

Laurier SOS: Students Offering Support



**STUDENTS OFFERING SUPPORT**

Wilfrid Laurier University – Chapter 8-13 and 6

**BU227 – Intro. To Financial Accounting  
Final Exam-AID  
Review Package**

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## Laurier SOS: Students Offering Support

Students Offering Support is a multi-national charitable sustainable social venture that develops and supports chapters in post-secondary schools across North America. Each University chapter raises money to raise roofs through raising marks during our 'Exam-AID' group review sessions, taught and coordinated by student volunteers for university and high school students. Each year, the money raised is spent on sustainable education projects in developing nations on volunteer outreach trips. Since 2005, over 2,000 Students Offering Support volunteers have tutored over 25,000 students and raised more than \$700,000 for various rural communities across Latin America.

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### BU227 SOS Final Exam-AID Questions

#### **Question 1**

Shareholder's Equity 2012

#### Authorized Shares

1,000,000 non-voting preferred shares, no par value,  
non-cumulative dividend of 1.00 per share

Unlimited # of common shares, no par value

#### Issued and Outstanding Shares

50,000 preferred shares	\$50,000
500,000 Common Shares	6,750,000
Retained Earnings	<u>3,250,000</u>
<b>Total Shareholder's Equity</b>	<b>\$10,500,000</b>

#### **Required:**

Using the information in the above shareholder's equity section of the balance sheet for the year ended December 31, 2012 respond to the following questions. Each question is independent of the others unless otherwise stated.

- a) How much financing has the company received from shareholders since it was incorporated?
- b) If the company wished to raise more capital by issuing additional common shares, how many more shares could it issue?
- c) On average, how much has the company received for each common share it has issued?
- d) Assuming the company paid \$1,650,000 in dividends over its life to date, what is its total net income since inception?
- e) At the end of 2012, how much cash does the company have available to pay dividends or otherwise fund its operations?
- f) What is the book value of the assets owned by the company's shareholders?
- g) If the company paid dividends totaling \$310,000 in 2012, how much of this total did the preferred shareholders receive (in dollars)?
- h) If the company paid dividends totaling \$310,000 in 2012, how much of this total did the common shareholders receive (in dollars)?
- i) If you owned 100,000 C/S of this company, what would the proportion of total shareholder votes would you control?
- j) If the company, repurchased some of its outstanding common share for \$1,000,000 what would be the effect on total shareholders equity (in dollar's)
- k) If in 2013, the company paid 10% stock dividends to its common shareholders on a date when the common shares had a market price of \$15/share, what would be the effect on R/E (in dollars)?
- l) Based on the information in (K) what would be the effect on total shareholders equity (in dollars)?
- m) If in 2013 the company implemented a 2for1 stock split of its common shares on a date when the common shares had a market price of \$20/shares, how many common shares would be issued and outstanding after the split?

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- n) Based on the information in (M) what effect would the split have on the common share capital balance (in dollars)
- o) Based on the information in (M) how much would each common share be worth after the split?

### Question 2

Listed below are the balance sheet accounts for a company, many of which require the use of significant professional judgment in determining their balances. Assume you are the Chief Financial Officer of this company and that you earn a bonus based on the company's net income.

#### Accounts:

- Accounts Payable
- Current Portion of Mortgage Payable
- Prepaid Supplies
- Accounts Receivable
- Deficit
- Property, Plant, Equipment
- Accum. Amortization
- Goodwill
- Reserve for Inventory Obsolescence
- Allowance for doubtful accts.
- Inventory
- Share Capital
- Bonds Payable due 11/30/2012
- Mortgage Payable
- Unearned Revenue
- Cash
- Notes Payable due 12/31/2011
- Warranty Liability
- Contributed Surplus
- Notes Receivable due 12/31/2012

#### Required:

Choose 4 different accounts that you can manipulate permitted within GAAP related to each account. Your goal is to maximize your bonus. Explain the specific judgment on how you would manipulate the account to achieve your goal.

### Question 3

Answer the following questions using T for True and F for False

- 1) Credit terms "2/10 n/30" mean that if payment is made in two days, a 10% discount will be given, if not paid within two days, the full invoice price will be due in thirty days

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- 2) A manufacturing company uses three different inventory accounts to track their products costs
- 3) Shareholders have limited liability, which means that they are usually held personally liable for corporation's debts
- 4) The ending inventory of one accounting period becomes the beginning inventory amount of the next accounting period
- 5) If a second hand machine is purchased for operational use in a business, all renovation and repair costs on the used machine incurred by the purchasers prior to its operation use should be excluded from the cost of the asset
- 6) A liability is created on the date that a cash dividend is declared
- 7) Receivables turnover is computed as net credit sales divided by average net trade accounts receivables
- 8) If a company uses cash to pay off a current liability, the amount of working capital will decrease.
- 9) In accounting for amortization, acquisition cost and useful life are usually known quantities, where as residual value is an estimate because it relates to an amount in the future
- 10) All contingent liabilities should be recorded as either current or long-term liabilities on the balance sheet for the current period.

