

FINAL EXAMINATION (REGULAR)
FALL 2012

Name: _____

ID: _____

Duration: 3 hours

Instructions (very important):

1. This examination paper consists of **9 pages including** this page. Please make sure your copy has all pages before commencing to write.
2. Make sure that your FULL name (last name first), Student ID and Section Letter are on ALL of the three documents: computer input sheet, answer booklet and examination paper.
3. 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 in ink**. 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.**
4. Read the questions carefully and budget your time wisely.
5. Show all calculations on the examination booklet, and omit narratives for journal entries. Using abbreviated account names, headings, subheadings, total and subtotals is not recommended. **If you choose to use abbreviations, then a nominal deduction of 1 mark will be made per examination question.**
6. This is a closed book examination. However, a silent hand-held (not graphical or programmable) calculator and one standard language (not electronic) dictionary are permitted.
7. **Invigilators will not answer questions** (unless you think there is an **error** in the question).
8. Return the exam along with the computer input sheet and answer booklet(s) when you have finished.

Question	Topic	Total Marks
1	Multiple choice	21
2	Accounting for Inventory and Cost of Sales	15
3	Accounting for Bonds	16
4	Accounting for Long-term Assets	15
5	Analysis of Financial Statements	15
6	Preparation of Statement of Cash Flows	18
	Total	100

QUESTION 1 (21 marks; 35 minutes) *Multiple Choice*

Choose the letter that corresponds to the **best** answer, and **show your answer on the computer input sheet only**. Each correct answer is worth 1.5 marks.

1. The specific identification method should only be used if the inventory consists of :
 - a. Homogenous, non-distinguishable goods.
 - b. Non-interchangeable, distinguishable goods.
 - c. High-priced, low-volume goods.
 - d. Low-priced, high-volume goods.

2. If equipment with an original cost of \$125,000, a residual value of \$5,000, and accumulated depreciation of \$25,000 had a recoverable amount of \$80,000, then an impairment loss would be recorded for an amount equal to:
 - a. \$0
 - b. \$20,000
 - c. \$45,000
 - d. \$55,000

3. Which of the following statements is true?
 - a. Since intangible assets lack physical substance, they need to be disclosed only in the notes to the financial statements.
 - b. Goodwill should be combined and reported with other intangible assets on the statement of financial position.
 - c. Intangible assets are typically combined with property, plant, and equipment and reported in the “Property, Plant, and Equipment” section of the statement of financial position.
 - d. Property, plant, and equipment; intangible assets; and goodwill should be separately reported on the statement of financial position.

4. Beatrice works for the Blue Ribbon Corporation at a salary of \$550 per week. Quebec Pension Plan contributions are \$27.23 for the employee and the same for the employer. Federal and provincial income taxes total \$79.15. Employment insurance payments are \$9.79 for the employee and \$13.71 for the employer. How much should Beatrice receive in cash or cheque as her weekly net pay from the company?
 - a. \$392.89
 - b. \$433.83
 - c. \$470.85
 - d. \$550.00

5. Tunga Inc. borrows on January 1, 2011 an amount of \$994,000 from the bank at an annual interest rate of 7 percent. The bank loan will be repaid in three annual payments of \$378,766 each, starting at December 31, 2011. Each payment includes two components: a partial repayment of principal and interest for the year. What is the amount of interest expense that should be recognized by Tunga at the end of the second year?
 - a. \$34,790
 - b. \$46,386
 - c. \$47,937
 - d. \$69,580

6. Which of the following statements is not correct?
 - a. Ownership of common shares gives the owner a voting right.
 - b. If a company’s shares are sold by one shareholder to another, this transaction must be recorded by the company, and Share Capital would increase.
 - c. The authorization of share capital does not result in a transaction that is recorded by the company.
 - d. Legal capital cannot be distributed to shareholders.

7. Which is an example of a cash flow from a financing activity?
 - a. A receipt of cash from the sale of land.
 - b. A payment of cash for income taxes.
 - c. A payment of dividends to shareholders.
 - d. A receipt of cash for interest on an investment in bonds.

8. On December 5, 2012, Duane Inc. repaid long-term debt maturing on that date. Which of the following ratios for the year 2012 would not decrease as a result of this repayment?
 - a. Current Ratio
 - b. Quick Ratio
 - c. Times Interest Earned Ratio
 - d. Debt-to-Equity Ratio

9. Which of the following statements is true?
 - a. When a large stock dividend is declared, retained earnings are reduced by the market value of the shares distributed.
 - b. Neither stock dividends nor stock splits affect basic earnings per share calculations.
 - c. A three-for-one stock split increases the total outstanding shares by 300 percent.
 - d. A stock split has no financial statement effects because it is not a monetary transaction.

