

Instructions:

This examination paper contains 16 pages including this title page. Please ensure that it is complete.

2. You may not consult any other materials for any reason. Only non-programmable, non-communicating calculators may be used. You may not listen to or use any communicating or receiving hardware such as a cellular telephone, a Blackberry, or an iPod.

3. Answers for the multiple-choice questions must be recorded on the UW scantron card. All other questions must be answered in the space provided on the examination paper. Answers written outside of the provided space will not be graded. You must submit both this examination paper and the UW scantron card.

4. Show details of all calculations.

5. The examination is 90 minutes

Marking Scheme:

Question	Maximum Marks	Score
1	9	
2	42	
3	24	
Total	75	

Question 1 (9 marks)

You are exploring your investment opportunities and considering the purchase of shares in Landscaping Supply Inc. (LSI). The company manufactures wheelbarrows and grass trimming equipment to be sold to landscaping companies. You are reviewing some of their financial information as part of this decision making process. The Return on Asset (ROA) ratio is a useful tool in evaluating a company's performance. LSI's ROA last year (year-ended June 30, 2015) was approximately 15%.

Required:

1. Using the information provided below, calculate Landscaping Supply Inc.'s ROA for the year-ended June 30, 2016.
2. Compare your results with last year's ROA and comment on the result. Your response should provide more insight than simply it is higher or lower than last year.
3. What information does the ROA tell us and what is the reasoning behind the adjustment for interest expense in this calculation?

Landscaping Supply Inc.
Partial Statement of Financial Position
As At June 30, 2016

	2016	2015
ASSETS		
Cash	\$81,000	\$128,000
Trade receivable	120,000	100,000
Inventory	156,500	213,000
Equipment	4,190,000	2,100,000
Accumulated Depreciation Equipment	(420,000)	(320,000)
TOTAL ASSETS	<u>\$4,127,500</u>	<u>\$2,221,000</u>

Landscaping Supply Inc.
Statement of Earnings
For the Year Ended June 30, 2016

	2016	2015
Revenue	\$2,700,000	\$2,560,000
Cost of Goods Sold	<u>1,800,000</u>	<u>1,700,000</u>
Gross Margin	\$900,000	\$860,000
Operating Expenses	<u>498,000</u>	<u>408,000</u>
Operating Income	\$402,000	\$452,000
Interest	<u>16,000</u>	<u>16,000</u>
Income Before Taxes	\$386,000	\$436,000
Income Tax	<u>96,500</u>	<u>109,000</u>
Net Earnings	<u>289,500</u>	<u>327,000</u>

Question 1 response:

ROA Calculation:

$$= \$289,500 + 16,000 (1 - .25) / (2,221,000 + 4,127,500) / 2$$

$$= \$301,500 / 3,174,250$$

$$= .095 \quad 9.5\%$$

Comments regarding comparison to previous year:

- Decrease in ROA
- Stable or slight increase in revenue
- COGS stable (some may note that it is the same % of revenue but not a required comment)
- Operating expenses up (this is mainly due to depreciation; however if note that there is an increase in expenses this does partially account for the decrease in ROA)
- Main issue is an investment in Equipment – could signal growth – decrease in ROA is not a problem if this is the reason

Information provided by ROA and explanation regarding interest expense adjustment:

- The ROA informs us regarding management's ability to use assets (resources) to earn net income.
- The ROA, as compared to the Asset Turnover (which considers management's ability to use assets to earn revenue) provides information regarding management's ability to control expenses i.e. looks at net earnings
- The purpose of the interest expense adjustment is to remove the impact of the source of financing of the assets in order to allow comparisons across entities of their ability to use assets to earn income. Some entities may be using debt to finance assets while others are using equity and this adjustment removes the interest impact from the net earnings number.

Question 2 (42 marks)

Mountain Tires Inc. (MTI) and Spinning Wheels Inc. (SWI) are two Canadian companies that respectively sell bike tires and bicycle tire rims to manufacturers of mountain bikes. MTI imports the tires from Australia. SWI manufactures the rims. Both companies have September 30th year ends.

