**THE JOHN MOLSON SCHOOL OF BUSINESS**

**MBA 607 FINAL EXAM June 2013 (100 MARKS)**

**Question 1 – Multiple choice (52 marks, 2 marks each) – includes one for bonus marks**

1. The recording of depreciation expense will have the following effects:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Assets** | **Profit** | **Shareholder’s Equity** |
| a. | Decrease | Decrease | Decrease |
| b. | Decrease | No effect | No effect |
| c. | Decrease | No effect | Decrease |
| d. | Decrease | Decrease | No effect |

1. XYZ Company owns land which cost $300,000. If a "quick sale" of the land was necessary to generate cash, the company feels it would receive only $150,000. The company continues to report the asset on the balance sheet at $300,000. This is justified under which of the following concepts?
   1. [The historical-cost principle](http://www.principlesofaccounting.com/incorrect.htm)
   2. [The value is tied to objective and verifiable past transactions](http://www.principlesofaccounting.com/incorrect.htm)
   3. Neither of the above
   4. [Both "a" and "b"](http://www.principlesofaccounting.com/correct.htm)
2. Accrual Accounting is based on the following principle
   1. Full-disclosure
   2. Cost basis
   3. Matching Principle
   4. Periodicity
3. Near the end of the current year, a company required a customer to pay $200,000 as a deposit for work that is to begin in the following year. At the end of the current year the company reported the $200,000 as a liability on its balance sheet. Which accounting principle/guideline prevented the company from reporting the $200,000 on its income statement for the current year?
   1. Going Concern
   2. Matching Principle
   3. Materiality
   4. Revenue Recognition
4. On June 1, $800 of goods are sold with credit terms of 1/10, n/30. How much should the seller expect to receive if the buyer pays on June 8?
   1. $720
   2. $784
   3. $792
   4. $800
5. Client Wilson pays XYZ Co. $2,000 in December for services that will be provided in 45 days. XYZ uses the accrual basis of accounting. What will be the second account other than cash involved in the December accounting entry prepared by XYZ?
   1. Accounts Receivable
   2. [Prepaid Services](javascript:void(0))
   3. [Service Revenues](javascript:void(0))
   4. [Unearned Revenues](javascript:void(0))
6. XYZ Co. performed services for Client Mex in December and billed Mex $5,000 with terms of net 30 days. XYZ follows the accrual basis of accounting. In January, XYZ received the $5,000 from Mex. What account should XYZ credit in the January entry?
   1. [Accounts Receivable](javascript:void(0))
   2. [Service Revenue](javascript:void(0))
   3. [Owner's Equity](javascript:void(0))
   4. Prepaid Services
7. XYZ Co. follows the accrual basis of accounting and performs a service on account (on credit) in December. The service was billed at the agreed upon amount of $5,500. The effect of this entry on the balance sheet of XYZ is to
   1. Increase assets and owner’s equity by $5,500, each
   2. Increase assets by $5,500 and decrease owner’s equity by $5,500
   3. Increase in assets and liabilities by $5,500, each
   4. Increase assets and cash flow by $5,500, each
8. ABC Co. has current assets of $50,000 and total assets of $150,000. ABC has current liabilities of $30,000 and total liabilities of $80,000. What is the amount of ABC's owner's equity?
   1. $20,000
   2. $30,000
   3. $70,000
   4. $120,000
9. Which of the following is not considered a basic type of adjusting entry?
   1. An entry to convert a liability to a revenue
   2. An entry to accrue unpaid expenses
   3. An entry to convert an asset to an expense
   4. An entry to convert an asset to a liability
10. The United Shipping Co. made an adjusting entry accruing interest on a note payable for the month of January for $800. The note required 12% per annum on the principal. The principal amount of the note payable must have been
    1. $7,000
    2. $9,600
    3. $80,000
    4. $10,800
11. The loss on sale of an equipment previously used in the business is a
    1. Decrease in the operating activities
    2. Increase in the operating activities
    3. Decrease in investing activities
    4. Increase in investing activities
12. A retirement of a long-term bonds payable is part of
    1. Operating activities
    2. Investing activities
