

York University
Faculty of Liberal Arts and Professional Studies
School of Administrative Studies

AP/ADMS 3585 Intermediate Financial Accounting I
Midterm Examination 1 – VERSION A
Summer 2014

Instructors: Bartosz Amerski (section A) and Alla Volodina (section B)

June 21st, 2014
1:00pm to 4:00pm (3 hours)

Student name: _____

Student number: _____

Section: **A** **B**

Sign in sheet number: _____

Instructions:

1. This is a closed book examination. You are allowed to use a calculator. No other reading aids allowed.
2. There are 13 pages in total excluding the cover page.
3. Mark your multiple choice answers on the scantron sheet. Answers on the scantron sheet are final. No part marks will be given.
4. Answer Part B and C on the exam paper. Response written in pencil will not be remarked.
5. You may use the last page for rough work. This page will not be marked.
- 6. INCLUDE ALL OF YOUR RESPONSES IN THIS EXAMINATION PAPER WITH AN EXCEPTION OF QUESTION E. DO NOT INCLUDE YOUR RESPONSE TO QUESTION E IN THIS EXAMINATION PAPER. USE THE BOOKLETS PROVIDED TO YOU FOR QUESTION E ONLY.**

IMPORTANT: any responses to question E included in this examination paper will NOT be MARKED. Any responses to questions A – D included in the booklets will NOT be MARKED.

Marks Breakdown						
Question	MC	Part B	Part C	Part D	Part E	Total
Maximum Score	30	17	30	6	20	112
Suggested time (minutes)	52	30	52	10	35	180
Student Score						

PART A – 30 MC Questions (1 Mark each. Suggested time – 60 min)

Use the following information for questions 1 and 2.

1. The 2014 and 2015 financial statements of Bartosz & Alla Inc. contained the following errors:

	2014	2015
Ending inventory	\$10,000 overstated	\$16,000 understated
Insurance expense	4,800 understated	2,600 overstated

Assuming that none of the errors were detected or corrected, by what amount will 2014 income before taxes be overstated or understated?

- a) \$5,200 understated
 - b) \$5,200 overstated
 - c) \$14,800 overstated**
 - d) \$14,800 understated
2. Assuming that none of the errors were detected or corrected, by what amount will 2015 income before taxes be overstated or understated?
- a) \$28,600 understated**
 - b) \$23,800 understated
 - c) \$13,400 understated
 - d) \$13,400 overstated
3. Which of the following does NOT describe a cause of management bias?
- a) the need to comply with contracts, such as debt covenants
 - b) the desire to meet financial analysts' expectations
 - c) the tendency to downplay negative events
 - d) the desire for all stakeholders to have access to all information**
4. During 2014, Cantaloupe Corp disposed of Raspberry Division, a major segment of its business. Cantaloupe realized a gain of \$1,500,000, net of taxes, on the sale of Raspberry's assets. During 2014, Raspberry's operating losses, net of taxes, were \$1,800,000. How should these facts be reported in Cantaloupe's income statement for 2014?

	1. <u>Total Amount to be Included in</u>
	ii. <u>Income from</u> <u>Results of</u>
	b) <u>Continuing Operations</u> <u>Discontinued Operations</u>
a)	\$1,800,000 loss \$1,500,000 gain
b)	300,000 loss 0
c)	0 300,000 loss
d)	1,500,000 gain 1,800,000 loss

5. During a major renovation project of its head office, a worker was seriously injured. While the company believes that it was not at fault, it does include the incident in the notes to its financial statements. This is consistent with the
- full disclosure principle.**
 - periodicity assumption.
 - going concern assumption.
 - economic entity assumption.
6. The exercise of professional judgement does NOT involve
- the use of knowledge gained through education.
 - the application of knowledge gained through experience.
 - the use of ethical decision making.
 - aggressive accounting.**
7. Accounting information is considered to be relevant when it
- can be depended on to represent the economic conditions and events that it is intended to represent.
 - is capable of making a difference in a decision.**
 - is understandable by reasonably informed users of accounting information.
 - is verifiable and neutral.

A product and service are bundled together and sold to customers for \$350. The fair values of the product and service are \$300 and \$100 respectively.

