CONCORDIA UNIVERSITY
DEPARTMENT OF ACCOUNTANCY

FINANCIAL ACCOUNTING
COMM 217 ALL SECTIONS

FINAL EXAMINATION

Fall 2010

Duration: 3 hours

Name: ___________________________

Instructions:

1. This examination paper consists of **10 pages** including this page. Please make sure your paper has all pages before commencing to write.

2. You must answer the multiple choice questions by using the **computer input sheet**; darken the letter you choose **in pencil** on the computer input sheet. Write all your answers to the other questions in the **examination answer booklet**. You may answer the questions in any order you prefer. **Only the answers on the computer input sheet and in the examination booklet will be graded.**

3. Read the questions carefully and budget your time wisely. Show all calculations.

4. This is a closed book examination. However, a silent hand-held (not graphical) calculator and one standard language (not electronic) dictionary are permitted. All other materials such as: briefcases, textbooks, notes, books of tables, graphs, paper, electronic communication devices (e.g., cell phone, ipod, BlackBerry) must be deposited at the front or rear of the examination room. Purses must be placed under the student's chair.

5. **Invigilators will not answer questions** (unless you think there is an **error** in the question).

6. Return the exam along with the computer input sheet and answer booklets when you have finished.

Question	Topic	Total Marks
1	Multiple Choice	24
2	Accounting for Long-lived Assets	18
3	Accounting for Liabilities	18
4	Reporting Cash Flows	23
5	Analysis of Financial Statements	17
Total		100

QUESTION 1 (24 marks; 43 minutes) *Multiple Choice*

For each of the following, choose the letter that corresponds to the **best** answer, and **show your answer on the computer input sheet**. Each correct answer is worth 1.5 marks.

1. Which of the following transactions would not create a cash flow?
   A. The company purchased some of its own shares from a shareholder.
   B. Amortization of patent for the period.
   C. Payment of a cash dividend.
   D. Sale of equipment at its carrying amount (i.e., no gain or loss).

2. The following information is taken from the statement of financial position and related disclosures of Blue Bird Corporation:

Total contributed capital	$5,400,000
Outstanding shares:	
$6 preferred shares, no-par-value, callable at $101, issued at $100 per share	10,000 shares
Common shares, no-par-value	100,000 shares
Preferred dividends in arrears	2 years
Total shareholders' equity	$4,700,000

   Which of the following statements is **not** correct?

   A. The preferred dividends in arrears amount to $120,000 and should appear as a liability in the corporation's statement of financial position.
   B. Preferred shareholders would have received $180,000 if the company's board of directors declared cash dividends during the current year.
   C. The shareholders' equity section of the statement of financial position should contain a deficit of $700,000.
   D. The corporation has not paid any dividends on common shares during the past two years.

3. 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

4. Which of the following would be excluded from the acquisition cost of equipment purchased from a supplier?

   A. Cost to install the equipment.
   B. The cost of freight paid to transport the equipment to the buyer's factory.
   C. The cost to widen an entrance in the building to bring the equipment into the facilities.
   D. A purchases discount offered by the supplier.

5. In 2010, Gamma Company made an ordinary repair to a delivery truck at a cost of $300. Gamma's accountant debited the asset account, Delivery Vehicles. Was this treatment an error, and if so, what will be the effect on the financial statements of Gamma?

   A. The repair was accounted for correctly.
   B. The error increased assets and profit in 2010.
   C. In the years following 2010, profit will be too high.
   D. The error decreased profit in 2010.

6. A long-term asset that cost $100,000 had an estimated useful life of 5 years and estimated residual value of $10,000. From which year would the depreciation under the straight-line method start to be greater than that under the double declining-balance method?

   A. The first year. B. The second year. C. The third year. D. The fourth year.

7. The inclusion of the intangible asset Goodwill in the financial statements of a company indicates that the company:

   A. has a current favourable reputation with the customers.
   B. has had a satisfactory record of annual earnings.
   C. has purchased another business at a price in excess of the fair value of its net assets.
   D. has purchased another business at a bargain price that is below the fair value of its net assets.

8. How should the amount of federal income tax that is withheld from employees' paycheques by the employer be recorded on the employer's books?

   A. As a current liability.
   B. As an asset.
   C. As revenue.
   D. It should not be recorded because the amount does not belong to the employer.

