

PCONCORDIA UNIVERSITY  
DEPARTMENT OF ACCOUNTANCY

FINANCIAL ACCOUNTING  
COMM 217 ALL SECTIONS

SUGGESTED SOLUTION  
FINAL EXAMINATION  
WINTER 2009

**Question 1 (24 marks)**     *Multiple-choice*

(1.5 marks per correct answer)

1.    c
2.    b
3.    b
4.    c
5.    b
6.    b
7.    a
8.    c
9.    d
10.   b
11.   a
12.   c
13.   b
14.   c
15.   c
16.   b

**QUESTION 2 (19 marks)**Req. 1 (3 marks)

The acquisition cost of the machine = \$80,000 + 2,000 + 1,000 = \$83,000

Equipment (or Machinery) .....	83,000	
Cash .....		33,000
Notes Payable .....		50,000

Req. 2 (5 marks)

## a. Straight-line method

2006: Amortization expense =  $(\$83,000 - 1,500) / 10 \text{ years} = \$8,150$

2007: Amortization expense = \$8,150

## b. Double-declining-balance method

2006: Amortization expense =  $(\$83,000 - 0) \times (2/10) = \$16,600$

2007: Amortization expense =  $(\$83,000 - 16,600) \times (2/10) = \$13,280$

Req. 3 (2 marks)

The \$10,000 is a capital expenditure , because the replacement of a major part of the machine increased its useful life and its residual value.

Req. 4 (3 marks)

Net book value of the machine after the replacement, Jan. 1, 2008

=  $\$83,000 + 10,000 - \$8,150 \times 2 = \$76,700$

Remaining useful life =  $10 - 2 + 4 = 12 \text{ years}$

Amortization expense 2008 =  $(\$76,700 - 2,300) / 12 = \$6,200$

Req. 5 (6 marks)

Amortization expense from January 1 to June 30, 2009

=  $\$6,200 \times (6/12) = \$3,100$

Amortization expense .....	3,100	
Accumulated Amortization .....		3,100

Accumulated amortization, June 30, 2009

=  $(\$8,150 \times 2) + \$6,200 + \$3,100 = \$25,600$

Cash .....	50,000	
Notes receivable .....	10,000	
Accumulated amortization .....	25,600	
Loss on disposal of equipment (or machinery) .....	7,400	
Equipment (or Machinery) .....		93,000

**QUESTION 3 (17 marks)**Req. 1 (3 marks)

PV of principal = $\$40,000,000 \times 0.7894$	=	\$31,576,000
PV of interest payments = $\$40,000,000 \times 4\% \times \frac{1}{2} \times 7.0197$	=	<u>5,615,760</u>
		37,191,760

Cash	37,191,760	
Discount on bonds payable	2,808,240	
Bonds payable		40,000,000

Req. 2 (5 marks)

June 30, 2008 (effective-interest method)

Bond interest expense ( $\$37,191,760 \times 6\% \times \frac{1}{2}$ )	1,115,753	
Discount on bonds payable		315,753
Cash ( $\$40,000,000 \times 4\% \times \frac{1}{2}$ )		800,000

December 31, 2008 (effective-interest method)

Bond interest expense [ $(\$37,191,760 + 315,753) \times (6\% \times \frac{1}{2})$ ]	1,125,225	
Discount on bonds payable		325,225
Cash		800,000

Req. 3 (7 marks)

Bonds payable ( $\$40,000,000 \times \frac{1}{2}$ )	20,000,000
Discount on bonds payable *	1,246,244
Cash ( $\$20,000,000 \times .93$ )	18,600,000
Gain on early redemption of bonds	153,757

$$* (\$2,808,240 - \$315,753) \times \frac{1}{2} = \$1,246,244$$

Deb Ltd.  
Partial Balance Sheet  
As at July 1, 2008

**Long-term Debt**

Bonds payable, 4%, due December 31, 2011	\$20,000,000
Less: Discount on bonds payable	<u>1,246,243</u>
Book (carrying) value	<u>\$18,753,757</u>

Req. 4 (2 marks)

June 30, 2008 (straight-line)

Bond interest expense	1,151,030	
Discount on bonds payable $[(\$2,808,240 / (4 \times 2))]$		351,030
Cash		800,000

