Exam 2009, questions - Fall 2009, Final

Financial Accounting (Concordia University)

CONCORDIA UNIVERSITY **FINANCIAL ACCOUNTING**
DEPARTMENT OF ACCOUNTANCY **COMM 217/2 ALL SECTIONS**

FINAL EXAMINATION

Fall 2009

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. 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	21
2	Accounting for Long-term Assets	16
3	Preparation of Cash Flow Statement	21
4	Accounting for Liabilities	22
5	Analysis of Financial Statements	20
Total		100

Question 1 (21 marks; 38 minutes) **Multiple Choice**

For each of the following, choose the letter that corresponds to the **best** answer, and **show the answer on the computer input sheet only, not on this examination paper**. Each correct answer is worth 1.5 marks.

1. Straight-line amortization is used for reporting purposes by many companies because:
   a. It is always the best measure of the assets used up in the production process during the period.
   b. It represents a systematic allocation of the cost of assets over their expected economic lives.
   c. Tax laws require the use of straight-line amortization for most tangible assets.
   d. Noncurrent assets are used up so quickly that it makes little difference which amortization method is used.

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

3. When an asset is acquired, its recorded cost:
   a. Includes interest whenever the purchase price is borrowed.
   b. Is the list price, ignoring all discounts and price reductions.
   c. Includes all costs necessary to acquire the asset and get it in the condition and location such that the company can do with it what it intends.
   d. All the above.

4. If a company's total revenues and gross profit percentage have declined and you were concerned about the level of sales and the profit margins in the countries in which the company operates, where would you look for more information?
   a. The footnotes and other supplemental information accompanying the financial statements.
   b. The management's discussion and analysis section of the annual report.
   c. The segment reporting section of the company's annual report.
   d. All of the above.

5. Which of the following statements about share capital is true?
   a. Most companies that repurchase their own shares cancel them.
   b. Common shares are typically callable, while preferred shares are not.
   c. Preferred shares are not considered to represent the true residual ownership interest of a corporation.
   d. Both a and b could be correct.

6. At the time they are recorded, most long-term debt normally are valued at:
   a. The present value of future cash payments.
   b. The lower of cost or net realizable value.
   c. Market value.
   d. The amount that must be paid in the future.

7. The balance in the retained earnings account reflects the:
   a. Amount of cash available to be distributed to owners.
   b. Total margin of safety available to protect the claims of the creditors.
   c. Total amount of the corporation's earnings since its incorporation.
   d. Accumulated undistributed earnings of the corporation.

8. Stock dividends:
   a. Are proportional distributions of additional shares to current shareholders with no change in an individual shareholder's ownership percentage.
   b. Are valuable because they increase an individual shareholder's ownership proportion.
   c. Reduce corporate assets.
   d. Increase total shareholders' equity.

9. Which of the following statements is true?
   a. Dividends and interest are both expenses related to corporate financing.
   b. The retained earnings statement reports dividends declared, as well as all gains and losses.
   c. Once a cash dividend is declared, the corporation has a liability to its shareholders until the dividend is paid.
   d. Stock dividends on common shares do not affect retained earnings.

10. Assume the following share capital structure for Wolf Inc.:

    - Preferred shares, 6%, $25 par value, cumulative, 2,000 shares outstanding, with dividends in arrears for the years 2006, 2007, and 2008.
    - Common shares, no par value, 2,000 shares outstanding.

    Total dividends declared in 2009 were $30,000. The total amount of dividends payable to <u>common</u> shareholders is
    a. $30,000.
    b. $27,000.
    c. $21,000.
    d. $18,000.

11. The cash flow statement presents additional information about changes in financial position beyond the information reported in the balance sheet when:
    a. Property, plant and equipment are both purchased and sold during the period.
    b. Long-term debt is retired and new debt is issued.
    c. Intangible assets are increased by the purchase of trademarks and copyrights and decreased by annual amortization.
    d. All of the above.

12. Which of the following has the effect of increasing cash flows?
    a. Accounts receivable increases more than inventory increases.
    b. Accounts receivable increases less than inventory increases.
    c. Accounts receivable and inventory both decrease.
    d. Accounts receivable increases but inventory decreases by a smaller amount than the increase in accounts receivable.

13. Expenses that reduce net income in the current period but do not use cash are added back to determine cash generated by operations for the period. They include:
    a. Cost of goods sold.
    b. Interest expense on short-term bank loans.
    c. Amortization of intangible assets.
    d. Amortization of the premium on bonds payable.