9. A company has a current ratio of 2.4 before paying off a large current liability with cash. After this payment, the current ratio would be:

   A. Greater than 2.4 or less than 2.4 depending upon the amount of the liability.
   B. Less than 2.4.
   C. Equal to 2.4.
   D. Greater than 2.4.

10. On January 2, 2009, Muff Company borrowed $10,000 from Bank Nouvo. The loan was to be repaid in equal principal installments of $2,000, payable on December 31 of each year, beginning on December 31, 2009. Disregarding interest, the portion of the loan that should be reported as a current liability on the company's 2009 year-end statement of financial position would be:

    A. $8,000 B. $6,000 C. $4,000 D. $2,000

11. When a company prepares a bond indenture, certain provisions of the bonds are included. Which of the following are not provisions specified in the indenture?

    A. Dates of interest payments.
    B. Rate of interest to be paid.
    C. Cash to be received at the issue date.
    D. Maturity date.

12. On July 1, 2010, immediately after recording interest payments, Seals, Inc., retired one fifth of its $500,000 bonds payable for $97,500. The bonds were originally issued at par value in 2007. Which statement is correct?

    A. Cash of $100,000 will be paid to the bondholders.
    B. A gain of $2,500 will be reported in the income statement.
    C. A loss of $2,500 will be reported in the income statement.
    D. A gain of $2,500 will be reported as a separate component of shareholders' equity on the statement of financial position.

13. Vaughan Company has one class of capital shares issued. It is which of the following?

    A. Preferred shares, voting.
    B. Preferred shares, noncumulative.
    C. Common shares, nonvoting.
    D. Common shares.

14. Assume the following shares outstanding:
    (a) Preferred shares, $3, cumulative, 1,000 shares issued with dividends in arrears for three years: 2007, 2008, and 2009.
    (b) Common shares, 2,000 shares outstanding.

    Total dividends declared in 2010 were $30,000. What is the total amount of dividends payable to <u>common</u> shareholders?

    A. $18,000 B. $21,000 C. $27,000 D. $30,000

15. Which of the following ratios is <u>not</u> a test of liquidity?

    A. Receivable turnover.
    B. Payables turnover.
    C. Current ratio.
    D. Cash coverage ratio.

16. If a company has a quick ratio of 1.2, what respective effects will the borrowing of cash on a short-term basis and the collection of accounts receivable have on the ratio?

	Short-term Borrowing	Collection of Receivables
A.	Increase	No effect
B.	Increase	Increase
C.	Decrease	No effect
D.	Decrease	Decrease

QUESTION 2 (18 marks; 32 minutes) *Accounting for long term assets*

On January 1, 2009, JMSB's Fitness Center bought three used fitness machines from Good Health, Inc. for a total cash price of $57,000. Transportation costs on the machines were $3,000, paid in cash. The machines were immediately overhauled, installed, and started operating. The machines were different; therefore, each had to be recorded separately in the accounts. An appraiser was requested to estimate their market value at the date of purchase (prior to the overhaul and installation). The carrying amounts shown on Good Health's books also are available. The carrying amounts, appraisal results, installation costs, and renovation expenditures are as follows. All the installation costs and renovation expenditures were paid in cash.

	Machine A	**Machine B**	**Machine C**
Carrying amount – Good Health	18,000	28,000	12,000
Appraisal value	19,200	32,000	12,800
Installation costs	400	600	300
Renovation costs prior to use	2,000	500	700

By the end of year 2009, each machine had been operating 8,000 hours.

Required:

1. Prepare the journal entry to record the acquisition of the three machines on January 1, 2009. Show your calculations. **(8 marks)**
2. The Fitness Center uses different depreciation methods for the three machines as shown below. Prepare the journal entry to record depreciation expense for the three machines at December 31, 2009. Show your calculations. **(6 marks)**

	Estimates		
Machine	**Life / Total Operating Hours**	**Residual Value**	**Depreciation Method**
A	5 years	1,400	Straight line
B	50,000 hours	1,100	Units of production
C	4 years	2,500	Double-declining balance

3. On June 30, 2009, old equipment suffered irreparable damage from an accident. On the next day, a salvage company removed the equipment at no cost. The equipment was insured, and $15,000 cash was collected from the insurance company. On January 1, 2009, the company's accounting books reflected the following information about the equipment:

Original cost:	$76,200
Residual value:	$ 4,200
Estimated life:	15 years
Accumulated depreciation (straight line):	$57,600

Prepare all journal entries related to the disposal of this equipment. Show all your work.

