text{Total Liabilities}}{\text{Total Owners' Equity}}$
Total Asset Turnover Ratio	$\frac{\text{Net Sales}}{\text{Average Total Assets}}$
Return on Assets	$\frac{\text{Net Income}}{\text{Average Total Assets}}$
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	$\frac{\text{Net Income}}{\text{Net Sales}}$
Return on Equity	$\frac{\text{Net Income}}{\text{Average Shareholders' Equity}}$
Quality of Income Ratio	$\frac{\text{Cash Flow from Operating Activities}}{\text{Net Income}}$
Capital Acquisition Ratio	$\frac{\text{Cash Flow from Operating Activities}}{\text{Cash Paid for Property, Plant, and Equipment}}$

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Pages: 16, including cover

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3	14	
4	8	
5	27	
Total	75	

Question 1 (12 Marks)

Wier Corporation provides catering services for small businesses. The following alphabetical listing shows all of the account balances taken from the unadjusted trial balance at the end of the fiscal year. All account balances have the usual sign.

Wier Corporation
Unadjusted Trial Balance
December 31, 2009

Accounts Payable	\$ 4,600
Accounts Receivable	7,800
Accumulated Amortization, Building	24,000
Accumulated Amortization, Equipment	16,700
Advertising Expense	22,200
Building	180,000
Capital Stock	110,000
Cash	15,100
Equipment	56,500
Interest Expense	8,250
Inventory	42,700
Land	198,900
Mortgage Payable	150,000
Operating Expenses	57,700
Retained Earnings (as at Dec 31, 2008)	130,150
Revenue	260,500
Salaries Expense	121,900
Unearned Revenue	15,100

Required:

Provide the adjusting entries required at December 31, 2009. You do not need to include explanations. Answers must appear in the space provided.

- A) The mortgage payable was borrowed on September 1, 2005 and must be repaid in ten years. The note has an 8% interest rate and interest is paid in equal amounts on February 28 and August 31.

Interest Expense	\$4,000	
Interest Payable		\$4,000
$\\$150,000 * 8% * 4/12$		

- B) The equipment has an estimated life of 10 years with an expected salvage value of \$5,000. The company uses straight-line amortization.

Amortization Expense	\$5,150	
Accumulated Amortization		\$5,150
(\$56,500 – 5,000) / 10 years		

- C) Wier Corporation provided catering services during the last week of December to customers who had paid in advance. The customers payments had been recorded as Unearned Revenue. These catering services had an invoice price of \$1,500.

Unearned Revenue	\$1,500	
Revenue		\$1,500

- D) Salaries earned during the last week of December were \$1,800. These salaries will be paid on January 5, 2010.

Salaries Expense	\$1,800	
Salaries Payable		\$1,800

- E) Wier Corporation has not recorded or sent invoices to customers for catering services during December. The invoices for a total of \$12,100 will be sent on January 3, 2010.

Accounts Receivable	\$12,100	
Revenue		\$12,100

- F) The company had \$1,500 of inventory on hand on December 31, 2008. The company purchased \$41,200 of inventory during the year and debited the Inventory account. The manager counted the inventory on December 31, 2009 and found that inventory costing \$1,800 remained on hand.

Cost of Goods Sold	\$40,900	
Inventory		\$40,900
\$42,700 – 1,800		

Question 2 (14 marks)

Huson Limited is a small corporation which develops specialized business software. The company has been in business for a number of years and has net assets of \$350,000 and net liabilities of \$110,000 at the end of 2008. The company's fiscal year is December 31. All appropriate adjusting entries and closing entries were made at the end of December 2008.

Required:

Provide the journal entries required to record the following transactions that occurred in January 2009. You do not need to include explanations. Answers must appear in the space provided.

A) The company issued 10,000 shares to new investors and received \$140,000 in cash.

Cash	\$140,000	
Common Shares		\$140,000

B) Huson Limited purchased new office furniture with a cost of \$9,500 from Thompson Ltd. Huson Limited paid \$1,500 in cash and signed a note promising payment of the remainder, including interest at an 8% annual rate, in six months.

