

Name: _____ Student ID: _____ Section: _____

CONCORDIA UNIVERSITY
DEPARTMENT OF ACCOUNTANCY

FINANCIAL ACCOUNTING
COMM 217 ALL SECTIONS

FINAL EXAMINATION

Winter 2011

Duration: 3 hours

Instructions (very important):

1. This examination paper consists of **11 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**. 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. Show all calculations.
5. This is a closed book examination. However, a silent hand-held (not graphical) calculator and one standard language (not electronic) dictionary are permitted.
6. **Invigilators will not answer questions** (unless you think there is an **error** in the question).
7. Return the exam along with the computer input sheet and answer booklet(s) when you have finished.

Question	Topic	Total Marks
1	Multiple Choice	24
2	Accounting for Long-term Assets	16
3	Accounting for Bonds	21
4	Reporting and Interpreting Cash Flows	19
5	Analysis of Financial Statements	20
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 statement regarding the indirect method of reporting cash from operating activities is false?
 - A) Amortization expense is added back to net income.
 - B) An increase in accounts receivable is added to net income.
 - C) An increase in accounts payable is added to net income.
 - D) An increase in merchandise inventory is subtracted from net income.

2. On August 1, Energy Company purchased a coal digging machine in exchange for \$30,000 cash and 100 shares of AT common shares held by Energy Company as an investment. The AT common shares cost Energy Company \$5,000 and had a market value of \$4,200 on August 1. Energy Company paid \$200 in shipping costs and \$700 in installation costs. What is the total amount that should be debited to the Machinery account by Energy Company?
 - A) \$35,100
 - B) \$35,400
 - C) \$35,500
 - D) \$36, 200

3. The continuity (going concern) assumption is important in accounting for tangible operational assets because:
 - A) It helps a company decide whether to use straight-line amortization or an accelerated amortization method.
 - B) It justifies amortizing the asset over its expected useful life, without anticipating that the business will liquidate in the near future.
 - C) It provides justification for including residual values in calculating amortization.
 - D) It is consistent with maintaining assets in the accounting records at market value rather than acquisition cost.

4. Bubba Inc. purchased an asset on January 1, 2011. Bubba chose the straight-line method to amortize the asset. Had Bubba chosen an accelerated amortization method, which of the following would be true?
 - A) Amortization expense would be greater in 2011.
 - B) The book value of the asset would be less at the end of 2011.
 - C) Net income would be less in 2011.
 - D) All of the responses above are correct.

5. Which of the following methods ordinarily would be the most appropriate to determine depletion of natural resources for financial reporting purposes?
 - A) Straight line.
 - B) Double-declining balance.
 - C) Specific identification.
 - D) Units of production.

6. The following is a partial list of account balances from the books of Ellsworth Enterprise at December 31, 2010:

Accounts Payable	\$1,200
Accounts Receivable	1,000
Accrued Vacation Liability	900
Cash	3,000
Deferred Revenue	500
Income Taxes Payable	2,200
Notes Payable (due in 2 years)	600

Based solely upon these balances, what amount of current liabilities should appear on Ellsworth's balance sheet at that date?

- A) \$3,900 B) \$4,300 C) \$4,800 D) \$5,400
7. A positive financial leverage percentage indicates that:
- Interest payments can be deducted for income tax purposes.
 - The company's after-tax return on total assets is less than the after-tax cost of borrowing.
 - The return on shareholders' equity is enhanced through the use of debt in financing the acquisition of assets.
 - The dividends declared to shareholders exceed interest payments to creditors.
8. Assume that Ming Inc. reported the following information:
- Preferred shares, \$3, cumulative, 1,000 shares outstanding, with dividends in arrears for 3 years: 2007, 2008, and 2009.
 - Common shares, 2,000 shares outstanding.
- Total dividends declared in 2010 were \$30,000. What is the total amount of dividends to which common shareholders are entitled?
- A) \$18,000 B) \$21,000 C) \$27,000 D) \$30,000
9. In 2010, Toys 4 U had total liabilities of \$4,275 million and total assets of \$7,899 million. In 2009, their total liabilities were \$3,535 million and total assets were \$7,963 million. Which of the following statements is true?
- The debt-to-equity ratio decreased from 2009 to 2010.
 - Toys 4 U had more debt financing than equity financing in 2010.
 - The debt-to-equity ratio in 2010 means that Toys 4 U has less than half of its financing provided by creditors.
 - All of the responses above are true.

