

Name: _____

Student ID: _____

Section: _____

CONCORDIA UNIVERSITY
DEPARTMENT OF ACCOUNTANCY

FINANCIAL ACCOUNTING
COMM 217 ALL SECTIONS

FINAL EXAMINATION
Fall 2011

Duration: 3 hours

Instructions (very important):

1. This examination paper consists of **9 pages including** this page and the present value tables on the last 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.
5. Show all calculations on the examination booklet, and omit narratives for journal entries.
6. This is a closed book examination. However, a silent hand-held (not graphical or programmable) calculator and one standard language (not electronic) dictionary are permitted.
7. **Invigilators will not answer questions** (unless you think there is an **error** in the question).
8. 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-lived Assets	13
3	Accounting for Liabilities	20
4	Reporting Cash Flows	22
5	Analysis of Financial Statements	21
Total		100

QUESTION 1 (24 marks; 44 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. Goodwill is valued at:
 - a. The difference between the price paid for an ongoing business and the fair value of the identifiable assets acquired less liabilities assumed.
 - b. The difference between the fair value of the identifiable assets acquired and the liabilities assumed.
 - c. The total amount of cash paid to acquire another company.
 - d. The total amount of cash paid to acquire another company, less the value of the identifiable assets acquired.
2. When an asset is acquired, its recorded cost should include:
 - a. interest on notes payable related to the purchase.
 - b. the list price, ignoring all discounts and price reductions.
 - c. all costs necessary to acquire the asset and place it into a usable condition.
 - d. all of the above.
3. If a company's total revenues and gross profit percentage have declined and you were concerned about the level of sales and the profit margins in the countries in which the company operates, where would you look for more information?
 - a. The notes and other supplemental information accompanying the financial statements.
 - b. The management's discussion and analysis section of the annual report.
 - c. The segment reporting section of the company's annual report.
 - d. All of the above.
4. Which of the following statements about share capital is true?
 - a. Most companies that repurchase their own shares cancel them.
 - b. Common shares are typically callable, while preferred shares are not.
 - c. Preferred shares are not considered to represent the true residual ownership interest of a corporation.
 - d. Both a and c could be correct.
5. The balance in the retained earnings account reflects:
 - a. the amount of cash available to be distributed to owners.
 - b. the margin of safety available to protect the claims of the creditors.
 - c. the total amount of the corporation's profits since its incorporation.
 - d. the accumulated undistributed earnings of the corporation.
6. Robert reports pretax profit of \$200,000 on its income statement at December 31, 2011. Among the expenses is straight-line depreciation expense of \$200,000. On its tax return Robert reports a capital cost allowance (depreciation) of \$250,000. There are no other temporary differences between the income statement and the tax return. At the beginning of the year, the deferred income tax account had a debit balance of \$25,000. Robert is subject to a tax rate of 40%. Which of the following statements is correct?
 - a. The income tax expense for 2011 is \$60,000.
 - b. The deferred income tax account should be credited for \$30,000.
 - c. The deferred income tax account should have a debit balance of \$5,000 at Dec. 31, 2011.
 - d. The income tax payable at December 31, 2011 is \$90,000.

7. Which of the following statements is true?
- Dividends and interest are both expenses related to corporate financing.
 - The retained earnings statement reports dividends declared, as well as all gains and losses.
 - Once a cash dividend is declared, the corporation has a liability to its shareholders until the dividend is paid.
 - Stock dividends on common shares do not affect retained earnings.
8. The manager of Fast Growing Company receives an annual bonus based on the company's reported profit. What combination of the following accounting methods would the manager be inclined to use in a period of rising prices?
- Straight-line depreciation and weighted average cost.
 - Accelerated depreciation and weighted average cost.
 - Straight-line depreciation and FIFO cost.
 - Accelerated depreciation and FIFO cost.
9. In 2010, Deng Co. reported a fixed asset turnover ratio of 1.83. In 2011, its ratio was 1.63. A likely cause for this change in the turnover ratio is
- an increase in sales.
 - an increase in net fixed assets.
 - a decrease in net fixed assets.
 - an increase in profit.
10. Which of the following statements is true?
- Depreciation expense is added to profit in the operating activities section of the statement of cash flows because it has no cash effect on profit under the indirect method.
 - Depreciation is a non-cash expense that reduces profit but involves no outflow of cash.
 - The only cash effect for depreciation is the tax savings provided by its deduction to derive taxable income.
 - The three statements above are true.
11. Cumulative dividends in arrears are reported as
- an expense.
 - a reduction of preferred shares.
 - a contra-asset.
 - a note to the financial statements.
12. Given the following ratios for four companies, which company is least likely to experience problems paying its current liabilities promptly?
- | | Quick ratio | Receivable turnover |
|----|--------------------|----------------------------|
| a. | 1.2 | 58 |
| b. | 1.2 | 45 |
| c. | 1.0 | 55 |
| d. | 0.5 | 60 |
13. Under the effective interest method, amortization of a bond discount results in periodic interest expense that is
- less than the amount of interest paid.
 - equal to the stated rate of interest multiplied by the face value of the bonds.
 - lower in the early years than in the later years of the bond's life.
 - equal to the market rate of interest multiplied by the face value of the bonds.