10. The manager of Fast Growing Company receives an annual bonus based on the company's reported profit. What combination of the following accounting methods would the manager be inclined to use in a period of rising prices?
 - a. Straight-line depreciation and weighted average cost.
 - b. Accelerated depreciation and weighted average cost.
 - c. Straight-line depreciation and FIFO cost.
 - d. Accelerated depreciation and FIFO cost.

11. Hamburg Ltd. estimated at January 1, 2012, that its profit before income taxes would be \$7,500,000 for the year ended December 31, 2012. The company made quarterly tax payments in April, June, September, and December 2012 based on the estimated profit before income taxes, and a tax rate of 45%. The company's actual profit before income taxes for the year ended December 31, 2012 was \$7,700,000. What is the balance of the account Income Tax Payable at December 31, 2012?
 - a. \$ 0.
 - b. \$90,000.
 - c. \$200,000.
 - d. \$3,465,000.

12. Aaron Electric sells electric appliances, including refrigerators. In November 2012, repairs and returns under the warranty cost \$84,000. The journal entry to record product repairs and returns would include:
 - a. a debit to Estimated Warranty Liability for \$84,000.
 - b. a credit to Estimated Warranty Liability for \$84,000.
 - c. a debit to Warranty Expense for \$84,000.
 - d. a credit to Warranty Expense for \$84,000.

13. An examination of the books and records of Poulin Ltd. shows that the inventory on December 31, 2011 (ending inventory) was understated by \$1,000 due to miscounting some of the inventory items. Assuming that the company maintains a periodic inventory system, what effect does this error have on the following:

	<u>Cost of Sales</u> <u>2011</u>	<u>Profit 2011</u>	<u>Owners' Equity</u> <u>Dec. 31, 2012</u>
a.	Overstated	Understated	No effect
b.	Understated	Overstated	Overstated
c.	Overstated	Understated	Understated
d.	Understated	No effect	No effect

14. An accrued liability results from an expense that is
- incurred but not yet paid.
 - incurred and paid.
 - paid but not yet incurred.
 - neither incurred nor paid.

QUESTION 2 (15 marks; 25 minutes): Accounting for Inventory and Cost of Sales

Vines Inc. is a wine store located in Montreal. During 2012, Vines Inc. had the following transactions related to a specific brand of French wine.

Date	Transaction	# Number of Bottles	Purchase Price per Bottle	Sale Price per Bottle
October 9	Purchase	120	\$26	
October 11	Sale	100		\$36
October 17	Purchase	70	27	
October 22	Sale	60		40
October 25	Purchase	80	28	

There were 60 bottles in the beginning inventory at a total cost of \$1,500. Vines Inc. uses a perpetual inventory system.

Required: (Show detailed calculations unless you are instructed not to do so. Round your answers to the nearest cent.)

- Calculate the cost of ending inventory at October 31, 2012, assuming that Vines Inc. uses the **weighted average** costing method. **(6 marks)**
- Prepare the journal entries to record the sale on October 22, assuming that the **FIFO** costing method is used. **(4 marks)**
- Vines Inc.'s Chief Financial Officer wants to assess the impact of using a periodic inventory system on your answers to requirements 1 and 2 above.
 - Would your answer to requirement 1 change and by how much? **(4 marks)**
 - Would your answer to requirement 2 change? Explain. *No calculation is required for this part of requirement 3.* **(1 mark)**

QUESTION 3 (16 marks; 30 minutes): Accounting for Bonds

On July 1, 2012, Magana Corporation sold bonds which had the following characteristics:

Face value:	\$1,500,000
Maturity date:	June 30, 2017
Interest payment dates:	June 30 and December 31
Coupon rate	12% (annual)
Market rate	10% (annual)

The company uses the effective interest method and has a December 31 fiscal year end.

Required: (Show detailed calculations and round your answers to the nearest dollar.)

