### UNIVERSITY OF TORONTO JOSEPH L. ROTMAN SCHOOL OF MANAGEMENT

## MGT220F - FINANCIAL ACCOUNTING II TERM TEST MONDAY, JULY 24, 2000

Duration: 1 ½ hours

Aid Allowed: Non-programmable calculator. Programmable calculators will be reset.

**INSTRUCTIONS:** 

<u>Part 1</u>. Multiple choice questions. Answers to multiple choice questions are to be recorded on the mark sense sheet IN PENCIL.

FILL IN THE MARK SENSE SHEET AS YOU WORK THROUGH THE QUESTIONS. NO EXTRA TIME WILL BE GIVEN AT THE END OF THE TEST TO COMPLETE THE MARK SENSE SHEET. ONLY THE MARK SENSE SHEET WILL BE GRADED.

<u>Part 2</u>. Write your answer in the space provided on the test paper. This part of the test should be written in ink. Show and label all calculations to obtain maximum marks. *Remarking.* Only papers written in ink, and not using white-out, will be considered for remarking. Papers must be submitted before leaving class on the day that they are returned to be considered for remarking. Papers will be remarked in total. The mark may go up, go down, or remain the same.

		MARKS
TABLES ATTACHED	1.	
	2.	
	TOTAL	
	NAME	
	STUDENT NUMBER	
	STUDENT NUMBER	

#### PART 1. Select the BEST answer for each of the following independent questions.

- 1. Generally accepted accounting principles
  - a. are fundamental truths or axioms that can be derived from laws of nature.
  - b. Derive their authority from legal court proceedings.
  - c. **Derive their credibility and authority from general recognition and** acceptance by the accounting profession.
  - d. Have been specified in detail in the CICA conceptual framework.
  - e. None of the above
- 2. The quality of information that gives assurance that it is reasonably free of error and bias, and is a faithful representation is
  - a. relevance
  - b. reliability
  - c. verifiability
  - d. neutrality
  - e. none of the above
- 3. Timeliness is an ingredient of the primary quality of

	Relevance	<u>Reliability</u>
а.	Yes	Yes
b.	No	Yes
c.	Yes	Νο
d.	No	No

- e. None of the above
- 4. Neutrality is an ingredient of the primary quality of

	<u>Relevance</u>	<u>Reliability</u>
a.	Yes	Yes
b.	No	Yes
C.	Yes	No
d.	No	No
e.	None of the above	

5. Information about different entities and about different periods of the same entity can be prepared and presented in a similar manner. Comparability and consistency are related to which of these objectives?

	<u>Comparability</u>	<u>Consistency</u>
a.	Entities	Entities
b.	Entities	Periods
C.	Periods	Entities
d.	Periods	Periods

- e. none of the above
- 6. In classifying the elements of financial statements, the primary distinction between revenues and gains is
  - a. the materiality of the amounts involved.
  - b. The likelihood that the transactions involved will recur in the future
  - c. The nature of the activities that gave rise to the transactions involved
  - d. The costs versus the benefits of the alternative methods of disclosing the transactions involved
  - e. None of the above
- 7. Which of the following elements of financial statements is NOT a component of net income?
  - a. revenues
  - b. distributions to the owners
  - c. losses
  - d. expenses
  - e. none of the above
- 8. Which of the following is an implication of the going concern assumption?
  - a. the historical cost principle is credible
  - b. amortization policies are justifiable and appropriate
  - c. the current—noncurrent classification of assets and liabilities is justifiable and significant
  - d. all of the above
  - e. none of the above

- 9. Which of the following, in the most precise sense, means the process of converting noncash resources and rights into money?
  - a. recognition
  - b. measurement
  - c. realization
  - d. allocation
  - e. none of the above
- 10. Application of the full disclosure principle
  - a. is theoretically desirable but not practical because the costs of complete disclosure exceed the benefits
  - b. is violated when important financial information is buried in the notes to the financial statements
  - c. **is demonstrated by the inclusion of information such as information about** contingencies
  - d. requires that the financial statements be consistent and comparable
  - e. none of the above
- 11. Recording the cost of a wastebasket with an estimated useful life of 20 years as an expense of the period when purchased is an example of the application of the
  - a. consistency characteristic
  - b. matching principle
  - c. materiality constraint
  - d. historical cost principle
  - e. none of the above
- 12. The major elements of an income statement are
  - a. revenue, cost of goods sold, selling expenses, and general administrative expenses
  - b. operating section, nonoperating section, extraordinary gains, and cumulative effects
  - c. revenues, expenses, gains, and losses
  - d. all of the above
  - e. none of the above
- 13. Difficulties with the economists' capital maintenance approach to measurement of income include
  - a. selection of the method to measure net assets
  - b. more subjective measurements
  - c. less detail concerning the composition of the net income
  - d. all of the above
  - e. none of the above

