

Name: _____

Student ID: _____

Section: _____

CONCORDIA UNIVERSITY
DEPARTMENT OF ACCOUNTANCY

FINANCIAL ACCOUNTING
COMM 217 ALL SECTIONS

FINAL EXAMINATION
Winter 2012

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	21
3	Accounting for Bonds	17
4	Analysis of Financial Statements	19
5	Reporting Cash Flows	19
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. Under the accrual basis of accounting,
 - a. cash must be received before revenue is recognized.
 - b. profit is calculated by matching cash outflows against cash inflows.
 - c. events that change a company's financial statements are recognized in the period they occur rather than only in the period in which cash is paid or received.
 - d. the ledger accounts must be adjusted to reflect a cash basis of accounting before financial statements are prepared under international financial reporting standards.
2. The unadjusted balance of Allowance for Doubtful Accounts
 - a. is relevant when using the Aging of Trade Receivables method to calculate the bad debt expense.
 - b. is relevant when credit card sales are made.
 - c. is relevant when notes receivable are used.
 - d. will never show a debit balance.
3. In its first year of operations G Ltd. reported profit before income taxes of \$50,000 on its income statement. For the same year the tax return showed taxable income of \$30,000. The only reason for this difference was because the company claimed \$20,000 more capital cost allowance (CCA) on its tax return than it recorded as depreciation expense for financial reporting purposes. The company is subject to an income tax rate of 30%. The journal entry to record income tax expense for the first year of operations will include
 - a. A debit to deferred income tax asset, \$6,000.
 - b. A credit to deferred income tax liability, \$6,000.
 - c. A debit to deferred income tax asset, \$20,000.
 - d. A credit to deferred income tax liability, \$20,000.
4. Both the employer and employee must make contributions for:
 - a. employment insurance premiums.
 - b. Canada or Quebec Pension Plan.
 - c. the employees' income taxes.
 - d. both a and b.
5. The Grimaldi Corporation guarantees its products against defects for one year. In what year should the corporation report the warranty expense?
 - a. in the year that the product is sold.
 - b. in the year that the product becomes defective and is repaired or replaced.
 - c. warranty expense is never recorded because the cost of the warranty is included in the product's selling price.
 - d. none of the above.
6. One feature that is generally not associated with preferred shares is the:
 - a. cumulative feature
 - b. callable feature
 - c. voting right
 - d. conversion right

13. 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.

14. Zoya Ltd. reported the following changes in 2011:

Current liabilities	\$75,000 increase
Noncurrent liabilities	45,000 decrease
Shareholders' equity	51,000 decrease
Noncurrent assets	42,000 increase
Current assets (other than cash)	18,000 increase

The increase (decrease) in cash during 2011 is therefore:

- (\$81,000)
 - (\$57,000)
 - \$30,000
 - \$39,000
15. Libman Inc. and LowKey Corp. are identical in all respects, except that Libman uses the FIFO method and LowKey uses the weighted average method for inventory costing purposes. Prices have been rising steadily over the past several years. Which statement would be **incorrect** in comparing the financial statements of these two companies?
- The cost of ending inventory for Libman would be higher than that for LowKey.
 - The retained earnings for Libman would be higher than the retained earnings for LowKey.
 - The profit in the current year for Libman would be higher than LowKey's profit.
 - The income tax liability for Libman would be less than the income tax liability for LowKey, ignoring any deferred taxes.
16. The Tamer Corporation sells on credit with terms of "net 30 days." If the company's credit policy and collection activity is working efficiently, how many times should the company's trade receivables turn over in a year?
- approximately 6 times
 - approximately 8 times
 - approximately 12 times
 - This cannot be determined without information about credit sales and trade receivables.

QUESTION 2 (21 marks; 38 minutes) *Accounting for long-lived assets*

This question consists of two independent parts: A and B.

For all requirements in Parts A and B, do not use abbreviations and skip a line between journal entries.

PART A (14 marks)

Durham Bike Shop Ltd. specializes in selling and repairing a wide variety of bicycles. Some of the company's cash transactions during 2011 follow. The Company's fiscal year ends on December 31.

March 1 Paid \$190,000 cash to purchase the following assets:

Asset	Market Value	Estimated Useful Life	Estimated Residual Value
Land	\$ 88,000	—	—
Building	132,000	25 years	\$14,000

The Company plans to use the straight-line depreciation method for the building.

