École de gestion TELFER School of Management

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Final Examination

ADM 2340: Financial Accounting
Autumn 2007

Student Name: ______________________________

Student #: ___________________________________

Section: (check one) **A (Pyper) ___ B (Pyper)___ C (Kalyta)___ D (Pyper)___**
E (Tassé)___ F (Collier)___ G (Kalyta)___

1. All questions including multiple-choice questions must be answered in a separate booklet.
2. Please do not ask the professor or the invigilator to explain or interpret questions. State any assumptions you feel are necessary. Only questions concerning possible errors in the exam will be answered.
3. Books and notes are not permitted.
4. Programmable calculators are not allowed. Calculators must not be shared.
5. Show all supporting calculations clearly where required. Answers will not be marked if written illegibly.
6. Language dictionaries are allowed but will be checked. Electronic dictionaries are not allowed.

I	**/ 18**
II	**/ 15**
III	**/ 18**
IV	**/ 19**
V	**/ 20**
TOTAL	**/ 90**

Part I: Multiple-choice **(18 points)**

Choose the most appropriate answer. Each correct answer is worth 1 point.

1. During the current year, Jamul Corporation sold $1,000,000 in goods that cost $750,000. Cash sales were $400,000 and credit sales $600,000. Jamul collected $500,000 of the credit sales during the year. What amount of revenue should Jamul recognize for the year under the accrual based accounting?

a. $400,000.
b. $600,000.
c. $900,000.
d. $1,000,000.

Use the following information for Questions 2 and 3:

Sweetwater Construction agreed to build a business centre for $25,000,000 over the next three years. Estimated cost for years one through three are: $10,000,000; $5,000,000; and $5,000,000.

2. Estimated profit or loss for year two, assuming the percentage of completion method, would be

a. $0.
b. $1,250,000.
c. $2,500,000.
d. $3,750,000.

3. Assume that in year two, total estimated costs to complete the job were revised to $27,000,000. Under the percentage of completion method, the loss for year three would be

a. $(2,000,000).
b. $(4,500,000).
c. $(5,750,000).
d. None of the answers above is correct.

4. When a perpetual inventory system is used,

a. a physical inventory count must be taken to determine the cost of goods sold.
b. the recognition of the cost of goods sold is deferred until the accounting year-end.
c. the balance in the inventory account is updated after each sale.
d. timeliness of data is sacrificed for lower costs of operation.

5. A building currently has a net book value of $450,000 after three years of straight-line amortization totaling $150,000. The estimated residual value is $50,000. What was the building's original cost?

a. $550,000.
b. $600,000.
c. $650,000.
d. None of the answers above is correct.

6. An amortizable asset with a cost of $42,500 and a residual value of $2,500 was amortized using the units-of-production method. Total estimated units of output were 80,000. 5,400 units were produced in year 1. Amortization expense for year 1 was

a. $2,700.
b. $2,869.
c. $21,250.
d. None of the answers above is correct.

7. On January 1, 2007, AT Inc. borrowed $5,000,000 from the local bank. The debt was to be repaid in equal installments over the next four years at each year-end. The first payment was made on December 31, 2007. What was the balance in AT's long-term liabilities with respect to the bank loan on January 1, 2008?

a. $2,500,000.
b. $3,750,000.
c. $4,000,000.
d. $5,000,000.

Use the following information for Questions 8 and 9:

Valdez Co. borrowed $25,000 on October 1, 2006 on a nine-month note, bearing a 16% annual interest. Interest and principal are due at maturity.

8. The entry to record the transaction on October 1, 2006 would include a

a. credit to cash.
b. debit to interest expense.
c. debit to interest payable.
d. None of the answers above is correct.

9. The total liability reflected on the December 31, 2006 balance sheet concerning this borrowing would equal

a. $25,000.
b. $26,000.
c. $26,333.
d. $28,000.

Use the following information for Questions 10 and 11:

Elizabeth Inc.'s shareholders' equity consists of:

Common shares (17,500 shares)	$175,000
Retained earnings	85,000
Total shareholders' equity	$260,000

10. Assume Elizabeth repurchased 2,000 shares for $12 a share. Total shareholders' equity will be

a. $175,000.
b. $236,000.
c. $240,000.
d. $260,000.

11. Assume Elizabeth repurchased 1,000 shares for $9 a share. The entry will include a

a. debit to retained earnings for $1,000
b. credit to gain on sale of shares for $1,000
c. debit to common shares for $9,000
d. credit to contributed surplus for $1,000

12. Which of the following companies would be least likely to calculate gross profit margin?

a. An automobile dealership.
b. An insurance company.
c. A manufacturer of toys.
d. A wine producer.

13. Purchase of inventory for cash will

a. increase the quick ratio.
b. decrease the quick ratio.
c. not affect the quick ratio.
d. either decrease, or increase, or have no effect on the quick ratio, depending on the inventory value.

