

**Concordia University  
Department of Accountancy**

**Financial Accounting  
COMM 217 All Sections**

**Suggested Solution  
Final Examination  
Winter 2010**

**Question 1 (24 marks)**     *Multiple-choice*

(1.5 marks per correct answer)

1.    d
2.    a
3.    d
4.    c
5.    d
6.    b
7.    d
8.    b
9.    c
10.   b
11.   c
12.   c
13.   c
14.   a
15.   b
16.   c

**Question 2 (20 marks)****Allocation of the lump sum (3 marks)**

*Note: The interest cost is not added to the acquisition costs of the assets (not capitalized). Instead it is recorded as an expense on December, 31.*

Appraised values:

Land	\$225,000	$225,000/450,000 = 50\%$	$50\% \times 420,000 = \$210,000$
Building	180,000	$180,000/450,000 = 40\%$	$40\% \times 420,000 = 168,000$
Equipment (machine)	<u>45,000</u>	$45,000/450,000 = 10\%$	$10\% \times 420,000 = \underline{42,000}$
Total	\$450,000	100%	\$420,000

**July 1, 2009 (4 marks)**

	Dr.	Cr.
Land	210,000	
Building	168,000	
Equipment (42,000 + 3,000 )	45,000	
Note payable		420,000
Cash		3,000

**October 1, 2009: Disposal of the destroyed asset (warehouse): (6 marks)**

Amortization expense up to the date of the disposal (9 months):

$$(150,000 - 10,000) / 10 \text{ years} \times 9/12 = 10,500$$

$$\begin{aligned} \text{Net book value at disposal date} &= \text{Cost} - \text{Accumulated Amortization} \\ &= 150,000 - (84,000 + 10,500) = 55,500 \end{aligned}$$

Cash received (proceeds) for the insurance company = \$55,500 → no gain or loss to record

Entries: October 1, 2009	Dr.	Cr.
Amortization expense	10,500	
Accumulated amortization (warehouse)		10,500
Cash	55,500	
Accumulated amortization (84,000 + 10,500)	94,500	
Building		150,000

**Payment of interest on the note payable: (1 mark)**

December 31, 2009:	Dr.	Cr.
Interest expense	16,800	
Cash		16,800

**December 31, 2009: Amortization of the building and equipment purchased on July 1, 2009 (partial period = 6 months) (6 marks)**

Amortization of the building (straight-line)

$$(168,000 - 18,000) / 15 \text{ years} \checkmark \times 6/12 = 5,000$$

Amortization of the equipment (machine), (double-declining balance):  
 $45,000 \times 2 / 5 \text{ years} \times 6/12 = 9,000$

Entries: December 31, 2009

	Dr.	Cr.
Amortization expense (5,000 + 9,000)	14,000	
Accumulated amortization (building)		5,000
Accumulated amortization (equipment)		9,000

### Question 3 (17 marks)

#### Req. 1 (8 marks)

January 1, 2010

Bond interest payable	45,000	
Cash		45,000

July 1, 2010 (effective-interest method)

Bond interest expense ( $\$1,607,650 \times 5\% \times \frac{1}{2}$ )	40,191	
Premium on bonds payable (45,000-40,191)	4,809	
Cash		45,000

December 31, 2010 (effective-interest method)

Bond interest expense	40,071*	
Premium on bonds payable (45,000-40,071)	4,929	
Bond interest payable		45,000
* $[(\$1,607,650 - 4,809) \times 5\% \times \frac{1}{2}]$		

#### Req. 2 (5 marks)

Jaro Inc.  
 Partial Income Statement  
 For the year ended December 31, 2010

Other revenues and expenses:

Bond interest expense	\$ 80,262 (\$40,191+40,071)
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Jaro Inc.  
 Partial Balance Sheet  
 As at December 31, 2010

Current Liabilities

Bond interest payable	\$ 45,000
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Long-term Liabilities

Bonds payable, 6%, due December 31, 2018	\$1,500,000
Add: Bond premium ( $\$107,650 - 4,809 - 4,929$ )	<u>97,912</u>
	<u>\$1,597,912</u>

**Req. 3 (4 marks)**

January 1, 2011

Bonds payable (\$1,500,000/2)	750,000	
Premium on bonds payable (\$97,912/2)	48,956	
Cash (\$750,000x104%)		780,000
Gain on redemption of bonds		18,956

**Question 4 (20 marks)****Req. 1 (8 marks)**

Kumar Inc.  
Cash Flow Statement (Partial)  
For the Year ended December 31, 2009

## Operating activities

Net income	\$ 12
Add (deduct) items not affecting cash :	
Amortization expense	10
Gain on sale of investments	(6)
Loss on sale of equipment	2
Increase in accounts receivable	(10)
Decrease in merchandise inventory	4
Decrease in accounts payable	(14)
Decrease in income taxes payable	<u>(1)</u>
Cash from operating activities	<u>\$ (3)</u>

**Req. 2 (4 marks)**

Kumar Inc.  
Cash Flow Statement (Partial)  
For the Year Ended December 31, 2009

## Investing activities:

Purchase of equipment (note a)	\$ (22)
Sale of equipment (note b)	10
Sale of long-term investment (note c)	<u>24</u>
Cash from investing activities	\$ 12

