

Mid Term Exam Intermediate Financial Accounting I Winter 2012 ADM2342

(SUGGESTED SOLUTIONS)

Name: _____

ID#: _____

Section: Monday & Thursday (day) M

Thursday (evening) N

Instructions:

- Write your name and student ID number above.
- Turn off all cell phones.
- This examination “**SUGGESTED SOLUTION**” comprises **5** questions over **16** numbered pages.
- Answer Question 1’s multiple-choice questions in the SCANTRON sheet provided.
- **Answer Question 1’s multiple-choice questions first. The proctors will collect your SCANTRON sheet 50 minutes after the examination commences.**
- Answer questions 2-5 in this booklet. The booklet is **not** to be removed from the examination room. You may not separate the pages.
- **Do not answer questions 2-5 using a pencil. No marks can be earned for an answer written in pencil.**
- Limit your answer to the space provided. Blank space for rough work and supporting calculations are given at the end of each question.
- This exam will be marked out of 100 marks (for convenience) and is 2½ hours long. You should budget approximately 1.5 minutes per mark. The exam is worth 35% of the overall course mark.
- Please do not ask the invigilator or the professor any questions, as they will not be answered. State reasonable assumptions, if you feel they are necessary.
- Language (non-electronic) dictionaries are allowed but only after permission is given by the proctors at the examination.
- You **must** sign the Statement of Academic integrity on page 2 of this exam.

	Question	Marks
	1: Multiple Choice	/30
Chapter 3	2	/6
Chapter 4	3: part 1	/6
	3: part 2	/8
	3: part 3	/10
	3: part 4	/6
Chapter 5	4: part 1	/6.5
	4: part 2	/10
	4: part 3	/5
Chapter 6	5: part 1	/5
	5: part 2	/7.5
	TOTAL	/100

Statement of Academic Integrity

The Telfer School of Management does not condone academic fraud, an act by a student that may result in a false academic evaluation of that student or of another student. Without limiting the generality of this definition, academic fraud occurs when a student commits any of the following offences: plagiarism or cheating of any kind, use of books, notes, mathematical tables, dictionaries or other study aid unless an explicit written note to the contrary appears on the exam, to have in his/her possession cameras, radios (radios with head sets), tape recorders, pagers, cell phones, or any other communication device which has not been previously authorized in writing.

Statement to be signed by the student:

I have read the text on academic integrity and I pledge not to have committed or attempted to commit academic fraud in this examination.

Signed: _____

Note: an examination copy or booklet without that signed statement will not be graded and will receive an exam grade of zero.

QUESTION 1 (30 marks)

Answer ALL parts to this question on the SCANTRON sheet provided. Each part is independent. The marker will not assess anything you write on this and the following page.

REMINDER: The proctors will collect your SCANTRON sheet 50 minutes after the examination commences.

1. Financial statements are prepared for the user. Which of the following best describes the responsibility for the preparation of financial statements?
 - a. They are the responsibility of management.
 - b. They are the responsibility of external auditors.
 - c. They are the responsibility of shareholders.
 - d. They are the responsibility of standard setters.
2. Which of the following supports the use of "simplified GAAP" for private companies?
 - a. Private companies usually have less complex business models.
 - b. The financial statement users of private companies tend to have first-hand information.
 - c. Private companies tend to have fewer users.
 - d. All of these
3. Canada Customs and Revenue Agency does not report reporting principles for tax as for accounting. Which of the following is most likely to be the same for accounting and tax reporting?
 - a. Amortization expense
 - b. Development costs
 - c. Long-term leases
 - d. Revenue Recognition
4. The Sarbanes-Oxley Act (SOX) was not enacted to:
 - a. Help prevent fraud and poor financial reporting practices.
 - b. Ensure the act was applied internationally.
 - c. Enable the SEC to increase its policing efforts.
 - d. Introduce new independence rules for auditors
5. Which of the following does not describe a step in the AcSB's standard setting process?
 - a. Issue an emerging Issues Abstract
 - b. Develop an Exposure Draft
 - c. Write a project proposal
 - d. Develop a Re-exposure Draft.
6. Information that is representationally faithful is:
 - a. Complete
 - b. Neutral
 - c. Free from material error or bias
 - d. All of these
7. Which of the following *best* describes the importance of qualitative characteristics as part of the conceptual framework of financial reporting?
 - a. Relevance and representational faithfulness must always be present.
 - b. Representational faithfulness may be traded off.
 - c. Timeliness is a fundamental qualitative characteristic.
 - d. All of these
8. Schmidt Ltd. aims to improve the qualitative characteristics of its financial statements. Your assistant has presented you with options shown below. Which of those options would *most* likely improve the *comparability* of your company's financial statements?
 - a. The restatement of its financial statements from Canadian GAAP to US GAAP for its American investors
 - b. The preparation of monthly financial statements
 - c. The introduction of a policy that specifies how Schmidt's capital assets should be amortized
 - d. The use of foreign-trained accountants

