

CONCORDIA UNIVERSITY
DEPARTMENT OF ACCOUNTANCY

FINANCIAL ACCOUNTING
COMM 217 ALL SECTIONS

FINAL EXAMINATION

Winter 2009

Duration: 3 hours

Instructions (very important):

1. This examination paper consists of **12 pages including** this page and the present value tables. Please make sure your copy has all pages before commencing to write.
2. 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.**
3. Read the questions carefully and budget your time wisely. Show all calculations.
4. This is a closed book examination. However, a silent hand-held (not graphical) calculator and one standard language (not electronic) dictionary are permitted.
5. **Invigilators will not answer questions** (unless you think there is an **error** in the question).
6. Return the exam along with the computer input sheet and answer booklets when you have finished.

Question	Topic	Total Marks
1	Multiple Choice	24
2	Accounting for Long-term Assets	19
3	Accounting for Bonds	17
4	Preparation of cash flow statement	21
5	Analysis of Financial Statements	19
Total		100

QUESTION 1 (24 marks; 43 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. Amortization expense is recognized primarily
 - a. to comply with government regulations.
 - b. to measure the decline in the sales price of a long-term asset.
 - c. to allocate the original cost of an asset over its estimated useful life.
 - d. to reduce the original cost of amortizable assets to their current replacement cost.

2. Triton Corporation purchased a truck for \$85,000 on January 1, 2008. The truck had an estimated useful life of 500,000 km and an estimated residual value of \$5,000. In 2008, the truck was driven 50,000 km and, in 2009, 75,000 km. What is the book value of the truck at the end of 2009 under the units of production method?
 - a. \$77,000. b. \$65,000. c. \$20,000 d. None of the above

3. Goodwill is valued at:
 - a. The total amount of cash paid to acquire another company.
 - b. The difference between the price paid to acquire an ongoing business and the fair value of the identifiable assets acquired less liabilities assumed.
 - c. The total amount of cash paid out to acquire another company, less the value of the identifiable assets acquired.
 - d. The difference between the fair value of the identifiable assets acquired and the liabilities assumed.

4. Westward Electric sells electric appliances, including refrigerators. The company's experience in recent years has indicated that warranty costs average 3.1% of sales. During April 2009, sales of refrigerators were \$3,000,000 and cash payments for warranty service on refrigerators were \$84,000. The journal entry to record the warranty expense for April is:

a. Warranty expense	84,000	
Cash		84,000
b. Liability for warranties		84,000
Cash		84,000
c. Warranty expense	93,000	
Liability for warranties		93,000
d. Warranty expense	93,000	
Cash		93,000

5. Hamburg Ltd. estimated at January 1, 2008, that its income before income taxes would be \$7,500,000 for the year ended December 31, 2008. The company made quarterly tax payments in April, June, September, and December 2008 based on the estimated income before income taxes, and a tax rate of 45%. The company's actual income before income taxes for the year ended December 31, 2008 was \$7,700,000. What was the balance of the account Income Tax Payable at December 31, 2008?
- a. \$ 0. b. \$90,000. c. \$200,000. d. \$3,465,000.
6. Which of the following statements is correct?
- a. The periodic interest payment on a bond is based on the market interest rate.
b. When issuing bonds, companies usually sell the bonds to an underwriter which, in turn, sells the bonds to the potential buyers.
c. Selling a bond at a premium means that the amount received is lower than the face value of the bond.
d. The nominal interest rate and the market interest rate are usually equal on the date of issuance of the bond.
7. An accrued liability results from an expense that is
- a. incurred but not yet paid.
b. incurred and paid.
c. paid but not yet incurred.
d. neither incurred nor paid.
8. Which of the following statements about the Cash Flow Statement is **not** correct?
- a. It is one of the four basic financial statements.
b. It provides information about the cash receipts and cash payments of an entity during a given period of time.
c. It provides a reconciliation between the ending balance of the Cash account and the ending balance of cash as it appears on the bank statement.
d. It provides information about the operating, investing, and financing activities of the entity.
9. Which of the following items reported in the operating activities section on the cash flow statement might indicate a potential liquidity problem?
- a. Positive cash flow appears to have been maintained by increasing accounts payable.
b. Cash flows seem to be lower in the current year because of an increase in accounts receivable and inventory.
c. Prepaid expenses have not decreased in the current year.
d. Both (a) and (b) are correct.