8. Under the relative fair value method, how much would be allocated to the product?
- \$300.00
 - \$262.50**
 - \$200.00
 - \$175.00
9. Under the residual method, how much would be allocated to the product?
- \$300.00
 - \$262.50
 - \$250.00**
 - \$200.00
10. On January 1, 2014, the merchandise inventory of Morton Corp. was \$600,000. During 2014, Morton purchased \$1,150,000 of merchandise and recorded sales of \$1,350,000. The gross profit rate on these sales was 35%. What is the estimated dollar value of the inventory at December 31?
- \$877,500
 - \$872,500**
 - \$562,500
 - \$472,500

Use the following information for question 11.

The following information is available for Anselmo Corporation's inventories:

December 31, 2014:

At cost: \$585,000

At lower of cost and net realizable value (NRV): \$525,000

Anselmo uses a periodic inventory system and an allowance account to adjust its inventory from cost to the lower of cost and NRV.

11. Anselmo's 2014 journal entry to adjust its inventory from cost to the lower of cost and net realizable value (NRV) will include a
- debit of \$60,000 to Loss on Inventory Due to Decline in NRV.**
 - credit of \$60,000 to Loss on Inventory Due to Decline in NRV.
 - debit of \$60,000 to Allowance to Reduce Inventory to NRV.
 - credit of \$60,000 to Inventory.
12. The assumption that a business enterprise will NOT be sold or liquidated in the near future is known as the
- economic entity assumption.
 - monetary unit assumption.
 - fair value principle.
 - going concern assumption.**

Blueberry Inc. reported the following information for 2014:

Sales revenue	\$520,000
Cost of goods sold	350,000
Operating expenses	55,000
Gain on the sale of equipment.....	70,000
Cash dividends received on investment securities	3,000

13. For 2014, on a multiple-step income statement, Blueberry would report other income of
- \$185,000.
 - \$ 73,000.**
 - \$ 70,000.
 - \$ 3,000.
14. Which one of the following types of losses is excluded from the determination of net income in the income statement?
- material losses resulting from correction of errors related to prior periods**
 - material losses resulting from sale of assets not originally acquired for resale
 - material losses resulting from write-off of intangibles
 - material losses resulting from sale of investments

15. Which of the following is a required disclosure in the income statement when reporting the disposal of a segment of the business?
- a) The gain or loss on disposal should be reported as an unusual item.
 - b) Results of operations of a discontinued segment should be disclosed immediately below other irregular items.
 - c) Earnings per share from both continuing operations and net income should be disclosed on the face of the statement or in the notes.**
 - d) The gain or loss on disposal should not be segregated, but should be reported together with the results of continuing operations.
16. Financial instruments do NOT include
- a) cash.
 - b) inventory.**
 - c) derivatives.
 - d) accounts payable.
17. An example of an item which is NOT an element of working capital is
- a) accrued interest on notes receivable.
 - b) goodwill.**
 - c) inventory.
 - d) short-term investments.
18. On January 1, 2014, Trumpet Ltd. sold land that cost \$180,000 for \$240,000, receiving a note bearing interest at 10 percent. The note will be paid in three annual instalments of \$96,510 starting December 31, 2014. Assuming that collection of the note is very uncertain, how much revenue from this sale should Trumpet recognize in 2014?
- a) \$0**
 - b) \$18,000
 - c) \$24,000
 - d) \$96,510
19. The inventory turnover ratio is calculated by dividing the cost of goods sold by
- a) beginning inventory.
 - b) ending inventory.
 - c) average inventory.**
 - d) number of days in the year.
20. In preparing a statement of cash flows, repurchase of a company's own shares at an amount greater than cost would be classified as a(n)
- a) operating activity.
 - b) extraordinary activity.
 - c) financing activity.**
 - d) investing activity.
21. A statement of cash flows prepared under the INDIRECT method adds and subtracts certain items to the base number. Decreases in unearned revenues would be shown as
- a) a deduction from net income.**
 - b) an addition to net income.

- c) a deduction from sales.
 - d) an addition to sales.
22. Free cash flow is calculated as net cash provided by operating activities less
- a) capital expenditures.
 - b) dividends.
 - c) capital expenditures and dividends.**
 - d) capital expenditures and depreciation.