April 15 Purchased a used pickup truck for \$20,500. The truck is expected to be used for five years and driven 120,000 kilometers. Its estimated salvage value is \$3,900.

April 16 Installed heavy-duty racks costing \$1,400 that will enable the truck to carry several bicycles. The truck was then immediately placed into service.

June 30 Paid John's garage for an oil change (\$35) and the replacement of a muffler (\$165).

Required:

1. Apportion (allocate) the total purchase price to Land and Building based on their relative market values. Show your computations. **(2 marks)**
2. Prepare journal entries to record the above transactions (March 1 to June 30). **(4.5 marks)**
3. Which depreciation method should the Company use to depreciate the truck? Briefly justify your answer. **(2 marks)**
4. Prepare adjusting journal entries on December 31, 2011 to record depreciation on the long-lived assets. Assume that the Company uses the units-of-production method to depreciate the truck, which was driven 9,000 kilometers since it was placed into service. **(5.5 marks)**

PART B (7 marks)

Winningham Company sold a machine on April 1, 2012 for \$24,000. The machine was purchased on January 1, 2010 for \$60,000. It is expected to have a residual value of \$3,000 at the end of its useful life of five years. The Company uses the double-declining balance method to depreciate the machine.

Required:

Prepare the journal entries required to record depreciation for 2012 and the sale of the machine on April 1, 2012. The Company has recorded depreciation properly on this machine up to December 31, 2011.

QUESTION 3 (17 marks; 30 minutes) *Accounting for Bonds*

On April 1, 2011 Yanick Ltd. issued \$30,000,000 face value bonds that mature in 10 years. The bonds have a coupon (i.e., nominal/stated/contractual) rate of 5.5% per year, and pay interest every six months beginning, October 1, 2011. The market rate of interest was 6% per year at the time of issuance.

Yanick Ltd. uses the effective interest method to amortize bond discount or premium. The Company adjusts its accounts annually, and at no other time during the year. Yanick's fiscal year is the same as the calendar year. (Round your computations to the nearest dollar.)

Required:

- Prepare in proper form the journal entries for Yanick Ltd. at April 1, October 1, and December 31, 2011. Do not use abbreviations, and skip a line between entries. Omit narratives. **(9.5 marks)**
- Show in proper form (no abbreviations) how the Liabilities section of Yanick's statement of financial position (balance sheet) would appear on December 31, 2011. **(4.5 marks)**
- If all the bonds are re-purchased at 94 on the open market on January 1, 2012, how much cash, in total, will the Company pay? How much will be the gain or loss on early redemption? Specify if this is a gain or a loss. No journal entries are requested for this requirement. **(3 marks)**

QUESTION 4 (19 marks; 34 minutes) *Analysis of Financial Statements*

Selected condensed financial statements of Tim Hortons Inc. and Starbucks Corporation are presented below (FY means Fiscal Year):

Income Statements (in millions of dollars)

	Tim Hortons FY 2011	Starbucks FY 2011
Net sales	2,802	11,700
Cost of sales	1,742	4,949
Gross profit	1,060	6,751
Operating expenses	500	5,226
Operating income	560	1,525
Other income	4	319
Interest expense	30	33
Profit before tax	534	1,811
Income tax expense	155	563
Profit	379	1,248

Statements of Financial Position (in millions of dollars)

	Tim Hortons		Starbucks	
	FY 2011	FY 2010	FY 2011	FY 2010
Assets				
Current Assets				
Cash and cash equivalents	289	711	1,148	1,164
Net receivables	186	203	617	607
Inventory	134	101	966	543
Other current assets	0	0	1,064	442
Total Current Assets	609	1,015	3,795	2,756
Long-term investments	45	49	479	533
Property, plant and equipment	1,439	1,382	2,355	2,416
Intangible assets	4	6	433	334
Other long-term assets	67	45	298	346
Total Assets	2,164	2,497	7,360	6,385
Liabilities				
Current liabilities				
Trade payables	458	485	1,626	1,365
Current portion of long-term debt	10	10	449	414
Total Current Liabilities	468	495	2,075	1,779
Long-term debt	439	430	550	549
Other long-term liabilities	123	120	350	383
Total Liabilities	1,030	1,045	2,975	2,711
Stockholders' Equity				
Share capital	310	333	88	203
Retained earnings	824	1,119	4,297	3,471
Total Stockholders' Equity	1,134	1,452	4,385	3,674
Total Liabilities and Stockholders' Equity	2,164	2,497	7,360	6,385