Notes:

a. Beg. Balance of PP&E	\$154
Cost of equipment sold	(40)
Purchase of building	60
Purchase of equipment	<u>(X)</u>
Ending balance, PP&E	\$196

$$X = \$22$$

b. Loss on sale = Cash received – Book value of equipment sold

$$-2 = X - (\$40 - \$28) \rightarrow X = \$10$$

c. Gain on sale = Cash received – Cost of investment

$$6 = X - (\$18 - \$0) \rightarrow X = \$24$$

### Req. 3 (2 marks)

Change in Cash = Cash from operating activities

+ Cash from investing activities

+ Cash from financing activities

$$(\$90 - \$68) = -\$3 + \$12 + Y \rightarrow Y = \$13 \text{ cash } \underline{\text{inflow}}$$

### Req. 4 (6 marks)

(a) Cash collected from customers = Sales revenue – Increase in Accounts Receivable  
= \$140 – \$10 = \$130.

(b) Cash paid to suppliers of merchandise inventory

$$\text{Purchases} = \text{EI} + \text{COGS} - \text{BI} = \$28 + \$84 - \$32 = \$80$$

$$\text{Payments to suppliers} = \text{Beg. A/P} + \text{Purchases} - \text{Ending A/P} = \$38 + \$80 - \$24 = \$94$$

(c) Payment for taxes = Beg. Bal. Income Taxes Payable + Income tax expense – End. Bal.,  
Income Taxes Payable = \$4 + \$4 – \$3 = \$5

### Question 5 (19 marks)

#### Req. 1: Ratio computations (14 marks)

2009	2008
$\frac{(145,000 + 30,000)}{(505,000 + 210,000)} = \frac{175,000}{715,000} = 24.47\%$	$\frac{(160,000 + 40,000)}{(495,000 + 135,000)} = \frac{200,000}{630,000} = 31.75\%$
$\frac{(145,000 + 30,000 + 570,000 + 565,000)}{(505,000 + 210,000)} = \frac{1,310,000}{715,000} = 1.83$	$\frac{(160,000 + 40,000 + 425,000 + 555,000)}{(495,000 + 135,000)} = \frac{1,180,000}{630,000} = 1.87$
$= \frac{365}{\frac{4,290,000}{(570,000 + 425,000)/2}} =$ $\frac{365}{\frac{4,290,000}{497,500}} = 42.33 \text{ days}$	$= \frac{365}{\frac{4,015,000}{(425,000 + 330,000)/2}} =$ $\frac{365}{\frac{4,015,000}{377,500}} = 34.32 \text{ days}$
$\frac{4,290,000}{(2,535,000 + 1,995,000)/2} =$ $\frac{4,290,000}{2,265,000} = 1.89$	$\frac{4,015,000}{(1,995,000 + 2,305,000)/2} =$ $\frac{4,015,000}{2,150,000} = 1.87$
$\frac{(3,935,000 + 3,220,000)/2}{(1,780,000 + 1,600,000)/2} =$ $\frac{3,577,500}{1,690,000} = 2.12$	$\frac{(3,220,000 + 2,940,000)/2}{(1,600,000 + 1,379,000)/2} =$ $\frac{3,080,000}{1,489,500} = 2.07$
$\frac{405,000 - 165,000}{(1,780,000 + 1,600,000)/2} =$ $\frac{240,000}{1,690,000} = 14.2\%$	$\frac{215,000 - 85,000}{(1,600,000 + 1,379,000)/2} =$ $\frac{130,000}{1,489,500} = 8.73\%$
$\frac{(670,000 + 240,000 - 850,000)/46,500}{66} =$ $\frac{1.29}{66} = 1.95\%$	$\frac{(579,000 + 130,000 - 670,000)/35,000}{62} =$ $\frac{1.11}{62} = 1.79\%$

#### Req. 2 (1 mark) (use judgement)

For Stef. Furniture Inc. the **current ratio** is between 1 and 2 which is a good indicator of the ability to meet current obligations.

The slight decrease during the period indicates a deterioration during 2009\*. Moreover, the cash ratio (a more stringent measure) exhibits a significant decrease. It shows that the liquidity of the company has decreased.

#### Req. 3 (2 marks) (use judgement)

Credit terms 1/10, n/30 mean that Stef. Furniture Inc. is supposed to collect accounts receivable within 30 days. The average collection period is 34 days in 2008 and 42 days in 2009 (longer than the credit terms). It shows that the company's ability to collect from customers quickly has

deteriorated (the collection efforts have been less effective in 2009). One reasonable rule is to consider that the average collection period should not exceed 1.5 times the credit terms, or 45 days in this case (Textbook, p. 694).

**Req. 4 (2 marks) (use judgement)**

Investors mainly care about Profitability, Market test ratios.  
(students normally shouldn't give comments about the Financial leverage ratio).

*Profitability:*

- The fixed asset turnover ratio is stable 1.87 in 2009 and 1.89 in 2008 and comparable to the industry average (1.88)
- The ROE has increased (14.2% in 2009 compared to 8.73% in 2008), and is now better than the industry average (10%)

So the profitability indicators are favourable.

*Market test:* the dividend yield (1.95% in 2009 and 1.79% in 2008) is higher than the industry average (1.5%). It shows that Stef. Furniture Inc. dividend-paying performance is good, and makes the company attractive for an investor.

To conclude, YES we can say that this company is attractive for an investor.