You have been hired as a co-op student to assist Shari, the accountant for MTI and SWI, in the preparation of the year-end financial statements. In your meeting with Shari she tells you “MTI is still in the process of making the adjusting journal entries and needs your help in that regard. SWI has everything ready to go and needs some help with statement preparation.”

She has provided you with the Unadjusted Trial Balance and some additional information for Mountain Tires Inc. She has obtained the Statement of Financial Position and Earnings Statement information for Spinning Wheels Inc.

Required Mountain Tires Inc.:

1. Using the additional information noted below for MTI, prepare the required year-end adjusting journal entries in the chart provided.
2. Enter your adjustments on the spreadsheet, complete the “Adjusted Trial Balance” columns and prepare the entry for income taxes. The tax rate is 30%.
3. Record your journal entry for taxes in the chart provided and enter your entry for taxes on the spreadsheet.
4. As you learned in AFM 101, make sure at all stages of the process Dr’s = Cr’s

Additional Information for Mountain Tires Inc.:

- a) The company changed insurance companies during the year. The new insurance company offered a reduction in annual insurance premiums for the building; however MTI had to pay the annual premium in advance. With the previous insurance provider MTI paid the premiums monthly. MTI made a payment of \$3,600 on September 1, 2016 to the new insurance company for coverage for September 1, 2016 to September 30, 2017/August 31, 2017.
- b) MTI owns the building that the company operates out of. It was purchased on October 1, 2010. The depreciation has not been recorded yet for 2016. Shari mentioned to you in your meeting that she had not yet received the property tax bill for the building for the 2016 year. She is expecting the bill to arrive soon and the amount owing is \$5,800.
- c) Mountain Tires Inc. borrowed \$60,000 on July 1, 2016. The annual interest rate is 5% and the interest is payable June 30, 2017.
- d) During August 2016, a sales representative for MTI entered into an agreement with a new customer to deliver \$60,000 of tires in October 2016. New customers must provide a 10% deposit payment. Shari tells you that the deposit was received in August and recorded as Revenue.
- e) September has been a busy month for MTI and the last shipment for \$8,000 (selling price) of tires has not been billed yet. This shipment is for one of SWI’s largest customers. No deposits are required and they pay within 60 days. Shari tells you that MTI has met the “Revenue Recognition” requirements for this shipment and the costs have been recorded but the invoices have not been prepared or recorded yet.

Mountain Tires Inc. Adjusting Journal Entries (explanations are not required) (18 out of 42 marks):

Account Titles	Debits	Credits
Insurance Expense	\$300/\$277	
Prepays \$3,600/12 or \$3600/13		\$300/\$277
Depreciation Expense	\$50,000	
Accumulated Depreciation Building \$250,000/5		\$50,000
Property Tax Expense	\$5,800	
Accrued Liabilities/ (Also accepted Taxes Payable for this midterm)		\$5,800
Interest Expense	\$750	
Interest Payable \$60,000 * .05 * 3/12		\$750
Revenue	\$6,000	
Unearned Revenue/Deferred Revenue \$60,000 * .10		\$6,000
Trade Receivable/Accounts Receivable	\$8,000	
Revenue		\$8,000

Mountain Tires Inc. (10 out of 42)

ACCOUNT TITLE	9/30/2016 UNADJUSTED TRIAL BALANCE		ADJUSTMENTS		9/30/2016 ADJUSTED TRIAL BALANCE	
	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT
ASSETS						
Cash	67,000.00				67,000.00	
Trade receivable	50,000.00		8,000.00		58,000.00	
Prepays	3,600.00			300.00	3,300.00	
Tire Inventory	21,000.00				21,000.00	
Building	1,200,000.00				1,200,000.00	
Accumulated Depreciation Building		250,000.00		50,000.00		300,000.00
LIABILITIES						
Trade payable		46,700.00				46,700.00
Unearned Revenue				6,000.00		6,000.00
Interest Payable				750.00		750.00
Accrued Liabilities				5,800.00		5,800.00
Taxes Payable/ Income Taxes Payable				9,015.00		9,015.00
Bank Loan		60,000.00				60,000.00
SHAREHOLDERS' EQUITY						
Capital stock		110,000.00				110,000.00
Retained Earnings		790,000.00				790,000.00
Revenue		380,000.00	6,000.00	8,000.00		382,000.00
Cost of Tires	222,000.00				222,000.00	
Wages	55,000.00				55,000.00	
Shipping	12,000.00				12,000.00	
Insurance	4,300.00		300.00		4,600.00	
Property Taxes			5,800.00		5,800.00	
Utilities	1,800.00				1,800.00	
Depreciation			50,000.00		50,000.00	
Interest			750.00		750.00	
Income Tax			9,015.00		9,015.00	
TOTALS	1,636,700.00	1,636,700.00	79,865.00	79,865.00	1,710,265.00	1,710,265.00