Suggested solutions to these Multiple Choice Questions are not provided. Students are encouraged to check their textbook for the solutions.

QUESTION 1 (30 marks) (continued)

9. You want to improve the qualitative characteristics of your firm's financial statements. Which of the following options would *most* likely improve the *timeliness* of your company's financial statements?
- To increase the frequency of issue from annually to quarterly
 - To increase the number of disclosures
 - To increase the amortization period for capital assets from 5 to 7 years.
 - To change the timing of when revenues are recognized
10. Gains and losses are based on whether they are related to an entity's major ongoing or central operations. These gains or losses may be related to
- | | <u>Peripheral Activities</u> | <u>Use by Others of Resources</u> |
|----|------------------------------|-----------------------------------|
| a. | Yes | No |
| b. | Yes | Yes |
| c. | No | Yes |
| d. | No | No |
11. Which of the following is a real (permanent) account?
- Goodwill
 - Sales
 - Accounts Receivable
 - Both Goodwill and Accounts Receivable
12. Which of the following is a nominal (temporary) account?
- Unearned Revenue
 - Salary Expense
 - Inventory
 - Retained Earnings
13. If the inventory account at the end of the year is understated, the effect will be to
- overstate the gross profit on sales.
 - understate the net purchases.
 - overstate the cost of goods sold.
 - overstate the goods available for sale.
14. Which of the following items should be journalized?
- a letter advising an employee of a pay raise.
 - a customer's pending bankruptcy (assuming an adequate allowance for doubtful accounts has already been set up).
 - a customer's pending bankruptcy (assuming an adequate allowance for doubtful accounts has *not* already been set up).
 - (a) and (b).
15. Below are several statements about the trial balance. Which of these statements is *not* correct?
- debits and credits must balance.
 - the equality of credits and debits ensures that no errors were made.
 - the post-closing trial balance includes temporary accounts only.
 - (b) and (c).
16. Comprehensive income includes all changes in equity during a period *except*
- gains and losses from discontinued operations.
 - unrealized gains and losses on available for sale securities.
 - those resulting from investments by owners and distributions to owners.
 - gains and losses from irregular items.
17. Other comprehensive income is
- income from unusual activities.
 - income that is not related to normal earnings activities.
 - income items that bypass the income statement.
 - included in income from continuing operations.

Suggested solutions to these Multiple Choice Questions are not provided. Students are encouraged to check their textbook for the solutions.

QUESTION 1 (30 marks) (continued)

