

BUSI 2001D – Intermediate Accounting 1
Winter 2013
Test 2 – March 15th, 2013



Name: _____

Student #: _____

- 1) There are 45 marks available on this exam
- 2) This exam includes 8 pages and 5 questions.
- 3) This is a closed note, closed book examination.
- 4) All answers should be entered in this booklet.
- 5) You may use a calculator during the examination.
- 6) Show all your work and calculations.
- 7) **Good Luck!**

Question 1 (4 marks) (8 minutes)

The following information is available from Sorens Company:

Allowance for doubtful accounts, as of December 31, 2010	\$8,000 cr.
Accounts receivable, as of December 31, 2010	200,000
Credit sales during 2011	400,000
Accounts receivable written off during 2011	9,000
Cash collections during 2011	430,000

At December 31, 2011, it has been determined that 2.5% of ending Accounts receivable will be uncollectible. What amount should Sorens record as bad debt expense for the year ended December 31, 2011?

Question 2 (4 marks) (8 minutes)

Morton Ltd uses periodic inventory system and prepares its financial statements quarterly. It provides you with the following information taken from its books as of March 31, 2013:

	Debit	Credit
Merchandise inventory, as of January 1, 2013	\$600,000	
Transportation-In, January 1- March 31, 2013	20,000	
Purchases, January 1- March 31, 2013	1,274,000	
Purchase returns, January 1- March 31, 2013		\$85,000
Sales, January 1- March 31, 2013		2,079,000

You also collected the following data:

- The gross profit rate is 35%
- Morton Ltd uses the net method of recording purchases and sales

Required

Determine the estimated ending inventory of Morton as of March 31, 2013.

Question 3 (5 marks) (10 minutes)

The records for Maple Leaf Sports and Entertainment showed the following data over the prior three years (all amounts are in millions):

	<u>2010</u>	<u>2011</u>	<u>2012</u>
<i>Income statement</i>			
Sales	\$242	\$238	\$265
Cost of goods sold	121	127	132
Net income	36	27	43
<i>Statement of Financial Position</i>			
Inventory	\$67	\$95	\$78
Retained earnings	56	83	106

After the company's December 31, 2012 books were closed, a Sprout co-op student discovered two errors, which have not been recorded:

- 1) Ending inventory in 2010 was overstated by \$7M.
- 2) The purchases recorded in 2011 included an invoice for merchandise that was received in December 28, 2011 and dated January 4, 2012. The amount of the invoice was \$12M. The merchandise was shipped FOB destination point and received on January 6th, 2012. The ending inventory balances on December 31, 2011 and 2012 were correct.

Required

- 1) For each of these errors, determine the impact on Cost of Goods Sold, Net Income and Retained Earnings (Specify whether the item is overstated, understated, or there is no impact). Enter your answer by completing the following table:

	Error 1	Error 2
Impact on COGS of 2010		No impact
Impact on Net income of 2010		No impact
Cumulative impact on R/E of 2010		No impact
Impact on COGS of 2011		
Impact on Net income of 2011		
Cumulative Impact on R/E of 2011		
Impact on COGS of 2012	No impact	
Impact on Net income of 2012	No impact	
Cumulative impact on R/E of 2012	No impact	

- 2) Determine the amount of Cost of goods sold for the year ended December 31, 2011 after correcting the two errors 1 and 2.

Question 4 (15 marks) (30 minutes)

On January 1, 20x6, Emerald Ltd. purchased 40% of the voting common shares of Zina Ltd. for \$1,000,000. This provides Emerald Ltd. with significant influence over Zina Ltd, and the investment in Zina is therefore classified as Investment in Associates. At the date of acquisition, Zina Ltd.'s assets and liabilities were comprised of the following:

	<i>Book Value</i>	<i>Fair Market Value</i>
Cash	\$100,000	\$100,000
Accounts receivable	200,000	200,000
Inventory	300,000	400,000
Long-term assets	600,000	900,000
Accounts payable	(150,000)	(150,000)
Income taxes payable	(50,000)	(50,000)
Long-term debt	(500,000)	(550,000)

Long-term assets are comprised of the following:

	<i>Net Book Value</i>	<i>Fair Market Value</i>
Land	\$100,000	\$200,000
Building	400,000	600,000
Equipment	<u>100,000</u>	<u>100,000</u>
	\$600,000	\$900,000

You also collected the following information:

- Land was sold in 20x6.
- The building is being depreciated on a straight-line basis and has a remaining useful life of 40 years.
- The equipment is being depreciated on a straight-line basis and has a remaining useful life of 2 years.
- The long-term debt is due in 5 years.
- Zina Ltd. reported net income of \$794,400, and dividends of \$950,000 on its December 31, 20x6, statement of income and retained earnings.

Required -

- a) Prepare the journal entry to record the investment in Zina Ltd. in the books of Emerald Ltd. on January 1, 20x6.
- b) Calculate the amount of goodwill generated on the acquisition of the shares of Zina. Ltd.
- c) Prepare all required journal entries in the books of Emerald Ltd. on December 31, 20x6.

Question 5 (17 marks) (34 minutes)

On January 1, 2012, the Siros Company sold a piece of equipment to Midi Company and accepted a note receivable. Assume the following independent terms of the note receivable:

- (i) Total price is \$155,000 payable as follows: \$5,000 cash payable on January 1, 2012 and \$150,000 payable in 4 years. The cash price of the equipment on January 1, 2012 was \$140,000.
- (ii) \$150,000 payable in 5 years and 3% interest payable each year starting December 31, 2012. The cash price of the equipment on January 1, 2012 was \$130,000.
- (iii) \$150,000 payable in 4 years and the customer's borrowing rate is 3.5%.