- 14. Which of the following is NOT a generally practised method of presenting the income statement?
  - a. The single-step income statement
  - b. The multiple-step income statement
  - c. Including correction of errors made in a previous year
  - d. As a combined income statement and statement of retained earnings
  - e. None of the above
- 15. How should an unusual event not meeting the criteria for an extraordinary item be disclosed in the financial statements?
  - a. shown as a separate item in operating revenues or expenses if material
  - b. shown in operating revenues or expenses if material but not shown as a separate item
  - c. shown net of income tax after ordinary net earnings but before extraordinary items
  - d. shown net of income tax after extraordinary items but before net earnings
  - e. none of the above
- 16. Which of the following is true about intraperiod tax allocation?
  - a. it arises because certain revenue and expense items appear in the income statement either before or after they are included in the tax return
  - b. it is required for extraordinary items, cumulative effect of accounting policy changes, and estimate changes
  - c. its purpose is to allocate income tax expense evenly over a number of accounting periods
  - d. its purpose is to relate the income tax expense to the items which affect the amount of tax
  - e. none of the above
- 17. Which of the following is a limitation of the balance sheet?
  - a. Many items are omitted
  - b. Judgement must be used
  - c. Current values are not reflected
  - d. All of the above
  - e. None of the above

- 18. The net assets of a business are equal to
  - a. current assets minus current liabilities
  - b. total assets minus total liabilities
  - c. total assets minus shareholders' equity
  - d. working capital plus capital assets
  - e. none of the above
- 19. The correct order to present current assets is
  - a. cash, accounts receivable, prepaid items, inventories
  - b. cash accounts receivable, inventories, prepaid items
  - c. cash, inventories, accounts receivable, prepaid items
  - d. cash, inventories, prepaid items, accounts receivable
  - e. none of the above
- 20. The basis for classifying assets as current or noncurrent is conversion to cash within
  - a. the accounting cycle or one year, whichever is longer
  - b. the operating cycle or one year, whichever is longer
  - c. the accounting cycle or one year, whichever is shorter
  - d. the operating cycle or one year, whichever is shorter
  - e. none of the above
- 21. Working capital is
  - a. capital which has been reinvested in the business
  - b. unrestricted retained earnings
  - c. cash and receivables less current liabilities
  - d. cash, receivables and inventories less current liabilities
  - e. none of the above
- 22. Which of the following loss contingencies ordinarily will NOT be accrued as liabilities?
  - a. pending lawsuits whose outcome is uncertain
  - b. guarantees of indebtedness of others
  - c. disputes over additional income taxes for prior years
  - d. all of the above
  - e. none of the above

- 23. A gain contingency can be accrued when
  - a. it is certain that a dispute will be settled in the company's favour
  - b. it is probable that a future asset will be accrued by the company
  - c. the amount of the gain can be reasonably estimated, and it is highly likely that the company will win the case
  - d. all of the above
  - e. none of the above
- 24. Which of the following is an appropriate computation for return on investment (ROI)?
  - a. total assets divided by net income
  - b. net income divided by shareholders' equity
  - c. sales divided by total assets
  - d. all of the above
  - e. none of the above
- 25. Which table would you use to determine how much you would need to have deposited three years ago at 10% compounded annually in order to have \$1,000 today?
  - a. Present value of \$1
  - b. Future value of \$1
  - c. Present value of an annuity due
  - d. Present value of an ordinary annuity
  - e. None of the above
- 26. An amount is deposited for eight years at 12%. If compounding occurs quarterly, then the table value (factor) is found at
  - a. 12% for eight periods
  - b. 3% for eight periods
  - c. 12% for 32 periods
  - d. 3% for 32 periods
  - e. none of the above
- 27. A decrease in net assets arising from peripheral or incidental transactions is called a(n)
  - a. capital expenditure
  - b. cost
  - c. loss
  - d. expense
  - e. none of the above