10. On April 1, 2011, immediately after recording interest payments, Seals, Inc., retired one fifth of its \$500 million bonds payable for \$97.5 million. The bonds were originally issued in 2001 at par value. Which of the following statements is correct?
- A) Cash of \$100 million will be paid to the bondholders.
 - B) A gain of \$2.5 million will be reported on the income statement.
 - C) A loss of \$2.5 million will be reported on the income statement.
 - D) A loss of \$2.5 million will be reported as a separate component of shareholders' equity on the balance sheet.
11. Which of the following statements is correct with respect to preferred shares?
- A) They must have a par value.
 - B) They are never issued without voting privileges.
 - C) They cannot exist unless there also are common shares.
 - D) They always provide for a fixed payment to be made to the shareholders even for years when no dividends have been declared.
12. Which of the following statements is incorrect?
- A) Issuance of shares creates cash inflow related to financing activities.
 - B) Payment of a cash dividend creates cash outflow related to investing activities.
 - C) Repurchase of the company's shares creates cash outflow related to financing activities.
 - D) All of the statements above are incorrect.
13. Callable bonds refer to bonds that are:
- A) Turned in for reimbursement at the option of the bondholder.
 - B) Converted to common shares at the option of the bondholder.
 - C) Called for early retirement at the option of the issuer.
 - D) Called by the issuer for conversion to debentures.
14. Which of the following statements regarding retained earnings is true?
- A) Retained earnings is an asset.
 - B) Retained earnings has a debit balance for a profitable corporation.
 - C) Retained earnings represents the future dividend liability of the company.
 - D) Retained earnings represents the income that has been earned by the company, less any dividends declared since the first day of operations.
15. On July 1, 2010, Wilson, Inc., borrowed \$12,000 from First Bank on a one-year note payable. Interest at an annual rate of 8 percent is payable on December 31, 2010 and on June 30, 2011, the due date of the note. The note payable should be reported on the balance sheet at December 31, 2010 as:
- A) Long-term liability, \$12,480.
 - B) Current liability, \$12,480.
 - C) Long-term liability, \$12,000.
 - D) Current liability, \$12,000.

16. Westward Electric sells electric appliances, including refrigerators. The company's experience in recent years indicates that warranty costs average 3.1% of sales. During April 2011, sales of refrigerators were \$3,000,000 and cash payments for warranty service on refrigerators were \$84,000. The journal entry to record the warranty expense for April is:

A)	Warranty expense	84,000	
	Cash		84,000
B)	Liability for warranties	84,000	
	Cash		84,000
C)	Warranty expense	93,000	
	Liability for warranties		93,000
D)	Warranty expense	93,000	
	Cash		93,000

QUESTION 2 (16 marks; 29 minutes)

Accounting for Long-term Assets

Andrei Ltd. bought a machine and a building on January 1, 2009 for \$180,000. The appraised values for the machine and the building were \$70,000 and \$140,000, respectively, on that date. The machine had an estimated useful life of 10 years and an estimated residual value of \$1,500, and the building had an estimated useful life of 20 years and an estimated residual value of \$2,000. Andrei signed a \$100,000 note payable and paid the balance in cash. On January 1, 2010, Andrei completed a major renovation on the building which cost \$50,000. This expenditure was expected to increase the building's total estimated useful life by six years and its estimated residual value to \$4,100. The company uses the double-declining-balance method to amortize the machine, and the straight-line method to amortize the building. The company's fiscal year ends on December 31.

Required:

1. Prepare the journal entry or entries related to the acquisition of the machine and the building on January 1, 2009. **(3 marks)**
2. Compute the amortization expense for the machine for each of the years 2009 and 2010. Journal entries are not required. **(2 marks)**
3. Compute the amortization expense for the building for each of the years 2009 and 2010. Journal entries are not required. **(4 marks)**
4. Andrei sold the building on June 30, 2011, and received \$50,000 cash and a \$110,000 note receivable. Prepare the journal entry or entries to record the sale of the building. (Hint: Accumulated amortization needs to be updated.) **(7 marks)**

QUESTION 3 (21 marks; 38 minutes) *Accounting for Bonds*

Duke Flatbush Ltd, a merchandising company specializing in 1950's era baseball memorabilia, issued \$313,600,000 face value debenture bonds on February 1, 2010 for cash. The bonds mature on February 1, 2020. The annual contractual (coupon) rate on the bonds is 7.5%, and interest must be paid semi-annually on August 1 and February 1, respectively, beginning August 1, 2010. The annual market rate was 8% for similar bonds at the time of issuance.