18. Accumulated other comprehensive income would be reported
- in the shareholders' equity section.
 - in the retained earnings section.
 - in net income.
 - in net income from continuing operations.
19. An asset can be classified as held for sale when
- It is probable that the assets will be sold within one year
 - The sale has been authorized by the company's management
 - The asset is available for immediate sale
 - All of these
20. The statement of changes in shareholder's equity
- Is a required statement under IFRS
 - Is a required statement under ASPE
 - Is a required statement under either IFRS or ASPE
 - None of these
21. Preparing the statement of cash flows (indirect method) involves determining the following except
- cash provided by operations.
 - cash provided by or used in investing and financing activities.
 - change in cash during the period.
 - cash collections from customers during the period.
22. The cash debt coverage ratio is computed by dividing net cash provided by operating activities by
- average long-term liabilities.
 - average total liabilities.
 - ending long-term liabilities.
 - ending total liabilities.
23. The current cash debt coverage ratio is often used to assess
- financial flexibility.
 - liquidity.
 - profitability.
 - solvency.
24. A measure of a company's financial flexibility is the
- cash debt coverage ratio.
 - current cash debt coverage ratio.
 - free cash flow.
 - cash debt coverage ratio and free cash flow.
25. Free cash flow is calculated as net cash provided by operating activities less
- capital expenditures.
 - dividends.
 - capital expenditures and dividends.
 - capital expenditures and amortization.
26. Under the earnings approach, revenue is recognized by the consignor when the
- goods are shipped to the consignee.
 - consignee receives the goods.
 - consignor receives an advance from the consignee.
 - consignor receives an account of sales from the consignee.
27. The concept of commercial substance in purchase and sales transactions means that
- The transaction is a bona fide purchase and sale
 - The entity's cash flows are expected to change
 - The transaction must involve tangible assets
 - (a) and (b)

Suggested solutions to these Multiple Choice Questions are not provided. Students are encouraged to check their textbook for the solutions.

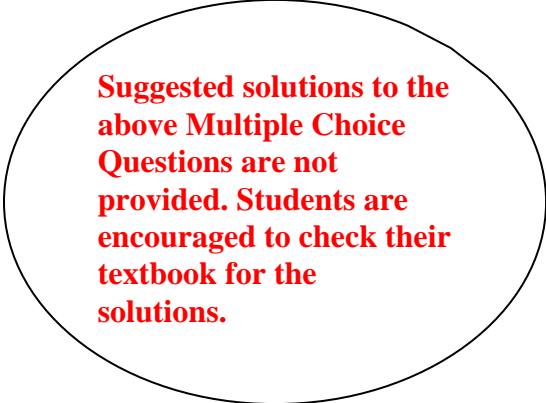
QUESTION 1 (30 marks) (continued)

28. The concept of a constructive obligation in business law refers to an obligation
- that may not be explicitly stated in the contract
 - that may have been created through past practice
 - that may be enforceable under common law
 - All of these
29. A credit that is realized through an entity's ordinary activities would be treated as
- gain
 - revenue
 - income
 - none of these
30. When a sale involves goods *and* services, the selling price should *not* be
- allocated to each of these parts
 - allocated only to the part with the higher value
 - allocated using the relative fair value method
 - allocated using the residual method

Answer ALL parts to this question on the SCANTRON sheet provided. Each part is independent. The marker will not assess anything you write on this and the previous page.

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END OF MULTIPLE CHOICE



Suggested solutions to the above Multiple Choice Questions are not provided. Students are encouraged to check their textbook for the solutions.

QUESTION 2 (6 marks)

The following unadjusted trial balance was taken from the books of Caslup Corporation on December 31, 2011.

<u>Account</u>	<u>Debit</u>	<u>Credit</u>
Cash	\$ 40,000	
Accounts Receivable	108,000	
Note Receivable	8,000	
Allowance for Doubtful Accounts		\$ 1,800
Merchandise Inventory	54,000	
Unexpired Insurance	4,800	
Furniture and Equipment	138,000	
Accumulated Depreciation of Furniture & Equipment		15,000
Accounts Payable		10,800
Common Stock		44,000
Retained Earnings		65,000
Sales		410,000
Cost of Goods Sold	128,000	
Salaries Expense	53,000	
Rent Expense	<u>12,800</u>	
Totals	<u>\$546,600</u>	<u>\$546,600</u>

At year end, the following items have not yet been recorded.

- a. Insurance expired during the year, \$3,000.
- b. Estimated bad debts, 1 percent of gross sales.
- c. Depreciation on furniture and equipment, 10% per year.
- d. Interest at 9% is receivable on the note for one full year.
- e. Rent paid in advance at December 31, \$6,800 (originally charged to expense).
- f. Accrued salaries at December 31, \$6,200.

