

FINAL EXAMINATION (REGULAR)
WINTER 2013

Name: _____ ID: _____

Duration: 3 hours

Instructions (very important):

1. This examination paper consists of **9 pages including this 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 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. Using abbreviated account names, headings, subheadings, totals and subtotals is not recommended, and it may be subject to mark deduction.
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.** If you think there is an **error** in the question, ask your instructor when he/she visits the exam room.
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	21
2	Accounting for Inventory and Cost of Sales	15
3	Accounting for Long-term Assets	15
4	Accounting for Bonds	16
5	Preparation of Statement of Cash Flows	19
6	Analysis of Financial Statements	14
	Total	100

QUESTION 1 (21 marks; 35 minutes)

Multiple Choice

1. Company A's ending inventory had been overstated by \$10,000 and \$8,000 in 2011 and 2012 respectively. Before the effect of these errors, the company's pre-tax profit in 2012 had been computed as \$100,000. What is the correct amount of pre-tax profit in 2012?

- a. \$ 98,000
- b. \$100,000
- c. \$102,000
- d. \$118,000

2. An adjustment to ending inventory under the lower of cost and net realizable value (LCNRV) rule are **least likely** to be recorded by a company that sells:

- a. A household staple like laundry detergent.
- b. Fashion apparels.
- c. Seasonal items like snow blowers.
- d. High-tech goods like Personal Digital Assistants.

3. All other things being constant, which of the following statements is true?

- a. The balance of ending inventory and cost of sales move in the same direction.
- b. The balance of ending inventory and net income move in the opposite direction.
- c. The balance of ending inventory and net income move in the same direction.
- d. None of the above is true because it depends on which inventory costing method a company adopts.

4. Company A paid \$620,000 for a patent that had 10 years remaining. After two years, the company sold the patent for \$500,000. The company should report:

- a. A debit to cash of \$500,000 and a credit to patents of \$500,000.
- b. A debit to patents of \$620,000, a credit to cash of \$500,000, and a credit to accumulated amortization of \$120,000.
- c. A debit to cash of \$500,000, a debit to accumulated amortization of \$124,000, a credit to patents of \$620,000, and a credit to gains of \$4,000.
- d. A debit to patents of \$496,000, a debit to losses of \$4,000, and a credit to cash of \$500,000.

5. Which of the following statements is true when the straight-line method is used to compute depreciation expense?

- a. Carrying value is constant during an asset's useful life.
- b. Accumulated depreciation is constant during an asset's estimated useful life.
- c. Depreciation expense equals the depreciable cost divided by an asset's useful life.
- d. None of the above is true.

6. Company A uses an accelerated depreciation method while Company B uses the straight-line method. All other things being equal, during the first few years of using a similar asset Company A will show which of the following compared to Company B?

- a. Higher asset values and higher net income.
- b. Lower asset values and higher net income.
- c. Higher asset values and lower net income.
- d. Lower asset values and lower net income.

7. When a possible obligation is remote in likelihood, a company should:
- Include a description in the foot notes to the financial statements.
 - Record the amount of the liability times the probability of its occurrence.
 - Record the estimated amount of loss as a provision on the balance sheet.
 - Omit this information from its financial statements and footnotes.
8. Company A issues \$1 million of new shares and pays \$200,000 in cash dividends during 2012. In addition, the company issued a new bond for \$1.5 million, and paid off existing bonds with a face value of \$2 million. The company also received \$500,000 dividend. Company A's net cash flow from financing activities in 2012 is:
- An inflow of \$800,000.
 - An outflow of \$200,000.
 - An outflow of \$100,000.
 - An inflow of \$300,000.
9. Compared with its competitor Company B, Company A has a lower quality of earnings ratio but a higher EPS. Which of the following is **least likely** to be the explanation?
- Company A sells a higher percent of goods on credit.
 - Company A has fewer common shares outstanding.
 - Company A earns a higher percent of net income from non-operating activities.
 - Company A pays a higher dividend.
10. Company A had a current ratio of 4.44 in 2011 and 5.84 in 2012. Which of the following is the best explanation?
- An increase in cash and equivalents and short-term investments.
 - An increase in current assets that exceeded the increase in current liabilities.
 - A decrease in current liabilities.
 - A decrease in long-term liabilities.
11. On January 1 2013, Company A borrows \$20,000 for four years at an interest rate of 8%. Interest is paid semi-annually on June 30 and December 31. A partial repayment of principal, \$5000, is due each year on December 31. What would be reported on the balance sheet on March 31 2013, the end of Company A's fiscal year?
- \$400 as interest expense and \$20,000 under long-term debt.
 - \$400 as interest payable, \$5,000 as current portion of long-term debt under current liabilities, and \$15,000 under long-term debt.
 - \$1,600 of interest payable under current liabilities, \$5,000 as current portion of long-term debt under current liabilities, and \$15,000 under long-term debt.
 - \$400 as interest payable under current liabilities and \$20,000 under long-term debt.
12. Which of the following would cause the greatest increase in a company's inventory turnover ratio?
- Keep the same amount of inventory while the number of units sold is increasing.
 - Increase the amount of inventory while the number of units sold is increasing.
 - Keep the same amount of inventory while the number of units sold is decreasing.
 - Decrease the amount of inventory while the number of units sold is increasing.

