CONCORDIA UNIVERSITY
DEPARTMENT OF ACCOUNTANCY

FINANCIAL ACCOUNTING
COMM 217 ALL SECTIONS

FINAL EXAMINATION

Winter 2010

Duration: 3 hours

Instructions (very important):

1. This examination paper consists of **10 pages including** this page. Please make sure your copy has all pages before commencing to write.
2. 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.**
3. Read the questions carefully and budget your time wisely. Show all calculations.
4. This is a closed book examination. However, a silent hand-held (not graphical) calculator and one standard language (not electronic) dictionary are permitted.
5. **Invigilators will not answer questions** (unless you think there is an **error** in the question).
6. Return the exam along with the computer input sheet and answer booklets when you have finished.

Question	Topic	Total Marks
1	Multiple Choice	24
2	Accounting for Long-term Assets	20
3	Accounting for Bonds	17
4	Reporting cash flows	20
5	Analysis of Financial Statements	19
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. Brooks Company had the following cash transactions: sold equipment for $100,000, purchased a building for $80,000, sold long-term investments for $20,000 and repaid a note payable for $25,000 plus $1,500 of interest. What was the net cash flow from <u>investing</u> activities (parentheses indicate an outflow)?

   A) ($45,000). B) $13,500. C) $15,000. D) $40,000.

2. Intangible assets include which of the following?
   A) Leaseholds, patents, and copyrights.
   B) Accounts receivable, franchises, and trademarks.
   C) Copyrights, licenses, and land.
   D) Natural resources, patents, and trademarks.

3. On March 1, Chapine Company purchased a new stamping machine for $5,000. Chapine paid cash for the machine. Other costs associated with the machine were: transportation costs, $300; sales tax paid, $200; and installation cost, $100. What cost was recorded for the machine?

   A) $5,000 B) $5,200 C) $5,500 D) $5,600

4. Residual value can be defined as:
   A) of the amount paid to acquire a tangible operational asset.
   B) The book value of an asset.
   C) The amount expected to be recovered when an asset is disposed of at the end of its estimated useful life.
   D) The current value of an asset as of the balance sheet date.

5. Which of the following should be considered when a company is making strategic decisions about how to finance its assets?
   A) Whether they can borrow funds at a lower rate than the return on its assets.
   B) The debt-to-equity ratio.
   C) The proportion of current liabilities to long-term liabilities.
   D) All of the above are considerations of the decision.

6. To finance a new department, Dannella Yogurt Corporation borrowed $80,000 at an interest rate of 10% on April 1, 2009. If the company is subject to an income tax rate of 40%, what is the net of tax interest rate for 2009?

   A) 4% B) 6% C) 10% D) 14%

7. Which of the following is a typical example of a current liability?
   A) Revenue collected in advance.
   B) Accrued interest payable.
   C) Employee taxes withheld.
   D) All of the responses are correct.

8. On July 1, 2009, immediately after recording interest payments, Seals, Inc., retired one fifth of its $500,000 bonds payable for $97,500. The bonds were originally issued at par value in 2009. Which statement is correct?
   A) Cash of $100,000 will be paid to the bondholders.
   B) A gain of $2,500 will be reported in the income statement.
   C) A loss of $2,500 will be reported in the income statement.
   D) A loss of $2,500 will be reported as a separate component of shareholders' equity in the balance sheet.

9. Which one of the following is not a basic right of an owner of common share?
   A) Participation in the corporation by voting in shareholder meetings.
   B) Participation in the profits of the corporation through dividends declared by the board of directors.
   C) Sharing in the responsibility of setting next year's budget.
   D) Sharing in the distribution of assets of the corporation at liquidation.

10. Which of the following statements is incorrect?
    A) Issuance of shares creates cash inflow connected to financing activities.
    B) Payment of a cash dividend creates cash outflow connected to investing activities.
    C) Purchase of bonds issued by another corporation creates cash outflow connected to investing activities.
    D) All of the statements are incorrect.

11. The Basket Corporation has the following classes of shares:

    Preferred shares, $1, noncumulative, 40,000 shares issued and outstanding.
    Common shares, 100,000 shares issued, 50,000 shares outstanding.