Required

Prepare the necessary adjusting entries.

a. Insurance Expense	3,000	
Unexpired Insurance		3,000
b. Bad Debt Expense	4,100	
Allowance for Doubtful Accounts.....		4,100
c. Depreciation Expense	13,800	
Accumulated Depreciation of F. & E.		13,800
d. Interest Receivable.....	720	
Interest Revenue.....		720
e. Prepaid Rent.....	6,800	
Rent Expense		6,800
f. Salaries Expense.....	6,200	
Salaries Payable		6,200

QUESTION 3 (30 marks)**Answer ALL parts to this question. Each part is independent.****PART 1 (6 marks)**

Shanghai Ltd. had the following balances at January 1, 2011:

Accumulated other comprehensive income: \$58,000

Retained earnings: \$30,000

Common shares: \$420,000

During the year the company generated other comprehensive income of \$70,000 and earned net income of \$200,000.

Required

Prepare a statement of (changes in) shareholder's equity for the year ended December 31, 2011

SHANGHAI LTD.
Statement of Shareholder's Equity
For the Year Ended December 31, 2011

	Total	Common Shares	Retained Earnings	Accumulated Other Comprehensive Income
Beginning balance	\$508,000	\$420,000	\$30,000	\$58,000
Net income	\$200,000		\$200,000	
Other comprehensive income	\$70,000			\$70,000
Comprehensive income				
Ending balance	<u>\$778,000</u>	<u>\$420,000</u>	<u>\$230,000</u>	<u>\$128,000</u>

PART 2 (8 marks)

Norman Corporation's capital structure consists of 20,000 shares of common stock. The company adheres to IFRS. At December 31, 2011 an analysis of the accounts and discussions with company officials revealed the following information:

Sales	\$1,200,000
Purchase discounts	18,000
Purchases	720,000
Flood loss (net of \$18,000 tax)	42,000
Selling expenses	128,000
Cash	60,000
Accounts receivable	90,000
Common stock	200,000
Accumulated amortization	180,000
Dividend revenue	18,000
Inventory, January 1, 2011	152,000
Inventory, December 31, 2011	125,000
Unearned service revenue	4,400
Accrued interest payable	1,000
Land	370,000
Patents	100,000
Retained earnings, January 1, 2011	270,000
Interest expense	17,000
Cumulative effect (to January 1, 2011) of change from FIFO to weighted average inventory method (net of \$15,000)	35,000
General and administrative expenses	160,000
Dividends declared	29,000
Allowance for doubtful accounts	5,000

QUESTION 3 (30 marks) continued

Notes payable (maturity Jul/01/2014)	200,000
Machinery and equipment	450,000
Materials and supplies	40,000
Accounts payable	60,000

Unless indicated otherwise, you may assume an effective income tax rate of 30%.

Required

- (a) Prepare a multiple-step income statement.
 (b) Prepare a retained earnings statement.

Norman Corporation
INCOME STATEMENT
For the Year Ended December 31, 2011

Sales			\$1,200,000
Cost of goods sold:			
Merchandise inventory, Jan. 1		\$152,000	
Purchases	\$720,000		
Less purchase discounts	<u>18,000</u>		
Net purchases		<u>702,000</u>	
Merchandise available for sale		854,000	
Less merchandise inventory, Dec. 31		<u>125,000</u>	
Cost of goods sold			<u>729,000</u>
Gross profit on sales			471,000
Operating expenses:			
Selling expenses		128,000	
General and administrative expenses		<u>160,000</u>	
Total operating expenses			<u>288,000</u>
Operating income			183,000
Other revenue and expense:			
Dividend revenue		18,000	
Interest expense		(17,000)	
Loss from flood		<u>(60,000)</u>	<u>(59,000)</u>
Income before taxes			124,000
Income taxes			<u>37,200</u>
Net income			<u>\$ 86,800</u>
 Earnings per share			 <u>\$4.34</u>

Norman Corporation
RETAINED EARNINGS STATEMENT
For the Year Ended December 31, 2011

Retained earnings, January 1, 2011		\$270,000
Cumulative effect of change in inventory methods,		
net of applicable taxes of \$15,000		<u>(35,000)</u>
Adjusted beginning retained earnings		235,000
Add: Net income	\$86,800	
Deduct: Dividends declared	<u>29,000</u>	<u>57,800</u>
Retained earnings, December 31, 2011		<u>\$292,800</u>