Office Furniture	\$9,500	
Cash		\$1,500
Note Payable		8,000

C) Huson Limited signed a contract with a customer for the development of new software. The software has a selling price of \$150,000. The customer paid a \$25,000 deposit and will pay the remaining \$125,000 when the software is delivered in April.

Cash	\$25,000	
Unearned Revenue		\$25,000

D) The company sold old computer equipment which had an original cost of \$40,000. The accumulated amortization on the equipment at December 31, 2008 is \$30,000. Huson Limited received \$8,000 in cash for the equipment.

Cash	\$8,000	
Accumulated Amortization	30,000	
Loss on Sale of Equipment	2,000	
Equipment		\$40,000

E) The electric utility bill of \$780 for January was paid.

Utility Expenses	\$780	
Cash		\$780

F) Dividends of \$5,000 were declared and paid on January 15.

Retained Earnings (or Dividends)	\$5,000	
Cash		\$5,000

G) Purchased \$1,200 of office supplies on account. Huson Limited expects to pay for supplies in February.

Office Supplies Inventory	\$1,200	
Accounts Payable		\$1,200

Question 3 (14 marks)

The following information and financial statements relate to Dunmore Limited for 2009:

- a) Purchased equipment for \$35,000 cash.
- b) Sold the long-term investment on January 1, 2009 for \$37,000.
- c) Sold equipment for \$14,000 that had originally cost \$43,000 and had \$29,000 of accumulated amortization.
- d) Issued \$44,000 of bonds payable at face value.
- e) Dividends were paid in cash.

Comparative Balance Sheet Information

	December 31	
Assets	<u>2009</u>	<u>2008</u>
Cash	\$376,700	\$195,000
Accounts receivable	123,900	85,000
Inventories	13,200	27,000
Long term investment	0	37,000
Equipment	272,000	280,000
Accumulated amortization, equipment	<u>(154,000)</u>	<u>(135,000)</u>
Total assets	<u>\$631,800</u>	<u>\$489,000</u>
Liabilities and Shareholders' Equity		
Accounts payable	\$94,100	\$63,000
Bonds payable	44,000	0
Capital stock	96,000	96,000
Retained earnings	<u>397,700</u>	<u>330,000</u>
Total liabilities and shareholders' equity	<u>\$631,800</u>	<u>\$498,000</u>

Income Statement

For the Year Ended December 31, 2009

Revenues (including gains)		\$162,000
Amortization expense	\$48,000	
Other expenses (including losses)	<u>29,000</u>	<u>77,000</u>
Income before taxes		\$85,000
Income tax expense		8,300
Net income		<u>\$76,700</u>

Required:

Prepare the statement of cash flows for Dunmore Limited for 2009 using the indirect method. *Please use the table on the following page to complete this question.* Be sure to prepare a schedule for any non-cash items for disclosure, if appropriate.

Dunmore Limited
Statement of Cash Flows
for the year ended December 31, 2009

Operating Activities:

<u>Net Income</u>	<u>\$76,700</u>	
<u>Add (deduct) items not affecting cash</u>		
<u>Amortization Expense</u>	<u>48,000</u>	
<u>Increase in accounts receivable</u>	<u>(38,900)</u>	
<u>Decrease in inventories</u>	<u>13,800</u>	
<u>Increase in accounts payable</u>	<u>31,100</u>	
_____	_____	
_____	_____	
_____	_____	
_____	_____	
Net cash flow from operating activities		<u>\$130,700</u>

Investing Activities:

<u>Sale of long-term investment</u>	<u>\$37,000</u>	
<u>Purchase of equipment</u>	<u>(35,000)</u>	
<u>Sale of equipment</u>	<u>14,000</u>	
_____	_____	
Net cash flow from investing activities		<u>16,000</u>

Financing Activities:

<u>Issue bonds</u>	<u>\$44,000</u>	
<u>Payment of dividends</u>	<u>(9,000)</u>	
_____	_____	
_____	_____	
Net cash flow from financing activities		<u>35,000</u>
<u>Net increase in cash</u>		<u>\$181,700</u>
<u>Cash, beginning of year</u>		<u>195,000</u>
<u>Cash, end of year</u>		<u>\$376,700</u>

Non-cash Investing and Financing Activities

Question 4 (8 Marks)

The answers to the following questions must appear in the space provided.