1. Prepare the journal entry to record the issuance of the bonds on July 1, 2012. Present value tables are on page 9. **(4 marks)**
2. On July 1, 2013, after the interest is paid, Magana retires 40% of the bonds at 98. Record the early retirement of the bonds. **(7 marks)**
3. List the items that will appear on the statement of cash flows with respect to the early retirement of the bonds. Identify the amount that should be reported and the section where it will be reported. The company uses the **indirect method** to report cash flows from operating activities. **(3 marks)**
4. Show how the remaining bonds will appear on the statement of financial position immediately after the early retirement of bonds. **(2 marks)**

QUESTION 4 (15 marks; 25 minutes): Accounting for Long-term Assets

On September 1, 2011 Patel Tool and Die Inc. (PTD) incurred the following costs in acquiring equipment, land, and building:

➤ Purchase price of equipment	\$105,000
➤ Purchase price of land and building (the land and the building had market values of \$600,000 and \$300,000, respectively).....	840,000
➤ Delinquent real estate taxes on the land	4,000
➤ Renovation costs of the building prior to use	20,000
➤ Costs incurred for the building dedication ceremony	3,000

Required: (Show detailed calculations and round your answers to the nearest dollar.)

1. Calculate the acquisition cost of both the land and the building. **(4 marks)**
2. PTD depreciates the building over 30 years with \$30,000 residual value using the double-declining balance method. PTD depreciates the equipment over 10 years with \$5,000 residual value using the straight-line method. Calculate the depreciation expense for the building and the equipment for 2011 and 2012, respectively. **(7 marks)**
3. On October 31, 2011 PTD sold a machine (not the equipment referred to above) for \$18,000 cash. The machine had a carrying amount (or book value) of \$13,200 and an original cost of \$115,200. Prepare journal entries to record this transaction. **(4 marks)**

QUESTION 5 (15 marks; 30 minutes): Analysis of Financial Statements

Aaron Brees took a summer intern position at Mount Royal Security Ltd. after finishing his first year study at John Molson School of Business. Drew Rogers, Aaron's mentor, asked Aaron to analyze Bell Canada Enterprises (BCE) and Telus Communications Company. Selected condensed financial statements of BCE and Telus are presented below (FY means Fiscal Year):

Income Statements for FY 2011 (in millions of dollars)

	BCE	Telus
Sales Revenue	18,185	9,779
Cost of Sales	<u>(4,981)</u>	<u>(6,062)</u>
Gross Profit	13,204	3,717
Operating Expense	<u>(9,509)</u>	<u>(1,809)</u>
Operating Income	3,695	1,908
Other Income/Expenses	<u>125</u>	<u>(32)</u>
Profit before Interest and Taxes	3,820	1,876
Interest Expense	<u>(674)</u>	<u>(510)</u>
Profit Before Income Tax	3,146	1,366
Income Tax Expense	<u>(554)</u>	<u>(328)</u>
Profit	<u>\$2,592</u>	<u>\$1,038</u>

Condensed Statement of Financial Position (in millions of dollars)

	BCE		Telus	
	<u>FY2011</u>	<u>FY2010</u>	<u>FY2011</u>	<u>FY2010</u>
Assets				
Current Assets				
Cash and Cash Equivalents	779	655	25	43
Net Trade Receivables	1,896	1,636	973	710
Inventory	441	428	283	270
Other Current Assets	438	414	109	104
Total Current Assets	3,554	3,133	1,390	1,127
Total Non-Current Assets	35,973	33,162	18,209	18,092
Total Assets	39,527	36,295	19,599	19,219
Liabilities				
Current Liabilities	5,953	4,565	3,949	2,964
Long Term Debt	10,649	9,824	5,313	6,090
Other Long-term Liabilities	5,608	5,715	2,158	2,611
Total Liabilities	22,210	20,104	11,420	11,665
Shareholders' Equity				
Share Capital	15,520	15,000	5,428	5,841
Retained Earnings	1,797	1,191	2,751	1,713
Total Shareholders' Equity	17,317	16,191	8,179	7,554

Additional Information:

	BCE	Telus
• Stock price per share at December 31, 2011	\$35.46	\$43.56
• Cash dividend paid in 2011, per share	\$1.97	\$2.00
• Weighted-average number of common shares outstanding for the year 2011	759 million	320 million
• Cash flows from operating activities	\$4,724 million	\$2,546 million
• Interest paid during 2011	\$685 million	\$479 million
• Income tax paid during 2011	\$527 million	\$353 million

Required: (Show detailed calculations and round your answers to two decimal places.)