Required:

1. Calculate the Return on Assets ratio and the Inventory Turnover ratio for Tim Hortons for fiscal year (FY) 2011 and briefly explain what these ratios mean. **(4 marks)**
2. Calculate the Times-interest-earned ratio and the Quick ratio for Starbucks for fiscal year (FY) 2011, and briefly explain what these ratios mean **(4 marks)**
3. The DuPont model (or ROE profit driver analysis) decomposes Return on Equity (ROE) into three components:

$$\text{Return on Equity} = \text{Net Profit Margin} \times \text{Asset Turnover} \times \text{Financial Leverage}$$
 - a. Calculate the various ratios in the ROE decomposition model above for both Tim Hortons and Starbucks for fiscal year 2011. **(8 marks)**
 - b. What conclusions can you draw based on your calculations in requirement 3 (a)? Be specific. **(3 marks)**

QUESTION 5 (19 marks; 34 minutes) *Reporting and interpreting cash flows*

Below are the summary statements of financial position Mowtak Ltd. at December 31, 2011 and 2010, respectively:

	2011	2010
Cash	\$ 20,000	\$ 113,000
Trade receivables, net	70,000	40,000
Merchandise inventory	20,000	35,000
Prepayments	8,000	10,000
Property and Equipment, net	<u>2,124,000</u>	<u>1,292,000</u>
Total Assets	<u>\$2,242,000</u>	<u>\$1,490,000</u>
Trade payables	\$ 47,000	\$ 39,000
Income taxes payable	12,000	28,000
Note payable, due Nov. 1, 2012	45,000	105,000
Common shares	360,000	300,000
Retained earnings	<u>1,778,000</u>	<u>1,018,000</u>
Total Liabilities and Equity	<u>\$2,242,000</u>	<u>\$1,490,000</u>

The income statement for 2011 showed the following information:

Sales	\$4,000,000
Gross profit	2,600,000
Operating expenses (<u>includes</u> depreciation of \$90,000)	1,200,000
Interest expense	30,000
Gain on disposal of equipment	60,000
Income tax expense	320,000

Additional information:

- Property and equipment were acquired for \$950,000 cash during 2011. Also during 2011, property and equipment were sold in exchange for cash.
- Trade payables relates only to transactions with suppliers of merchandise inventory.

Required:

- Prepare in good form (no abbreviations) the Operating Activities section only of Mowtak's statement of cash flows for the year 2011. Use the indirect method. Do NOT prepare an entire statement of cash flows. **(6 marks)**
- Calculate the following amounts:
 - Cash collected from customers in 2011 **(1.5 marks)**
 - Cash paid to suppliers of merchandise inventory in 2011 **(3.5 marks)**
 - Cash received for sale of property and equipment in 2011 **(2.5 marks)**
 - Cash paid for dividends to shareholders in 2011. **(1.5 marks)**
- Based on the information provided in the question and your answers to the previous requirements, calculate and briefly explain each of the following:
 - Quality of earnings ratio
 - Free cash flow.

(4 marks)