OR

Norman Corporation
RETAINED EARNINGS STATEMENT
For the Year Ended December 31, 2011

Retained earnings, January 1, 2011		\$270,000
Cumulative effect of change in inventory methods,		
net of applicable taxes of \$15,000		<u>35,000</u>
Adjusted beginning retained earnings		305,000
Add: Net income	\$86,800	
Deduct: Dividends declared	<u>29,000</u>	<u>57,800</u>
Retained earnings, December 31, 2011		<u>\$362,800</u>

QUESTION 3 (30 marks) continued

PART 3 (10 marks)

Ajmal Corporation management formally decided to discontinue operation of its Ratnatunga Division on November 1, 2010. Ajmal is a successful corporation with earnings of \$150 million or more before taxes for each of the past five years. The Ratnatunga Division, a major part of Ajmal's operations, is being discontinued because it has not contributed to this profitable performance.

The Ratnatunga Division had a net book value (carrying amount) of \$96 million on November 1, 2011. Ajmal's management has entered into negotiations for a cash sale of the division for \$87 million.

The expected sale date and final disposal of the division is July 1, 2012. Ajmal Corporation has an accounting year ending May 31. The results of operations for the Ratnatunga Division for the fiscal year ending May 31, 2012 and the estimated results for June 2012 are presented below. The before-tax losses after October 31, 2011, are calculated without depreciation on the plant and equipment.

Period	Before-tax loss
June 1, 2011, to October 31, 2011	\$(6,100,000)
November 1, 2011, to May 31, 2012	(3,900,000)
June 1-30, 2012 (estimated)	(750,000)

The Ratnatunga Division will be accounted for as a discontinued operation on Ajmal's 2011–2012 accounting year financial statements. Ajmal's tax rate is 40% on operating income and all gains and losses.

Required

- (a) Explain how the Ratnatunga Division's assets would be reported on Ajmal Corporation's balance sheet as at May 31, 2012, based on IFRS.
- (b) Show how the discontinued operations and pending sale of the Ratnatunga Division would be reported on Ajmal Corporation's income statement for the year ended May 31, 2012. Assume the income from continuing operations is \$10,000,000.

- (a) **The Ratnatunga Division's assets should be identified separately on Campbell Corporation's balance sheet as of May 31, 2011 as held for sale current assets and carried at their net realizable value of \$87 million, i.e., the expected amount of the cash sale.**
- (b) **Note to student: the operating loss must be reported as a separate component after income from continuing operations. The operating loss up to year end is presented as a loss from discontinued operations. The operating loss from a discontinued segment is presented net of tax. Separate earnings per share figures would also be required. The division assets would be measured at the lower of net book value and fair market value less costs to sell. The loss would be presented as a separate component of discontinued operations, on an after-tax basis.**

Income from continuing operations:		\$10,000,000
Loss from operations of the Ratnatunga division less applicable income tax recovery of \$4,000,000	\$(6,000,000)	
Loss from impairment of Ratnatunga division assets less applicable income tax recovery of \$3,600,000*	<u>(5,400,000)</u>	<u>\$(11,400,000)</u>
Net loss		<u>\$(1,400,000)</u>
* Book value of assets	\$96,000,000	
Fair value	<u>87,000,000</u>	
Impairment loss	\$(9,000,000)	
Applicable taxes (40%)	<u>3,600,000</u>	
After-tax loss	<u>\$(5,400,000)</u>	

QUESTION 3 (30 marks) continued

PART 4 (6 marks)

Moffat Corporation maintains its records on the cash basis. You have been engaged to convert its cash basis income statement to the accrual basis. The cash basis income statement, along with additional information, follows:

Moffat Corporation
Income Statement (Cash Basis)
For the Year Ended December 31, 2011

Cash receipts from customers		\$380,000
Cash payments:		
Wages	\$150,000	
Taxes	65,000	
Insurance	40,000	
Interest	<u>25,000</u>	<u>280,000</u>
Net income		<u>\$100,000</u>

Additional information:

	<u>Balances at December 31</u>	
	<u>2011</u>	<u>2010</u>
Accounts receivable	\$50,000	\$30,000
Wages payable	15,000	25,000
Taxes payable	14,000	19,000
Prepaid insurance	8,000	4,000
Accumulated amortization	95,000	80,000
Interest payable	3,000	9,000

No plant assets were sold during 2010.