Required (*Round the results to the nearest dollar*):

1. Calculate the cash proceeds from the bond issue, and show the journal entry Duke would make to record this event. **(4 marks)**
2. Duke uses the effective-interest method to amortize bond discount or premium. Show the journal entry to record interest on the first interest date, August 1, 2010. (There were no previous entries in respect of interest.) **(2 marks)**
3. Show the journal entry to record the accrual of interest on January 31, 2011– the company's year-end date. (The only previous entry in respect of interest was the one you made on August 1, 2010.) **(3 marks)**
4. Show, in good form, how the liabilities section of Duke's balance sheet would be presented as at January 31, 2011. **(5 marks)**
5. Show the journal entry to record the payment of interest, February 1, 2011. **(1.5 marks)**
6. Assume that Duke redeems 20% of the outstanding bonds for cash at 102 immediately after the payment of interest on February 1, 2011. Show the journal entry to record this early redemption of bonds. **(3.5 marks)**
7. If the remaining bonds (80% of face value) remain outstanding until maturity, how much will be the cumulative (total) interest expense for the period February 1, 2011 to February 1, 2020? **(2 marks)**

QUESTION 4 (19 marks; 34 minutes) *Reporting and Interpreting Cash Flows*

The following information has been reported by Karou Corp. on its balance sheets at December 31, 2011 and 2010, and on its income statement for the year ended December 31, 2011. All amounts are in millions of dollars.

Balance Sheets		
Assets	<u>2011</u>	<u>2010</u>
Cash	\$ 97	\$ 94
Accounts receivable (net)	32	26
Merchandise inventory	135	90
Prepaid expenses	<u>40</u>	<u>42</u>
Total current assets	304	252
Property, plant and equipment	420	370
Accumulated amortization	<u>(168)</u>	<u>(129)</u>
Total assets	<u>\$556</u>	<u>\$493</u>
Liabilities and Shareholders' Equity		
Accounts payable	\$ 31	35
Interest payable	3	2
Income taxes payable	<u>9</u>	<u>5</u>
Total current liabilities	43	42
Bonds payable, at par	<u>90</u>	<u>120</u>
Total liabilities	133	162
Common shares	200	140
Retained earnings	<u>223</u>	<u>191</u>
Total liabilities and shareholders' equity	<u>\$556</u>	<u>\$493</u>

Income Statement

Sales	\$970
Gain on sale of equipment	<u>6</u>
	<u>976</u>
Expenses	
Cost of goods sold	550
Wages expense	95
Utilities expense	136
Amortization expense	69
Interest expense	6
Income tax expense	<u>24</u>
Total expenses	<u>880</u>
Net income	<u>\$ 96</u>

Additional information (dollars in millions)

- a. Old equipment with an original cost of \$40, and a net book value of \$10 was sold for cash.
- b. New equipment was purchased for cash.
- c. Bonds with a face value (par value) of \$20 were converted to common shares in December 2011. There was no gain or loss on the conversion.
- d. Accounts payable relates only to transactions with suppliers of merchandise inventory.

Required:

1. Prepare, in good form, a cash flow statement for Karou Corp. for the year ended December 31, 2011. Use the indirect method to calculate the cash flow from operating activities. To facilitate your work, non-cash working capital items (non-cash current assets minus current liabilities) increased by \$48 million during the year. You do not have to show in your cash flow statement the separate effects of changes in each non-cash current asset and current liability, i.e., use the \$48 million figure. **(13 marks)**
2. Assume that the cash flow statement you prepared for requirement 1 above was distributed to the Company's board of directors along with the other financial statements and related notes. After glancing at the cash flow statement, one of the board members commented: "This statement does not show how much cash was received from operations and how much cash was paid for operating activities. Could we ask the controller to provide us with these details?"