**QUESTION 4 (21 marks)**Req. 1 (15 marks)

SARATOGA Limited  
Cash Flow Statement  
For the Year ended December 31, 2008  
(in thousands of dollars)

**Operating activities**

Net income	\$87,000	
Add (deduct) items not affecting cash:		
Amortization expense	5,400	
Loss on sale of equipment	1,800	
Increase in inventory	(3,000)	
Increase in prepaid expenses	(2,400)	
Decrease in accounts receivable	6,000	
Increase in accounts payable	7,600	
Increase in interest payable	1,000	
Decrease in income tax payable	(200)	
	<u>16,200</u>	
<b>Cash from operating activities</b>		<b>103,200</b>

**Investing activities**

Acquisition of equipment	(15,000)	
Disposal of equipment		
(\$4,800 – 600 ) – 1,800 (loss)	2,400	
Acquisition of building	(60,000)	
Acquisition of long term investments	<u>(12,000)</u>	
<b>Cash used in investing activities</b>		<b>(84,600)</b>

**Financing activities**

Proceeds from issuance of common shares	12,000	
Dividends paid		
(\$28,800 + 87,000 – 98,400 )	<u>(17,400)</u>	
<b>Cash used in financing activities</b>		<b>(5,400)</b>

**Change in cash**

	<b>13,200</b>	
Cash and short-term investments, beginning	<u>19,800</u>	
Cash and short-term investments, ending		<b>33,000</b>

Req. 2 (2 marks)

Cash paid to suppliers of merchandise inventory

Beg. Inventory + Purchases – Cost of goods sold = Ending Inventory

Purchases = EI + COGS – BI = \$110,000 + (\$9,000 – \$6,000) = \$113,000

Beg. A/P + Purchases – Payments = Ending A/P

Payments = Purchases + Ending A/P – Beg. A/P

\$113,000 + (\$9,400 – \$17,000) = \$105,400

Req. 3 (4marks)

Interest paid = Beg. Interest payable + Interest expense – Ending Interest payable

= \$5,200 + \$600 – \$1,600 = \$4,200

Income taxes paid = Beg. Income tax payable + Income tax expense – Ending Income tax payable

= \$28,200 + \$2,000 – \$1,800 = \$28,400

**Significant non-cash investing and financing activities:**

Acquisition of land by issuing \$36,000 bonds

**QUESTION 5 (19 marks)****Req. 1 (17 marks)**

a.  $\text{Current ratio} = (25,000 + 15,000 + 50,000 + 170,000) / (20,000 + 40,000) = 4.3$

**Liquidity test**

b.  $\text{Income before income taxes} = 176,000 - 24,000 - 50,000 = \$102,000$

$\text{Net income} = \$102,000 \times (1 - 30\%) = \$71,400$

$\text{EPS} = \$71,400 / 60,000 = \$1.19$       **Profitability test**

c.  $\text{P/E ratio} = 20 / 1.19 = 16.81$       **Market test**

d.  $\text{Times interest earned} = (176,000 - 50,000) / 24,000 = 5.25$       **Solvency test**

e.  $\text{CGS} = \$400,000 - 40,000 - 176,000 = \$184,000$

$\text{Inventory turnover} = 184,000 / [(170,000 + 120,000)/2] = 1.27 \text{ times}$       **Liquidity test**

f.  $\text{Debt-to-Equity} = (\$20,000 + 40,000 + 100,000) / (170,000 + 90,000) = 0.61$

**Solvency test**

g.  $\text{ROA} = [71,400 + 24,000 \times (1 - 30\%)] / [(420,000 + 450,000) / 2] = 0.20$

**Profitability test**

h.  $\text{ROE} = 71,400 / [(260,000 + 220,000) / 2] = 0.29$       **Profitability test**

i.  $(36,000 / 60,000) / 20 = 3\%$       **Market test**

j.  $\text{Quality of income} = 142,800 / 71,400 = 2$       **Profitability test**

**Req. 2 (2 marks)**

The price-earnings ratio reflects investors' assessment of the future prospects of a company. The company's P/E ratio of 16.81 is significantly higher than the industry average (10.5). Hence, investors appear to believe that the company has good income growth potential in the future.