Tehran Ltd. uses FIFO to cost its inventory. The following information is available for Tehran's inventory of product # 101:

Beginning inventory: 120 units @ \$3.14 per unit
March 1: Purchase of 250 units @ \$3.50 per unit
April 10: Sale of 100 units @ \$5.10 per unit

23. Assuming Tehran uses the *perpetual* inventory system, the second entry to account for the April 10 sale is
- a) debit Cost of Goods Sold and credit Inventory, \$350.
 - b) debit Cost of Goods Sold and credit Purchases, \$350.
 - c) debit Cost of Goods Sold and credit Inventory, \$314.**
 - d) debit Cost of Goods Sold and credit Purchases, \$314.
24. Which of the following statements is correct regarding long-term construction contracts?
- a) ASPE only allows the use of the completed-contract method.
 - b) ASPE only allows the use of the percentage-of-completion method.
 - c) IFRS only allows the use of the percentage-of-completion and the zero-profit method.
 - d) IFRS allows the use of the percentage-of-completion and the zero-profit method, but does not preclude the use of the completed-contract method.**
25. Which of the following statements does NOT describe a long-term construction project that is accounted for under the completed contract method?
- a) Revenues are recognized at the end of the contract.
 - b) Revenues are recognized evenly throughout the contract.**
 - c) Gross profit is recognized at the end of the contract.
 - d) Losses are recognized immediately.
26. Cost estimates at the end of the second year indicate a loss will result on completion of the entire contract. Which of the following statements is correct?
- a) Under the completed-contract method, the loss is not recognized until the year the construction is completed.
 - b) Under the percentage-of-completion method, the gross profit recognized in the first year must not be changed.
 - c) Under the completed-contract method, when the billings exceed the accumulated costs, the amount of the estimated loss is reported as a current liability.**
 - d) Under the completed-contract method, when the Construction in Process balance exceeds the billings, the estimated loss is added to the accumulated costs.

27. On June 1, Electronics Distribution (ED) shipped 100 TVs to TV World (TVW) on consignment. ED buys these TVs from their supplier for \$600 each and sells them to TVW for \$800. TVW then retails them for \$1,200 each. By the end of June, TV World reported that they had sold 60 of these TVs, and remitted the appropriate amount to ED. How much revenue should be recorded by ED in connection with this transaction?
- \$72,000
 - \$60,000
 - \$48,000**
 - \$36,000
28. For last month, Perma Corp.'s cost of goods sold and ending inventory were \$100,000 and \$150,000 respectively. Assuming Perma had neither purchases nor returns during the month, what was the cost of its *beginning* inventory?
- \$50,000
 - \$150,000
 - \$250,000**
 - Cannot be determined from the information given.

The following information was available from the inventory records of Lock Company for January:

	<u>Units</u>	<u>Unit Cost</u>	<u>Total Cost</u>
Balance at January 1	3,000	\$9.77	\$29,310
Purchases:			
e) January 6	2,000	10.30	20,600
f) January 26	2,700	10.71	28,917
Sales:			
g) January 7	(2,500)		
h) January 31	<u>(4,200)</u>		
Balance at January 31	<u>1,000</u>		

29. Assuming that Lock uses the *periodic* inventory system, what should the inventory be at January 31, using the weighted-average inventory method, rounded to the nearest dollar?
- \$10,237**
 - \$10,260
 - \$10,360
 - \$10,505
30. Assuming that Lock uses the *perpetual* inventory system, what should the inventory be at January 31, using the moving-average inventory method, rounded to the nearest dollar?
- \$10,237**

- b) \$10,260
- c) \$10,360**
- d) \$10,505

Part B (17 Marks)

The board of directors of Snowbird Construction Corp. is meeting to choose between the completed-contract method and the percentage-of-completion method of accounting for long-term contracts in the company's financial statements. You have been engaged to assist Snowbird's controller in the preparation of a presentation to be given at the board meeting. The controller provides you with the following information:

- Snowbird commenced doing business on January 1, 2014.
- Construction activities for the year ended December 31, 2014, were as follows:

<u>Project</u>	<u>Total contract price</u>	<u>Billings through 12/31/14</u>	<u>Cash collections through 12/31/14</u>
A	\$ 615,000	\$ 340,000	\$ 310,000
B	450,000	135,000	135,000
C	475,000	475,000	390,000
D	600,000	240,000	160,000
E	<u>480,000</u>	<u>400,000</u>	<u>400,000</u>
	<u>\$2,620,000</u>	<u>\$1,590,000</u>	<u>\$1,395,000</u>

<u>Project</u>	<u>Contract costs incurred through 12/31/14</u>	<u>Estimated additional costs to complete contracts</u>
A	\$ 510,000	\$120,000
B	130,000	260,000
C	350,000	-0-
D	370,000	290,000
E	<u>320,000</u>	<u>80,000</u>
	<u>\$1,680,000</u>	<u>\$750,000</u>

- Each contract is with a different customer.
- Any work remaining to be done on the contracts is expected to be completed in 2015.

