



Exam 2014, questions Final W14

Financial Accounting (Concordia University)



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FINAL EXAMINATION (REGULAR)
WINTER 2014

Name: _____ ID: _____

Duration: 3 hours

Instructions (very important):

1. This examination paper consists of **12 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	18
2	Financial Statements	19
3	Inventory and Cost of Sales	12
4	Long-Term Assets	14
5	Liabilities	22
6	Statement of Cash Flows	15
	Total	100

Question 1 Multiple Choice:

(18 marks; 25 minutes)

For each of the following multiple choice question, 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. In the absence of other errors, an overstatement of ending inventory in 2011 would lead to:
 - a. Overstatement of ending inventory in 2012.
 - b. Overstatement of cost of sales in 2012.
 - c. Understatement of cost of sales in 2012.
 - d. Understatement of ending inventory in 2012.
2. Under IFRS, which of the following assets is not depreciated or amortized?
 - a. Goodwill
 - b. Land.
 - c. Building.
 - d. Both A and B.
3. Recognizing expense as capital expenditure, instead of revenue expenditure, would lead to:
 - a. Lower profit in the current year.
 - b. Higher profit in the current year.
 - c. No effect on profit.
 - d. Higher or lower profit based on a company's income tax rate.
4. MAB Inc. signed a note payable in exchange for equipment. How does this transaction affect MAB's statement of cash flows?
 - a. Increases cash from financing activities.
 - b. Decreases cash from financing activities.
 - c. Increases cash from investing activities.
 - d. There is no effect.
5. If MAB Inc.'s gross salaries are \$12,000, and it withholds \$1,800 for income taxes and \$800 for Employment Insurance and other deductions, the journal entry to record the employees' pay should include:
 - a. debit to Salary Expense for \$9,400.
 - b. debit to Salary Payable for \$9,400.
 - c. credit to Salary Payable for \$12,000.
 - d. credit to Cash for \$9,400.
6. On the dividend declaration date, a company needs to do the following:
 - a. debit Dividends Declared and credit Dividends Payable for the amount of the dividend.
 - b. debit Dividend Expense and credit Cash for the dividend amount.
 - c. debit Dividends Payable and credit Cash for the dividend amount.
 - d. establish who will receive the dividend payment.
7. Which of the following transaction is most likely to improve a company's solvency?
 - a. Issuing common stock.
 - b. Tightening credit terms.
 - c. Paying previously declared dividends.
 - d. None of the above.

8. Which of the following statement is correct?
- Both cumulative and noncumulative preferred stockholders receive dividends in arrears.
 - Cumulative preferred stockholders' unpaid dividends are accumulated each year until dividends are declared.
 - Noncumulative preferred stockholders do not receive dividends.
 - Cumulative preferred stockholder's right to receive dividends is forfeited in any year that dividends are not declared.
9. Which of the following statements is correct?
- A stock split would not reduce the stock price, but a stock dividend would.
 - A stock split would reduce the stock price, but a stock dividend would not.
 - A stock split would decrease total shareholders' equity, but a stock dividend would not.
 - A stock split would not reduce retained earnings, but a stock dividend would.
10. On January 1, MAB Inc. issued a 5-year bond with a face value of \$10,000 and a coupon rate of 7%; interests are paid annually. The issue price of the bond was \$10,866, implying a market interest rate of 5%. At the end of the first year, the company would do the following?
(Note: no calculation is required.)
- debit Interest Expense for \$700 and credit Interest Payable for \$700.
 - debit Interest Expense for \$700, credit Premium on Bonds Payable for \$157, and credit Interest Payable for \$543.
 - debit Interest Expense for \$543, debit Premium on Bonds Payable for \$157, and credit Interest Payable for \$700.
 - debit Interest Expense for \$543, credit Premium on Bonds Payable for \$157, and credit Interest Payable for \$700.
11. MAB Inc. provides warranties for its products. The company estimates that the warranty expense would be 1% of total sales. In 2013 MAB's sales were \$5,000,000. Actual cost of servicing products under warranty was \$75,000. On January 1, 2013, the estimated warranty liability account had a balance of \$30,000. What is the amount of estimated warranty liability at December 31, 2013?
- a. \$75,000. b. \$5,000 c. \$50,000 d. \$80,000
12. MAB Inc. paid \$34,000 for a vehicle that had an estimated useful life of 4 years, total capacity of 200,000 miles, and a residual value of \$2,000. After 2 full years of using the vehicle (40,000 miles in year 1 and 54,000 miles in year 2), the company sold the vehicle for \$12,000 and reported a loss on disposal of \$6,960. What method of depreciation did the company use?
- Units-of-production method
 - Double-declining method
 - Straight-line method
 - Cannot determine base on the information given.