Present Value Tables

TABLE A.1

Present Value of \$1, $p = 1/(1 + i)^n$

Periods	2%	2.5%	2.75%	3%	3.75%	4%	4.25%	5%	5.5%
1	0.9804	0.9756	0.9732	0.9709	0.9639	0.9615	0.9592	0.9524	0.9479
2	0.9612	0.9518	0.9472	0.9426	0.9290	0.9246	0.9201	0.9070	0.8985
3	0.9423	0.9286	0.9218	0.9151	0.8954	0.8890	0.8826	0.8638	0.8516
4	0.9238	0.9060	0.8972	0.8885	0.8631	0.8548	0.8466	0.8227	0.8072
5	0.9057	0.8839	0.8732	0.8626	0.8319	0.8219	0.8121	0.7835	0.7651
6	0.8880	0.8623	0.8498	0.8375	0.8018	0.7903	0.7790	0.7462	0.7252
7	0.8706	0.8413	0.8270	0.8131	0.7728	0.7599	0.7473	0.7107	0.6874
8	0.8535	0.8207	0.8049	0.7894	0.7449	0.7307	0.7168	0.6768	0.6516
9	0.8368	0.8007	0.7834	0.7664	0.7180	0.7026	0.6876	0.6446	0.6176
10	0.8203	0.7812	0.7624	0.7441	0.6920	0.6756	0.6595	0.6139	0.5854
20	0.6730	0.6103	0.5813	0.5534	0.4789	0.4564	0.4350	0.3769	0.3427
Periods	6%	7%	8%	9%	10%	11%	12%	13%	14%
1	0.9434	0.9346	0.9259	0.9174	0.9091	0.9009	0.8929	0.8850	0.8772
2	0.8900	0.8734	0.8573	0.8417	0.8264	0.8116	0.7972	0.7831	0.7695
3	0.8396	0.8163	0.7938	0.7722	0.7513	0.7312	0.7118	0.6931	0.6750
4	0.7921	0.7629	0.7350	0.7084	0.6830	0.6587	0.6355	0.6133	0.5921
5	0.7473	0.7130	0.6806	0.6499	0.6209	0.5935	0.5674	0.5428	0.5194
6	0.7050	0.6663	0.6302	0.5963	0.5645	0.5346	0.5066	0.4803	0.4556
7	0.6651	0.6227	0.5835	0.5470	0.5132	0.4817	0.4523	0.4251	0.3996
8	0.6274	0.5820	0.5403	0.5019	0.4665	0.4339	0.4039	0.3762	0.3506
9	0.5919	0.5439	0.5002	0.4604	0.4241	0.3909	0.3606	0.3329	0.3075
10	0.5584	0.5083	0.4632	0.4224	0.3855	0.3522	0.3220	0.2946	0.2697
20	0.3118	0.2584	0.2145	0.1784	0.1486	0.1240	0.1037	0.0868	0.0728

TABLE A.2

Present Value of Annuity of \$1, $P = [1 - 1/(1 + i)^n]/i$

Periods	2%	2.5%	2.75%	3%	3.75%	4%	4.25%	5%	5.5%
1	0.9804	0.9756	0.9732	0.9709	0.9639	0.9615	0.9592	0.9524	0.9479
2	1.9416	1.9274	1.9204	1.9135	1.8929	1.8861	1.8794	1.8594	1.8463
3	2.8839	2.8560	2.8423	2.8286	2.7883	2.7751	2.7620	2.7232	2.6979
4	3.8077	3.7620	3.7394	3.7171	3.6514	3.6299	3.6086	3.5460	3.5052
5	4.7135	4.6458	4.6126	4.5797	4.4833	4.4518	4.4207	4.3295	4.2703
6	5.6014	5.5081	5.4624	5.4172	5.2851	5.2421	5.1997	5.0757	4.9955
7	6.4720	6.3494	6.2894	6.2303	6.0579	6.0021	5.9470	5.7864	5.6830
8	7.3255	7.1701	7.0943	7.0197	6.8028	6.7327	6.6638	6.4632	6.3346
9	8.1622	7.9709	7.8777	7.7861	7.5208	7.4353	7.3513	7.1078	6.9522
10	8.9826	8.7521	8.6401	8.5302	8.2128	8.1109	8.0109	7.7217	7.5376
20	16.3514	15.5892	15.2273	14.8775	13.8962	13.5903	13.2944	12.4622	11.9504
Periods	6%	7%	8%	9%	10%	11%	12%	13%	14%
1	0.9434	0.9346	0.9259	0.9174	0.9091	0.9009	0.8929	0.8550	0.8772
2	1.8334	1.8080	1.7833	1.7591	1.7355	1.7125	1.6901	1.6681	1.6467
3	2.6730	2.6243	2.5771	2.5313	2.4869	2.4437	2.4018	2.3612	2.3216
4	3.4651	3.3872	3.3121	3.2397	3.1699	3.1024	3.0373	2.9745	2.9137
5	4.2124	4.1002	3.9927	3.8897	3.7908	3.6959	3.6048	3.5172	3.4331
6	4.9173	4.7665	4.6229	4.4859	4.3553	4.2305	4.1114	3.9975	3.8887
7	5.5824	5.3893	5.2064	5.0330	4.8684	4.7122	4.5638	4.4226	4.2883
8	6.2098	5.9713	5.7466	5.5348	5.3349	5.1461	4.9676	4.7988	4.6389
9	6.8017	6.5152	6.2469	5.9952	5.7590	5.5370	5.3282	4.1317	4.9464
10	7.3601	7.0236	6.7101	6.4177	6.1446	5.8892	5.6502	5.4262	5.2161
20	11.4699	10.5940	9.8181	9.1285	8.5136	7.9633	7.4694	7.0248	6.6231