14. The manager of Fast Growing Company receives an annual bonus based on the company's reported net income. What combination of the following accounting methods would the manager be inclined to use in a period of rising prices?
    a. Straight-line amortization and weighted average cost.
    b. Accelerated amortization and weighted average cost.
    c. Straight-line amortization and FIFO cost.
    d. Accelerated amortization and FIFO cost.

Question 2 (16 marks; 28 minutes) *Accounting for Long-term Assets*

Laura Corp. purchased two machines (Machine A and Machine B) from a vendor on January 1, 2009 for a total purchase price of $350,000. The appraised values for Machine A and Machine B were $240,000 and $160,000, respectively. To prepare the machines for use, Laura paid installation costs of $2,000 for Machine A and repair costs of $1,000 for Machine B on the purchase date. Laura signed a $250,000 note payable to the machine vendor and paid the balance of the purchase price and other expenditures in cash.

Due to the different characteristics of the two machines, Laura used two different amortization methods: Machine A (estimated useful life of 10 years and residual value of $5,000) was amortized using the double-declining-balance method, and Machine B (estimated total production of 100,000 units and residual value of $6,000) was amortized using the units-of-production method. The fiscal year ends on December 31.

Required:
1. Apportion the total purchase price to the two machines based on the relative appraised values. Show computations. **(2 marks)**
2. Prepare the journal entry (or entries) to record the purchase, including all of the expenditures. **(4 marks)**
3. Compute the amortization expense related to Machine A for each of the years 2009 and 2010. Journal entries are not required. **(3 marks)**
4. Assume Laura sold Machine B on September 30, 2009 for $125,000 in cash. Machine B had produced 9,000 units in total by that date. Prepare the journal entries to record the sale of Machine B, including the entry to record amortization expense up to the date of sale. **(7 marks)**

Question 3 (21 marks; 38 minutes) ***Preparation of cash flow statement***

Below are the summary balance sheets for RT Ltd. at December 31, 2009 and 2008, respectively:

	2009	2008
Cash	$ 20,000	$ 113,000
Accounts receivable, net	70,000	40,000
Merchandise inventory	20,000	35,000
Prepaid expenses	8,000	10,000
Property and Equipment, net	2,124,000	1,292,000
Total Assets	$2,242,000	$1,490,000
Accounts payable	$ 47,000	$ 39,000
Income taxes payable	12,000	28,000
Note payable, due Nov. 13, 2010	45,000	105,000
Common shares	360,000	300,000
Retained earnings	1,778,000	1,018,000
Total Liabilities and Equity	$2,242,000	$1,490,000

The income statement for 2009 showed the following information:

Sales	$4,000,000
Gross profit	2,600,000
Operating expenses (includes amortization of $90,000)	1,200,000
Interest expense	30,000
Gain on disposal of equipment	60,000
Income tax expense	320,000
Net income	$1,110,000

Additional information

1. Property and equipment were acquired for $950,000 cash during 2009. Also during 2009, property and equipment were disposed of in exchange for cash (the amount can be derived).
2. Accounts payable relates only to transactions with suppliers of merchandise inventory.

Required:

1. Prepare in good form a complete cash flow statement (all sections) for the year 2009. Use the indirect method for the operating section of the statement. **(16 marks)**

2. a) How much cash was collected from customers in 2009? **(2 marks)**
   b) How much cash was paid to suppliers of merchandise inventory in 2009? **(3 marks)**

QUESTION 4 (22 marks; 40 minutes) ***Accounting for Liabilities***

PART A (9 marks)
Dillon Company operates on a calendar-year basis. At the beginning of December 2008, Dillon had the following liabilities listed on its books:

Account Payable	$79,300
Rent Payable	42,000
Unearned Revenue	9,000
Estimated Warranty Liability	47,000
Note payable, 8%	50,000

During December 2008, the following events occurred:

1. Purchased equipment at a cost of $41,000 on account, payable on January 15, 2009. Freight charges were $2,500, payable on January 2.
2. Purchased inventory for $106,000 on account.
3. Made payments of $92,000 on account to suppliers.
4. Borrowed $40,000 from the First Foundering Bank on December 15 at 6 percent annual interest. The principal and interest are due 3 months from the date of the loan.
5. Although Dillon owed one month's rent at the beginning of December, the company failed to make any rent payments during the month. It leases its building under a lease with two years remaining and equal monthly rentals.
6. The company earned one-third of the unearned revenues for repair services that had been prepaid by customers prior to December 1.
7. Dillon's products are sold with a 3-year warranty. The company computes its warranty expense for the year (not previously recorded) as $22,000. During December, the company paid $1,000 in warranty claims.
8. Employees of the company are paid a total of $1,200 per day. Three work days elapsed between the last payday and the end of the fiscal year.
9. The 8% note is payable in annual principal installments of $5,000 on December 31st of each year. Interest on the note is paid every December 31st.