    The company was formed in 2008, but it did not pay dividends in its first year of existence. In 2009, the board of directors of Basket declared a total dividend of $180,000 to be paid to the holders of preferred and common shares. What was the amount of the dividend paid in 2009 on each common share?
    A) $1.80 B) $2.00 C) $2.80 D) $3.60

12. If a company plans to differentiate its products by offering low prices and discounts for items packaged in bulk (such as a discount retailer that requires membership for its customers), which ratio is the company attempting to boost?
    A) Net profit margin
    B) Return on equity
    C) Total assets turnover
    D) All of the above

13. A contingent liability that is "reasonably possible" but "cannot reasonably be estimated"
    A) Must be recorded and reported as a liability.
    B) Does not need to be recorded or reported as a liability.
    C) Must only be disclosed as a note to the financial statements.
    D) Must be reported as a liability, but not recorded.

14. Aaron Electric sells electric appliances, including refrigerators. In April 2010, repairs and returns under the warranty cost $84,000. The journal entry to record product repairs and returns for April 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.

15. On January 2, 2008, Needy Company borrowed $10,000 from Eastern Bank. The loan is payable in equal principal installments of $2,000 each, payable on December 31 of each year, beginning in 2008. Disregarding interest, the portion of the $10,000 loan that should be considered a long-term liability on the company's 2008 year-end balance sheet would be
    A) $8,000. B) $6,000 C) $2,000 D) $ 0

16. The effect of a stock split is
    A) to reduce the amount of retained earnings and increase total contributed capital.
    B) to reduce the amount of retained earnings and reduce the amount of total assets.
    C) to reduce the average issuance price of common shares.
    D) none of the above responses.

QUESTION 2 (20 marks; 36 minutes) *Accounting for long term assets*

Broadway Ltd. completed the following transactions in 2009:

July 1, 2009: purchased land, a building and used equipment for a lump sum of: $420,000. Broadway Ltd. signed a 6-month note for this amount (paid in December 2009). The appraised values for the individual components of the transaction were: $225,000 for the land, $180,000 for the building and $45,000 for equipment.

Additional costs related to this purchase of assets were as follows:

July 1, 2009: renovation of the equipment to make it ready for use: $3,000 (paid in cash)

December 31, 2009: payment of the interest cost to finance the deal: $16,800

> *The building is amortized using the straight-line method over 15 years and its estimated residual value is $18,000.*
>
> *The equipment is amortized using the double-declining balance method over 5 years and its estimated residual value is $2,000.*

October 1, 2009: lost a warehouse in a fire. The warehouse was recorded for a cost of $150,000. The accumulated amortization on December 31, 2008 was $84,000.

> *The warehouse is amortized using the straight-line method over 10 years and its estimated residual value is $10,000.*

Proceeds received from the insurance company were $55,500.

Required:

Prepare the necessary journal entries to record the preceding transactions, including amortization entries in 2009. Omit narratives, and show your calculations.

QUESTION 3 (17 marks; 31 minutes) *Accounting for Bonds*

The following is from Jaro Inc.'s balance sheet at December 31, 2009 (in thousands of dollars):

Current Liabilities	
Bond interest payable	$ 45,000
Long-term Liabilities	
Bonds payable, 6%, due December 31, 2018	$1,500,000
Add: Bond premium	107,650
	$1,607,650

The bonds above were issued on January 1, 2009 at a price to yield a market interest rate of 5%. Interest must be paid semi-annually on July 1 and January 1. The company uses the effective-interest method and has a December 31 fiscal year end.

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

1. Prepare the journal entries to record bond related transactions on January 1, 2010, on July 1, 2010, and on December 31, 2010. **(8 marks)**

2. Show how the bond-related amounts would be presented on the company's Balance sheet and Income statement in its annual report dated December 31, 2010. **(5 marks)**

3. Assume that on January 1, 2011, after paying interest to bondholders (ignore any accrued interest for the day January 1), Jaro Inc. redeems 50% of the outstanding bonds at 104. Prepare the journal entry associated with this early redemption of bonds. **(4 marks)**

QUESTION 4 (20 marks; 36 minutes) *Reporting and interpreting cash flows*

The following information has been reported by Kumar Inc. on its balance sheets at December 31, 2009 and 2008, and on its income statement for the year ended December 31, 2009. Amounts are in millions of dollars.