Required

Prepare a single-step accrual accounting income statement, in good form, for Moffat Corporation for the year ended December 31, 2011.

Moffat Corporation
Income Statement (Accrual Basis)
For the Year Ended December 31, 2011

Revenue (\$380,000 + \$50,000 – \$30,000)		\$400,000
Expenses		
Wages (\$150,000 + \$15,000 – \$25,000)	\$140,000	
Taxes (\$65,000 + \$14,000 – \$19,000)	60,000	
Insurance (\$40,000 + \$4,000 – \$8,000)	36,000	
Depreciation (\$95,000 – \$80,000)	15,000	
Interest (\$25,000 + \$3,000 – \$9,000)	<u>19,000</u>	
Total expenses		<u>270,000</u>
Net Income		<u>\$130,000</u>

QUESTION 4 (21.5 marks)

Answer ALL parts to this question. Each part is independent.

PART 1 (6.5 marks)

Use the code letters listed below (a – m) to indicate, for each balance sheet item (1 – 13) listed below, the usual valuation reported on the balance sheet.

- | | |
|---------------------------------------|----------------------------------|
| ___ 1. Common shares | ___ 8. Long-term bonds payable |
| ___ 2. Prepaid expenses | ___ 9. Land (in use) |
| ___ 3. Natural resources | ___ 10. Land (future plant site) |
| ___ 4. Property, plant, and equipment | ___ 11. Patents |
| ___ 5. Trade accounts receivable | ___ 12. Trading securities |
| ___ 6. Copyrights | ___ 13. Trade accounts payable |
| ___ 7. Merchandise inventory | |

- a. No par value
- b. Current cost of replacement
- c. Amount payable when due, less unamortized discount or plus unamortized premium
- d. Amount payable when due
- e. Fair value at balance sheet date
- f. Net realizable value
- g. Lower of cost or market
- h. Original cost less accumulated depreciation
- i. Original cost less accumulated depletion
- j. Historical cost
- k. Unexpired or unconsumed cost
- m. Original cost net of accumulated amortization

- | | | |
|-------------|--------------|--------------|
| 1. a | 6. m | 11. m |
| 2. k | 7. g | 12. e |
| 3. i | 8. c | 13. d |
| 4. h | 9. j | |
| 5. f | 10. j | |

QUESTION 4 (21.5 marks) continued**Answer ALL parts to this question. Each part is independent.****PART 2 (10 marks)**

Typical balance sheet classifications are as follows.

- | | |
|------------------------|----------------------------------|
| a. Current Assets | g. Long-Term Liabilities |
| b. Investments | h. Capital Shares |
| c. Plant Assets | i. Contributed Surplus |
| d. Intangible Assets | j. Retained Earnings |
| e. Other Assets | k. Notes to Financial Statements |
| f. Current Liabilities | l. Not Reported on Balance Sheet |

Indicate by use of the above letters how each of the following items would be classified on a balance sheet prepared at December 31, 2011. If a contra account, or any amount that is negative or opposite the normal balance, put parentheses around the letter selected. A letter may be used more than once or not at all.

_____ 1. Accrued salaries and wages	_____ 16. Natural resources— timberlands
_____ 2. Rental revenues for three months collected in advance	_____ 17. Deficit (no income earned since beginning of company)
_____ 3. Land used as plant site	_____ 18. Goodwill
_____ 4. Equity securities classified as short- term	_____ 19. Ninety-day notes payable
_____ 5. Cash	_____ 20. Investment in bonds in another company; will be held to 2013 maturity
_____ 6. Accrued interest payable due in thirty days	_____ 21. Land held for speculation
_____ 7. Premium on preferred shares issued	_____ 22. Death of company president
_____ 8. Dividends in arrears on preferred shares	_____ 23. Current maturity of bonds payable
_____ 9. Petty cash fund	_____ 24. Investment in subsidiary; no plans to sell in the near future
_____ 10. Unamortized discount on bonds payable due 2014	_____ 25. Trade accounts payable
_____ 11. Common shares at no par value	_____ 26. Preferred shares, no par value
_____ 12. Bond indenture covenants	_____ 27. Prepaid expenses for next twelve months
_____ 13. Unamortized premium on bonds payable due in 2019	_____ 28. Copyright
_____ 14. Allowance for doubtful accounts	_____ 29. Accumulated depreciation
_____ 15. Accumulated amortization	_____ 30. Earnings, not distributed to shareholders