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a) (1) and (2)

Projects	<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>	<u>E</u>
Contract price	\$615,000	\$450,000	\$475,000	\$600,000	\$480,000
Contract costs incurred	510,000	130,000	350,000	370,000	320,000
Additional costs to complete	<u>120,000</u>	<u>260,000</u>	<u>-0-</u>	<u>290,000</u>	<u>80,000</u>
Total cost	630,000	390,000	350,000	660,000	400,000
Total gross profit (loss)	<u>\$ (15,000)</u>	<u>\$ 60,000</u>	<u>\$125,000</u>	<u>\$ (60,000)</u>	<u>\$ 80,000</u>

The amount reported as gross profit (loss) under the percentage-of-completion method for 2014 is:

Project A	\$ (15,000)	
B	20,000	$\$60,000 \times (\$130,000 \div \$390,000)$
C	125,000	
D	(60,000)	
E	<u>64,000</u>	$\$80,000 \times (\$320,000 \div \$400,000)$
	<u>\$134,000</u>	

b) Construction in Process	20,000	
Construction Expenses	130,000	
Revenue from Long-term Contracts.....		150,000

c) Billings	\$240,000
Cash collections	<u>160,000</u>
Accounts receivable	<u>\$ 80,000</u>
Billings on Construction in Process	\$240,000
Costs incurred	\$370,000
Loss reported	<u>(60,000)</u>
Construction in process	<u>\$310,000</u>

Instructions

- a) Prepare a schedule by project, using the percentage-of-completion method (based on estimated costs) calculating the amount of gross profit (or loss) for the 2014 calendar year. **(10 marks)**

b) Prepare the general journal entry to record revenue and gross profit on **Project B** for 2014, assuming that the percentage-of-completion method is used. **(4 Marks)**

c) Indicate the balances that would appear in the statement of financial position at December 31, 2014 for the following accounts for **Project D**, assuming that the percentage-of-completion method is used. **(3 marks)**

Part C (30 Marks)

Late Night Inc (LNI) balance sheet for the year ended December 31, 2012 and December 31, 2013 is as follows:

Late Night Inc
Comparative Balance Sheet
As at Ended December 31, 2013

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	2013	2012
Assets		
Cash	\$ 17,000	\$ 43,000
Accounts Receivable	104,000	90,000
Inventory	80,000	65,000
Prepaid expenses	48,000	45,000
Current Assets	249,000	243,000
Land	551,000	310,000
Buidlings	860,000	810,000
Accumualted depreciation	(250,000)	(220,000)
Long-term Investment	99,000	90,000
Total Assets	1,509,000	1,233,000
Liabilities and shareholders' equity		
Accounts payable	\$ 50,000	\$ 60,000
Accrued interest payable	2,000	5,000
Notes payable	165,000	142,000
Current liaibilities	217,000	207,000
Long-term bank loan	600,000	400,000
Total liabilities	817,000	607,000
Preferred shares	-	100,000
Common shares	265,000	210,000
Retained earnings	427,000	316,000
Total equity	692,000	626,000
Total Liabilities and shareholders' equity	1,509,000	1,233,000

- During the year, LNI declared and paid cash dividends of \$50,000.
- LNI bought and sold land during the year. The land that was sold for \$200,000 originally cost \$250,000
- LNI received dividend in the amount of \$25,000 from a company in which it holds shares (classified on the balance sheet as long-term investment).
- A gain of \$25,000 was realized on the sale of a building that cost \$200,000. Accumulated depreciation at time of sale was \$150,000.
- LNI borrowed money from a finance company, which accounted for the increase in notes payable.
- The company's expenses for the year included \$30,000 for income tax and \$30,000 for interest.
- LNI's policy is to report investment income and interest paid in the cash flows from operating activities section, while dividends paid are classified as a cash outflow from financing activities.

Required:

Prepare the cash flow statement in good form, using the indirect method, for LNI for the year ended December 31, 2013.

Must get number and sign correct to receive 1 mark.

