

## Final Exam Intermediate Financial Accounting II Fall 2007 ADM3340

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Instructions:

1. Please check one of the following:

Section	Professor	Check one /
A:	Conheady	<input type="checkbox"/>
B:	Collier	<input type="checkbox"/>

2. This examination comprises 5 questions over 17 numbered pages. Answer all questions in this booklet. The booklet is not to be removed from the examination room. You may separate the pages but ensure that you put them back together and stapled before handing in.
3. Limit your answer to the space provided. Blank sheets for rough work and supporting calculations are given at the end of each question.
4. This exam is out of 100 marks and is 3 hours long. You should budget approximately 1.8 minutes per mark.
5. Please do **not** ask the invigilator or the professor any questions, as they will **not** be answered. State reasonable assumptions, if you feel they are necessary.
6. Language dictionaries (non-electronic) are allowed if the invigilator permits them.
7. You **must** sign the Statement of Academic integrity on page 2 of this exam.

Question		Marks
1	Restatements	/25
2	Cash Flow Statement	/20
3	Bonds Payable	/25
4	Earnings per Share	/15
5	Complex Debt/Equity Instruments	/15
<b>TOTAL</b>		<b>/100</b>

**Statement of Academic Integrity**

The Telfer School of Management does not condone academic fraud, an act by a student that may result in a false academic evaluation of that student or of another student. Without limiting the generality of this definition, academic fraud occurs when a student commits any of the following offences: plagiarism or cheating of any kind, use of books, notes, mathematical tables, dictionaries or other study aid unless an explicit written note to the contrary appears on the exam, to have in his/her possession cameras, radios (radios with head sets), tape recorders, pagers, cell phones, or any other communication device which has not been previously authorized in writing.

**Statement to be signed by the student:**

I have read the text on academic integrity and I pledge not to have committed or attempted to commit academic fraud in this examination.

Signed: \_\_\_\_\_

Note: an examination copy or booklet without that signed statement will not be graded and will receive a final exam grade of zero.

**Question No. 1 (25 marks)**

The unadjusted before-tax income for String Company was \$101,000 for 2004 and \$77,400 for 2005. However, the accountant noted the following information that is not reflected in the income figures above:

1. A review of the company's provision for uncollectible accounts during 2005 resulted in a determination that 1% of sales is the appropriate amount of bad debts expense to be charged to operations, rather than the 1.5% that had been used for the preceding two years. Bad debts expense recognized in 2004 and 2003 was \$25,000 and \$17,500, respectively. String Company would have recorded \$22,500 bad debts expense under the old rate for 2005. No entry has yet been made in 2005 for bad debts expense.
2. The inventory on hand on December 31, 2004 was understated by \$8,640.
3. The bookkeeper, in recording interest expense for both 2004 and 2005 on bonds payable, made the following journal entry on an annual basis:

Interest expense	15,000	
Cash		15,000

The bonds have a face value of \$250,000 and pay a stated interest rate of 6% annually. They were issued at a discount of \$15,000 on January 1, 2004 to yield an effective interest rate of 7%. The effective interest method of bond discount amortization is used.

4. Ordinary repairs to equipment have been charged in error to the equipment account during 2004 and 2005. Repairs in the amount of \$8,500 in 2004 and \$9,400 in 2005 were so charged. The company applies a rate of 10% to the balance of the equipment account at year-end in determining its amortization charges on the equipment.
5. During 2005, String Company changed from the double-declining balance method of amortization for its building to the straight-line method. String changed to the straight-line method, as it was the most widely used method in the industry in Canada thus making its financial statements more relevant to users in their decision-making. Total amortization under both methods for the past three years is shown below. Double-declining balance amortization has been recognized in 2005.

	Straight-line	Double-declining
2003	\$32,000	\$60,000
2004	32,000	57,000
2005	32,000	54,150

6. String Company acquired land on January 1, 2002 at a cost of \$45,000. The land was charged to a vehicles account in error and has been amortized since then on the basis of a five-year life with no residual value.

Disregard any income tax implications.