- | | | | | | |
|-------------|----------------|----------------|----------------|--------------|----------------|
| 1. f | 6. f | 11. h | 16. c | 21. b | 26. h |
| 2. f | 7. i | 12. k | 17. (j) | 22. l | 27. a |
| 3. c | 8. k | 13. g | 18. d | 23. f | 28. d |
| 4. a | 9. a | 14. (a) | 19. f | 24. b | 29. (c) |
| 5. a | 10. (g) | 15. (c) | 20. b | 25. f | 30. j |

QUESTION 4 (21.5 marks) continued**Answer ALL parts to this question. Each part is independent.****PART 3 (5 marks)**

The Controller of Ottawa All Stars Ltd has provided you with the following information:

Ottawa All Stars Ltd
Income Statement
For the Year Ended December 31, 2011

Net Sales		620,000
Cost of Goods Sold		<u>200,000</u>
Gross Profit		420,000
Operating expenses (including depreciation expense of \$65,000)		<u>410,000</u>
Income from operations		10,000
Other revenues and expenses		
Gain on sale of equipment	30,000	
Interest expense	<u>40,000</u>	<u>10,000</u>
Income before income taxes		0
Income taxes		<u>0</u>
Net income		<u><u>0</u></u>

Ottawa All Stars Ltd
Comparative Account Information
Relating to Operations
For the Year Ended December 31, 2011

	2011	2010
Accounts receivable	56,000	40,000
Prepaid insurance	5,000	6,000
Inventory	12,000	20,000
Accounts payable	59,000	47,000
Interest payable	600	1,500
Income taxes payable	4,200	6,000
Unearned revenue	20,000	14,000

RequiredPrepare a statement of cash flows (for the company's operating activities only), in good form, for the year ended December 31, 2011 using the *indirect* format.

**Ottawa All Stars Ltd
Partial Statement of Cash Flows
For the Year Ended December 31, 2011**

Cash flows from operating activities

Net income		\$ 0
Adjustments:		
Gain on sale of equipment	(30,000)	
Depreciation expense	65,000	
Increase in accounts receivable	(16,000)	
Decrease in prepaid insurance	1,000	
Decrease in inventory	8,000	
Increase in accounts payable	12,000	
Decrease in interest payable	(900)	
Decrease in income taxes payable	(1,800)	
Increase in unearned revenue	<u>6,000</u>	
Net cash provided by operating activities		<u><u>\$ 43,300</u></u>

QUESTION 5 (12.5 marks)

Answer ALL parts to this question. Each part is independent.

PART 1 (5 marks)

Wagga-Wagga Company sells office equipment. On January 1, 2011, Wagga-Wagga entered into an instalment sale contract with Diehl Company. The contract specifies six consecutive equal annual payments of \$312,000, each payable on January 1. The first payment was made on January 1, 2011, the date the contract was agreed upon.

Additional information is as follows:

The cash selling price of the equipment, i.e., the fair value or amount that would be realized on an arms-length outright cash sale, is \$1,525,571.

The cost of sales relating to the equipment is \$1,200,000.

The total finance charges relating to the **entire** instalment period are \$346,429 based on a stated interest rate of 9% which is appropriate for an instalment contract of this duration and risk.

Circumstances are such that the collection of the instalment sale is reasonably assured and measurement uncertainties do not exist.

Required

Under the earnings approach what income (loss) before income taxes should Wagga-Wagga appropriately record as a result of this transaction for the year ended December 31, 2011? Show supporting calculations in good form.

