**THE JOHN MOLSON SCHOOL OF BUSINESS**

**MBA 607 FINAL EXAM Dec 2012 (100 MARKS)**

**KEY ANSWERS**

**Question 1 – Multiple choice (50 marks, 2 marks each)**

|  |  |
| --- | --- |
| 1 | a |
| 2 | a |
| 3 | c |
| 4 | d |
| 5 | c |
| 6 | d |
| 7 | a |
| 8 | a |
| 9 | c |
| 10 | d |
| 11 | c |
| 12 | b |
| 13 | c |
| 14 | a |
| 15 | a |
| 16 | a |
| 17 | c |
| 18 | b |
| 19 | d |
| 20 | b |
| 21 | b |
| 22 | d |
| 23 | b |
| 24 | a |
| 25 | d |

26 c

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

1. (3 marks, 1 mark for proper identification of both methods, 2 marks for arguments)

The decision of whether to use LIFO or FIFO depends upon management's financial reporting objectives. In a period of rising prices, LIFO will assign more recent (and higher) costs to the cost of goods sold, therefore minimizing reported income. For this reason, LIFO is popular for income tax purposes. However, the IRS requires companies that use LIFO for income tax purposes also to use the LIFO method in their financial statements.  
The FIFO method, in contrast, assigns older (and lower) costs to the cost of goods sold, thereby enabling the company to report a higher gross profit. This method may be preferred by a management that is concerned with creating a superficial impression of profitability.

1. (2 marks)

The retail method may be used as a valuation method in conjunction with the taking of a physical inventory. In these cases, the inventory is counted and priced at retail prices, but the cost of the inventory is then estimated by applying the cost ratio to this retail price. In the balance sheet, the inventory is shown at the estimated cost figure.

1. (4 marks)

Student's answer should include two of the following features of most preferred stocks that justify the term *preferred*:  
(a) *Preferred as to dividends* Preferred stock is entitled to receive each year a dividend of specified amount before any dividend is paid on the common stock.  
(b) *Cumulative as to dividend rights* If any or all of the regular dividend on cumulative preferred stock is omitted in a given year, the amount omitted is *in arrears* and must be paid in a subsequent year before any dividend can be paid on the common stock.  
(c) *Preferred as to assets in event of liquidation* If a business is terminated, the preferred stock is entitled to payment in full of its par value or a higher stated liquidation value before any payment is made to common stockholders.  
  
(Student may also list *conversion privilege* as a "preferred" feature of some preferred stock.)

1. (2 marks, half mark each)

EPS=net income/no of shares outstanding

Current ratio= current assets/current liabilities

Gross Margin percentage = gross margin/net sales revenues

PE ratio = market price per share/net income per share

1. a. 3 marks (each account half a mark)

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Oct** | **1** | Office Equipment (new computer) | | | | | 8,000 | |  |
|  | | |  | Loss on Trade-in of Plant Assets |  | 3,500 | |  | | |
|  |  | Accumulated Depreciation: Office Equip. (old computer) | | | | | 11,000 | |  |
|  | | |  |  | Office Equipment (old computer) |  | | 15,000 | | |
|  | | |  |  | Cash |  | |  | | | 1,500 |
|  | | |  |  | Notes Payable |  | |  | | | 6,000 |
|  |  | **Acquired new computer system by trading in old** | | | | |  | |  |
|  |  | **computer, paying part cash, and issuing a 1-year,** | | | | |  | |  |
|  |  | **8% note payable. Recognized loss equal to book value of old computer ($4,000) minus trade-in allowance ($500) or debit cash $500 for trade-in allowance and record loss of $3,000.** | | | | |  | |  |

|  |
| --- |
| b. (2 marks)  Gains and losses on asset disposals do not affect gross profit because they are not part of the cost of goods sold(gross profit=net sales-COGS). Such gains and losses do, however, affect net income reported in a firm’s income statement (non-operating). |
|

1. (3 marks, each part 1.5 marks)

a. The current ratio (2.1:1 i.e. CA/CL = 126000/60000)

1. The quick ratio (0.67:1 i.e. (cash + temporary investments + accounts receivable) / current liabilities = (10000+0+30000)/60000)
2. What is inventory turnover ratio? (1 mark)

Inventory turnover measures how quickly a company is moving inventory off the shelves to customers. It indicates how many times, during the course of a quarter or year, a company sells and replaces its inventory of component parts, materials and final products.

1. Compute: Inventory turnover ratio for the year (1 mark) (COGS/average inventory = 525000/100000=5 (or 4.77 if 110000 is used))
2. Analyze the position of XYZ company given that ABC company, XYZ’s only competitor, has an inventory turnover of 6. (2 marks)

ABC is doing better than XYZ company. It’s selling more inventory to customers. It has more efficient operations than XYZ company or something along those lines.

1. Compute: Accounts Receivable turnover ratio (1 mark) ((credit sales/ accounts receivable = 830000/83000=9.65 or 9.82 if 84500 is used)
2. On average, how many days of sales were in Accounts Receivable during the year (1 mark) (365/accounts receivable turnover = 365/9.65=37.8 or 37.2 days)
3. (3 marks, 1 mark each entry: all accounts in an entry should be correct otherwise zero mark)

a. 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

Cash 10,000

Equipment 6,000

Share Capital 16,000

1. Dec 1: Paid $20,000 in advance for a one-year lease starting from this date

Prepaid rent 20,000

Cash 20,000

1. 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.

Cash 40,000

Deferred Revenue (unearned) 40000

1. Revenue recognition is An accounting principle under generally accepted accounting principles (GAAP) that determines the specific conditions under which income becomes realized as revenue.

9. (4 marks)

1. c 4. d 7. a

2. c 5. d 8. c

3. a 6. b

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

|  |  |
| --- | --- |
| 1. | Accrual |
| 2. | Deferral |
| 3. | Deferral |
| 4. | False |
| 5. | False |
| 6. | True |
| 7. | False |
| 8. | True |
| 9. | False |
| 10. | False |
| 11. | False |
| 12. | False |
| 13. | True |
| 14. | False |
| 15. | True |
| 16. | Increase |
| 17. | Premium |
| 18. | Discount |