### Question 4

The charter of Nike specified a maximum of 25,000 shares of common stock. At the current date, 5000 shares remain unissued, and 2,000 of the issued shares have been reacquired and are still held by Nike.

Required: What is the number of shares?

<u>Type</u>	<u>Shares</u>
i) Issued	
ii) Unissued	
iii) Authorized	
iv) Outstanding	
v) Treasury Stock	

### Question 5

The BOD of the Heather INC. held a meeting on May 31, 2012 and voted to issue a dividend. On June 3, 2012 they mailed cheques to all names that were on the shareholders register as at June 1, 2012.

Required:

For each of the following dates, state the appropriate term, relative to the above transaction and state if there is an entry made on that date to record a transaction in the company's books of account:

	Name of Date	Transaction required? (Yes/No)
May 31, 2012		
June 3, 2012		
June 1, 2012		

### Question 6

<b>Phil's Inc.</b> <b>Income Statement</b>
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For the Year Ended December 31, 2012	
<b>Revenues:</b>	
Sales Revenue.....	\$550,000
Interest Revenue.....	4,300
Gain on sale of plant & equipment.....	<u>2,500</u>
Total Revenues.....	556,800
<b>Expenses:</b>	
Cost of goods sold.....	\$277,000
Depreciation – plant & equipment.....	38,500
Bad debts expense.....	30,000
Other expenses.....	<u>135,000</u>
Total expenses.....	<u>480,500</u>
Income before Tax	76,300
Income tax expense	<u>49,595</u>
<b>Net Income</b>	<u>\$26,705</u>

Phil's Inc. Comparative Balance Sheet At December 31, 2012					
2011			2012		
2011			2012		
<b>Current assets:</b>			<b>Current liabilities:</b>		
Cash	\$152,000	\$9,205	Accounts payable	\$49,200	\$29,200
Accounts Receivable	97,500	180,000	Other payables	50,500	35,000
Inventory	182,500	305,500	Current tax liability	47,000	53,000
Prepaid expenses	8,000	9,500	<b>Long-term liabilities:</b>		
Interest receivable	1,000	1,500	Notes payable	63,000	43,000
<b>Plant assets:</b>			Dividend payable	20,000	15,000
Land	31,000	55,000	<b>Shareholder's equity:</b>		
Equipment	152,000	196,000	Share capital	230,000	362,000
Accum. Depreciation - Equipment	(20,000)	(63,500)	Retained earnings	<u>144,300</u>	<u>156,005</u>
<b>Total Assets</b>	<u>\$604,000</u>	<u>\$693,205</u>	<b>Total liabilities &amp; shareholders' equity</b>	<u>\$604,000</u>	<u>\$693,205</u>

**Required:**

1. Prepare the cash flow statement of Phil's Inc. for the year ended December 31, 2012. Format operating activities by the indirect method.
2. How will what you learned in this problem help you evaluate an investment?

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### Question 7

**Drizzy Drake Ltd.  
Balance Sheet  
At December 31, 2012**

<b>ASSETS</b>		<b>LIABILITIES</b>	
<b>Current Assets</b>		<b>Current Liabilities</b>	
<u>Cash</u>	\$ 2,100	<u>Notes Payable</u>	\$ 5,000
<u>Petty Cash</u>	100	<u>Accounts Payable</u>	30,900
<u>Temporary Investments</u>	10,000	<u>Wages Payable</u>	8,500
<u>Accounts Receivable - net</u>	40,500	<u>Interest Payable</u>	2,900
<u>Inventory</u>	31,000	<u>Taxes Payable</u>	6,100
<u>Supplies</u>	3,800	<u>Warranty Liability</u>	1,100
<u>Prepaid Insurance</u>	1,500	<u>Unearned Revenues</u>	1,000
Total Current Assets	<u>89,000</u>	Total Current Liabilities	<u>55,500</u>
		<b>Long-term Liabilities</b>	
<b>Property, Plant &amp; Equipment</b>		<u>Notes Payable</u>	20,000
<u>Land</u>	5,500	<u>Bonds Payable</u>	<u>340,000</u>
<u>Buildings</u>	180,000	Total Long-term Liabilities	<u>360,000</u>
<u>Equipment</u>	201,000	<b>Total Liabilities</b>	<u>415,500</u>
Less: <u>Accum Depreciation</u>	<u>(56,000)</u>		
Prop, Plant & Equip - net	<u>330,500</u>		
		<b>STOCKHOLDERS' EQUITY</b>	
<b>Intangible Assets</b>		<u>Common Stock</u>	100,000
<u>Goodwill</u>	105,000	<u>Retained Earnings</u>	209,000
<u>Trade Names</u>	<u>200,000</u>	Total Stockholders' Equity	<u>309,000</u>
Total Intangible Assets	<u>305,000</u>		
<b>Total Assets</b>	<b>\$724,500</b>	<b>Total Liab. &amp; Stockholders' Equity</b>	<b>\$724,500</b>