14. An aging of a company's trade receivables indicates that \$4,000 is estimated to be uncollectible. The Allowance for Doubtful Accounts shows an unadjusted debit balance of \$1,100. The adjustment to record bad debt expense for the period requires a
- debit to Bad Debts Expense for \$4,000.
 - credit to Allowance for Doubtful Accounts for \$2,900.
 - debit to Bad Debts Expense for \$2,900.
 - credit to Allowance for Doubtful Accounts for \$5,100.
15. Which of the following events decreases shareholders' equity?
- Payment of a previously declared cash dividend.
 - Declaration of a 5-percent stock dividend.
 - Declaration of a cash dividend for preferred shares.
 - Declaration of a 2-for-1 stock split.
16. On December 1, 2011 Beep Inc. makes a sale of \$10,000 on account with terms 2/10, n/30. If the customer pays the account on December 8, 2011, which of the following statements would be incorrect, ignoring any income tax effects?
- Profit would decrease by \$200.
 - Average shareholders' equity would decrease by \$100.
 - The return on equity ratio would decrease.
 - Cash would increase by \$10,000.

QUESTION 2 (13 marks; 23 minutes)*Accounting for long-lived assets*

The Vezina Company acquired equipment on January 1, 2008. The following items, paid in cash, were associated with the acquisition of the equipment:

Sales price	\$900,000
Freight-in	20,000
Installation costs	10,000

The equipment has an estimated useful life of 10 years, and its residual value is estimated at \$30,000.

On January 1, 2010 the company spent \$150,000 cash to completely overhaul the equipment, which increased its operating efficiency and its useful life to 12 years (starting from January 1, 2010). The estimated residual value remained unchanged from its original estimate.

On September 30, 2011, the company sold the equipment for \$750,000 cash.

The company uses the straight-line method of depreciation, and has a December 31 year-end.

Required:

- Prepare the journal entries to record the acquisition of the equipment and related depreciation for 2008. **(4 marks)**
- Prepare the journal entries to record the expenditure and depreciation of the equipment for 2010. **(4 marks)**
- Calculate the gain or loss on the sale of the equipment on September 30, 2011. **(3 marks)**
- Assume for this requirement only that the company used the double-declining method of depreciation since 2008 instead of the straight-line method. Calculate the depreciation expense for 2009. **(2 marks)**

QUESTION 3 (20 marks; 36 minutes) *Accounting for Liabilities*

Robert Inc. is a retail company selling technology products. Robert's fiscal year end is December 31. Below is selected information about Robert's operations during 2011.

1. During March, Robert sold 200 units of one of its technology products at \$200 each, subject to provincial sales tax of 8% of the sales price, and goods and services tax of 5% of the sales price. All sales are on account. Each unit carries a one-year warranty. Robert promises to repair the unit should it become defective. The estimated cost to the company to honour the warranty is \$30 per unit and experience has shown that approximately 7% of all units may have to be repaired during the warranty period.

Required:

Prepare journal entries to record (1) the sales during March and (2) the associated warranty expense. **(4.5 marks)**

2. The payroll register for November 2011 showed the following totals. Salaries were paid on November 30.

Gross salaries	\$19,500
Income taxes withheld	4,200
QPP withheld	975
Private medical insurance deductions	675
EI withheld	448
Union dues withheld	324

Required:

- a. How much cash did Robert pay to the employees on November 30? **(2 marks)**
- b. What is the total compensation expense that should be recorded on Roberts' books for November 2011, assuming that the employer matches the QPP deductions and is responsible for 1.40 times the EI deductions? **(2 marks)**
3. On January 1, 2011, Robert issued bonds with a face value of \$200,000 when the market rate of interest was 10% per year. The bonds mature in 10 years and have a stated interest rate of 9.5% per year. Interest is payable semi-annually on July 1 and January 1. The bonds are callable at 101, starting on January 1, 2012. The company uses the effective-interest method to amortize bond discount or premium.

Required

- a. Calculate the price of the bond issue. Present value tables are on the last page of the exam. **(2.5 marks)**
- b. Record all of the journal entries related to the bonds in 2011. **(6 marks)**
- c. Assume that the market interest rate dropped to 9% on January 1, 2012, and that Robert decided to call all of the bonds on that day. Prepare the journal entry to record the early redemption of the bonds on January 1, 2012 assuming all applicable interest has been recorded and paid to that date. **(3 marks)**

QUESTION 4 (22 marks; 40 minutes) *Reporting and interpreting cash flows*

Drapeau Corp. has provided you with financial information for the years 2011 and 2010, respectively. The company's fiscal year ends on December 31.