Assume the role of the Company controller and calculate the following amounts for 2011:

- a) Cash collected from customers,
- b) Cash paid to suppliers of merchandise inventory,
- c) Cash paid for interest.

(6 marks)**QUESTION 5 (20 marks; 36 minutes)** *Analysis of Financial Statements*

Selected financial statements for Pharm Ltd. are presented below.

Pharm Ltd.		
Income Statement		
For the Year Ended December 31, 2010		
Net sales		\$520,000
Cost of goods sold		<u>360,000</u>
Gross profit		160,000
<i>Operating expenses:</i>		
Salaries	\$60,000	
Rent	24,000	
Insurance	12,000	
Utilities	10,000	
Repairs and maintenance	5,000	
Amortization	4,000	
Supplies used	<u>2,000</u>	<u>117,000</u>
Operating income		43,000
<i>Other income and (expense):</i>		
Gain on disposal of equipment	1,000	
Interest expense	<u>(4,000)</u>	<u>(3,000)</u>
Income before income taxes		40,000
Income tax expense		<u>14,000</u>
Net income		<u>\$ 26,000</u>

Pharm Ltd.
Balance Sheet
As at December 31, 2010

	<u>2010</u>	<u>2009</u>
ASSETS		
<i>Current Assets</i>		
Cash	\$ 10,000	\$ 11,000
Accounts receivable	25,000	39,000
Merchandise inventory	23,000	19,000
Prepaid insurance	7,000	8,000
Supplies on hand	<u>7,000</u>	<u>4,000</u>
<i>Total current assets</i>	<u>72,000</u>	<u>81,000</u>
<i>Long-term Assets</i>		
Equipment, at cost	60,000	24,000
Less: Accumulated amortization	<u>10,000</u>	<u>7,000</u>
	<u>50,000</u>	<u>17,000</u>
<i>Total Assets</i>	<u>\$122,000</u>	<u>\$98,000</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
<i>Current Liabilities</i>		
Accounts payable	\$ 1,000	\$ 5,000
Income taxes payable	9,000	7,000
Rent payable	3,000	-0-
Interest payable	<u>1,000</u>	<u>2,000</u>
<i>Total current liabilities</i>	<u>14,000</u>	<u>14,000</u>
<i>Long-term Liabilities</i>		
Bonds payable, due 2011	<u>48,000</u>	<u>38,000</u>
<i>Total Liabilities</i>	<u>62,000</u>	<u>52,000</u>
<i>Shareholders' Equity</i>		
Common shares	5,000	5,000
Retained earnings	<u>55,000</u>	<u>41,000</u>
<i>Total shareholders' equity</i>	<u>60,000</u>	<u>46,000</u>
Total liabilities and shareholders' equity	<u>\$122,000</u>	<u>\$98,000</u>

Additional information about the company's operations during 2010 follows:

- a. Credit sales were 40 percent of total net sales.
- b. There were 1,000 common shares outstanding during 2010.
- c. The market price per common share was \$371 on December 31, 2010.

Required:

1. A friend of yours is considering investing excess cash in Pharm Ltd. Select seven appropriate ratios from the list below to analyze the company's operations, liquidity and financial position for 2010, and explain to your friend the meaning of each ratio you calculate. The ratios you select must include **three profitability ratios, three liquidity ratios, and one solvency ratio. (14 marks)**

As you select seven ratios from the following list, indicate the category of the ratio you select – profitability, liquidity or solvency. The ratios below are listed in random order:

Cash ratio	Return on assets
Current ratio	Quality of income
Fixed asset turnover	Quick ratio
Return on equity	Receivables turnover
Times interest earned	Profit margin
Inventory turnover	Price-earnings ratio
Debt to equity	Dividend yield

2. Evaluate the company's profit margin ratio and explain how a shareholder might use it. **(2 marks)**
3. Explain to a shareholder why the current ratio and the quick ratio are different. Do you observe any liquidity problems? Explain. **(2 marks)**
4. Assume that the company sells merchandise on account with terms 1/10, n/30. Is the company's experience in collecting from credit customers consistent with this credit policy? Explain. **(2 marks)**

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	0.5534	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