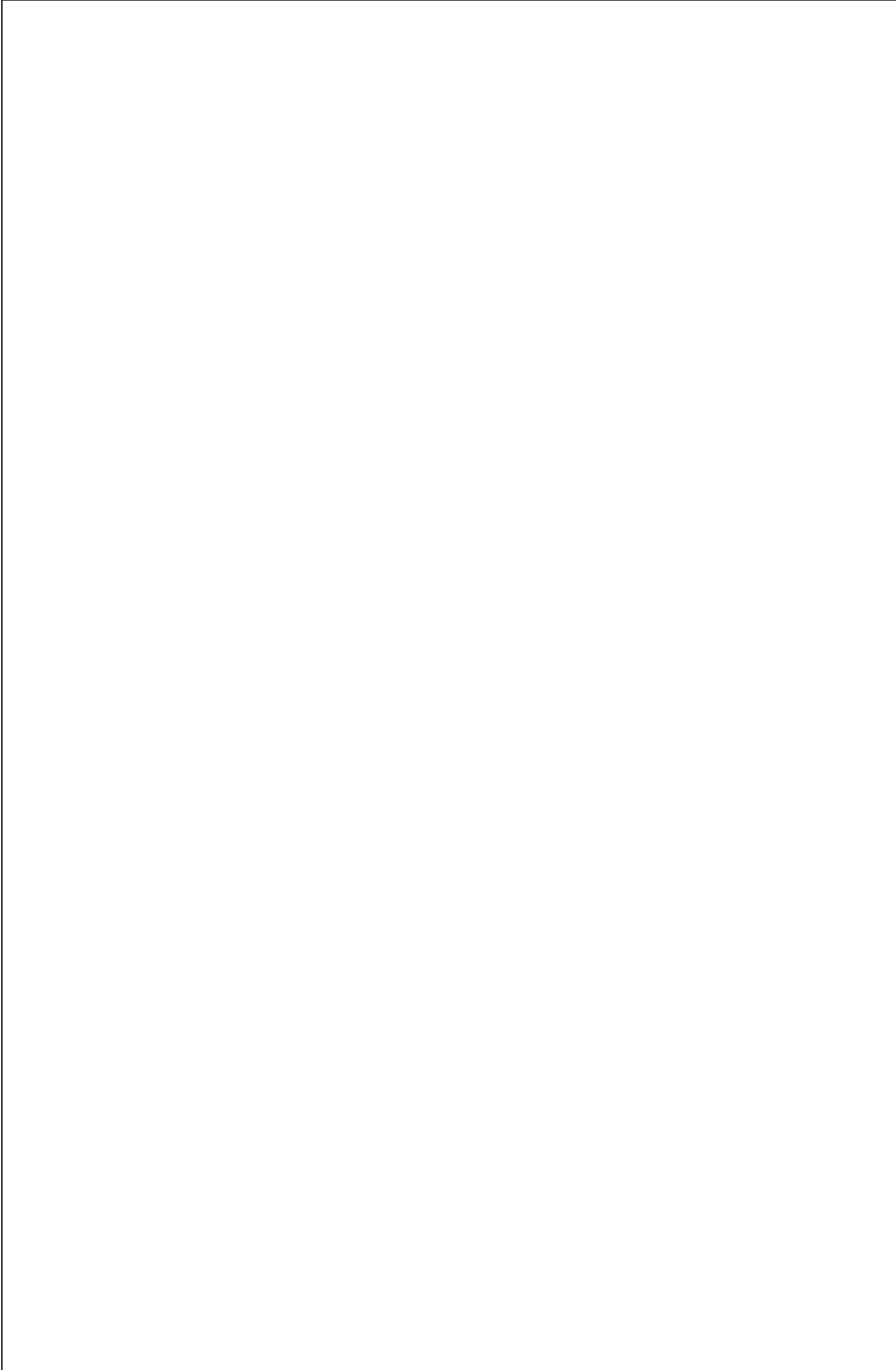
**Required:**

- (a) Prepare a schedule showing the calculation of corrected income before taxes for 2004 and 2005 taking into account the six items noted above.
- (b) Prepare a correcting journal entry for 2005 covering items 5 and 6 above assuming the books are closed for 2005.