    3. Financing activities
    4. Supplemental activities
13. A company purchased items for inventory during 2011 at continuously higher costs. Its last two purchases of 2011 were 20 units on December 20 at a cost of $15 per unit and 30 units on December 30 at a cost of $16 per unit. On December 28, 2011 the company made its last sale for the year when it sold 10 units. Which inventory cost flow assumption will cause the $16 cost per unit to be expensed as part of the year 2011's cost of goods sold?
    1. LIFO
    2. Weighted Average Method
    3. FIFO
    4. Specific Identification Method
14. Prepaid insurance is reported as a(n) [\_\_\_\_\_\_\_\_\_](javascript:void(0)) on a company's balance sheet.
    1. Asset
    2. Liability
    3. Equity
    4. Expense
15. Hahn Corp. has three employees. Each earns $600 per week for a five day work week ending on Friday and paid on Friday. This month the last day of the month falls on a Wednesday. The company should make an adjusting entry
    1. Debiting Wage Expense for $1,080 and crediting Wages Payable for $1,080
    2. Debiting Wage Expense for $360 and crediting Wages Payable for $360
    3. Crediting Wage Expense for $1,080 and debiting Wages Payable for $1,080
    4. Crediting Wage Expense for $360 and debiting Wages Payable for $360
16. Which of the following activities is least likely to be limited to "year-end"?
    1. Closing the accounts
    2. Drafting notes to accompany statements
    3. Recording transactions
    4. Undergoing an audit
17. Fixed expenses are best described as expenses that remain the same
    1. On a per unit basis as volume changes
    2. In total within a reasonable change in volume
    3. In total even if volume triples or increases sharply
    4. None of the above
18. Adjusting entries are needed:
    1. Whenever revenue is not received in cash
    2. Whenever expenses are not paid in cash
    3. Only to correct errors in the initial recording of business transactions
    4. Whenever transactions affect the revenue or expenses of more than one accounting period
19. Which of the following statements is not true regarding prepaid expenses?
    1. Prepaid expenses represent assets
    2. Prepaid expenses are shown in a special section of the income statement
    3. Prepaid expenses become expenses only as goods or services are used up
    4. Prepaid expenses appear in the balance sheet
20. The combination of Selling Expenses and Administrative Expenses is referred to as
    1. General expenses
    2. Operating expenses
    3. Investing expenses
    4. Financing expenses
21. When a company changes its book depreciation from an accelerated method to the straight-line method, it is considered to be a(n)
    1. Discontinued operation
    2. Extraordinary item
    3. Going concern
    4. Change in accounting principle
22. If a company is experiencing continuous cost increases for the merchandise that it purchases, which cost flow assumption will result in the least amount of profit and the least amount of income tax expense?
    1. FIFO
    2. LIFO
    3. Weighted average
    4. Specific Identification method
23. A company has properly recorded all of its purchases of merchandise inventory, but made an error when counting its ending inventory. As a result of the error the company's Inventory account is overstated by $24,000. (This means that the amount in the Inventory account is too high by $24,000.) What is the impact of this error on the company's income statement? Specifically, the company's reported profit (ignoring income tax expense) in the period of the error is \_\_\_\_\_\_\_. (assume periodic inventory method is used)
    1. Too high
    2. Too low
    3. Not affected
    4. Cannot be identified
24. Which of the following are parts of manufacturing overhead
    1. Direct labor
    2. Accumulated depreciation
    3. Depreciation expense
    4. Indirect labor
25. In preparing a statement of cash flows, cash flows from operating activities

a. are always equal to accrual accounting income.

b. are calculated as the difference between revenues and expenses.

c. can be calculated by appropriately adding to or deducting from net income those items in the income statement that do not affect cash.

d. can be calculated by appropriately adding to or deducting from net income those items in the income statement that do affect cash.