10. The account Retained Earnings refers to
- a component of shareholders' equity that is contributed by shareholders in the form of cash or some other assets.
 - net income that has been earned in previous years, but has not been distributed to shareholders.
 - an expense that is reported in the income statement.
 - a temporary account that is closed to the account Common Shares at the end of the accounting period.
11. The statement of retained earnings:
- is a basic financial statement that shows the change in retained earnings during a year.
 - indicates the amount of cash available for the payment of dividends.
 - includes cash income and cash dividends.
 - shows revenue, expenses, and dividends for the accounting period.
12. From the point of view of a common shareholder, which of the following relationships would be considered to have the lowest significance?
- The return on assets is consistently higher than the industry average.
 - The return on equity has increased in each of the last five years.
 - Net income is greater than the amount of working capital.
 - The return on assets is greater than the rate of interest being paid to creditors.
13. In 2008, Zeus Company had a fixed asset turnover of 1.42 while its competitor Venus Corporation had a fixed asset turnover of 1.85. What is the most likely explanation of the lower ratio for Zeus Company?
- Zeus is more efficient at generating net sales from its property, plant and equipment.
 - Zeus is generating less sales revenue relative to its existing property, plant and equipment.
 - Zeus is less efficient at generating net income from using its property, plant and equipment.
 - Zeus is more efficient at generating net income from using its property, plant and equipment.

14. An examination of the books and records of Poulin Ltd. shows that the inventory on December 31, 2008 (ending inventory) was understated by \$1,000 due to miscounting some of the inventory items. Assuming that the company maintains a periodic inventory system, what effect does this error have on the following:

	<u>Cost of Goods Sold</u> <u>2008</u>	<u>Net Income</u> <u>2008</u>	<u>Owners' Equity</u> <u>Dec. 31, 2008</u>
a.	Overstated	Understated	No effect
b.	Understated	Overstated	Overstated
c.	Overstated	Understated	Understated
d.	Understated	No effect	No effect

15. A grocery store has an average gross profit of 20% of sales, and its sales are \$400,000 on average per month. The manager of the store is concerned about inventory shrinkage and wants to impress upon his employees how damaging this problem can be. If various inventory items costing \$3,000 were stolen from the store, how much would sales have to increase in order to generate the same **amount** of gross profit?

a. \$3,000. b. \$3,600. c. \$15,000. d. \$80,000.

16. Manu Inc. has the following shares outstanding during 2008 and 2009: 1,000 no par value, noncumulative preferred shares and 50,000 shares of no par value common shares. The dividend rate for preferred shares is \$4 per share. Dividends were not declared in 2008. In 2009, \$12,000 of dividends are declared and paid. What is the amount of dividends allocated to common shareholders in 2009?

a. \$12,000 b. \$8,000 c. \$5,000 d. \$4,000

QUESTION 2 (19 marks; 34 minutes) *Accounting for Long-term Assets*

Marc Company bought a machine on January 1, 2006 for \$80,000. The machine has an estimated useful life of 10 years and an estimated residual value of \$1,500. Marc Company signed a \$50,000 note payable and paid the balance of the invoice in cash. Additionally, Marc Company paid in cash \$2,000 for transportation costs and \$1,000 for installation costs on January 1, 2006. On January 1, 2008, the company completed the replacement of a major part of the machine which cost \$10,000. This expenditure was expected to increase the machine's total estimated useful life by four years and its estimated residual value to \$2,300. The company's fiscal year ends on December 31.

Required:

1. Prepare the journal entry or entries related to the acquisition of the machine on January 1, 2006. **(3 marks)**

2. Compute the amortization expense for the machine for each of the years 2006 and 2007, assuming the company uses
 - a. Straight-line method;
 - b. Double-declining-balance method.
 Journal entries are not required. **(5 marks)**

3. Is the \$10,000 expenditure (related to the replacement of a major part of the machine) a revenue expenditure or a capital expenditure? Explain. **(2 marks)**

4. Assume for this part that the company uses the straight-line method. Compute the amortization expense for the machine for 2008. **(3 marks)**

5. Assume for this part that the company uses the straight-line method. Marc sold the machine on June 30, 2009, and received \$50,000 cash and a \$10,000 note receivable. Prepare the journal entry (entries) to record the sale of the machine. **(6 marks)**

QUESTION 3 (17 marks; 31 minutes) *Accounting for Bonds*

Deb Ltd. issued 4-year, \$40 million debentures on January 1, 2008. The annual stated (contractual) interest rate is 4%, and interest must be paid semi-annually on June 30 and December 31. The annual market rate for similar bonds was 6% at the time of issuance. The company uses the effective interest method to amortize bond discount/premium.