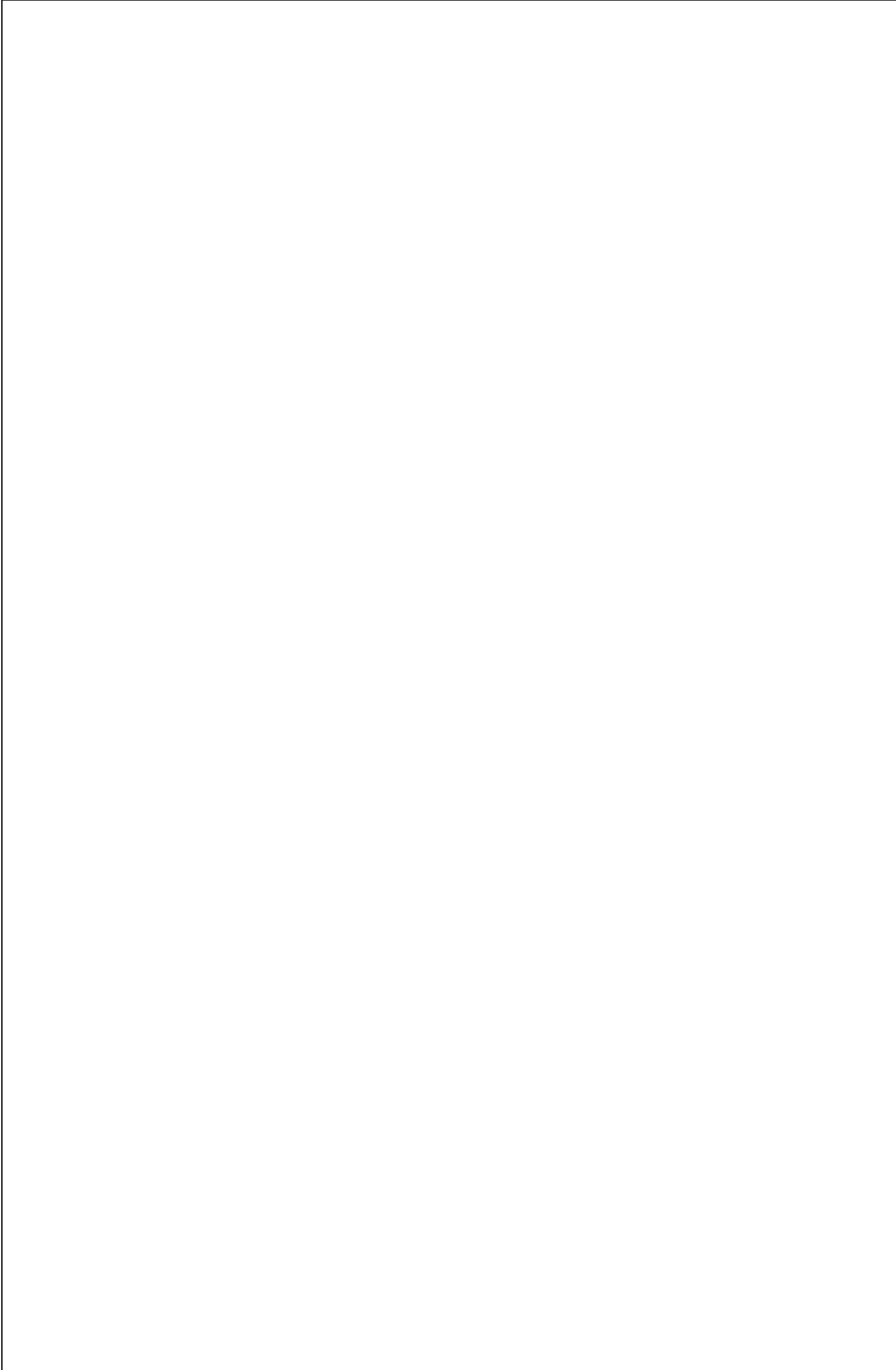
**Question No. 1 (25 marks) (continued)**

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**Question No. 1 (25 marks) (continued)**



**Question No. 1 (25 marks) (continued)**



**Question No. 2 (20 marks)**

Dexter's Midnight Runners Company (DMR) provides after-hours fax and courier services. The comparative Balance Sheet for DMR is presented below:

<b>Dexter's Midnight Runners Company</b>		
<b>Balance Sheet</b>		
<b>December 31, 2006</b>		
	<b>2006</b>	<b>2005</b>
<b>Assets</b>		
Cash	\$ 95	\$ 75
Accounts Receivables	60	80
Inventory	130	100
Prepaid Expenses	<u>25</u>	<u>15</u>
Total Current Assets	310	270
Long-term Investments (acquired at par)	140	150
Land	600	500
Buildings	400	300
Equipment	500	400
Accumulated Amortization - Equipment	<u>(300)</u>	<u>(400)</u>
Total Assets	<u>\$1,650</u>	<u>\$1,220</u>
<b>Liabilities and Shareholders Equity</b>		
Accounts Payable	\$ 35	\$ 45
Dividends Payable	<u>20</u>	<u>40</u>
Total Current Liabilities	55	85
Notes Payable	155	150
Long-term Bank Loan	<u>500</u>	<u>400</u>
Total Liabilities	710	635
Preferred Shares	—	200
Common Shares	450	300
Retained Earnings	<u>490</u>	<u>85</u>
Total Equity	940	585
Total Liabilities and Shareholders Equity	<u>\$1,650</u>	<u>\$1,220</u>

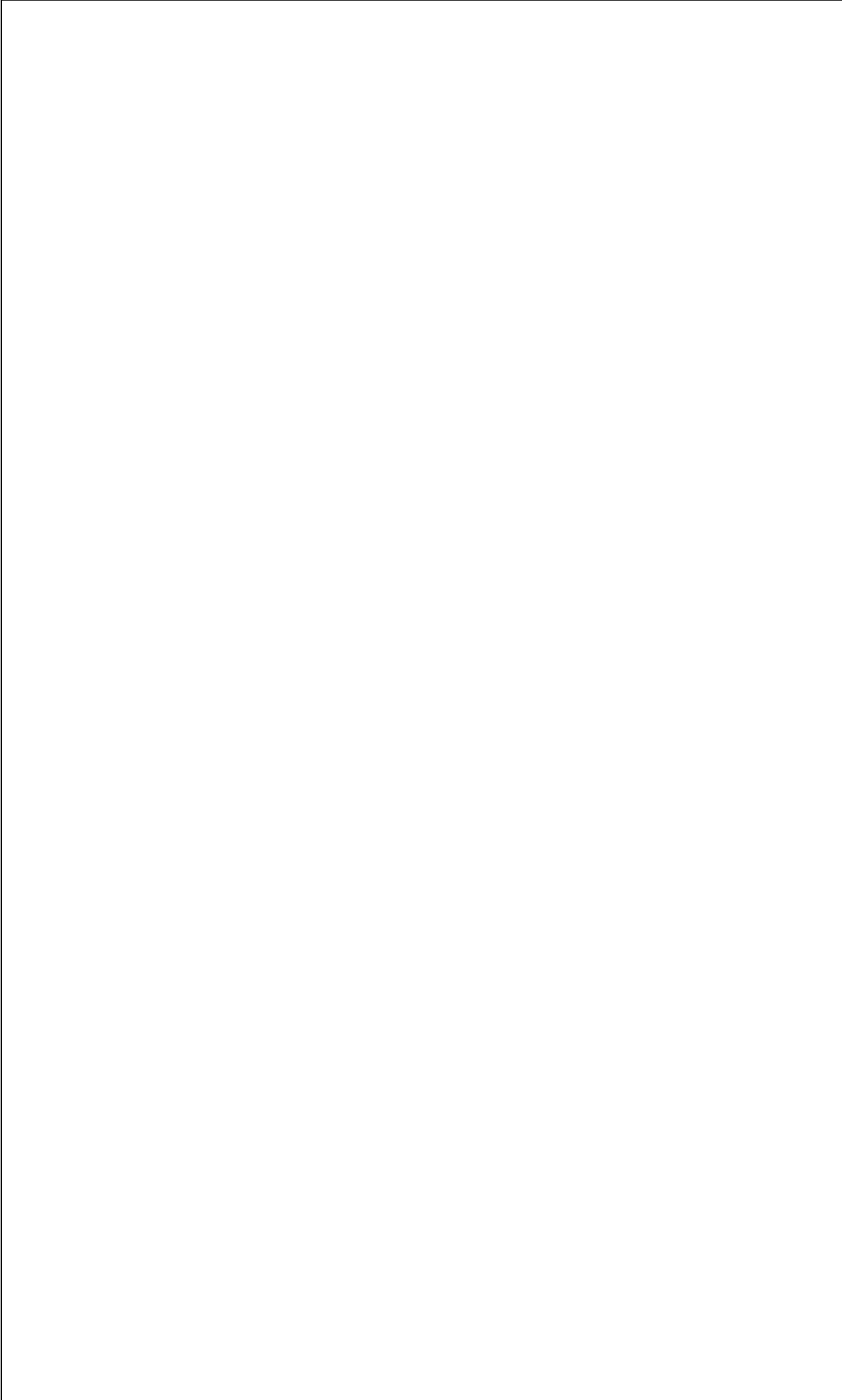
Addition information:

- DMR classified its long-term investments as held-to-maturity. The sale of the portfolio during the year resulted in a loss of \$5.
- DMR issued common stock in exchange for equipment having a fair market value of \$100.
- A building was sold for a loss of \$50. The cost of the building was \$250 and the accumulated amortization at the time of the sale was \$150.
- DMR sold land for \$450 during the year that had cost \$400.
- During the year, DMR declared and issued common stock dividends of \$50.

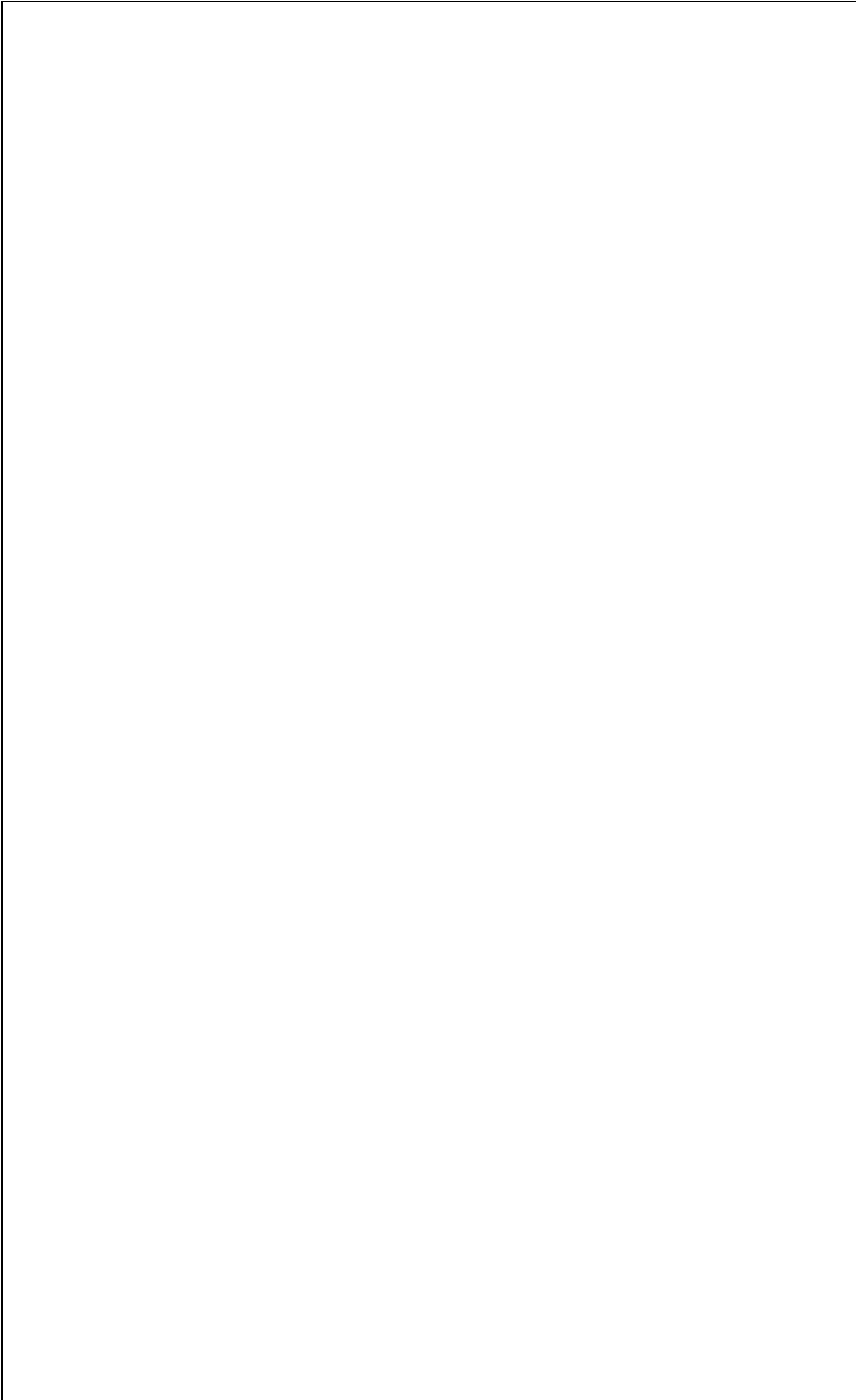
**Required:**

Prepare, in good form, a Cash Flow Statement for Dexter's Midnight Runners Company for the period ending December 31, 2006.