- A. Discuss the role of the auditors in the financial reporting process for a publicly traded company.
- **Review the underlying accounting processes and information in order to express an opinion on the fairness of the financial statements**
 - **Ensure and conclude that financial statements comply with GAAP**
- B. The article “Capital Pains: Big Cash Hoards” discusses the level of cash and treasure shares in US companies. Briefly discuss potential uses for these large cash balances.
- **Keep the money in the bank**
 - **Return it to the shareholders through dividends or share repurchases**
 - **Seek growth by investing in their own businesses or buying another company**
 - **Pay off some of the company’s own debt**
- C. Discuss the benefits of a high value for the Capital Acquisition Ratio. (A list of the ratios appears on the final page of the examination.)
- **Less likely to need additional debt to finance purchase of fixed assets**
 - **This reduces interest costs and bankruptcy risks associated with higher levels of debt**
 - **Less likely to need to issue additional capital stock to finance purchase of fixed assets**
 - **Avoids the dilution effect on existing shareholders**
 - **More likely to be able to finance internally the purchase of fixed assets**
- D. Various articles discuss the implications of aggressive accounting. Briefly discuss the meaning of the term “aggressive accounting.”
- **Making choices among accounting alternatives that lead to higher asset, revenue, and income numbers or lower liability or expense numbers in the current year**

Question 5 (27 marks)

Choose the correct response from the answers provided. There is no mark penalty for incorrect responses. Mark the correct responses by completing the University of Waterloo answer card, using a black lead HB pencil only. Write your name and student number on the answer card and **mark your student number in the appropriate ovals**. You **do not** need to complete the section number and card number. **Answers recorded on the following pages will not be marked.**

1. On January 1, 2009, Grover Inc., started the year with a \$22,000 credit balance in its retained earnings account. During 2009, the company earned net income of \$40,000 and declared and paid dividends of \$10,000. Also, the company received cash of \$15,000 as an additional investment by its owners. Therefore, the balance in retained earnings on December 31, 2009, would be which of the following?
 - A) \$42,000.
 - B) \$52,000.
 - C) \$57,000.
 - D) \$67,000.

2. Winn Company's 2009 income statement reported total revenues, \$110,000, and total expenses (including \$10,000 amortization), \$70,000 (i.e., a net income of \$40,000). The 2009 balance sheet reported the following: accounts receivable--beginning balance, \$16,000 and ending balance, \$14,000; wages payable--beginning balance, \$2,000 and ending balance, \$1,500. Therefore, based only on this information, the 2009 net cash inflow from operating activities was which of the following?
 - A) \$48,500.
 - B) \$50,000.
 - C) \$51,500.
 - D) \$59,500.

3. During 2009, Blue Corporation incurred operating expenses amounting to \$100,000, of which \$75,000 were paid in cash; the balance will be paid in January 2010. Transaction analysis of operating expenses for 2009, should reflect which of the following?
 - A) decrease shareholders' equity, \$75,000; decrease assets, \$75,000.
 - B) decrease assets, \$100,000; decrease shareholders' equity, \$100,000.
 - C) decrease assets, \$100,000; increase liabilities, \$25,000; decrease shareholders' equity, \$100,000.
 - D) decrease shareholders' equity, \$100,000; decrease assets, \$75,000; increase liabilities, \$25,000.

4. What are the primary qualities of accounting information that increase the usefulness to decision makers?
- A) relevance and cost-benefit.
 - B) reliability and comparability.
 - C) reliability and relevance.
 - D) materiality and relevance.
5. Hill's Copy Service performed photocopy services during December, 2009, but had not collected any cash (or other assets) from its customers by the end of the accounting period, December 31, 2009. What effect did performing these services have on the fundamental accounting model?
- A) Increased assets and increased liabilities.
 - B) Increased assets and increased shareholders' equity.
 - C) Increased assets and decreased shareholders' equity.
 - D) Decreased liabilities and decreased shareholders' equity.
6. Brooks Company sold equipment for \$100,000, purchased a building for \$80,000, sold long-term investments for \$20,000 and repaid a note payable for \$25,000 plus \$1,500 of interest. What was the net cash flow from investing activities (parentheses indicate an outflow)?
- A) (\$45,000).
 - B) \$13,500.
 - C) \$15,000.
 - D) \$40,000.
7. At the end of December, the owner of an apartment complex realized that the December rent had not been collected from one of the tenants. December 31 was the end of the accounting year; therefore, the owner made the appropriate adjusting entry at that time. When the December rent was collected in January of the following year, the entry made by the apartment owner should include which of the following?
- A) debit to Rent revenue receivable.
 - B) credit to Rent revenue receivable.
 - C) debit to Rent revenue collected in advance.
 - D) credit to Rent revenue.