Continue Question 2

Mountain Tires Inc.

Income Tax Adjusting Journal Entry (3 out of 42 marks):

Account Titles	Debits	Credits
Income Taxes Expense	\$9,015	
Taxes Payable \$30,050 * .30		\$9,015

Continue Question 2

Required Spinning Wheels Inc. (11 out of 42 marks):

1. Using the information Shari has obtained for you below (comparative Statement of Financial Position and Earnings Statement for September 30th 2016) *prepare the Cash from Operating Activities section of the Cash Flow Statement for the Year Ended September 30, 2016 using the indirect method.*
2. Shari has informed you that “the depreciation for the year is included in the Operating Expenses,” and “SWI did purchase equipment during the year but they did not sell any.”

Spinning Wheels Inc.
Statement of Financial Position
As At September 30, 2016

	2016	2015
Cash	\$81,000	\$75,000
Trade receivable	190,000	138,500
Rims Inventory	56,500	39,000
Equipment	865,000	720,000
Accumulated Depreciation Equipment	(258,750)	(172,500)
TOTAL ASSETS	<u>\$933,750</u>	<u>\$800,000</u>
Trade payable	\$172,000	\$149,000
Interest Payable	750	1,750
Accrued Liabilities	15,250	29,250
Taxes Payable	28,725	
Bank Loan	100,000	70,000
Capital stock	85,000	85,000
Retained Earnings	\$532,025	\$465,000
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	<u>\$933,750</u>	<u>\$800,000</u>

Spinning Wheels Inc.
Statement of Earnings
For the Year Ended September 30, 2016

Revenue	\$810,000
Cost of Goods Sold	<u>590,000</u>
Gross Margin	\$220,000
Operating Expenses	<u>122,250</u>
Operating Income	\$97,750
Interest	<u>2,000</u>
Income before tax	\$95,750
Income Tax	<u>28,725</u>
Net Earnings	<u><u>\$67,025</u></u>

11 marks

Spinning Wheels Inc.
Statement of Cash Flows

For the Year Ended September 30, 2016

Operating Activities:

<u>Net Earnings</u>	<u>\$67,025</u>	
<u>Increase in Trade Receivable</u>	<u>(51,500)</u>	
<u>Increase in Inventory</u>	<u>(17,500)</u>	
<u>Increase in Trade Payable</u>	<u>23,000</u>	
<u>Decrease in Interest Payable</u>	<u>(1,000)</u>	
<u>Decrease in Accrued Liabilities</u>	<u>(14,000)</u>	
<u>Increase in Taxes Payable</u>	<u>28,725</u>	
<u>Depreciation</u>	<u>86,250</u>	
<u>Net cash flow from operating activities</u>		<u>121,000</u>

Question 3 (24 marks)

Choose the correct response from the answers provided. There is no mark penalty for incorrect responses. Mark the correct responses by completing the University of Waterloo answer scantron card, using a black lead HB pencil only. Write your name and student number on the answer card and **mark your student number in the appropriate ovals**. You **do not** need to complete the section number and card number. **Answers recorded on the following pages will not be marked.**

- 1) Which government regulatory agency has the legal authority to prescribe financial reporting requirements for corporations that sell their securities in Canadian stock exchanges in the province of Ontario?
 - A. AcSB.
 - B. OSC.**
 - C. CRA.
 - D. CICA.