**Question No. 2 (20 marks) (continued)**



**Question No. 2 (20 marks) (continued)**



**Question No. 3 (25 marks)**

On May 1, 2003 BondBeagle Ltd. issues \$100,000 face value bonds. The bond date is March 1, 2003 and the bonds carry a coupon rate of 10% per year, payable semi-annually on August 31 and February 28. The bonds' maturity date is March 1, 2006. Proceeds upon issuance, excluding accrued interest were \$95,322.

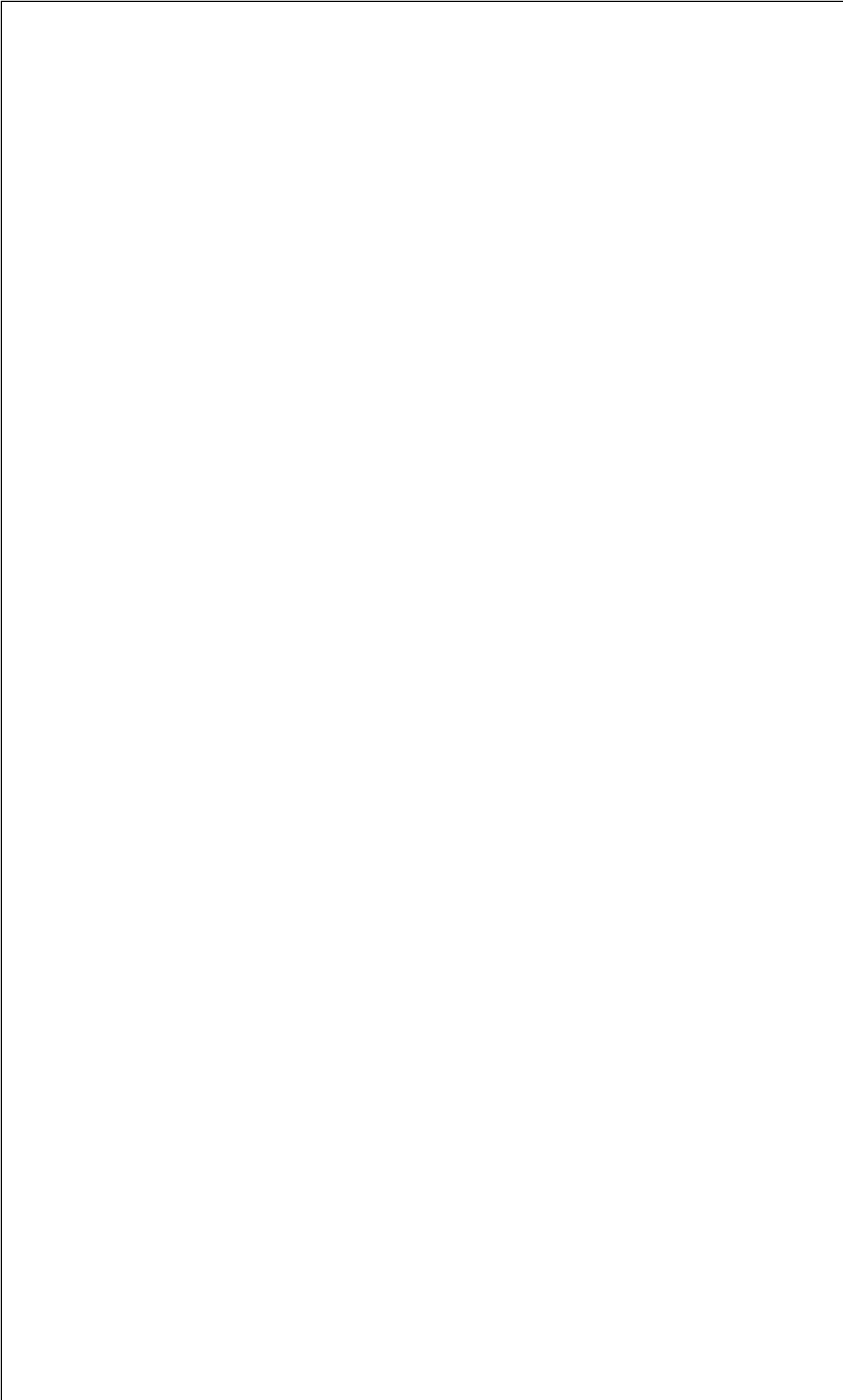
BondBeagle Ltd. uses the straight-line method to amortize any bond premium or discount. On November 1, 2005 the company retires 50% of the bonds at 98%, excluding accrued interest. BondBeagle Ltd.'s accounting year-end is December 31.