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**Drizzy Drake Ltd.  
Income Statement  
For the Year Ended December 31, 2012**

Sales (all on credit)	\$500,000
<b>Cost of Goods Sold</b>	<u>380,000</u>
<b>Gross Profit</b>	<u>120,000</u>
Operating Expenses	
<b>Selling Expenses</b>	35,000
<b>Administrative Expenses</b>	<u>45,000</u>
Total Operating Expenses	<u>80,000</u>
Operating Income	40,000
<b>Interest Expense</b>	<u>12,000</u>
Income before Taxes	28,000
<b>Income Tax Expense</b>	<u>5,000</u>
Net Income after Taxes	\$ 23,000

**Required:**

1. Compute the following ratios for Drizzy Drake Ltd. and state the importance of each.
  - a. Working capital
  - b. Current ratio
  - c. Quick ratio (Acid-test ratio)
2. Compute the following ratios for Drizzy Drake Ltd. and state the importance of each.
  - a. Accounts receivable turnover
  - b. Days' sales in accounts receivable
  - c. Inventory turnover

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### Q1 -ANSWERS

- A) 7,250,00
- B) Unlimited #
- C) 13.50
- D) 4,900,000
- E) Unknown
- F) 10,500,000
- G) 50,000
- H) 260,000
- I) 20% or (1/5)
- J) – 1,000,000
- K) – 750,000
- L) 0 (or no effect)
- M) 1,000,000
- N) 0 (or no effect)
- O) \$10

### Question 2 Answers :

*Note: you may have had a different answer but it doesn't mean it is wrong. The answers provided are just examples. There are many other ways to manipulate financial statements*

ACCOUNT	SPECIFIC DETAILS OF MANUIPULATION
Accounts Receivable	Aggressively recognize revenue by ignoring one or more of the 3 revenue recognition criteria
Accum. Amort.	Lengthen useful lives of assets to decrease amort. Expense
Accum. Amort.	Increase residual values to decrease amort. Expense
Accum. Amort.	Change amortization method to one that reduces amort. expense
Allowance for Doubtful Accounts(ADA)	Decrease % of credit sales (or of aged A/R) used as ADA estimate to reduce bad debt exp.
Inventory	Choose costing method (LIFO, FIFO, etc) that results in lowest possible COGS
Inventory Reserve	Ignore/reduce needed LCM write-down by overstating market value of slow

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	moving/obsolete inventory
Prepays	Record items as prepaids instead of expensing in period items were actually used
PP&E	Capitalize cost/expenses that would normally be expensed (or record as betterment instead of R&M)
PP&E	Ignore/reduce needed impairment writedown/off by overstating future benefits/cash flows from assets
Goodwill	Record as GW items that would normally be expensed upon acquisition
Goodwill	Ignore needed impairment writedown/off by overstating future value to be derived from GW
Accounts Payable	Purposely understate accruals by ignoring or delaying recognition of expenses incurred during period
Unearned Revenue	Ignore rev. recognition criteria regarding performance or service/delivery of goods to recognize revenue earlier than should be
Warranty Liability	Reduce estimate of number and/or costs of future warranty claims

### Question 3 Answers

- 1 F
- 2 T
- 3 F
- 4 T
- 5 F
- 6 T
- 7 T
- 8 F
- 9 F
- 10 F

### Question 4 Answers

- i) 20,000 → (25,000 – 5000)
- ii) 5,000
- iii) 25,000
- iv) 18,000 → (20,000 – 2,000)
- v) 2,000

### Question 5 Answers

May 31, 2012 – Declaration Date – YES  
 June 3, 2012 Payment Date – YES  
 June 1, 2012 Date of Record – NO