- 2) With whom does primary responsibility for the information in a corporation's financial statements rest?
 - A. The shareholders of the corporation.
 - B. The managers of the corporation.**
 - C. The Ontario Securities Commission.
 - D. The public accountant who audited the financial statements.

- 3) In the Article, "Earnings Quality; Why Aren't All Earnings Equal," there are certain accounts management can manipulate that might benefit management but at the cost of poor earnings quality. Of the following accounts, which is the most susceptible to manipulation?
 - A. Cash
 - B. Inventory**
 - C. Short Term Investments
 - D. Accounts Payable

- 4) Why is the operating activities section often believed to be the most important part of a statement of cash flows?
 - A. It shows the net increase or decrease in cash during the period.
 - B. It shows the dividends that have been paid to shareholders.
 - C. It gives the most information about changes in the current asset and liability accounts.
 - D. It indicates a company's ability to generate cash from operations to meet current cash needs.**

- 5) Which of the following statements is TRUE?
 - A. Publicly traded enterprises must use the accounting standards prescribed for private enterprises for external reporting.
 - B. The SEC is the most influential Canadian regulator of the flow of financial information provided by publicly traded companies in Canada.
 - C. The Accounting Standards Board is a government body.
 - D. Publicly traded enterprises must use IFRS for external reporting for fiscal years that start on or after January 1, 2011.**

- 6) Collection of a \$600 accounts receivable
- A. increases an asset \$600; decreases a liability \$600.
 - B. has no effect on total assets.**
 - C. decreases an asset \$600; decreases a liability \$600.
 - D. decreases a liability \$600; increases shareholders' equity \$600.
- 7) Assume a company's January 1, 2016, financial position was: Assets, \$40,000 and Liabilities, \$15,000. During January 2016, the company completed the following transactions: (a) paid on a note payable, \$4,000 (no interest); (b) collected trade receivables, \$4,000; (c) paid trade payables, \$2,000; and (d) purchased a truck, \$1,000 cash, and \$8,000 notes payable. What is the company's January 31, 2016, financial position?

	Assets	Liabilities	Shareholders' Equity
A)	\$42,000	\$9,000	\$33,000
B)	\$44,000	\$17,000	\$27,000
C)	\$43,000	\$18,000	\$25,000
D)	\$42,000	\$17,000	\$25,000

- A. Choice A
 - B. Choice B
 - C. Choice C
 - D. Choice D**
- 8) Financing activities involve
- A. acquiring investments.
 - B. issuing shares.**
 - C. acquiring long-lived assets.
 - D. lending money.
- 9) In the Article, "For Good Measure," the following statement **does not describe** Sustainability Reporting:
- A. Extra disclosure that offers reporting companies additional benefits, such as employee loyalty and consumer reputation.
 - B. Reporting that gives information about the organization's economic, environmental, social and governance performance.
 - C. A reporting process that results in communication about value creation over time.**
 - D. Provides an opportunity for accountants to measure factors that were once considered to be outside the scope of traditional number crunching.
- 10) Accrued expenses are
- A. paid and recorded in an asset account after they are used or consumed.
 - B. incurred but not yet paid or recorded.**
 - C. incurred and already paid or recorded.
 - D. paid and recorded in an asset account before they are used or consumed.

- 11) Which of the following businesses would most likely have the shortest operating cycle?
- A. A pizza franchise such as Pizza Pizza**
 - B. A grocery chain such as Loblaws
 - C. A jewellery manufacturer such as Mappins
 - D. A retail chain such as Walmart

- 12) Which of the following activities will most likely result in a reported **loss** on the statement of earnings?
- A. Interest expense
 - B. The sale of inventory to customers
 - C. The sale of old equipment**
 - D. The wages and benefits paid to employees

- 13) At the end of 2015, the following data were taken from the accounts of Vert Inc.
- | | |
|--|-----------|
| Share Capital | \$300,000 |
| Retained Earnings, beginning balance January 1, 2015 | 150,000 |
| Total Revenue 2015 | 500,000 |
| Total Expenses 2015 | 200,000 |

The 2015 closing entries would include which of the following?

