Concordia University **Financial Accounting**

Department of Accountancy **COMM 217 All Sections**

Suggested Solution
Final Examination

Fall 2010

QUESTION 1 (24 marks):

1. B
2. A
3. D
4. D
5. B
6. C
7. C
8. A
9. D
10. D
11. C
12. B
13. D
14. A
15. D
16. C

QUESTION 2 (18 marks):

Req. 1 (8 marks)

The journal entry:

Machine A	20,400	
Machine B	31,100	
Machine C	13,000	
Cash		64,500

Allocation of purchase price plus transportation costs (57,000 + 3,000 = 60,000):

	Appraised Value		*Apportionment of Lump-Sum Cost*	
Machine	*Amount*	*Ratio*	*Computations*	*Apportioned Cost*
A	$ 19,200	.30	$60,000 x .3	18,000
B	32,000	.50	60,000 x .5	30,000
C	12,800	.20	60,000 x .2	12,000
Total	64,000	1.00		$60,000

Cost of each machine:

	Machine			
	A	*B*	*C*	*Total*
Allocated cost (from above).....	$18,000	$30,000	$12,000	$60,000
Installation costs	400	600	300	1,300
Renovation costs.....	2,000	500	700	3,200
Total cost paid in cash.....	$20,400	$31,100	$13,000	$64,500

Req. 2 (6 marks)

The journal entry:

Amortization expense	15,100	
Accumulated amortization - Machine A		3,800
Accumulated amortization - Machine B		4,800
Accumulated amortization - Machine C		6,500

Computation of annual amortization for each machine:

Machine	**Method**	**Computation**
A	Straight-line	($20,400 – $1,400) ÷ 5 years = $3,800
B	Units-of-production	($31,100 – $1,100) ÷ 50,000 hours = $.60 $.60 x 8,000 hours = $4,800
C	Double declining balance	$13,000 ÷ 4 years x 2 = $6,500

Req.3 (4 marks)

(a) The entry for amortization expense for January to June 2009:

Amortization expense	2,400	
Accumulated amortization		2,400

[($76,200 – $4,200) ÷ 15 years] x 6/12 = $2,400

(b) The entry to record disposal:

Cash	15,000	
Accumulated amortization	60,000 (57,600 + 2,400)	
Loss on disposal of equipment	1,200	
Equipment		76,200

QUESTION 3 (18 marks):

Part A (6 marks)

1. Cash	11,300	
Sales Revenue		10,000
HST Payable		1,300
Cost of goods sold	8,000	
Inventories		8,000
2. Long-term liability	50,000	
Current portion of long-term liability		50,000
3. Warranty expense	6,000	
Estimated warranty liabilities		6,000
4. Estimated warranty liabilities	2,500	
Cash		1,500
Inventory-parts		1,000
5. Property tax expense	4,000	
Property tax payable		4,000

Part B (12 marks)

1. July 1, 2010 (3 marks)

Cash	4,573,520*	
Discounts on bonds payable	426,480	
Bonds payable		5,000,000

Issuance price = ($5,000,000 x 0.7441) + ($5,000,000 x 4% x ½) x 8.5302 = $4,573,520

2. (5 marks)

Carey Ltd.
Partial Balance Sheet
As of December 31, 2010

Current Liabilities

Interest payable	$100,000 ($5,000,000 * 4%* 1/2)

Long-term Liabilities

Bonds payable, 4%, due June 30, 2015	$5,000,000
Less: Discount on bonds payable	389,274*
Book (carrying) value	$4,610,726

*Calculation:
Interest expense = $4,573,520 x 6% x 1/2 = $137,206
Uunamortized discount = $426,480 – (137,206 – $100,000) = $389,274

Carey Ltd.
Partial Income Statement
For the Year Ended on December 31, 2010

Other revenues and expenses (Non-operating expenses)

Interest expense	$ 137,206

3. (4 marks)

January 1, 2011

Bonds payable	1,000,000	
Loss on early redemption	97,855	
Cash		1,020,000*
Discount on bonds payable		77,855**

*Redemption price = $5,000,000 x 1.02 x 0.2 = $1,020,000
**Discount = 0.2 x $389,274 = $77,855

QUESTION 4 (23 marks):

Req. 1 (5 marks)

KITCHENWARE INC.
Statement of Cash Flows
For the Year Ended December 31, 2010

Cash flows from operating activities:	
Net income	$12,000
Add (deduct) items not affecting cash:	
Amortization expense	15,200
Loss on sale of furniture	1,200
Gain on sale of investment	(800)
Increase in trade accounts receivable	(45,700)
Decrease in inventories	20,000
Increase in trade payables	3,900
Net cash flow from operating activities	$ 5,800

Req. 2 (5 marks)

a.