QUESTION 3 (18 marks; 32 minutes) *Accounting for Liabilities*

Part 1 **(6 marks)**

Randy Company operates on a calendar-year basis. During 2010, the following events occurred:

1. Sold merchandise for $10,000 cash plus Harmonized Sales Tax (HST) at 13%. The cost of merchandise sale was $8,000. Randy uses the perpetual inventory system.
2. Reclassified a long-term liability of $50,000 to a current liability.
3. Determined that warranty expense for the year was $6,000.
4. Paid cash of $1,500 and replaced parts costing $1,000 to satisfy its product warranty.
5. Received assessment of property taxes of $4,000 for the year, which is payable in two installments of $2,000 each on March 31, 2011 and June 30, 2011.

Required:
Prepare journal entries to record each of the above transactions.

Part 2 **(12 marks)**

Carey Ltd**.** issued 5-year, $5,000,000 debentures on July 1, 2010. The debentures have an annual stated (contractual) interest rate of 4% with interest payable semi-annually on January 1 and July 1, beginning January 1, 2011. The annual market rate for similar bonds was 6% at the time of issuance. The company uses the effective interest method and has a December 31 fiscal year end.

Present value factors for selected periods and interest rates are shown below.

	Present Value of $1						**Present Value of Ordinary Annuity of $1**					
Periods	2%	3%	4%	6%	8%	12%	2%	3%	4%	6%	8%	12%
5	0.9057	0.8626	0.8219	0.7473	0.6806	0.5674	4.7135	4.5797	4.4518	4.2124	3.9927	3.6048
10	0.8203	0.7441	0.6756	0.5584	0.4632	0.3220	8.9826	8.5302	8.1109	7.3601	6.7101	5.6502

Required:
1. Prepare the journal entry to record the issuance of the debentures on July 1, 2010. **(3 marks)**

2. Show how the bond-related amounts would be presented on the company's <u>statement of financial position</u> and <u>income statement</u> in its annual report dated December 31, 2010. **(5 marks)**
3. Assume that on January 1, 2011, after paying interest to bondholders (ignore any accrued interest for the day January 1), Carey Ltd. redeems 20% of the outstanding bonds at 102. Prepare the journal entry associated with this early redemption of the bonds. **(4 marks)**

QUESTION 4 (23 marks; 42 minutes) *Reporting and interpreting cash flows*

Mary Wong, the sole shareholder and manager of Kitchenware Inc., has approached you and asked you to prepare a statement of cash flows for her company. The Company sells kitchen utensils that are used in most households. Mary is presently worried about the meeting that she has scheduled in two weeks with a lending officer of her bank. It is time for a review of the Company's loan from the bank.

Mary provided you with the following condensed financial statements for the fiscal years ended December 31, 2009 and 2010. She assures you that the financial statements are free of any omissions or misstatements, and that they conform to international financial reporting standards.

KITCHENWARE INC.
Statement of Financial Positions as at December 31
(In thousands of dollars)

	2010	**2009**
Assets		
Current assets		
Cash	$ 1,000	$ 3,400
Short-term investments	2,000	8,000
Trade accounts receivable	56,300	10,600
Inventories	10,000	30,000
Total current assets	69,300	52,000
Noncurrent assets		
Furniture and fixtures, at cost	59,000	26,000
Less: accumulated depreciation	(24,000)	(12,000)
Investments	2,000	3,000
Total non-current assets	37,000	17,000
Total assets	$106,300	$69,000
Liabilities and Shareholders' Equity		
Current liabilities		
Bank loan	$ 18,000	$ 8,000
Trade accounts payable	17,000	13,100
Dividends payable	-0-	600
Total current liabilities	35,000	21,700
Noncurrent liabilities		
Mortgage notes payable	28,000	-0-
Total liabilities	63,000	21,700
Shareholders' equity		
Share capital	24,000	22,000
Retained earnings	19,300	25,300
Total shareholders' equity	43,300	47,300
Total liabilities and shareholders' equity	$106,300	$69,000