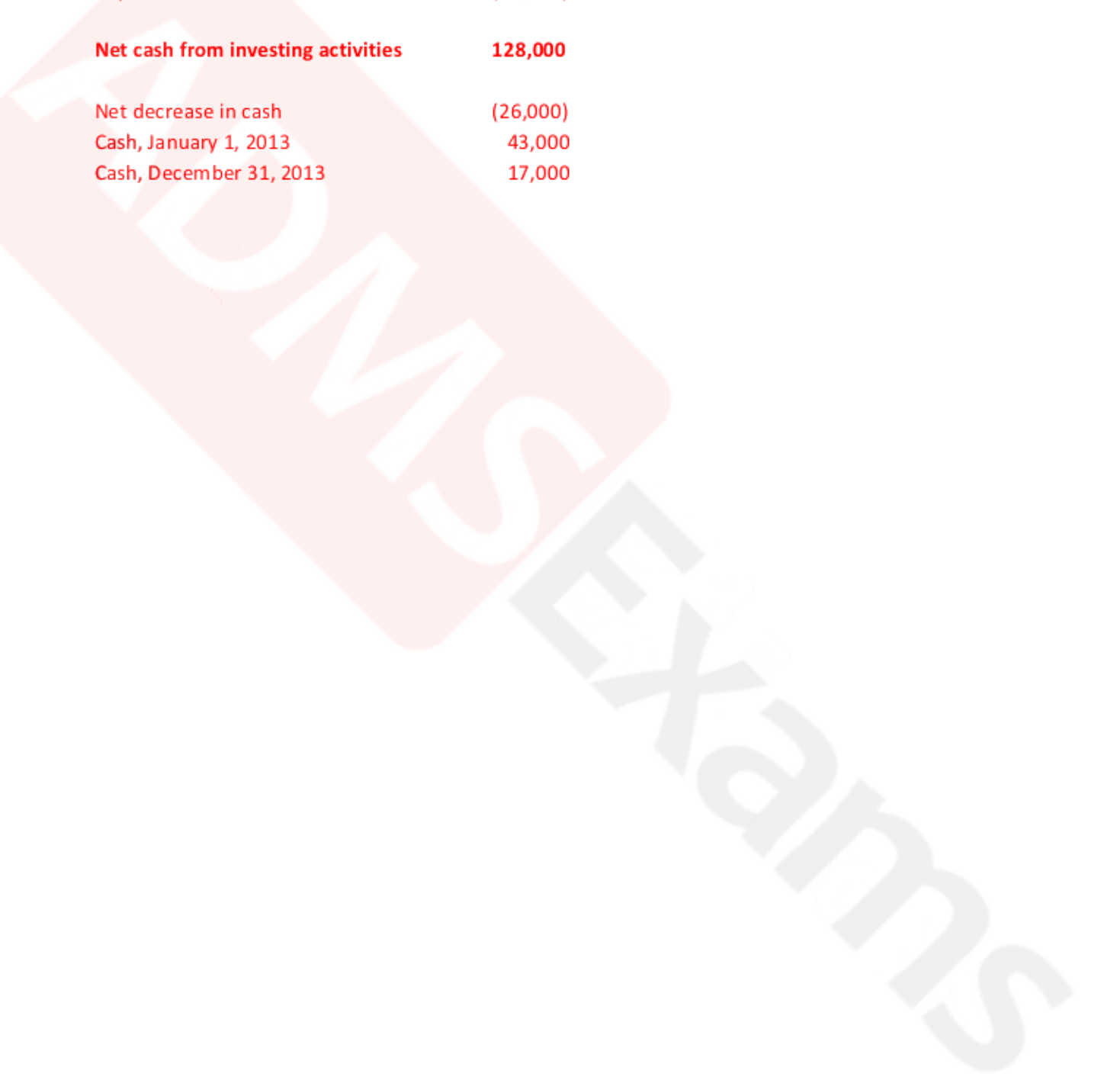
SOLUTION:

Late Night Inc		
Statement of Cash Flows		
As at Ended December 31, 2013		
Cash flows from operating activities		
Net income	161,000	=beginning balance RE(316K) - closing balance (427K) - dividends (50K)
Adjustments for:		
Depreciation expense	180,000	=opening balance (220K) - building depreciaton (150K) + deprecaition expense this year (180K) = closing balance (250)
Loss on sale of land	50,000	
Gain on sale of building	(25,000)	
Increase in AR	(14,000)	
Increase in inventory	(15,000)	
Increase in prepaid expenses	(3,000)	
Decrease in AP	(10,000)	
Interest paid (decrease in Accrued interest)	(3,000)	
Net cash flow from operations	321,000	
Cash flow from investing activities		
Purchaese of land	(491,000)	=310K (opening blanace) - \$250K (Cost of land sold) +491K (purchased) = \$551K closing
Sale of land	200,000	
Purchase of building	(250,000)	=810K (opening blanace) - 200K (cost ofbuilding sold) +\$250K (buidling purchased) = \$860K closing
sale of building	75,000	=\$200K cost - \$150K accumulated deprecation = \$50K net book value + \$25K on sale = \$75K sales price
Purchaese of long-term investment	(9,000)	
Net cash used in investing activities	(475,000)	
Cash flows from financing activities		
Issues notes payable	23,000	