Question 2 Financial Statements:**(19 marks; 25 minutes)**

The North West Company Inc. is a Canadian grocer primarily operating in Northern and Western Canada. The company's consolidated statement of financial position and consolidated income statement for fiscal year 2012 (ended on January 31, 2013) appear on the next two pages.

Required:

1. Calculate the following ratios for fiscal year 2012 (*Round all your calculations to two decimal places*): **(6 marks)**

- | | |
|-------------------------|--------------------------------|
| a. Quick ratio | b. Times interest earned ratio |
| c. Debt-to-Equity ratio | d. Fixed asset turnover ratio |

2. Assume North West is applying for an eight-year loan of \$75 million. Which ratio(s) calculated in requirement 1 would be the least useful in evaluating the company's loan application, and why? **(2 marks)**

3. Which ratios would be most relevant to potential investors of North West's stock? Name three ratios and briefly discuss why each would be relevant to equity investors' decision. **Note: Do not repeat a ratio mentioned in Requirement 1. (3 marks)**

4. According to a note in the company's annual report, all North West's purchase is made on account. The balance of North West's Net Trade Payable was \$127,481 at the end of fiscal year 2012, and \$119,943 at the end of fiscal year 2011. Compute North West's trade payable turnover ratio for fiscal year 2012. What do your results suggest about the company? In the retail industry, suppliers normally demand a full payment within 30 days. **(2.5 marks)**

5. **This requirement follows requirement 4 above.** Estimate the amount of cash North West had paid to its suppliers during fiscal year 2012. **(2.5 marks)**

6. According to a note in the company's annual report, North West uses the first-in, first-out method to account for the cost of food inventories. Why do you think the company made this choice? **(1.5 mark)**

7. Did North West pay cash dividend during the fiscal year 2012? If yes, do the attached financial statements provide you with sufficient information to calculate the amount of dividend paid? Be specific in your answers. **(1.5 marks)**

Consolidated Statement of Financial Position

(\$ in thousands)	January 31, 2013	January 31, 2012
CURRENT ASSETS		
Cash	\$ 38,675	\$ 26,984
Trade receivable (Note 5)	70,040	76,539
Inventories (Note 6)	187,200	186,124
Prepaid expenses	<u>7,981</u>	<u>6,189</u>
	<u>303,896</u>	<u>295,836</u>
NON-CURRENT ASSETS		
Property and equipment, net (Note 7)	274,027	270,370
Goodwill (Note 8)	26,162	26,319
Intangible assets (Note 8)	20,136	14,620
Deferred tax assets (Note 9)	12,904	7,422
Other assets (Note 10)	<u>14,269</u>	<u>12,350</u>
	<u>347,498</u>	<u>331,081</u>
TOTAL ASSETS	<u>\$ 651,394</u>	<u>\$ 626,917</u>
CURRENT LIABILITIES		
Trade payable and accrued liabilities	\$ 130,501	\$ 122,349
Current portion of long-term debt (Note 11)	40,417	629
Income tax payable	<u>19,266</u>	<u>5,024</u>
	<u>190,184</u>	<u>128,002</u>
NON-CURRENT LIABILITIES		
Long-term debt (Note 11)	122,937	175,263
Defined benefit plan obligation (Note 12)	28,431	27,616
Deferred tax liabilities (Note 9)	2,026	2,440
Other long-term liabilities	<u>11,566</u>	<u>9,887</u>
	<u>164,960</u>	<u>215,206</u>
TOTAL LIABILITIES	<u>355,144</u>	<u>343,208</u>
SHAREHOLDERS' EQUITY		
Share capital (Note 15)	165,358	165,133
Contributed surplus	3,485	3,180
Retained earnings	128,224	115,991
Accumulated other comprehensive income	<u>(817)</u>	<u>(595)</u>
TOTAL EQUITY	<u>296,250</u>	<u>283,709</u>
TOTAL LIABILITIES & EQUITY	<u>\$ 651,394</u>	<u>\$ 626,917</u>