**Wagga-Wagga Company
Calculation of Income Before Income Taxes
On Instalment Sales Contract
For the Year Ended December 31, 2011**

Sales	<u>\$1,525,571</u>
Cost of Sales	<u>1,200,000</u>
Gross Profit	325,571
Interest Revenue (Schedule I)	<u>109,221</u>
Income before Income Taxes	<u>\$ 434,791</u>

Schedule I

**Calculation of Interest Revenue on
Instalment Sales Contract**

Cash selling price (sales)	<u>\$1,525,571</u>
Payment made on January 1, 2011	<u>312,000</u>
Balance outstanding at 31/12/2011	1,213,571
Interest rate	<u>9%</u>
Interest Revenue	<u>\$ 109,221</u>

The following table is not required in your solution and is provided for information purposes only.

	A	B	C	D	E	F	G
		[B] Beginning of year principal balance	[C] Payment on 1st January	[D] Reduction in principal at 1st January	MS Excel formulae for Column D	[F = (B - D) x 9%] Interest revenue at 9% for the calendar year and accrued at 31st December	[G = B - D] Balance of principal at close of business on 1st January (after the payment)
1	Year						
2	2011	1,525,571	312,000	312,000	312,000 =C3	109,221	1,213,571
3	2012	1,213,571	312,000	202,779	202,779 =C3-F2	90,971	1,010,793
4	2013	1,010,793	312,000	221,029	221,029 =C4-F3	71,079	789,764
5	2014	789,764	312,000	240,921	240,921 =C5-F4	49,396	548,843
6	2015	548,843	312,000	262,604	262,604 =C6-F5	25,761	286,239
7	2016	286,239	312,000	286,239	286,239 =C7-F6	0	0
8		Totals	1,872,000	1,525,571		346,429	

QUESTION 5 (12.5 marks) continued**Answer ALL parts to this question. Each part is independent.****PART 2 (7.5 marks)**

Malachite Construction Ltd. has entered into a contract beginning January 1, 2010, to build a bridge in Ottawa. It estimates that the bridge will cost \$14.8 million and will take three years to construct.

The bridge will be billed to the municipality at \$15.5 million. The following data are for the construction period:

	2010	2011	2012
Costs to date	\$ 4,500,000	\$13,790,000	\$15,700,000
Estimated costs to complete	10,500,000	1,934,000	-0-
Progress billings to date	4,600,000	10,000,000	15,500,000
Cash collected to date	3,000,000	9,000,000	15,500,000

Required

Under the earnings approach:

Using the percentage-of-completion method, prepare a schedule that shows the calculation of the estimated revenue, expenses, and gross profit or loss that would be recognized during each year of the construction period.

	2010	2011	2012
Contract price: (A)	<u>\$15,500,000</u>	<u>\$15,500,000</u>	<u>\$15,500,000</u>
Costs:			
Opening balance of costs	0	4,500,000	13,790,000
Costs incurred during year	<u>4,500,000</u>	<u>9,290,000</u>	<u>1,910,000</u>
Costs incurred to date (B)	4,500,000	13,790,000	15,700,000
Estimated costs to complete	<u>10,500,000</u>	<u>1,934,000</u>	<u>0</u>
Total estimated costs (C)	<u>15,000,000</u>	<u>15,724,000</u>	<u>15,700,000</u>
Percentage complete (B/C)	30.00%	87.70% **	100.0%
Revenue to date (A x % complete)	4,650,000	13,593,500	15,500,000
Less previous revenue		<u>(4,650,000)</u>	<u>(13,593,500)</u>
Revenue for the year (D)	<u>4,650,000</u>	<u>8,943,500</u>	<u>1,906,500</u>
Construction costs to be expensed for the year	<u>4,500,000</u>	<u>9,317,500</u>	<u>1,882,500</u>
Gross profit for this year	<u>\$150,000</u>	<u>\$(374,000) *</u>	<u>\$24,000***</u>

* 100% of the loss to date is recognized:

$$\$15,500,000 - \$13,790,000 - \$1,934,000 - \$150,000 = (\$374,000)$$

** rounded to two places of decimal.

*** $\$150,000 - \$374,000 + \$24,000 = \$200,000$ final loss.