Balance Sheets

	2009	2008
Cash	$ 90	$ 68
Accounts receivable (net)	34	24
Merchandise inventory	28	32
Long-term investments	0	18
Property, plant and equipment	196	154
Accumulated amortization	(78)	(96)
Total assets	$270	$200
Accounts payable	$ 24	38
Income taxes payable	3	4
Bonds payable	80	20
Common shares	115	100
Retained earnings	48	38
Total liabilities and shareholders' equity	$270	$200

Income Statement

Sales	$140
Cost of goods sold	(84)
Gross margin	56
Amortization expense	(10)
Other operating expenses	(34)
Operating income	12
Gain on sale of investments	6
Loss on sale of equipment	(2)
Income before income tax	16
Income tax expense	4
Net income	$ 12

Additional information

a. Old equipment was sold for cash during 2009. It had an original cost of $40, and an accumulated amortization of $28.
b. A new building was acquired during the year, and $60 of bonds were issued in full payment. In addition, new equipment was purchased for cash.
c. Accounts payable relates only to transactions with suppliers of merchandise inventory.

Required:

1. Prepare, in good form, the Operating Activities section of the cash flow statement for Kumar Inc. for the year ended December 31, 2009. Use the indirect method to calculate the cash flow from operations. You are not required to prepare a complete cash flow statement. **(8 marks)**
2. Prepare, in good form, the Investing Activities section of the cash flow statement for Kumar Inc. for the year ended December 31, 2009. **(4 marks)**
3. Based on your answers to requirements 1 and 2 above, determine the net cash flow from Financing Activities. You are not required to prepare the Financing Activities section of the cash flow statement. **(2 marks)**
4. The president of Kumar Inc. Mr. Hamid, was provided with a copy of the Operating Activities section of the cash flow statement that you prepared in requirement 1, and made the following comment: “This report is supposed to show operating cash inflows and outflows during the year, but I don’t see how much cash Kumar Inc. received from customers and how much it paid to suppliers of merchandise inventory and for income taxes. Please ask whoever prepared this statement to provide me with these numbers.” Based on Mr. Hamid’s comment, calculate the following amounts for 2009:
   a) Cash collected from customers
   b) Cash paid to suppliers of merchandise inventory
   c) Cash paid for income taxes **(6 marks)**

QUESTION 5 (19 marks; 34 minutes) *Analysis of Financial Statements*

STEF Furniture Inc. reported the following selected income statement and balance sheet information.

STEF Furniture Inc.
Comparative Income Statement
For the Years Ended December 31, 2009 and 2008

	2009	2008
Net Sales	$4,290,000	$4,015,000
Gross margin	1,725,000	1,470,000
Other operating expenses	1,220,000	1,185,000
Interest expense	100,000	70,000
Income before income tax	405,000	215,000
Income tax expense	165,000	85,000

STEF Furniture Inc.
Comparative Balance Sheet
As at December 31, 2009 and 2008
(Selected 2007 amounts given for computation of certain ratios)

	2009	2008	2007
Assets			
Cash	$ 145,000	$ 160,000	
Short term investments	30,000	40,000	
Accounts receivables, net	570,000	425,000	$ 330,000
Inventories	565,000	555,000	495,000
Property, plant, and equipment, net	2,535,000	1,995,000	2,305,000
Long term investment	50,000	15,000	
Intangible assets	40,000	30,000	
Total assets	**$ 3,935,000**	**$ 3,220,000**	**$ 2,940,000**
Liabilities and Shareholders' Equity			
Accounts payable	$ 505,000	$ 495,000	
Short-term notes payable	210,000	135,000	
Long-term liabilities	1,440,000	990,000	
Total liabilities	2,155,000	1,620,000	
Common shares	930,000	930,000	800,000
Retained earnings	850,000	670,000	579,000
Total liabilities and shareholders' equity	**$ 3,935,000**	**$ 3,220,000**	

Other information:

- All sales are on credit.
- Short term investments are very liquid investments (less than 3 months to maturity).
- The market price per common share is $66 at December 31, 2009, and $62 at December 31, 2008.
- The average number of shares outstanding is 46,500 in 2009 and 35,000 in 2008.

Required:

1. Compute the following ratios for 2009 and 2008 (show your calculation for 2009 first): **(14 marks)**
    a. Cash ratio
    b. Current ratio
    c. Average collection period (average age of receivables)
    d. Fixed asset turnover ratio (Industry average: 1.88)
    e. Financial leverage ratio (Industry average: 3.25)
    f. Return on equity (Industry average: 10%)
    g. Dividend yield (Industry average: 1.5%)

2. Based on your calculations of the ratios in requirement 1, discuss whether STEF Furniture Inc.'s ability to meet its current obligations has improved or deteriorated during 2009? **(1 mark)**
3. STEF Furniture Inc. offers its customers credit terms of 1/10, n/30. How well is the company managing its accounts receivable? **(2 marks)**
4. Based on your calculations of the ratios in requirement 1, do you think this company is attractive for an investor? Explain briefly. **(2 marks)**