1. Aaron recalled from his COMM 217 class that equity analysts generally conduct analyses of a company's profitability, liquidity, and solvency, so he decided to evaluate three ratios: *Return on Assets*, *Quick Ratio*, and *Times Interest Earned Ratio*. Calculate these three ratios for both BCE and Telus for FY 2011. **(6 marks)** What conclusions would Aaron draw? **(2 marks)**
 2. Drew asked Aaron to strengthen his profitability analysis by further considering the *Quality of Earnings* ratio. Calculate *Quality of Earnings* for both BCE and Telus for FY 2011. **(2 marks)** Why did Drew ask Aaron to calculate the *Quality of Earnings* ratio in addition to the *Return on Assets*? **(1 mark)** What conclusions would Aaron draw? **(1 mark)**
 3. Aaron received a phone call from a client who wanted to buy a security with a high *Price/Earnings Ratio*. What does the *Price/Earnings Ratio* measure in general? **(1 mark)**
 4. Which company, BCE or Telus, should Aaron recommend to this client, and why? **(2 marks)**
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QUESTION 6 (18 marks; 35 minutes): Preparation of the Statement of Cash Flows

Below are Mortimer Limited's income statement for the year ended December 31, 2012 and the company's comparative statements of financial position at December 31, 2012 and 2011, respectively, **(in thousands of dollars)**:

	<u>2012</u>
Sales revenue	\$ 390,000
Cost of goods sold	220,000
Other operating expenses (including depreciation -- see additional information, on next page)	60,000
Gain on sale of land	7,000
Loss on sale of equipment	1,500
Interest expense	9,000
Income tax expense	<u>25,000</u>
Profit	<u>\$ 81,500</u>

	<u>2012</u>	<u>2011</u>
Cash	\$ 32,000	\$ 63,000
Trade receivables	19,000	14,000
Merchandise inventory	6,000	9,000
Prepaid operating expenses	1,000	3,000
Land	84,000	112,000
Building	62,000	44,000
Accumulated depreciation – Building	(6,600)	(3,000)
Equipment	16,000	9,000
Accumulated depreciation – Equipment	(3,000)	(2,000)
Trade payables	9,400	36,000
Interest payable	2,000	3,000
Income tax payable	5,000	1,000
Bonds payable, at par	30,000	40,000
Share capital	40,000	30,000
Retained earnings	124,000	139,000

Additional information for 2012 (in thousands of dollars):

- Depreciation expense consists of \$3,600 for the building and \$2,000 for the equipment.
- Mortimer disposed of land for cash (amount can be derived). No land was acquired.
- Mortimer constructed an extension to its building for cash. No other activity affected the Building account.
- Equipment with a cost of \$12,000 was purchased for cash. Old equipment was sold for cash (amount can be derived).
- Trade payables relate exclusively to transactions with suppliers of merchandise inventory.
- Bondholders exchanged \$10,000 par value bonds for common shares of Mortimer Limited.
- Ninety-percent (90%) of Mortimer's sales are on account; the remainder are for cash. No discounts are offered.

Required:

1. Calculate the following (**9 marks**):
 - a. Cash collected from customers
 - b. Payments to suppliers of merchandise inventory
 - c. Payments for operating expenses
 - d. Payments for interest
2. Prepare in proper form the investing activities section of the Statement of Cash Flows for Mortimer Limited for the year ended December 31, 2012. A complete statement of cash flows is not required. (**8 marks**)
3. Mortimer's auditors insist that the contingent liability Mortimer discloses should be recognized as a provision. If the auditors' opinion is accepted, would Mortimer's cash flows from operations change? Explain. (**1 mark**)