13. The board of directors of a company that is facing financial difficulties might issue a 2-for-1 stock split rather than declare a 100% stock dividend, because:

- A stock split would not reduce the market price, whereas a stock dividend would.
- A stock split would reduce the market price, whereas a stock dividend would not.
- A stock split would increase shareholders' equity, whereas a stock dividend would not.
- A stock split would not reduce retained earnings, whereas a stock dividend would.

14. Company A has 9 million common shares and 1 million preferred shares outstanding. The preferred shares pay \$0.32 dividend per share, and dividends in arrears were \$30,000 before the company declared dividends in 2012. How much dividend do preferred and common shareholders receive respectively, if the total dividends declared were \$600,000?

- Preferred shareholders: \$60,000; Common shareholders: \$540,000.
- Preferred shareholders: \$350,000; Common shareholders: \$250,000.
- Preferred shareholders: \$320,000; Common shareholders: \$280,000.
- Preferred shareholders: \$90,000; Common shareholders: \$510,000.

QUESTION 2 (15 marks; 25 minutes) *Accounting for Inventory and Cost of Sales*

Miller Corp. sells chairs. Miller reported the following information (all transactions are on account) for the quarter ending March 31, 2013:

			Purchases		Sales	
			Units	Unit Cost	Units	Selling
<u>Price/Unit</u>						
Jan.	1	Beginning inventory	112	\$72		
	13	Purchase	76	\$71		
	29	Sale			121	\$99
Feb.	3	Purchase	56	\$69		
	16	Purchase	102	\$65		
Mar.	21	Sale			67	\$98

Required (*Round the results to two decimal places*):

In requirements 1-3, Miller uses a periodic inventory system.

1. Calculate the cost of ending inventory, cost of goods sold, gross profit, and gross profit percentage for the quarter ending March 31, 2013, assuming the **FIFO** inventory costing method is used. **(4 marks)**

2. Would Miller's gross profit increase or decrease if it uses the **weighted-average** cost method instead of FIFO? You simply need to *explain* the direction of the change in gross profit. No calculations are required. **(1.5 marks)**

3. Miller reports its ending inventory at the Lower of Cost and Net Realizable Value (LCNRV); the net realizable value of chairs declined to \$66 per unit on March 31, 2013. Prepare journal entries for March 31, 2013, assuming the **FIFO** inventory costing method is used. If no journal entry is required, indicate "no entry required" and briefly explain the reason. **(2 marks)**

In requirements 4-5, Miller uses a perpetual inventory system.

4. Prepare journal entries to record the sale on January 29, assuming the **FIFO** inventory costing method is used. **(3.5 marks)**

5. Calculate the cost of the 67 chairs sold on March 21, assuming the **weighted-average** cost method is used? Show your detailed calculations. Journal entries are not required. **(4 marks)**

QUESTION 3 (15 marks; 25 minutes)

Accounting for Long-term Assets

This question has four parts.

Part 1

On January 1, 2010, Macon paid \$85,000 for a machine which has an estimated useful life of five years and an estimated residual value of \$5,000. This machine is depreciated using the **double-declining-balance method**.

Required:

Prepare journal entries to record the disposal of this machine when Macon sold it for \$35,000 on December 31, 2012. **(4 marks)**

Part 2

In 2009, Macon paid \$55,000 for a truck which has an estimated useful life of 200,000 kilometers and an estimated residual value of \$5,000. This truck is depreciated using the **unit-of-production method**; it had driven 180,000 kilometers from 2009 to 2011, and 30,000 kilometers in 2012.

Required:

Calculate the depreciation expense of this truck in 2012. **(3 marks)**

Part 3

On December 31, 2012, Macon made a basket purchase of land and a building. The total purchase price was \$315,000. Macon also paid \$5,000 for the title of the land and \$1,000 for the building dedication ceremony. Appraised values of the land and the building were \$170,000 and \$230,000 respectively at the time of the purchase.

Required:

Calculate the acquisition cost of both the land and the building. **(4 marks)**

Part 4

On January 1, 2008, Macon paid \$100,000 for a tractor which has an estimated useful life of five years and no residual value. The tractor is depreciated using the **straight-line method**. On January 1, 2012, Macon spent \$30,000 to replace this tractor's engine. After the repair, Macon estimated that the tractor could be used for another three years and its residual value would be \$2,000.