Required

Under each independent terms (i), (ii) and (iii):

- 1) Record the sale of equipment on January 1, 2012.
- 2) Prepare the journal entries required on December 31, 2012 and December 31, 2013.

Solution

Question 1 (4 marks)

Accounts receivable:

Beginning balance	\$200,000	
Credit sales	400,000	
Cash collections	(430,000)	
Amounts written off	(9,000)	
Ending balance	<u>\$161,000</u>	1.5mark

Allowance for doubtful accounts:

Beginning balance	\$8,000	
Accounts written off	(9,000)	0.5 mark
Balance before adjustment	<u>1,000dr</u>	
Ending balance (161,000 x 2.5%)	4,025	1 mark
Bad debt expense	<u>\$5,025</u>	1 mark

Question 2

Estimated COGS = $2,079,000 \times 65\% = \$1,351,350$ **2 marks**

Estimated ending inventory:

Merchandise inventory, as of January 1, 2013	\$600,000	
Transportation-In	20,000	0.5 mark
Purchases, January 1- March 31, 2013	1,274,000	0.5mark
Purchase returns, January 1- March 31, 2013	(85,000)	0.5 mark
Estimated COGS	<u>(1,351,350)</u>	0.5 mark
Estimated ending inventory	<u>\$457,650</u>	

Question 3

	Error 1	Error 2
Cumulative Impact on COGS of 2010	Understated by \$7	No impact
Cumulative Impact on Net income of 2010	overstated by \$7	No impact
Cumulative Impact on R/E of 2010	Overstated	No impact
Cumulative Impact on COGS of 2011	Overstated by \$7	Overstated by \$12M
Cumulative Impact on Net income of 2011	Understated by \$7	Understated by \$12M
Cumulative Impact on R/E of 2011	No impact	Understated by \$12M
Cumulative Impact on COGS of 2012	No impact	understated by \$12M
Cumulative Impact on Net income of 2012	No impact	overstated by \$12M
Cumulative Impact on R/E of 2012	No impact	No impact
	2 marks	2 marks

3) $\$127M - 7M - \$12M = \$108M$ **1mark**

Question 4 (15 marks) (30 minutes)

a)

Investment in Zina	1,000,000	
Cash		1,000,000

1 mark

a.	Purchase price		\$1,000,000
	Net assets acquired - 500,000 x 40%	1	<u>200,000</u>
	Purchase price discrepancy		800,000
	Allocation to FV differences:		
	Inventory: \$100,000	1	
	LT assets: 300,000	1	
	LTD: <u>(50,000)</u>	1	
	\$350,000 x 40% =	0.5	<u>(140,000)</u>
	Goodwill	1	<u>\$ 660,000</u>

b) To recognize the investor's share in the investee's profit:

Investment in Zina	\$317,760	
Investment income		\$317,760
\$794,400 x 40% = \$317,760		

1 mark

To recognize the investor's share in the investee's dividends:

Cash/ dividends receivable	380,000	
Investment in Hurley		380,000
\$950,000 x 40% = \$380,000		

1 mark

Amortization of PPD:

Inventory	1	(100,000)	
Land	1	(100,000)	
Building: 200,000 ÷ 40	1	(5,000)	
LTD: 50,000 / 5	1	10,000	(195,000)
			<hr/>
			0.5 x 40%
			1 <u>\$78,000</u>

To recognize amortization of P.P.D:

Investment income	78,000	
Investment in Zina		78,000

1 mark

OK to combine entries.

Question 5 (17 MARKS)

1)

(i)	N/R		\$135,000	0.5	
	Cash		5,000	0.5	
		Sales revenue		0.5	\$140,000

(ii)	N/R		\$130,000		
		Sales revenue			\$130,000

1 mark

(iii): FV= 150,000; N = 4; I= 3.5 Solve for PV = \$130,716 **1.5 marks**

	N/R		\$130,716		
		Sales revenue			\$130,716

1 mark

2-

Imputed interest rate under (i)

FV= 150,000; PV= - 135,000; N = 4; solve for I = 2.67% **1.5 marks**

(i)	N/R		\$3,604		
		Interest revenue			\$3,604
		135,000 x 2.67%= 3,604	1.5 marks		

	N/R		\$3,700		
		Interest revenue			\$3,700
		(135,000+ 3,604)x 2.67% = \$3,700	1 marks		

(ii) Imputed interest rate under

FV= 150,000; PV= - 130,000; N = 5; pmt = 150,000 x 3% = \$4,500 solve for I = 6.18% **2 marks**

	N/R		3,534	0.5	
	Cash		4,500	0.5	
		Interest revenue		1	8,034
		130,000 x 6.18%= 8,034			

	N/R	3,752	0.5	
	Cash	4,500	0.5	
	Interest revenue		1	8,252
	(130,000 + 3,534) x 6.18% =			
	\$8,252			
(iii)				
	N/R	4,575		
	Interest revenue			4,575
	130,716 x 3.5% = 4,575		1 marks	
	N/R	4,706		
	Interest revenue			4,706
	(130,716 + 3,752) x 3.5% =			
	\$4,706		1 mark	