Present Value Tables

TABLE A.1

Present Value of \$1, $p = 1/(1 + i)^n$

Periods	2%	3%	3.75%	4%	4.25%	5%	6%	7%	8%
1	0.9804	0.9709	0.9639	0.9615	0.9592	0.9524	0.9434	0.9346	0.9259
2	0.9612	0.9426	0.9290	0.9246	0.9201	0.9070	0.8900	0.8734	0.8573
3	0.9423	0.9151	0.8954	0.8890	0.8826	0.8638	0.8396	0.8163	0.7938
4	0.9238	0.8885	0.8631	0.8548	0.8466	0.8227	0.7921	0.7629	0.7350
5	0.9057	0.8626	0.8319	0.8219	0.8121	0.7835	0.7473	0.7130	0.6806
6	0.8880	0.8375	0.8018	0.7903	0.7790	0.7462	0.7050	0.6663	0.6302
7	0.8706	0.8131	0.7728	0.7599	0.7473	0.7107	0.6651	0.6227	0.5835
8	0.8535	0.7894	0.7449	0.7307	0.7168	0.6768	0.6274	0.5820	0.5403
9	0.8368	0.7664	0.7180	0.7026	0.6876	0.6446	0.5919	0.5439	0.5002
10	0.8203	0.7441	0.6920	0.6756	0.6595	0.6139	0.5584	0.5083	0.4632
20	0.6730	0.5537	0.4789	0.4564	0.4350	0.3769	0.3118	0.2584	0.2145
Periods	9%	10%	11%	12%	13%	14%	15%	20%	25%
1	0.9174	0.9091	0.9009	0.8929	0.8850	0.8772	0.8696	0.8333	0.8000
2	0.8417	0.8264	0.8116	0.7972	0.7831	0.7695	0.7561	0.6944	0.6400
3	0.7722	0.7513	0.7312	0.7118	0.6931	0.6750	0.6575	0.5787	0.5120
4	0.7084	0.6830	0.6587	0.6355	0.6133	0.5921	0.5718	0.4823	0.4096
5	0.6499	0.6209	0.5935	0.5674	0.5428	0.5194	0.4972	0.4019	0.3277
6	0.5963	0.5645	0.5346	0.5066	0.4803	0.4556	0.4323	0.3349	0.2621
7	0.5470	0.5132	0.4817	0.4523	0.4251	0.3996	0.3759	0.2791	0.2097
8	0.5019	0.4665	0.4339	0.4039	0.3762	0.3506	0.3269	0.2326	0.1678
9	0.4604	0.4241	0.3909	0.3606	0.3329	0.3075	0.2843	0.1938	0.1342
10	0.4224	0.3855	0.3522	0.3220	0.2946	0.2697	0.2472	0.1615	0.1074
20	0.1784	0.1486	0.1240	0.1037	0.0868	0.0728	0.0611	0.0261	0.0115

TABLE A.2

Present Value of Annuity of \$1, $P = [1 - 1/(1 + i)^n]/i$

Periods	2%	3%	3.75%	4%	4.25%	5%	6%	7%	8%
1	0.9804	0.9709	0.9639	0.9615	0.9592	0.9524	0.9434	0.9346	0.9259
2	1.9416	1.9135	1.8929	1.8861	1.8794	1.8594	1.8334	1.8080	1.7833
3	2.8839	2.8286	2.7883	2.7751	2.7620	2.7232	2.6730	2.6243	2.5771
4	3.8077	3.7171	3.6514	3.6299	3.6086	3.5460	3.4651	3.3872	3.3121
5	4.7135	4.5797	4.4833	4.4518	4.4207	4.3295	4.2124	4.1002	3.9927
6	5.6014	5.4172	5.2851	5.2421	5.1997	5.0757	4.9173	4.7665	4.6229
7	6.4720	6.2303	6.0579	6.0021	5.9470	5.7864	5.5824	5.3893	5.2064
8	7.3255	7.0197	6.8028	6.7327	6.6638	6.4632	6.2098	5.9713	5.7466
9	8.1622	7.7861	7.5208	7.4353	7.3513	7.1078	6.8017	6.5152	6.2469
10	8.9826	8.5302	8.2128	8.1109	8.0109	7.7217	7.3601	7.0236	6.7101
20	16.3514	14.8775	13.8962	13.5903	13.2944	12.4622	11.4699	10.5940	9.8181
Periods	9%	10%	11%	12%	13%	14%	15%	20%	25%
1	0.9174	0.9091	0.9009	0.8929	0.8850	0.8772	0.8696	0.8333	0.8000
2	1.7591	1.7355	1.7125	1.6901	1.6681	1.6467	1.6257	1.5278	1.4400
3	2.5313	2.4869	2.4437	2.4018	2.3612	2.3216	2.2832	2.1065	1.9520
4	3.2397	3.1699	3.1024	3.0373	2.9745	2.9137	2.8550	2.5887	2.3616
5	3.8897	3.7908	3.6959	3.6048	3.5172	3.4331	3.3522	2.9906	2.6893
6	4.4859	4.3553	4.2305	4.1114	3.9975	3.8887	3.7845	3.3255	2.9514
7	5.0330	4.8684	4.7122	4.5638	4.4226	4.2883	4.1604	3.6046	3.1611
8	5.5348	5.3349	5.1461	4.9676	4.7988	4.6389	4.4873	3.8372	3.3289
9	5.9952	5.7590	5.5370	5.3282	5.1317	4.9464	4.7716	4.0310	3.4631
10	6.4177	6.1446	5.8892	5.6502	5.4262	5.2161	5.0188	4.1925	3.5705
20	9.1285	8.5136	7.9633	7.4694	7.0248	6.6231	6.2593	4.8696	3.9539