**Required: (Show all supporting computations)**

Present BondBeagle Ltd.'s journal entries for these bonds on the following dates:

- a) May 1, 2003
- b) December 31, 2004
- c) November 1, 2005
- d) December 31, 2005
- e) March 1, 2006

**Question No.3 (25 marks) (continued)**



**Question No.3 (25 marks) (continued)**

**Question No. 4 (15 marks)**

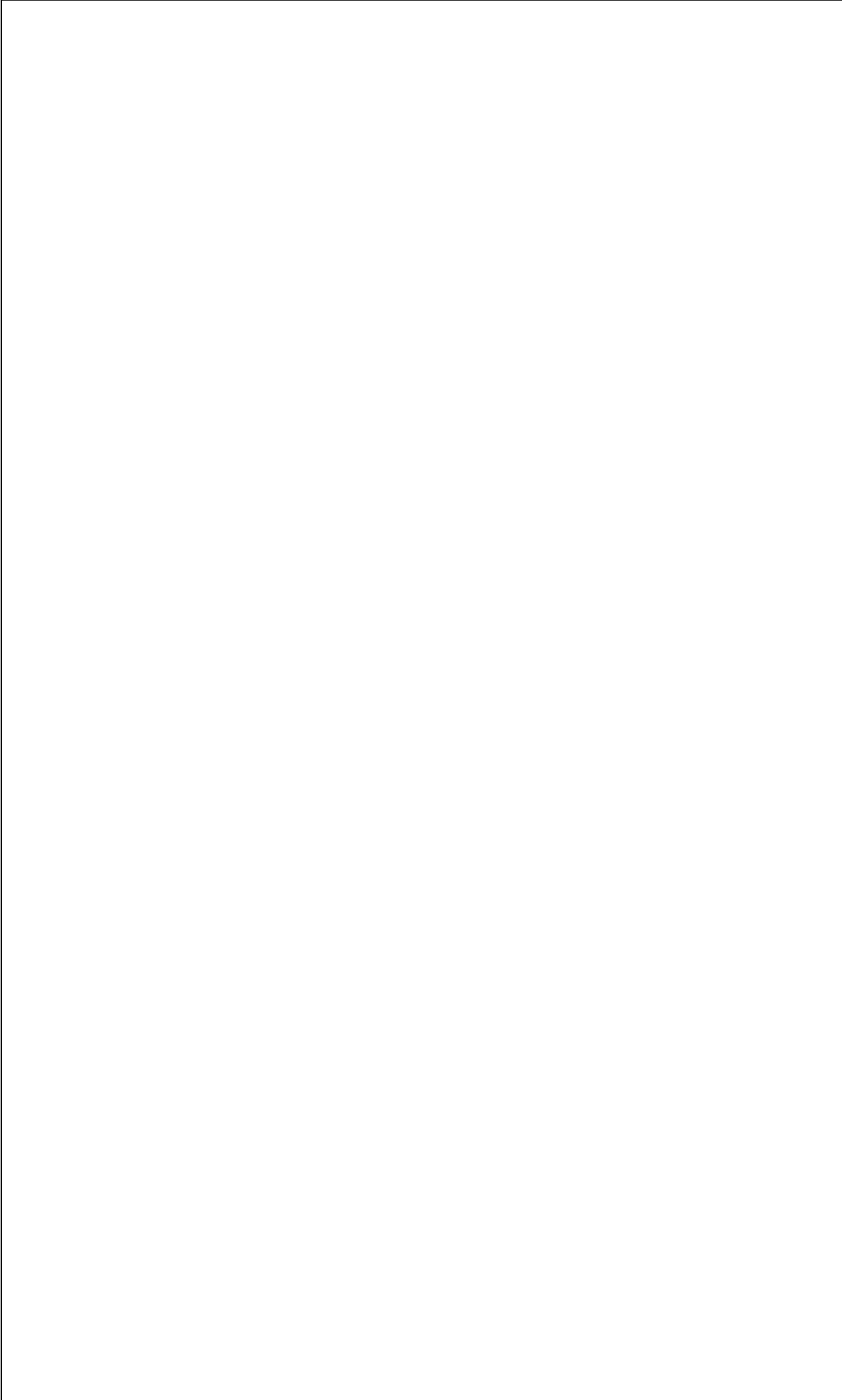
Sandown Corporation (SC) is required to disclose earnings per share (EPS) information in its annual financial statements ended December 31, 2006. The following facts are available:

- (a) SC is a public company.
- (b) At the beginning of the year, 425,000 common shares, issued for \$5,440,000, were outstanding. The authorized number of common shares is 1 million. On January 1, 2006, there were 46,000 \$1 cumulative preferred shares also outstanding. The preferred shares had been issued for \$460,000.
- (c) On November 1, 2006, SC issued another 125,000 common shares for \$1,875,000 cash.
- (d) On January 1, 2007, SC issued a further 50,000 common shares for \$700,000 cash.
- (e) For the period ending December 31, 2006, SC reported net income of \$2,400,000.
- (f) On January 1, 2006, SC had outstanding \$1 million face value of 4% convertible bonds, with interest payable on June 30 and December 31 each year. Each \$1,000 face value bond is convertible into 75 common shares at the option of the holder. On April 30, 2006, \$400,000 face value bonds were converted. The original proceeds of the bond were allocated between the bond and common stock conversion rights. Bond interest expense of \$40,975 was recognized this year, including discount amortization. Of this amount, \$7,450 related to converted bonds for the first quarter of the year.
- (g) SC has options outstanding for 60,000 common shares at an option price of \$5 per share. The average market value of common shares during the period was \$24.
- (h) SC has an effective tax rate of 40%.

**Required:**

Calculate the basic and diluted earnings per share figure that should be reported for 2006. Carry all per share calculations to the nearest whole share.

**Question No. 4 (15 marks) (continued)**



**Question No. 5 (15 marks)**

Answer ALL THREE parts. Each part is independent.

PART A: (6 marks)

Enzo Corporation has decided to raise additional capital by issuing \$160,000 face value bonds with a coupon rate of 10%. In discussions with their investment bankers, it was determined that to help the sale of the bonds, detachable stock warrants should be issued at the rate of one warrant for each \$100 bond sold. Shortly after issuance, the bonds were quoted at 80 without the warrants. The warrants had a market value of \$15.00 each. The bonds sold in the market at issuance for \$140,000.

**Required:**

Use the proportionate method and prepare the journal entry to record the issuance of the bonds.

PART B: (4 marks)

The executive officers of Coach Corporation have a performance-based compensation plan with performance criteria linked to growth in earnings per share (EPS). When annual EPS growth is 12%, the Coach executives earn 100% of a predetermined bonus amount. If growth is 16%, they earn 125%. If EPS growth is lower than 8%, the executives receive no additional compensation.

In 2006, Joanna Becker, the controller of Coach, reviews year-end estimates of bad debts expense and warranty expense. She calculates the EPS growth at 15%. Peter Reiser, a member of the executive group, remarks over lunch one day that the estimate of bad debt expense might be decreased, thereby increasing EPS growth to 16.1%. Becker is not sure she should do this because she believes that the current estimate of bad debts is sound. On the other hand, she recognizes that a great deal of subjectivity is involved in the calculation.

**Required:**

Explain the nature of the ethical issue involved here. What advice would you give to Joanna?