Consolidated Income Statement

(\$ in thousands, except per share amounts)	Year Ended January 31, 2013	Year Ended January 31, 2012
Net Sales	\$ 1,513,646	\$ 1,495,136
Cost of sales	<u>(1,068,940)</u>	<u>(1,067,153)</u>
Gross profit	444,706	427,983
Selling, operating and administrative expenses (Notes 16, 17)	<u>(347,588)</u>	<u>(338,674)</u>
Earnings from operations	97,118	89,309
Interest expense (Note 18)	<u>(5,809)</u>	<u>(6,026)</u>
Earnings before income taxes	91,309	83,283
Income taxes (Note 9)	<u>(26,161)</u>	<u>(25,322)</u>
NET EARNINGS FOR THE YEAR	<u>\$ 65,148</u>	<u>\$ 57,961</u>
NET EARNINGS PER SHARE (Note 20)		
Basic	\$ 1.35	\$ 1.20
Diluted	\$ 1.34	\$ 1.19
WEIGHTED-AVERAGE NUMBER OF SHARES OUTSTANDING (000's)		
Basic	48,384	48,378
Diluted	48,579	48,525

Question 3 Inventory and Cost of Sales:**(12 marks, 20 minutes)**

Vins Inc. is an online wine club promoting Canadian wines. All sales are in cash. During the first quarter of 2014, the company had the following transactions:

Date	Transaction	# bottles	Purchase price/bottle	Sale price/bottle
January 15	Purchase	100	25	
January 31	Sale	150		40
February 25	Purchase	100	26	
March 1	Sale	150		42
March 15	Purchase	50	27	

Additional information:

Vins had 150 bottles of wine at a cost of \$ 3,600 as at January 1, the beginning of its fiscal year 2014. Vins uses a **perpetual inventory system** and the **weighted average costing method**.

Required: (*Show detailed calculations and round to two decimal points*)

1. Calculate the cost of sales and the ending balance of inventory as at March 31, 2014. **(5 marks)**
2. Suppose Vins used a periodic inventory system and the weighted average costing method, instead. What would be the impact on the company's inventory turnover ratio and gross profit margin? Be specific in your answers, and no calculation is required. **(3.5 marks)**
3. Vins found on April 5, 2014 that 10 bottles of wine from the March 15 shipment had gone bad due to faulty corks. Assuming nothing can be recovered from these bottles, should the company record this information (if yes, prepare journal entries; if no, briefly explain why)? **(1.5 marks)**
4. **For this requirement only**, suppose Vins used a perpetual inventory system and the FIFO costing method, instead. How would your answers in requirement 1 change? Be specific in your answers, and no calculation is required. **(2 marks)**

Question 4 Long-Term Assets:**(14 marks, 30 minutes)**

In 2010, Waxi Inc. purchased a property to open a new warehouse, and incurred the following costs:

Purchase price of land with existing building	\$ 237,000
Legal fees for closing	3,000
Renovation costs for the building	49,000
Opening ceremony for the warehouse	1,000
Warehouse equipment costs	50,000
Delivery of new warehouse equipment	5,000

Additional information:

- Waxi's fiscal year ends on December 31. Depreciation related to the new warehouse and its equipment started from January 1, 2011.
- The market value for the land and the building was \$100,000 and \$200,000, respectively, when purchased.

Required: (*Show detailed calculations*)

1. Decide the cost of the land as at December 31, 2010. **(1.5 marks)**
2. Estimate the depreciation expense for the building during 2011. The useful life of the building is 30 years, and the residual value is \$50,000. Waxi uses the straight line method for the building. **(2.5 marks)**
3. Initially Waxi used a unit-of-production method to calculate the depreciation expense for the warehouse equipment; the equipment was expected to be able to handle 100,000 units over its lifetime and would have a residual value of \$5,000. After handling 20,000 units in 2011, Waxi switched to a double-declining method for the equipment, starting from January 1, 2012; the equipment was expected to work for another 3 years and would have a residual value of \$6,000. Calculate the depreciation expense for the equipment as at December 31, 2012. **(5 marks)**
4. **This requirement follows requirement 3 above.** Waxi sold the warehouse equipment on December 31, 2013, and received \$10,000 cash. Prepare journal entries for this transaction. **(5 marks)**

Question 5 Liabilities:**(22 marks; 40 minutes)****PART A**

Patty Ltd.'s statement of financial position shows the following:

PATTY LTD. Statement of Financial Position (Partial) As at December 31 st , 2011	
<i>Current Liabilities</i>	
Bond Interest Payable	\$ 45,000
<i>Non-Current Liabilities</i>	
Bond Payable, 6%, due January 1, 2021	\$ 1,607,649

The bond has a face value of \$ 1,500,000 and was issued on January 1st, 2011 at a price to yield a market interest rate of 5%. Interest is payable semi-annually on January 1st and July 1st. Patty's fiscal year ends on December 31st, and uses the effective interest rate method to amortize the discount or premium on its bond payable.