Required:
Identify the accounts that should be reported in the Current Liabilities section of Dillon's balance sheet as at December 31, 2008, and their respective balances at that date, as indicated below. Show your calculations. Journal entries are not required. **(9 marks)**

Account **Ending Balance**

PART B (13 marks)

Marina Inc. reported the following liabilities at December 31, 2008 (in thousands of Canadian dollars):

Bonds payable, 9% due December 31, 2011	*$100,000*
Less: Bond Discount	*(2,526)*
	$ 97,474

The company uses the effective interest method and has a December 31 fiscal year end.

Due to a significant decrease in the market interest rates, Marina Inc. decided to repurchase the existing bonds in the open market at 98.5 for early retirement on January 1, 2009 and issue new bonds that pay a lower interest rate.

The characteristics of the new bond issue are the following (dollars in thousands):

Issue date:	January 1, 2009
Term:	5 years
Principal or Par value:	$150,000
Annual stated interest rate:	6% (interest paid semi-annually on January 1 and July 1, starting July 1, 2009). The annual market interest rate for similar bonds was 7% at the time of issuance.

Present value factors for selected periods and interest rates are shown below:

	Present Value of $1				**Present Value of Annuity of $1**			
Periods	3 %	3.5%	6%	7%	3%	3.5%	6%	7%
5	0.8626	0.8420	0.7473	0.7130	4.5797	4.5151	4.2124	4.1002
10	0.7441	0.7089	0.5584	0.5083	8.5302	8.3166	7.3601	7.0236

Required:

1. Prepare the journal entries to record bond-related transactions on January 1, 2009 **(7 marks)**

2. Prepare the journal entries to record bond related transactions on July 1, 2009 and on December 31, 2009. **(6 marks)**

Please round your calculations to the nearest dollar.

Question 5 (20 marks; 36 minutes) ***Analysis of Financial Statements***

ABC Hardware Ltd. reported the following selected income statement and balance sheet information. The company's fiscal year ends on December 31:

	2009	**2008**
Sales	$706,000	$625,000
Sales discounts	3,000	5,000
Gross margin	301,000	310,000
Income from operations	171,000	168,000
Interest expense	52,000	40,000
Income before income tax	119,000	128,000
Income tax expense	38,000	45,000

Comparative Balance Sheet
As at December 31, 2009 and 2008
(Selected 2007 amounts given for computation of certain ratios)

	2009	**2008**	**2007**
Assets			
Cash	$ 42,000	$ 50,000	
Accounts receivables, net	232,000	161,000	$ 125,000
Inventories	298,000	274,000	172,000
Prepaid expenses	12,000	18,000	
Property, plant, and equipment	359,000	327,000	313,000
Accumulated amortization	(50,000)	(40,000)	(30,000)
Total assets	**$ 893,000**	**$ 790,000**	
Liabilities and Shareholders' Equity			
Accrued liabilities	$ 280,000	$ 276,000	
Unearned rent revenue	2,000	1,000	
Long-term liabilities	229,000	242,000	
Total liabilities	511,000	519,000	
Preferred shares, $3 annual dividend per share	60,000	60,000	
Common shares	150,000	120,000	12,000
Retained earnings	172,000	91,000	38,000
Total liabilities and shareholders' equity	**$ 893,000**	**$ 790,000**	

Other information:

- All sales are on credit.
- There are 2,000 preferred shares outstanding.
- The market price of ABC Hardware Ltd. common shares: $38 at December 31, 2009, and $62 at December 31, 2008.
- The weighted-average number of common shares outstanding: 15,000 during 2009, and 12,000 during 2008.
- Cash flows from operating activities (before interest and income tax expense): $76,000 for 2009, and $70,000 for 2008.
- Interest paid: $38,000 for 2009, and $20,000 for 2008.

Required:

1. Compute the following ratios for 2009 and 2008 (show your calculation for 2009 first): **(16 marks)**
    a. Quick ratio
    b. Inventory turnover
    c. Accounts receivable turnover
    d. Times-interest earned ratio
    e. Fixed asset turnover
    f. Earnings per share
    g. Profit margin
    h. Cash coverage

2. Decide (a) whether ABC Hardware Ltd.'s ability to pay its debts and sell inventory improved or deteriorated during 2009, and (b) whether the investment attractiveness of its common shares appears to have increased or decreased. Explain briefly. **(4 marks)**