14. Declaration of dividends is an example of a

a. cash flow from operating activities.
b. cash flow from financing activities.
c. cash flow from investing activities.
d. None of the answers above is correct.

15. An understatement of the ending inventory in Year 1, if not corrected, will cause

a. Year 1 net income to be understated and Year 2 net income to be overstated.
b. Year 1 net income to be overstated and Year 2 net income to be overstated.
c. Year 1 net income to be overstated; Year 2 net income will be correct.

d. Year 1 net income to be overstated and Year 2 net income to be understated.

16. In the case of cash dividends, a dividend liability comes into existence on the

a. date of declaration.
b. date of dividend payment.
c. last day of the accounting period in which the dividend is declared.
d. last day of the financial year.

17. Which of the following is not true?

a. Internally developed intangibles are usually capitalized.
b. Intangible assets have no physical form.
c. Intangibles can be amortized.
d. Accounts receivable are not classified as an intangible asset.

18. Consider the following information for Agro Inc.: Sales, $500,000; Operating expenses, $200,000; Interest expense, $50,000; Income tax expense, $75,000; Net income, $175,000. Agro's times interest earned ratio equals

a. 3.5
b. 4.5
c. 6
d. 10

Part II: Potpourri **(15 points)**

1. Under what conditions should a company record a contingent liability as a loss on the income statement and a liability on the balance sheet? Be concise. (3 points)

2. Plastik Inc. has negotiated a contract with a supplier to purchase 100,000 tons of ethylene per year for the next 5 years, at a pre-negotiated price of $1,500 per ton. Plastic believes that the contract might significantly affect the company's future operations. However, no transactions with respect to the contract have been made yet. How, if at all, should Plastic report the information about the contract in its current financial statements? Be concise. (2 points)

3. According to Canadian accounting practice, in general, liabilities should be recorded at the present value of the future payments. However, current liabilities are typically valued at the gross amount of the obligation instead of the present value amount. What is the key reason? Be concise. (2 points)

4. Preferred shareholders have a priority on asset distribution over common shareholders. What does it mean? Explain in your own words or provide an example. Be concise. (2 points)

5. Many companies offer stock option grants to their employees as an incentive compensation. Normally, the exercise price of such stock options either equals the market price of the company's shares at the time of the grant or exceeds the market price. In your opinion, why don't companies offer stock option grants at the exercise price below the market price at the time of the grant? Be concise. (2 points)

6. Would an auditor be considered independent for an audit of the financial statements of a non-for-profit organization for which he or she is serving as a treasurer on a voluntary basis (i.e., without compensation)? Briefly explain. (2 points)

7. What is the main difference between internal and external auditors? Be concise. (2 points)

Part III: Financial analysis **(18 points)**

1. On January 1, 2007, current assets of Jagr Limited totaled $500,000; Jagr's current ratio was 2.0. During 2007, Jagr completed the following transactions:

i. declared but did not pay dividends of $50,000;
ii. paid $10,000 for future period rent;
iii. paid previously declared dividends in the amount of $20,000;
iv. collected an account receivable in the amount of $12,000;
v. used $5,000 of prepaid rent.

Required:

a) Compute the current ratio (rounded up to two decimals) after each transaction. Clearly show your calculations. (5 points)

b) As a potential creditor, what additional information would you like to know to assess the short-term liquidity of Jagr Limited? Explain your answer. Be concise. (2 points)

2. Shanahan Corporation reported an inventory turnover ratio of 8.6 during 2006. In 2007, management introduced a new inventory control system that was expected to reduce average inventory levels by 25% without affecting sales volume. Given these circumstances, would you expect the inventory turnover to increase, decrease or remain unchanged during 2007? Explain your answer. Be concise. (2 points)

3. Toc Inc. is a rapidly growing distribution company in the information technology (IT) industry. Toc purchases IT products directly from manufacturers and sells the products to retailers. Consider the following data for Toc:

Account	2005	2006	2007
Total revenue	$21,000,000	$27,000,000	$35,000,000
Revenue from cash sales	11,000,000	13,000,000	21,000,000
Revenue from credit sales	10,000,000	14,000,000	14,000,000
Total expenses	16,000,000	20,000,000	26,000,000
Net income	5,000,000	7,000,000	9,000,000
Accounts receivable	$2,000,000	$2,500,000	$1,500,000

Required:

a) Calculate the average number of days (rounded up to one decimal) it took Toc Inc. to collect accounts receivable in 2006 and 2007. (3 points)

b) Calculate Toc's net profit margin (rounded up to three decimals) in 2006 and 2007. (2 point)

c) In early 2007, Toc Inc. implemented a new, more conservative credit-screening policy. At the end of the year, Toc's Chief Controller, the person directly responsible for the design and implementation of the new policy, was formally asked to evaluate the results. In the report, the Chief Controller noted that the new credit-screening policy was extremely beneficial for the company: it substantially reduced the company's balance in accounts receivable and increased the company's cash sales, without negatively affecting the profit margin. Toc's CEO returned the report with the following comment: "The numbers look good. However, it was a good year for the industry. I am not convinced that the increase in cash sales is due to the new credit-screening policy. Please, provide a detailed report on the customers who were purchasing from us on credit in 2006. How many of them have stopped using our services in 2007? How many of them have switched from credit purchases to cash purchases in 2007? Has the volume of their purchases decreased?"