- A. \$300,000 net credit to retained earnings.**
 - B. \$300,000 net debit to retained earnings.
 - C. \$500,000 debit to retained earnings.
 - D. \$200,000 credit to retained earnings.
- 14) The process that begins with analyzing transactions and ends with the preparation of a post-closing trial balance is called
- A. the accounting cycle.**
 - B. the business cycle.
 - C. the fiscal period.
 - D. the accounting period.
- 15) In the indirect method, a gain on sale of equipment is reported as:
- A. a decrease to net earnings.**
 - B. a decrease to equipment purchases.
 - C. an increase to revenues.
 - D. an increase to cash provided by investing activities.
- 16) For an investment to qualify as a cash equivalent, it must be readily convertible to a known amount of cash and which of the following is correct?
- A. It must be identified as a cash equivalent on the statement of earnings.
 - B. Must be sufficiently close to its maturity date so that its market value is relatively insensitive to interest rate changes.**
 - C. The investment must have a known foreign exchange rate.
 - D. It must mature within 4 months.

- 17) Which of the following transactions does *not* affect cash during a period?
- A. Sale of common shares
 - B. Year-end accrual for interest expense**
 - C. Short term borrowing of funds
 - D. Collection of an accounts receivable
- 18) Randy Inc. borrowed \$50,000 of long-term debt, paid cash dividends of \$8,000, sold long-term investments for \$12,000, received \$5,000 of dividend revenue, repaid a short-term loan of \$15,000, and purchased new equipment for \$19,000. What is the net cash flow from financing activities?
- A. \$70,000.
 - B. \$27,000.**
 - C. (\$20,000).
 - D. \$80,000.
- 19) In 2013, Cash Company reported a quality of earnings ratio of 1.60. In 2012 and 2011 the ratio was .97 and .98 respectively. Which of the following was the most likely cause of the large increase in the ratio?
- A. A decrease in expense while net earnings remained the same.
 - B. An increase in current assets such as receivables and inventory.
 - C. An increase in trade payables and accrued liabilities.**
 - D. An increase in sales revenue while net earnings remained the same.
- 20) Which one of the following is *not* a qualitative characteristic of useful accounting information?
- A. Going concern.**
 - B. Verifiability.
 - C. Relevance.
 - D. Comparability.
- 21) The two qualitative characteristics that are defined in terms of what influences or makes a difference to a decision maker are
- A. relevance and understandability.
 - B. faithful representation and materiality.
 - C. comparability and timeliness.
 - D. materiality and relevance.**
- 22) Accounting information should be neutral in order to enhance:
- A. materiality.
 - B. understandability.
 - C. comparability.
 - D. faithful representation.**
- 23) Which one of the following is a fundamental qualitative characteristic?
- A. Relevance.**
 - B. Timeliness.
 - C. Understandability.
 - D. Comparability.

- 24) Failure to make an adjusting entry to recognize accrued rent payable would cause which of the following
- A. an understatement of expenses, liabilities and shareholders' equity.
 - B. an overstatement of expenses and liabilities.
 - C. **an understatement of expenses and liabilities and an overstatement of shareholders' equity.**
 - D. an understatement of assets and shareholders' equity.

This page can be removed so that you can reference it as you work. Do not write on this page as it will not be marked.

Ratios

Current	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
Total Asset Turnover	$\frac{\text{Net Sales (or Operating Revenues)}}{\text{Average Total Assets}}$
Return on Assets	$\frac{\text{Net Earnings + Interest Expense (net of tax)}}{\text{Average Total Assets}}$
Return on Equity	$\frac{\text{Net Earnings}}{\text{Average Shareholders' Equity}}$
Earnings per Share	$\frac{\text{Net Earnings Available to Common Shareholders}}{\text{Average Number of Common Shares Outstanding}}$
Net Profit Margin	$\frac{\text{Net Earnings}}{\text{Sales (or Operating Revenues)}}$
Quality of Earnings	$\frac{\text{Cash Flow from Operating Activities}}{\text{Net Earnings}}$
Capital Expenditures Ratio	$\frac{\text{Cash Flow from Operating Activities}}{\text{Cash Paid for Capital Expenditures}}$