	2011	2010
Assets		
Cash	\$ 47,000	\$ 12,000
Trade Receivables	110,000	125,000
Merchandise inventory	25,000	36,000
Prepaid rent	0	7,000
Land, at cost	29,000	38,000
Equipment, at cost	690,000	600,000
Less: Accumulated depreciation	<u>(224,000)</u>	<u>(215,000)</u>
<i>Total Assets</i>	<u>\$ 677,000</u>	<u>\$ 603,000</u>
Liabilities		
Trade payables	\$ 32,000	\$ 61,000
Rent payable	4,000	0
Bonds payable, at par, due 2020	45,000	120,000
Shareholders' Equity		
Common shares	201,000	42,000
Retained earnings	<u>395,000</u>	<u>380,000</u>
<i>Total Liabilities and Shareholders' Equity</i>	<u>\$ 677,000</u>	<u>\$ 603,000</u>

Additional information for 2011:

- Net Profit for 2011 was \$22,000. The calculation of profit *includes* the following *selected* items and amounts: Cost of goods sold, \$293,000; Gross profit, \$444,000; Depreciation expense, \$27,000; Gain on sale of land, \$2,000; Loss on sale of equipment, \$4,000; and Rent expense, \$16,000.
- New equipment was purchased for \$142,000 cash in 2011. Old equipment was sold for cash in 2011 (the amount can be derived).
- Bonds payable with a face value of \$75,000 were converted to common shares in 2011.
- Trade payables relates to transactions with suppliers of merchandise inventory only.

Required

- How much cash was paid for rent in 2011? **(2.5 marks)**
- How much cash was paid to suppliers of merchandise inventory in 2011? **(3 marks)**
- How much cash was collected from customers in 2011? **(1.5 marks)**
- Prepare in proper form a complete Statement of Cash Flows for 2011 (*i.e.*, all sections). Use the indirect method for the Operating section. **(13 marks)**
- Calculate the quality of earnings ratio for 2011 and give a meaningful definition of this ratio. **(2 marks)**

QUESTION 5 (21 marks; 40 minutes) *Analysis of Financial Statements*

The comparative statements of financial position at December 31, 2011 and 2010 and the income statement of Nutritech Inc. for 2011 are presented below.

Nutritech Inc.
Statement of Financial Position
As at December 31

	2011	2010
Assets		
<i>Current Assets</i>		
Cash	\$ 201,000	\$ 186,000
Trade Receivables	115,000	82,000
Less: Allowance for Doubtful Accounts	(5,000)	(1,000)
Merchandise Inventory	125,000	135,000
Total Current Assets	436,000	402,000
<i>Non-current Assets</i>		
Long-Term Investment	105,000	105,000
Land	210,000	210,000
Equipment	1,220,000	900,000
Less: Accumulated Depreciation	(599,000)	(369,000)
Total Assets	\$1,372,000	\$1,248,000
Liabilities and Shareholders' Equity		
<i>Current Liabilities</i>		
Trade Payables	\$ 99,000	\$ 84,000
Interest Payable	39,000	36,000
Income Tax Payable	62,000	65,000
<i>Long-Term Liabilities</i>		
Notes Payable	400,000	385,000
Total Liabilities	600,000	570,000
<i>Shareholders' Equity</i>		
Share Capital	250,000	250,000
Retained Earnings	522,000	428,000
Total Liabilities and Shareholders' Equity	\$1,372,000	\$1,248,000

Nutritech Inc.
Income Statement
For the year ended December 31, 2011

Net Sales	\$3,510,000
Cost of Goods Sold	2,080,000
Gross Profit	1,430,000
Operating Expenses	955,000
Depreciation Expense	230,000
Operating Profit	245,000
Interest Expense	44,000
Income Tax Expense	66,000
Profit	\$ 135,000

Additional Information:

1. Nutritech's sales and purchases are all on credit.
2. Nutritech declared and paid \$5,000 of cash dividends to its preferred shareholders in 2011.
3. Nutritech's average number of common shares outstanding during 2011 is 20,000.

Required:

1. Calculate the following ratios for 2011 using the formulae discussed in the textbook for this course, and provide a meaningful explanation for each one. Round your calculations to two decimal places.
 - a. Profit Margin
 - b. Debt-to-Equity
 - c. Times Interest Earned
 - d. Return on Equity
 - e. Return on Assets
 - f. Receivables Turnover
 - g. Fixed Assets Turnover
 - h. Earnings Per Share

(16 marks)
2. Both the Times Interest Earned ratio and the Cash Coverage ratio are used to test a company's solvency. Explain briefly why creditors prefer the Cash Coverage ratio over the other ratio. Calculation of the Cash Coverage ratio is not required in order to answer this requirement. **(2 marks)**
3. Selected ratios for Nutritech for 2010 and the Industry Average for both 2011 and 2010 are provided below.

	Nutritech		Industry Average	
	2011	2010	2011	2010
Debt-to-Equity		0.75	0.52	0.53
Times Interest Earned		5.60	7.49	7.42
Return on Equity (%)		18.34%	15.55%	15.29%
Return on Assets (%)		12.34%	12.54%	12.28%

What conclusions can you draw from your analysis on this problem? **(3 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	4.1317	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