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### Question 6 Answers

#### Required 1:

Phil's Inc. Cash Flow Statement For the Year Ended December 31, 2012	
<b>Cash flows from operating activities:</b>	
Net Income:	\$26,705
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>	
Depreciation	38,500
Increase in accounts receivable	(82,500)
Increase in inventory	(123,000)
Increase in prepaid expenses	(1,500)
Increase in interest receivable	(500)
Decrease in accounts payable	(20,000)
Decrease in other payables	(15,500)
Increase in current tax liability	6,000
Increase in current tax liability	(198,500)
Net cash provided by operating activities	(171,795)
<b>Cash flows from investing activities:</b>	
Purchase of land	\$(24,000)
Purchase of equipment	(44,000)
Net cash used for investing activities	(68,000)
<b>Cash flows from financing activities:</b>	
Payment of dividends	(15,000)
Payment of notes payable	(20,000)
Issuance of common shares	132,000
Net cash used for financing activities	97,000
<b>Net decrease in cash</b>	<b>\$ (142,795)</b>
Cash balance, December 2011	152,000
Cash balance, December 2012	\$ 9,205

**Required 2:** This problem will help students learn how operating activities, investing activities and financing activities generate cash receipts and cash payments. By solving this problem, students will learn how companies prepare the cash flow statement. Students will thus be able to understand the meaning of cash flows from the three basic categories of business activities. This knowledge will aid their analysis of investments. For example, students should know that net cash *provided by* operating activities conveys a more positive signal about a company than net cash *used for* operations.

### Question 7 Answers

#### Required 1

<u>Financial Ratio</u>	<u>How to Calculate It</u>	<u>What It Tells You</u>
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<b>Working Capital</b>	$= \text{Current Assets} - \text{Current Liabilities}$ $= \$89,000 - \$55,500$ $= \mathbf{\$33,500}$	An indicator of whether the company will be able to meet its current obligations (pay its bills, meet its payroll, make a loan payment, etc.) If a company has current assets exactly equal to current liabilities, it has no working capital. The greater the amount of working capital the more likely it will be able to make its payments on time.
<b>Current Ratio</b>	$= \text{Current Assets} \div \text{Current Liabilities}$ $= \$89,000 \div \$55,500$ $= \mathbf{1.60}$	This tells you the relationship of current assets to current liabilities. A ratio of 3:1 is better than 2:1. A 1:1 ratio means there is no working capital.
<b>Quick Ratio (Acid Test Ratio)</b>	$= \frac{[(\text{Cash} + \text{Temp. Investments} + \text{Accounts Receivable}) \div \text{Current Liabilities}]}{1}$ $= \frac{[(\$2,100 + \$100 + \$10,000 + \$40,500) \div \$55,500]}{1}$ $= \frac{[\$52,700 \div \$55,500]}{1}$ $= \mathbf{0.95 : 1}$	This ratio is similar to the current ratio except that Inventory, Supplies, and Prepaid Expenses are excluded. This indicates the relationship between the amount of assets that can quickly be turned into cash versus the amount of current liabilities.

### Required 2

<u>Financial Ratio</u>	<u>How to Calculate It</u>	<u>What It Tells You</u>
<b><u>Accounts Receivable Turnover</u></b>	$= \frac{\text{Net Credit Sales for the Year}}{\div \text{Average Accounts Receivable for the Year}}$ $= \$500,000 \div \$42,000 \text{ (a computed average)}$ $= \mathbf{11.90}$	The number of times per year that the accounts receivables turn over. Keep in mind that the result is an <i>average</i> , since credit sales and accounts receivable are likely to fluctuate during the year. It is important to use the <i>average</i> balance of accounts receivable during the year.
<b><u>Days' Sales in Accounts Receivable</u></b>	$= \frac{365 \text{ days in Year}}{\div \text{Accounts Receivable Turnover in Year}}$ $= 365 \text{ days} \div 11.90$ $= \mathbf{30.67 \text{ days}}$	The <i>average</i> number of days that it took to collect the <i>average</i> amount of accounts receivable during the year. This statistic is only as good as the Accounts Receivable Turnover figure.
<b><u>Inventory Turnover</u></b>	$= \frac{\text{Cost of Goods Sold for the Year}}{\div \text{Average Inventory for the Year}}$ $= \$380,000 \div \$30,000 \text{ (a computed average)}$	The number of times per year that Inventory turns over. Keep in mind that the result is an <i>average</i> , since sales and inventory levels are likely to fluctuate during the year. Since

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	= <b>12.67</b>	inventory is at cost (not sales value), it is important to use the Cost of Goods Sold. Also be sure to use the average balance of inventory during the year.
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