Note: The present value factor table is not required for this question.

Required: (*Show detailed calculations, and round your answer to the nearest dollar*)

1. Assume that after paying the interest on January 1st, 2012, Patty redeemed one-third (1/3) of the bond at 102. Prepare journal entries to record this transaction. **(4 marks)**
2. **This requirement follows requirement 1 above.** Prepare journal entries to record the interest payment on July 1st, 2012. **(5 marks)**
3. How would the interest payment on July 1st impact Patty's Income Statement? Be specific in your answers, and no calculation is required. **(2 marks)**
4. In addition to the effective interest rate method, companies are also allowed to use the straight-line method to amortize the discount or premium on bond payable (**Hint:** i.e., the amount of amortization is the same in each period where the amortization is recorded). Would Patty's profit in 2011 increase, or decrease, if the company used the straight-line method? Be specific in your answers, and no calculation is required. **(2 marks)**

PART B

Catalin Corp. had the following events during the final three months of its fiscal year 2013:

- a. January 10, 2014: Sold merchandise on account. In addition to the invoice price of \$22,600, the client also had to pay a 15% sales tax. The cost of merchandise sold represents 70% of sales. Catalin uses a perpetual inventory system. Expected warranty claim is estimated at 2% of sales.
- b. March 1, 2014: Signed a six-month, 9% note payable of \$200,000 in order to purchase a land for future expansion. Interest is payable at maturity.

Required:

1. How are all liabilities arising from these transactions reported on Catalin's Statement of Financial Position as at March 31, 2014? You only have to state the relevant account names and the dollar amount. A (partial) statement of financial position is not required. **(3.5 marks)**
2. How do these transactions impact Catalin's Statement of Cash Flows? You only have to state (a) the direction of the impact (i.e., increase or decrease) and (b) the type of cash flows (i.e., operating, investing, or financing). A (partial) statement of cash flows is not required. **Hint:** A transaction might have multiple impacts. **(5.5 marks)**

Question 6 Statement of Cash Flows:**(15 marks; 40 minutes)**

Adamant Inc.'s financial statements are presented below:

ADAMANT INC.		
Statement of Financial Position		
As at December 31, 2013		
	2013	2012
<u>Assets</u>		
Cash	\$ 26,000	\$ 10,000
Trade receivable	76,000	48,000
Merchandise inventory	54,000	40,000
Property, plant, and equipment	160,000	156,000
Accumulated depreciation	60,000	48,000
Goodwill		22,000
Total assets	<u>\$ 256,000</u>	<u>\$ 228,000</u>

Liabilities and Shareholders' Equity

Trade payable	\$ 34,000	\$ 30,000
Salaries payable	3,800	4,200
Income tax payable	2,000	8,000
Bank loan payable	68,200	101,300
Common shares	36,000	28,000
Retained earnings	112,000	56,500
Total liabilities and shareholders' equity	<u>\$ 256,000</u>	<u>\$ 228,000</u>

ADAMANT INC.		
Income Statement		
For the Year Ended December 31, 2013		
Sales		\$ 512,000
Cost of goods sold		280,000
Gross profit		232,000
Operating expenses		156,500
Profit from operations		75,500
Interest expense		8,000
Profit before income tax		67,500
Income tax expense		12,000
Profit		<u>\$ 55,500</u>

Additional information:

- A piece of old equipment was sold at its carrying amount for cash. The equipment originally cost \$24,000 and the amount of its accumulated depreciation was \$7,000 at the time of sale.
- Equipment costing \$28,000 was purchased in exchange for \$8,000 cash and a \$20,000 long-term bank loan.
- Operating expenses are composed of \$19,000 of depreciation expense, \$15,500 of administrative expenses, \$100,000 of salary expenses, and a \$22,000 impairment loss on goodwill.

Required:

Prepare a complete statement of cash flows using the indirect method.