8. The financial statements for Ozzie Company show the following:

Cost of Goods sold \$121,000

	Beginning Balance	Ending Balance
Merchandise inventory	\$25,000	\$26,000
Accounts Receivable	35,000	33,000
Accounts Payable	18,000	21,000

How much cash was paid for merchandise?

- A) \$117,000.
- B) \$119,000.
- C) \$121,000.
- D) \$124,000.

9. Assume a company's January 1, 2009, financial position was: Assets, \$40,000 and Liabilities, \$15,000. During January 2009, the company completed the following transactions: (a) paid on a note payable, \$4,000 (no interest); (b) collected accounts receivable, \$4,000; (c) paid accounts payable, \$2,000; and (d) purchased a truck, \$1,000 cash, and \$8,000 notes payable. What is the company's January 31, 2009, financial position?

	Assets	Liabilities	Shareholders' Equity
A)	\$42,000	\$ 9,000	\$33,000
B)	\$44,000	\$17,000	\$27,000
C)	\$43,000	\$18,000	\$25,000
D)	\$42,000	\$17,000	\$25,000

10. At the end of its accounting period, December 31, 2009, May Corporation owed \$1,000 for property taxes which had not been recorded nor paid. Therefore, the 2009 adjusting entry should be which of the following?

- A) \$1,000 credited to an expense account and debited to a liability account.
- B) \$1,000 debited to an expense account and credited to an asset account.
- C) \$1,000 credited to a liability account and debited to an expense account.
- D) \$1,000 debited to a liability account and credited to an asset account.

11. At the end of 2008, Libby Company reported an ending balance for retained earnings of \$50,000. During 2009, the company reported the following amounts: Dividends declared and paid, \$30,000 and net income, \$40,000. The 2009 statement of Retained Earnings should report an ending balance for retained earnings of which of the following?
- A) \$ 60,000.
 - B) \$ 80,000.
 - C) \$ 90,000.
 - D) \$100,000.
12. The debt-to-equity ratio does which of the following?
- A) assesses solvency or the relative proportion of the company financed by debt as opposed to equity financing
 - B) assesses the liquidity or ability to pay current obligations as they come due
 - C) assesses the profitable operations of the company
 - D) All of these are correct
13. Two basic accounting principles determine when revenues and expenses are to be recorded under accrual basis accounting. What are they?
- A) recognition and measurement
 - B) revenue and matching
 - C) cost and matching
 - D) cost and revenue
14. Abe Cox is the sole owner and manager of Cox Auto Repair Shop. In 2009, Cox purchased a new automobile for personal use and continued to use an old truck in the business. Which of the following fundamentals prevents Cox from recording the cost of the new automobile as an asset to the business?
- A) Separate-entity assumption.
 - B) Revenue principle.
 - C) Full disclosure.
 - D) Cost principle.
15. Which of the following statements about cash flows from operating activities, in a cash flow statement prepared under the indirect method, is correct?
- A) An increase in accounts receivable would be subtracted from net income.
 - B) An increase in salaries payable would be subtracted from net income.
 - C) An increase in inventory would be added to net income.
 - D) Depreciation expense would be subtracted from net income.