Trade accounts receivables, beginning	$10,600	
+ Sales revenue	980,000	
– Cash collections from customers	(X)	[X = $934,300]
= Trade accounts receivable, ending	$ 56,300	

b. The computation of the cash paid to suppliers is a two-step process.

Inventories, beginning	$ 30,000	
+ Merchandise purchases	X	[X = $620,000]
– Cost of sales	(640,000)	
= Inventories, ending	$ 10,000	

Trade accounts payable, beginning	$ 13,100	
+ Merchandise purchases	620,000	[Y = $616,100]
– Cash payments to suppliers	(Y)	
= Trade accounts payable, ending	$ 17,000	

c. Loss on sale = Cash received – Book value of furniture sold
– $1,200 = X – ($5,000 – $3,200) → Cash received = $600

Req. 3 (5 marks)

Cash flows from investing activities:

Sale of furniture (amount determined in req. 2 above)	$ 600	
Purchase of furniture (note 1)	(38,000)	
Sale of investments ($1,000 change in balance + $800 gain)	1,800	
Net cash flow used for investing activities		$(35,600)

Note 1:

Cost of furniture, January 1, 2011	$26,000
+ Purchases during the year	X
– Cost of furniture disposed of	(5,000)
= Cost of furniture, December 31, 2011	$59,000

Purchases (X) = $38,000

Req. 4 (5 marks)

a.

$$\text{Quality of income ratio} = \frac{\text{Cash flow from operations}}{\text{Net income}} = \frac{\$5,800}{\$12,000} = 0.48$$

The quality of income ratio measures the portion of income that was generated in cash. This ratio helps establish whether there are significant differences between net income and operating cash flows. In this case, the large increase in Trade accounts receivable, which reflects sales on account, reduced the amount of cash from operations. (1 mark)

b. Free cash flow = Cash flow from operations – Dividends paid – Capital expenditures
= $5,800 – ($18,000 + 600)* – $38,000 = –$50,200.

* Beginning RE + Net income – Dividends Declared = Ending RE
$25,300 + 12,000 – X = 19,300 ➔ X = $18,000
The decrease in Dividends Payable should be added to the Dividends declared to get the amount of dividends paid.

Free cash flow represents the amount of cash that is available for additional capital expenditures, investments in other companies, and mergers and acquisitions, without the need for external financing. In this case, the operating activities did not generate sufficient cash to cover dividends and capital expenditures. **(1 mark)**

Req. 5 (3 marks)

As a professional accountant, I need to ensure that the proposed change is justified based on the available evidence. It should be consistent with GAAP. The proposed change would be acceptable if the original estimate of the useful life of these assets was understated or if regular maintenance or improvements increased the assets' useful life. However, if the proposed change is to improve the company's financial performance without valid justification, I would point out to Ms Wong that such a change is not appropriate. It should be noted that the proposed change would increase income but not affect cash flow.

QUESTION 5 (17 marks):

Req. 1 (14 marks)

a.	Quick ratio:	$\frac{\$20 + 1 + 116}{\$141}$	=	0.97	$\frac{\$20 + 5 + 80.5}{\$138.5}$	=	0.76
b.	Inventory turnover:	$\frac{\$201}{(\$149 + \$137)/2}$	=	1.41	$\frac{\$155}{(\$137 + \$86)/2}$	=	1.39
c.	Accounts receivable turnover:	$\frac{\$351.5}{(\$116 + \$80.5)/2}$	=	3.58	$\frac{\$310}{(\$80.5 + \$62.5)/2}$	=	4.34
d.	Times-interest-earned ratio:	$\frac{\$85.5}{\$26}$	=	3.29	$\frac{\$84}{\$20}$	=	4.20
f.	Return on equity:	$\frac{\$40.5}{(\$191 + \$135.5)/2}$	=	24.8%	$\frac{\$41.5}{(\$135.5 + \$109)/2}$	=	33.9%
h.	Price/earnings ratio:	$\frac{\$19.00^*}{\$2.70^*}$	=	7.04	$\frac{\$31.00^*}{\$3.46^*}$	=	8.96
i.	Cash coverage:	$\frac{\$78}{26}$	=	3*	$\frac{\$80}{20}$	=	4*

* Not in thousands.

Req. 2 (3 marks)

Decisions:

a. The company's ability to pay its debts deteriorated during 2010, as shown by decreases in the receivable turnover, the times-interest-earned ratio and cash coverage ratio. Of the first four ratios computed, the quick ratio improved and the inventory turnover improved slightly, so the ability to sell inventory remained steady.

b. The common shares' attractiveness dropped during 2010, as shown by the decrease in the market price of the common shares. This decrease is consistent with the decreases in return on assets, return on equity, earnings per share, and the price/earnings ratio.