**Question 2 – Short answers (32 marks)**

1. Briefly discuss the factors that management should consider in deciding whether management should use LIFO or FIFO (assume a long-run trend of slowly rising prices). (3 marks)
2. Many large retailers take a physical inventory near year-end and state in their annual report that inventory has been valued by the "retail method." What does this mean? (Your answer should address [1] whether inventory is valued in the financial statements at cost or retail prices, and [2] how this dollar amount is determined.) (2 marks)
3. Most preferred stocks do not have voting power, a basic right of common stock. Identify at least two features of most preferred stocks that justify or support use of the term preferred in describing these types of stock issues. (4 marks)
4. Briefly define the following ratios – ie. write the formula: (2 marks)
   * + - 1. EPS
         2. Current ratio
         3. Gross margin percentage
         4. Price earnings ratio
5. On October 1st, Mex Co. traded in its old computer system as part of the purchase of a new system. The old system had cost $15,000, and its accumulated depreciation amounted to $11,000. The new computer’s list price was $8,000. Mex Co. accepted a trade in allowance of $500 for the old computer system, paying $1,500 down in cash and issuing a one year, 8% note payable for the $6,000 balance owed. (5 marks)
   1. Prepare journal entries to record each of the disposal transactions. Assume that depreciation expense on each asset has been recorded up to the date of disposal. (3 points)
   2. Will the gains and losses recorded in part **a** above affect the gross profit reported in Mex’s income statement? Explain (2 points)
6. Use the following information to compute (3 marks)

At December 31 a company's records show the following information:

|  |  |  |
| --- | --- | --- |
|  | Cash | $ 10,000 |
|  | Accounts Receivable | 30,000 |
|  | Inventory | 80,000 |
|  | Prepaid Insurance | 6,000 |
|  | Long-term Assets | 200,000 |
|  | Accounts Payable | 30,000 |
|  | Notes Payable due in 10 months | 25,000 |
|  | Wages Payable | 5,000 |
|  | Long-term Liabilities | 70,000 |
|  | Stockholders' (Owner's) Equity | 196,000 |

1. The current ratio
2. The quick ratio
3. Use the following information of XYZ company to compute (6 marks)

For its most recent year a company had [Sales](http://www.accountingcoach.com/terms/S/sales.html) (all on credit) of $830,000 and [Cost of Goods Sold](http://www.accountingcoach.com/terms/C/cost-of-goods-sold.html) of $525,000. At the beginning of the year its [Accounts Receivable](http://www.accountingcoach.com/terms/A/accounts-receivable.html) were $83,000 and its [Inventory](http://www.accountingcoach.com/terms/I/inventory.html) was $100,000. At the end of the year its Accounts Receivable were $86,000 and its Inventory was $110,000.

* 1. What is inventory turnover ratio? (1 marks)
  2. Compute: Inventory turnover ratio for the year (1 mark)
  3. Analyze the position of XYZ company given that ABC company, XYZ’s only competitor, has an inventory turnover of 6. (2 marks)
  4. Compute: Accounts Receivable turnover ratio (1 mark)
  5. On average, how many days of sales were in Accounts Receivable during the year (1 mark)

1. Journalize the following transactions (i.e. write the journal entry) (3 marks)
   1. Oct. 3: Issued 1,400 shares to three investors who contributed a total amount of 10,000 in cash as well as a piece of equipment valued at $ 6,000
   2. Dec 1: Paid $20,000 in advance for a one-year lease starting from this date
   3. Dec 20: Received $40,000 in advance from a new client for services that had not yet been started. As at December 31, 2011, it was estimated that 50% of the services had been completed.

9. For each event listed below, select the appropriate category which describes the effect of the event on a statement of cash flows: (4 marks)

a. Cash provided/used by operating activities.

b. Cash provided/used by investing activities.

c. Cash provided/used by financing activities.

d. Not a cash flow.