16. The owner of an office building should report rent collected in advance as a debit to cash and a credit to which of the following?
- A) a revenue.
 - B) an asset other than cash.
 - C) a liability.
 - D) an expense.
17. On July 1, 2009, Childe Company paid the premium in advance of \$2,400 for a two-year fire insurance policy on machinery. At that time, the full amount paid was recorded as prepaid insurance. On December 31, 2009, the end of the accounting year, the required adjusting entry should include which of the following?
- A) a \$600 debit to prepaid insurance.
 - B) a \$600 debit to insurance expense.
 - C) a \$2,400 credit to prepaid insurance.
 - D) a \$2,400 debit to insurance expense.
18. What is the primary difference between revenues and gains?
- A) Gains are increases in net assets from peripheral activities while revenues are increases from ongoing activities.
 - B) Generally accepted accounting principles makes no distinction between them since they both increase income.
 - C) Revenues cause increases in net assets as a result of peripheral activities and gains cause increases through ongoing activities.
 - D) Both revenues and gains cause a decrease in net assets from ongoing and peripheral transactions respectively.
19. On January 1, 2009, Milburn Corporation had the following balances in its shareholders' equity accounts: Common shares - \$100,000 (10,000 shares) and Retained earnings - \$30,000. During 2009, the company issued 1,000 additional shares of common shares for \$10 per share, reported net income of \$40,000, and paid cash dividends of \$20,000. What amount of total shareholders' equity would the company report in its December 31, 2009, balance sheet?
- A) \$120,000.
 - B) \$140,000.
 - C) \$160,000.
 - D) \$180,000.

20. Lori Company sold an operational asset, a machine, for cash. It originally cost \$20,000. The accumulated amortization at the date of disposal was \$15,000. A gain on the disposal of \$2,000 was reported. What was the cash inflow from this transaction?
- A) \$3,000.
 - B) \$4,000.
 - C) \$5,000.
 - D) \$7,000.
21. A company reports sales revenue of \$120 million this year and \$110 million last year. Their total assets in the current year are \$80 million and last year's total assets were \$75 million. What is the current year's asset turnover ratio?
- A) 1.46
 - B) 1.50
 - C) 1.55
 - D) 1.61
22. Operating cash inflows and outflows are primarily connected to which of the following?
- A) acquisitions and sale of long lived assets
 - B) the sale of goods and services to customers and costs incurred to operate the business
 - C) issuance of shares, bank borrowings and repayments, and dividend payments
 - D) purchase and sale of long-term investments
23. On July 1, 2007, Bill Company signed a two-year \$8,000 note payable with 9 percent interest. At due date, July 1, 2009, the principal and interest will be paid in full. Interest expense should be reported on the income statement for the year ended December 31, 2007, in the amount of which of the following?
- A) \$ 360.
 - B) \$ 420.
 - C) \$ 720.
 - D) \$ 1,440.
24. Espresso Company purchased a machine that cost \$28,000 and had an estimated useful life of 7 years (no residual value) on January 1, 2008. The company uses the straight-line method of amortization. The net book value at the end of 2009, would be which of the following?
- A) \$16,000.
 - B) \$20,000.
 - C) \$24,000.
 - D) \$28,000.

25. The asset turnover ratio is used to assess which of the following?
- A) whether the company can pay their bills currently due with their existing cash and receivables
 - B) whether the company can borrow money from the bank
 - C) whether the company is using its assets effectively in generating sales revenue
 - D) whether the company is collecting cash from credit customers in a timely manner
26. Failure to make an adjusting entry to recognize accrued salaries payable would cause which of the following?
- A) an understatement of expenses and liabilities and an overstatement of shareholders' equity.
 - B) an overstatement of expenses and liabilities.
 - C) an understatement of expenses, liabilities and shareholders' equity.
 - D) an understatement of assets and shareholders' equity.
27. The operating cycle of a business is best defined as which of the following?
- A) the period of time for which we prepare our financial statements
 - B) the length of time over which our plant and equipment assets are expected to be used by the company in generating revenues
 - C) the time it takes for a company to purchase and pay for goods or services from suppliers, sell those goods or services to customers and collect cash from the customers
 - D) one year

Answer Key For Multiple Choice

1. B
2. C
3. D
4. C
5. B
6. D
7. B
8. B
9. D
10. C
11. A
12. A
13. B
14. A
15. A
16. C
17. B
18. A
19. C
20. D
21. C
22. B
23. A
24. B
25. C
26. A
27. C