Required (Round the results to the nearest dollar)

1. Prepare the journal entry to record the issuance of the bonds on January 1, 2008. **(3 marks)**
2. Prepare the journal entries to record interest expense on June 30, 2008 and December 31, 2008, respectively. **(5 marks)**
3. Assume that on July 1, 2008 Deb repurchases one-half of the outstanding bonds on the open market at 93 (ignore any accrued interest for the day July 1). Show the journal entry to record this transaction. Also show, in good form, how the long-term debt section of Deb's balance sheet would appear immediately after this transaction. **(7 marks)**
4. Assume for this part that the company uses the straight-line method. Prepare the journal entry to record interest expense on June 30, 2008. **(2 marks)**

QUESTION 4 (21 marks; 38 minutes)*Preparation of cash flow statement*

SARATOGA Limited reported the following comparative balance sheet items at December 31, 2008 and 2007, respectively, and income statement items for the year ended December 31, 2008 (in thousands of dollars):

	<u>2008</u>	<u>2007</u>
Cash	\$ 28,800	\$ 17,400
Short term investments	4,200	2,400
Accounts receivable	12,000	18,000
Merchandise inventory	9,000	6,000
Prepaid expenses	3,000	600
Land	48,000	12,000
Building	84,000	24,000
Accumulated amortization – Building	(6,600)	(3,000)
Equipment	16,200	6,000
Accumulated amortization – Equipment	(1,800)	(600)
Long term investments	12,000	0
Accounts payable	17,000	9,400
Interest payable	1,600	600
Income tax payable	1,800	2,000
Bonds payable	50,000	14,000
Share capital	40,000	28,000
Retained earnings	98,400	28,800

	<u>2008</u>
Sales revenue	\$ 304,200
Cost of goods sold	110,000
Other operating expenses (excluding amortization)	66,600
Amortization expense	5,400
Loss on sale of equipment	1,800
Interest expense	5,200
Income tax expense	28,200
Net income	\$87,000

Additional information (dollars in thousands):

- Short term investments have less than 3 months until maturity.
- The bonds payable were issued at par.
- The amortization expense consists of \$3,600 for the building and \$1,800 for the equipment.
- The company acquired land by issuing \$36,000 of bonds.
- Equipment costing \$15,000 was purchased for cash.
- The accounts payable relate to transactions with suppliers of merchandise inventory.
- The company sold equipment with a cost of \$4,800 less accumulated amortization of \$600.

Required:

1. Prepare in good form a complete Cash Flow Statement (All Sections) for SARATOGA Limited for the year ended December 31, 2008. Use the indirect method to prepare the operating activities section of the statement. **(15 marks)**
2. Compute the amount of cash paid to suppliers of inventory in 2008. **(2 marks)**
3. Prepare the following additional cash flow disclosures:
 - a) Cash paid for interest
 - b) Cash paid for income taxes
 - c) Significant non-cash investing and financing activities. **(4 marks)**

QUESTION 5 (19 marks; 34 minutes)

Husky Energy Inc. reported the following comparative balance sheet and selected income statement information for the last two years:

Husky Energy Inc. Comparative Balance Sheet At December 31, 2008		
<u>Assets</u>	<u>2008</u>	<u>2007</u>
Cash	\$ 25,000	\$ 40,000
Short-term investment	15,000	60,000
Accounts receivable (net)	50,000	30,000
Inventory	170,000	120,000
Property, plant, and equipment (net)	<u>160,000</u>	<u>200,000</u>
Total assets	<u>\$420,000</u>	<u>\$450,000</u>
 <u>Liabilities and shareholders' equity</u>		
Accounts payable	\$ 20,000	\$ 30,000
Unearned revenue	40,000	40,000
Bonds payable, due June 30, 2011	100,000	160,000
Common shares	170,000	145,000
Retained earnings	<u>90,000</u>	<u>75,000</u>
Total liabilities and shareholders' equity	<u>\$420,000</u>	<u>\$450,000</u>

Selected income statement information:

Sales	\$400,000
Sales return and allowances	40,000
Gross profit	176,000
Interest expense	24,000
Operating expenses	50,000

Additional information:

- 1) Cash dividends of \$36,000 were declared and paid in 2008 to common shareholders.
- 2) The weighted average number of common shares during 2008 was 60,000 shares.
- 3) The market price of common shares on December 31, 2008, was \$20 per share.
- 4) All sales were on account.
- 5) Cash flows from operating activities were \$142,800.
- 6) The income tax rate is 30%.

Required

1. Use the information above to calculate the following ratios for Husky Energy Inc. for 2008. Indicate whether each ratio is a measure of liquidity (L), profitability (P), solvency (S) or market tests (MT). **(17 marks)**

- | | |
|---|----------------------|
| a. Current ratio | f. Debt-to-equity |
| b. Earnings per share | g. Return on assets |
| c. Price-earnings ratio (industry:
10.5 times) | h. Return on equity |
| d. Times interest earned | i. Dividend yield |
| e. Inventory turnover | j. Quality of income |

2. Do you think the company has good prospects for growing its income? Indicate the ratio(s) that you used to reach this conclusion and explain your reasoning. **(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	0.5534	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	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