1. Payment on long-term debt

2. Issuance of bonds at a premium

3. Collection of accounts receivable

4. Cash dividends declared

5. Issuance of shares to acquire land

6. Sale of marketable securities (long-term)

7. Payment of employees' wages

8. Issuance of common shares for cash

**Question 3 – Circle the best answer (18 marks)**

|  |  |  |
| --- | --- | --- |
| 1. An adjusting entry to record interest expense incurred by a company but not yet included in its accounting records is categorized as a(n) | [**Accrual**](javascript:void(0)) | [**Deferral**](javascript:void(0)) |
| 1. An adjusting entry to adjust the amounts already recorded in the asset account Supplies and in the income statement account Supplies Expense is categorized as a(n) | [**Accrual**](javascript:void(0)) | [**Deferral**](javascript:void(0)) |
| 1. A law firm has received $10,000 for services to be performed in the future. In which category would you put the entry to adjust the accounts involved (Service Revenues and Unearned Revenues)? | [**Accrual**](javascript:void(0)) | [**Deferral**](javascript:void(0)) |

|  |  |  |
| --- | --- | --- |
| 1. The amount reported on the balance sheet for Property, Plant and Equipment is the company's estimate of the fair market value as of the balance sheet date. | [**True**](javascript:void(0)) | [**False**](javascript:void(0)) |
| 1. The total amount reported for stockholders' equity is the approximate fair value of the corporation as of the balance sheet date. | [**True**](javascript:void(0)) | [**False**](javascript:void(0)) |
| 1. The book value of a corporation is the total amount of stockholders' equity reported on the balance sheet. | [**True**](javascript:void(0)) | [**False**](javascript:void(0)) |
| 1. The third line of the balance sheet at the end of the year should begin with "For the Year Ended". | [**True**](javascript:void(0)) | [**False**](javascript:void(0)) |

|  |  |  |
| --- | --- | --- |
| 1. If a company continues to use equipment past the useful life that was assumed in determining the depreciation, there will be **no** Depreciation Expense in those additional years. | [**True**](javascript:void(0)) | [**False**](javascript:void(0)) |
| 1. Both [Land](http://www.accountingcoach.com/terms/L/land.html) and [Land Improvements](http://www.accountingcoach.com/terms/L/land-improvements.html) will generally be depreciated. | [**True**](javascript:void(0)) | [**False**](javascript:void(0)) |
| 1. If a company revises the estimated useful life of one of its assets being depreciated, the company will need to reissue its earlier financial statements as the earlier depreciation was incorrect. | [**True**](javascript:void(0)) | [**False**](javascript:void(0)) |

|  |  |  |
| --- | --- | --- |
| 1. [Depreciation Expense](http://www.accountingcoach.com/terms/D/depreciation-expense.html) shown on a company's income statement must be the same amount as the depreciation expense on the company's income tax return. | [**True**](javascript:void(0)) | [**False**](javascript:void(0)) |
| 1. The purpose of depreciation is to have the balance sheet report the current value of an asset. | [**True**](javascript:void(0)) | [**False**](javascript:void(0)) |
| 1. Depreciation Expense reflects an allocation of an asset's original cost rather than an allocation based on the economic value that is being consumed. | [**True**](javascript:void(0)) | [**False**](javascript:void(0)) |
| 1. An asset's useful life is the same as its physical life | [**True**](javascript:void(0)) | [**False**](javascript:void(0)) |
| 1. One company might depreciate a new computer over three years while another company might depreciate the same model computer over five years...and both companies are right. | [**True**](javascript:void(0)) | [**False**](javascript:void(0)) |

|  |  |  |
| --- | --- | --- |
| 1. The book value or carrying value of a bond issued at a discount will \_\_\_\_\_\_\_\_\_\_\_\_\_ as the discount is amortized. | [**decrease**](javascript:void(0)) | [**increase**](javascript:void(0)) |
| 1. The amortization of the bond \_\_\_\_\_\_\_\_\_\_\_ will result in less interest expense than the amount of the interest payments. | [**discount**](javascript:void(0)) | [**premium**](javascript:void(0)) |
| 1. If the coupon rate is less than the yield to maturity (YTM), then the bond is said to be sold at a \_\_\_\_\_\_\_\_\_\_\_. | [**discount**](javascript:void(0)) | [**premium**](javascript:void(0)) |