KITCHENWARE INC.
Income Statements
For the Years Ended December 31

	2010	2009
Sales revenue	$980,000	$880,000
Cost of sales	(640,000)	(560,000)
Gross profit	340,000	320,000
Operating expenses:		
Depreciation	(15,200)	(12,000)
Selling and general	(298,800)	(288,000)
Operating income	26,000	20,000
Interest expense	(9,600)	(3,200)
Loss on sale of furniture	(1,200)	-0-
Gain on sale of investments	800	-0-
Profit before income taxes	16,000	16,800
Income tax expense (@25%)	(4,000)	(4,200)
Profit	$12,000	$12,600

Additional information:

a. During 2010, the company sold old furniture with an original cost of $5,000 and $3,200 of accumulated depreciation up to the date of sale.

b. During 2010, the company sold one of the noncurrent investments that had cost $1,000. The gain on this sale is reported on the income statement.

c. The company considers short-term investments as cash equivalents.

Required:

1. Prepare a partial statement of cash flows for Kitchenware Inc. showing the operating activities section for the year ended December 31, 2010. The Company uses the indirect method to report cash flows from operations. (**5 marks**)
2. Compute the following amounts: (**5 marks**)
   a. Cash collected from customers, assuming that 90 percent of the sales are on credit.
   b. Cash paid to trade suppliers of merchandise
   c. Cash received for sale of old furniture
3. Prepare the investing activities section of the statement of cash flows for Kitchenware Inc. for the year ended December 31, 2010. (**5 marks**)
4. Compute and explain each of the following: (a) quality of earnings ratio, and (b) free cash flow. (**5 marks**)
5. In an effort to improve the company's financial performance, Mary Wong proposed that the furniture and fixtures can be depreciated over a longer period. This change will decrease depreciation expense by $2,000 in 2009 and by $4,000 in 2010. As a professional accountant, would this proposed change be acceptable to you? Explain. (**3 marks**)

QUESTION 5 (17 marks; 31 minutes) *Analysis of Financial Statements*

Comparative financial statement data of Olympic Hardware Ltd. are as follows:

OLYMPIC HARDWARE LTD.
Comparative Income Statements
For the Years Ended December 31, 2010 and 2009

	2010	2009
Net sales	$ 351,500	$ 310,000
Cost of goods sold	201,000	155,000
Gross margin	150,500	155,000
Operating expenses	65,000	71,000
Income from operations	85,500	84,000
Interest expense	26,000	20,000
Profit before income tax	59,500	64,000
Income tax expense	19,000	22,500
Profit	$ 40,500	$ 41,500

OLYMPIC HARDWARE LTD.
Comparative Statement of Financial Position December 31, 2010 and 2009
(and selected account balances at December 31, 2008)

	2010	2009	2008
Current assets:			
Cash	$ 20,000	$ 20,000	$ 15,000
Short-term investments	1,000	5,000	0
Trade receivables, net	116,000	80,500	62,500
Inventories	149,000	137,000	86,000
Prepayments	6,000	9,000	
Total current assets	292,000	251,500	
Property, plant, and equipment, net	154,500	143,500	
Total assets	$446,500	$395,000	351,500
Total current liabilities	$141,000	$138,500	
Long- term liabilities	114,500	121,000	
Total liabilities	255,500	259,500	
Common shares	105,000	90,000	90,000
Retained earnings	86,000	45,500	19,000
Total liabilities and shareholders' equity	$446,500	$395,000	

Other information:

a. The market price of Olympic Hardware Ltd. common shares was $19.00 at December 31, 2010 and $31.00 at December 31, 2009.
b. The weighted-average number of common shares outstanding was 15,000 during 2010 and 12,000 during 2009.
c. All sales are on credit.

d. Cash provided by operating activities (before interest and tax payments) was $78,000 in 2010 and $80,000 in 2009. In addition, the company paid interest of $26,000 in 2010 and $20,000 in 2009.

Required

1. Compute the following ratios for 2010 and 2009 (Round the results to two decimal places): **(14 marks)**
   a. Quick ratio
   b. Inventory turnover
   c. Trade receivables turnover
   d. Times-interest-earned ratio
   e. Return on equity
   f. Price/earnings ratio
   g. Cash coverage

2. Did the company's ability to pay its debts and to sell inventory improved or deteriorated during 2010? Did the investment attractiveness of its common shares appear to have increased or decreased? Explain. **(3 marks)**