- 28. Dalta Company had 500,000 common shares outstanding at December 31, 1998. During 1999, no additional common shares were issued. On January 1, 1999, Dalta issued 400,000 nonconvertible preferred shares. During 1999, Dalta declared and paid \$150,000 cash dividends on the common shares and \$125,000 on the preferred shares. Net income for the year ended December 31, 1999, was \$800,000. What should be Dalta's earnings per share, rounded to the nearest penny?
  - a. \$0.75
  - b. \$1.05
  - c. \$1.35
  - d. \$1.60
  - e. none of the above
- 29. Light Limited, had 5 million common shares outstanding on December 31, 1998. An additional 1 million common shares were issued on April 1, 1999, and 500,000 more on July 1, 1999. During 1997, Light issued 25,000 \$1,000 8% convertible bonds to mature in 10 years. Each bond is convertible into 20 common shares. No bonds were converted by the end of 1999. What is the number of shares to be used in computing basic earnings per share and fully diluted earnings per share, respectively?
  - a. 6,000,000 and 6,125,000
  - b. 6,500,000 and 7,000,000
  - c. 6,000,000 and 6,500,000
  - d. 6,500,000 and 6,500,000
  - e. none of the above
- 30. Dune Co. had 200,000 common shares, 20,000 convertible preferred shares, and \$1 million of 10% convertible bonds outstanding during 1999. The preferred shares are convertible into 40,000 common shares. During 1999, Dune paid dividends of \$1.20 per share on the common shares and \$4.00 per share on the preferred shares. Each \$1,000 bond is convertible into 45 common shares. Net income for 1999 was \$800,000 and the income tax rate is 40%.

Fully diluted earnings per share for 1999 is (rounded to the nearest penny)

- b. \$2.81
- c. \$3.05
- d. \$3.33
- e. none of the above

# PART B Show and label all calculations to obtain maximum marks. Draw time lines and indicate which table you are using.

Your friend, Barb Thomas, knows you are in the Commerce Programme at U of T. She calls you from time to time to get your help in making decisions of a financial nature. Some of the problems she needed help with follow:

- Barb has a \$500 overdue debt for medical books and supplies at Ned's Bookstore. She has only \$200 in her chequing account and does not want her parents to know about this debt. Ned's tells her that she may settle the account in one of two ways since she can't pay it all now:
  - a. Pay \$200 now and \$350 two years from today, when she completes her education
  - b. Pay \$650 one year after completion of her education.

Interest rate = 8%.

Which alternative should she choose? (hint: lowest present value) Problem 59 part c

2. She needed a new car. The price of the car she chose was \$18,953.95. The bank told her they would have to charge her a higher interest rate on the loan since she wanted to make only one payment a year at the end of each year. The amount of the each of the five payments is \$5,000. Before she actually purchases the car she wants to know what the interest rate is.

Problem 62 lease A

3. She owns a plot of land on which it was just discovered that toxic waste had been buried. Since it will take several years and a considerable sum of money before the property is fully detoxified and capable of generating revenue, Barb wishes to sell the land now. She has located two potential buyers:

Buyer is willing to pay \$255,000 for the land now.

Buyer B is willing to make 20 annual payments of \$40,000 each, with the first payment to be made in 5 years from today.

Assuming that the appropriate rate of interest is 9%, to whom should Barb sell the land? (hint: highest present value) Problem 64

#### SOLUTION TO PART B

Ned's Bookstore:

Alternative 1

?PV	i = 8	3%
200		350
		—
0	1	2
	n = 2	

Table: PV of a single sum (\$1) Table A-2

Present value of \$350 discounted at 8% for two years (\$350 x .85734) =	\$300.07
Present value of \$200 to be paid now	200.00
Present value of alternative 1	\$500.07

Present value of alternative 1

Alternative 2



Table: PV of a single sum (\$1) Table A-2

Present value of \$650 discounted at 8% for three years (\$650 x .79383) <u>\$515.99</u>

She should choose alternative 1.

Car loan interest rate:

Factor for PV of an ordinary annuity for five years

\$18,953.95 / \$5,000 = 3.79079

This factor implies a 10% interest rate

Sale of toxic land

Buyer A

?PV 225,000

Present value

\$255,000

Buyer B



PV or an ordinary annuity deferred 4 periods.

Table: PV of an ordinary annuity Table A-4 (Other possibilities)

PV of an ordinary annuity of \$40,000 for 24 periods at 9%	9.70661
Less: PV of an ordinary annuity of \$40,000 for 4 periods at 9%	<u>3.23972</u>
Difference	6.46689
Multiplied by annual payments	<u>\$40,000</u>
PV of payments	<u>\$258,675.60</u>

Choose Buyer B