Required:

Prepare journal entries to record the depreciation expense of this truck in 2012, assuming the **straight-line method** is still used. **(4 marks)**

QUESTION 4 (16 marks; 30 minutes)*Accounting for Bonds*

On March 1, 2013, Big Burst Inc. issued a bond with a face value of \$1,000,000. The bond will mature on March 1, 2023. The coupon rate is 8% and interest will be paid semi-annually, starting from September 1, 2013. Big Burst uses the effective-interest method to amortize bond discount or premium. At the time of issuance, the market rate was 6% for similar bonds. Big Burst's fiscal year ends on March 31.

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

1. Prepare the journal entry to record the bond issuance. Present value tables are on page 9.
(4 marks)
 2. Show, in good form, the liabilities section of Big Burst's balance sheet as at March 31, 2013.
(4 marks)
 3. Prepare the journal entry to record the first interest payment on September 1, 2013. (3 marks)
 4. Assume that Big Burst redeems 10% of the outstanding bonds for cash at 102 immediately after the first interest payment on September 1, 2013. Prepare the journal entry to record the bond redemption.
(3 marks)
 5. If the remaining bond (90% of face value) remains outstanding until maturity, how much will the cumulative (total) interest expense be (i.e. from September 1, 2013 to March 1, 2023)?
(2 marks)
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QUESTION 5 (19 marks, 45 minutes)*Preparation of Statement of Cash Flows*

Ponder Ltd. reported the following comparative balance sheet information as at December 31.

	<u>2012</u>	<u>2011</u>
Current assets		
Cash and cash equivalents	\$ 55,700	\$16,600
Trade receivables	62,100	45,000
Inventories	98,300	90,900
Prepaid expenses	4,700	8,200
Property, plant and equipment		
Land	16,100	23,000
Equipment, net	104,900	94,200
Total Assets	\$341,800	\$277,900
Current liabilities		
Trade payables	\$55,700	\$33,600
Salaries payable	7,100	20,400
Income taxes payable	1,400	900
Deposits from customers	11,000	17,100
Long term liabilities		
Note payable, due 2014	57,000	65,000
Shareholders' equity		
Common shares	135,000	129,000
Retained earnings	74,600	11,900
Total Liabilities and Shareholders' equity	\$341,800	\$277,900

Ponder also provided the following income statement information for year 2012.

Revenues	
Sales Revenue	\$428,000
Interest Revenue	<u>3,700</u>
Total revenues	431,700
Expenses	
Cost of sales	\$165,200
Salary expense	86,200
Depreciation expense	14,300
Other operating expenses	49,700
Interest expense	2,600
Loss on sale of land	2,900
Income tax expense	<u>9,000</u>
Total expenses	<u>329,900</u>
Profit	\$101,800

Additional information for 2012

- No land was acquired, but a tract of land was sold for cash.
- New equipment was purchased for \$27,000 cash.
- Old equipment with a cost of \$7,200 was sold at its carrying amount (book value).

Required

1. Prepare in proper form and style a **COMPLETE** Statement of Cash Flows for the year ended December 31, 2012. Use the **indirect method** for the operation activity section. (15 marks)
2. Based on the information provided in the question and your answers to the previous requirement, calculate and briefly explain each of the following (*Round the results to two decimal places*):
 - a) Cash Coverage Ratio
 - b) Free Cash Flow (4 marks)

QUESTION 6 (14 marks, 20 minutes)

Financial Statement Analysis

**Mommy Company
Income Statement**

	2012
Sales Revenue (net)	\$1,010,000
Cost of sales	<u>952,000</u>
Gross margin	58,000
Expenses (including \$4,000 interest expense)	<u>40,000</u>
Pre-tax profit	18,000
Income tax	<u>5,400</u>
Profit	\$12,600

Mommy Company
Comparative Statement of Financial Position as at December 31

	2012	2011
Assets		
Cash	\$ 49,500	\$ 18,000
Trade receivables (net)	37,000	32,000
Inventory	25,000	38,000
Property, plant, and equipment (net)	<u>95,000</u>	<u>105,000</u>
Total Assets	<u>\$206,500</u>	<u>\$193,000</u>
Liabilities		
Trade payables	\$ 42,000	\$ 35,000
Income taxes payable	1,000	500
Note payable, long term	40,000	40,000
Shareholders' Equity		
Share capital (9,000 shares)	90,000	90,000
Retained earnings	<u>33,500</u>	<u>27,500</u>
Total liabilities and shareholders' equity	<u>\$206,500</u>	<u>\$193,000</u>

Additional information

Mommy's stock price was \$23 on December 31, 2012.

Required (*Round the results to two decimal places*):

1. Compute the following ratios for year 2012, and indicate which category each ratio belongs to (profitability, liquidity, solvency, or market test). **(10 marks)**
 - a) Return on Equity
 - b) Inventory Turnover
 - c) Quick Ratio
 - d) Times Interest Earned Ratio
 - e) Dividend Yield
2. Explain why Quick Ratio is a more stringent test of a company's liquidity than Current Ratio. **(2 marks)**
3. Explain why some financial statement users prefer to use Cash Coverage Ratio instead of Times Interest Earned Ratio. **(2 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	0.5537	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	5.1317	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