i. What is the potential ethical problem with the Chief Controller's evaluation of the new credit-screening policy? Be concise. (2 points)

ii. Explain, in your words, why the effectiveness of the new credit-screening policy cannot be appropriately evaluated without knowing the answers to the CEO's questions. Be concise. (2 points)

Part IV: Capital assets **(19 points)**

ABC Co. purchased a new building on June 30, 2000. A large piece of equipment was included in the sale. The total price negotiated with the seller was $1,230,000 for the basket purchase of the building and equipment. The payment scheme agreed upon with the seller was as follows: ABC made a $500,000 down payment in cash; the remaining amount plus the 8% annual interest was due under a note payable one year from the date of purchase. In addition, on June 30, 2000, ABC paid $10,000 cash to insure the building for the first year of operations (i.e., the insurance covered the period from June 30, 2000 to June 30, 2001).

The fair market value of the building on the date of purchase was $1,000,000. The fair market value of the equipment was $500,000.

ABC Co. expected to use the building for 20 years and anticipated a residual value for the building of $300,000. The equipment was expected to be used for 10 years with a residual value of $110,000. The equipment was amortized using straight-line amortization and the building was amortized using the double-declining method.

On January 1, 2006, ABC Co. decided to sell the equipment. The equipment was sold for $200,000.

Required: (*narrative explanations are not required; however, all supporting calculations must be shown*)

1. Prepare the journal entry/entries made by ABC Co. on June 30, 2000. Assume that ABC maintains separate accounts for the building and equipment. (6 points)

2. Prepare the journal entry to record the amortization expense for the building for the year ended December 31, 2000. (2.5 points)

3. Prepare the journal entry to record the amortization expense for the equipment for the year ended December 31, 2000. (2.5 points)

4. Prepare the section of the balance sheet for the building and equipment as of December 31, 2000. (3 points)

5. Prepare the journal entry to record the sale of the equipment on January 1, 2006. (5 points)

Part V: Financial statements **(20 points)**

IMPORTANT: You must choose between Questions V-A and V-B. Clearly indicate your choice. Do not answer both questions. If, for any reason, you decide to answer both questions, only Question V-A will be marked.

(V-A) Balance sheet

The following is a list of accounts of Peter Inc. on December 31, 2007:

Account	Balance	Account	Balance
Accounts payable	$16,900	Goodwill	1,700
Accumulated amortization—building	20,000	Inventory	12,500
Amortization expense	6,200	Long-term debt	42,400
Bad debt expense	1,000	Loss on sale of long-term assets	23,000
Building	140,000	Notes receivable	6,200
Capital stock	27,000	Prepaid expenses	5,000
Cash	4,600	Sales revenue, net	280,000
Contributed surplus	2,200	Temporary investments	6,900
Cost of goods sold	168,000	Unrealized gain on temporary investments	11,000
Current portion of long-term debt	10,000	Wages expense	36,000
Deferred revenue	6,000	Warranty expense	12,000
Dividends declared	5,000	Warranty obligations (due in 2008)	$3,000
Dividends payable	3,000		

The balance in Peter's retained earnings on January 1, 2007 is $6,600.

Required:
Prepare, in proper format, the balance sheet on December 31, 2007. Clearly show your calculations.

(V-B) Statement of cash flows

The following is a list of accounts of DN Inc. on January 31, 2006, and January 31, 2007.

Account	Jan. 31, 2006	Jan. 31, 2007	Change
Amortization expense	$29,000	$29,000	-
Cash	43,000	93,000	50,000 ↑
Common shares	478,000	535,000	57,000 ↑
Gain on sale of land	-	5,000	5,000 ↑
Income taxes payable	70,000	32,000	38,000 ↓
Land	400,000	461,000	61,000 ↑
Machinery, net of amortization	127,000	98,000	29,000 ↓
Merchandise inventory	166,000	210,000	44,000 ↑
Net income	200,000	280,000	80,000 ↑
Other expenses	481,000	486,000	5,000 ↑
Prepaid rent	72,000	48,000	24,000 ↓
Retained earnings	113,000	186,000	73,000 ↑
Revenue	710,000	790,000	80,000 ↑
Wages payable	$147,000	$157,000	10,000 ↑

Additional information for the year ended January 31, 2007:
* A parcel of land was sold for $120,000 cash.
* Additional land was purchased for $176,000 cash.
* Common shares issued were $65,000.
* Common shares repurchased were $8,000.
* Dividends declared and paid were $207,000.

Required:

Prepare, in proper format, the cash flow statement for the year ended Jan. 31, 2007 using the indirect method.