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Proceeds of bank loan	200,000
Issue ordinary shares	55,000
Redeem preferred shares	(100,000)
Payment of cash dividends	(50,000)
Net cash from investing activities	128,000
Net decrease in cash	(26,000)
Cash, January 1, 2013	43,000
Cash, December 31, 2013	17,000

=210K opening balance and \$265K closing balance = 55K common shares



Part D (6 Marks)

Warm and Sunny Inc (WSI) was formed on January 1, 2013. At that time it issued 50,000 ordinary shares. Subsequent transactions affecting its shareholdings follow.

2013

- September 1: WSI issued 20,000 preferred shares
- December 1: WSI issued 10,000 common shares
- Dividends were not declared in 2013.

2014

- February 1: WSI issued 15,000 common shares
- June 1: WSI repurchased 20,000 shares.
- July 1: WSI declared and paid \$50,000 dividends on the common shares.
- September 1: WSI sold 65,000 shares.
- WSI's net income for the year ended December 31, 2014 was \$500,000.

Required:

i) What was WSI's weighted average number of ordinary shares outstanding in 2014?

Jan 1 - Jan 31	Opening balance	60,000	1/12	5000
Feb 1 - May 31	Issued 15K common	75,000	4/12	25000
June 1 - Aug 31	Repurchased 20K shares	55,000	3/12	13750
Sept 1 - Dec 31	Issued 65K sshares	120,000	4/12	40000
				83750

1 mark for each line – 5000, 25000, 13750 and 40000 for a total of 4 marks. Student must get the number correct.

ii) What was WSI's basic EPS in 2014?

$$500K / 83750 = 5.97$$

Part E (20 marks)

Furniture-R-Us (FUR) manufactures modern furniture and sells it to wholesalers and retailers. FUR is owned by the the Meerams family. The fiscal 2013 year was a tough one for FUR. In the second half of December 2013, an earthquake struck the region where FUR operates. Thankfully no one was hurt but management was caught off guard and some of FUR's manufacturing equipment was damaged. The family approached a local bank for financing and the bank has asked for audited financial statements for the fiscal 2013 in order to make its final decision.

FUR has hired you to advise the owners on the events that occurred in 2013 and recommend the most appropriate way of recording these transactions on the financial statements:

The Meerams created a new line of hand-made wood furniture that is quite modern. The Meerams approached several retail stores and they felt that it would be too risky for them to purchase the furniture from the Meerams for resale. However, they agreed to take some inventory from the Meerams and place it on their store shelves. If the furniture does not get sold within the next year, the stores will return the inventory to FUR without any penalty fees. All of the inventory was recognized on the income statement as cost of goods sold and corresponding revenue was also recognized as of December 31, 2013.

At the end of December 2013, management asked an expert to assess damage done to their old equipment as a result of the earthquake. The intention was to sell it, but unfortunately the expert said the equipment was not worth much in its present condition. He recommended to repair the equipment before selling. He estimated that the repairs would take approximately one month. Management decided to go ahead with the repairs and classified the equipment as held for sale on the Statement of Financial Position. The equipment will be put up for sale as soon as it's repaired. Management has no plans to keep it as new equipment was already ordered and will be operational in the beginning of January.

FUR manufactures two lines of furniture: furniture for kids and furniture for adults. FUR employs 10 administrative employees and 10 factory workers. FUR produced approximately 800,000 units of furniture in 2010 and 500,000 units in 2011. Each unit costs approximately \$195 to produce and sells for \$1000. The company has established a solid relationship with its major supplier and is able to negotiate significant volume discounts. One of the deals guarantees FUR a volume discount of 10% or 20% if FUR purchases enough materials in the next six months to produce at least 400,000 or more than 550,000 units respectively. The materials can be returned for up to 6 months if not used. FUR receives the rebate when the return period lapses. Currently, the cost of inventory reported on the financial statements includes all of the building's heat and electricity costs of \$50,000, factory staff wages and administrative personnel wages of \$100,000 and gross material costs of \$325,000.

Required:

FUR has hired you to advise the owners on the events that occurred in 2013 and recommend the most appropriate way of recording these transactions on the financial statements. **Make sure to provide a complete discussion – your response will not be interpreted.**

Respond to the case in a separate booklet.

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