

Mid Term Exam (SUGGESTED SOLUTIONS)
Intermediate Financial Accounting II
Fall2013
ADM3340

Section A (Day):

Section B (Tuesday evening):

Name: _____

ID#: _____

Required:

- Write your name and student ID number above.
- Turn off all cell phones.
- This examination “**SUGGESTED SOLUTION**” comprises **4** multi-part questions over **19** numbered pages. Answer all questions in this booklet. Booklet is **not** to be removed from the examination room. You may not separate the pages.
- Do not answer questions using a pencil or erasable pen: if you do you will forfeit the right to ask that your exam be remarked.
- Limit your answer to the space provided. Blank sheets 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 40% 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.
- This exam paper must remain stapled: do not take this exam paper apart.
- Present value tables are provided on pages **18 and 19**.
- Language (non-electronic) dictionaries are allowed with the proctor’s permission.
- You **must** sign the Statement of Academic integrity on page 2 of this exam.

	Question		Marks
Ch 12	1: part 1	Goodwill	/3
	1: part 2	Intangibles: acquisition & amortization	/6
	1: part 3	Intangibles: impairment & reversal under ASPE	/6
	1: part 4	Intangibles: impairment & reversal under IFRS	/6
Ch 13	2: part 1	Promotion liabilities	/9
	2: part 2	Balance sheet presentation	/8
	2: part 3	Definitions	/5
Ch 14	3: part 1	Bond liabilities: issuance	/10
	3: part 2	Bond liabilities: retirement	/12
	3: part 3	Troubled debt restructuring	/12
	3: part 4	Fair value option	/4
Ch 15	4: part 1	Retained earnings	/4
	4: part 2	Dividends	/9
	4: part 3	Treasury stock	/6
	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 (21 marks)

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

PART 1: (3 marks)

Question 1

Once goodwill has been recognized in the accounts there has been much disagreement over how it should be treated in subsequent periods. Discuss briefly three alternative treatment approaches.

- a. Charge goodwill off immediately to shareholders' equity. Under this alternative goodwill is not deemed to be an asset that is separable from the business itself and therefore should not be recognized as a separate asset. In addition, immediate expensing would be consistent with the expensing of costs of internally generated goodwill. As well, there is no rational method to amortize goodwill, due to the many uncertainties involved; therefore, financial statements will be more reliable if it is expensed.
- b. Amortize goodwill over its useful life. Goodwill at the time of purchase erodes in value over time and therefore it should be charged to income over the estimated period in which it is expected to benefit the business.
- c. Retain goodwill indefinitely unless impairment occurs. Current and future expenses help to maintain existing goodwill; therefore, it can have an indefinite life. Amortization of goodwill is entirely arbitrary and leads to distortions of net income.

Question 1 (21 marks) (continued)

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

PART 2: (6 marks)

The following transactions involving intangible assets of Fredericton Corporation occurred on or near December 31, 2012. Complete the chart on the following page by writing the journal entry(ies) needed (i) at that date to record the transaction and (ii) at December 31, 2013 to record any resultant amortization. If no entry is required at a particular date, write "none needed."

- (a). Fredericton paid Moncton Company \$200,000 for the exclusive right to market a particular product, using the Moncton name and logo in promotional material. The franchise runs for as long as Fredericton is in business. Fredericton decided to amortize the franchise over 25 years.
- (b). Fredericton spent \$300,000 developing a new manufacturing process and has applied for a patent. It believes that its application will be successful and that the process will be successfully implemented and used for 10 years.
- (c). In January, 2013, Fredericton 's application for a patent (#2 above) was granted. Legal and registration costs incurred were \$35,000. The patent runs for 17 years from the grant date. The manufacturing process will be useful to Fredericton for 10 years.
- (d). Fredericton incurred \$90,000 in successfully defending one of its patents in an infringement lawsuit. The patent expires during December, 2016.
- (e). Fredericton incurred \$200,000 in an unsuccessful patent (not related to #3 or #4 above) defence. As a result of the adverse verdict, the patent, with a remaining unamortized cost of \$99,000, is deemed worthless.

(i) On Date of Transaction

a. Franchise (asset) ..	200,000	
Cash		200,000
b. Deferred		
Devel. Costs (asset)	300,000	
Cash.....		300,000
c. Patents (asset).....	35,000	
Cash.....		35,000
d. Patents (asset).....	90,000	
Cash.....		90,000
e. Legal Fees Expense	200,000	
Cash.....		200,000
Loss on Impairment of		
Patent.....	99,000	
Acc impairment losses		99,000
(or Patent)		

(ii) On December 31, 2013

a. Franchise Amort. Exp.	8,000	
Acc Amortization Franchise		8,000
b. Devel. Cost		
Amortization Expense	30,000	
Deferred		
Devel. Costs		30,000
c. Patent Amortization		
Expense	3,500	
Acc Amortization Patents		3,500
d. Patent Amortization		
Expense	22,500	
Acc Amortization Patents		22,500
e. "None needed."		

Question 1 (21 marks) (continued)

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

PART 2: (6 marks) (continued)

	(i) On Date of Transaction	(ii) On December 31, 2013
(a)		
(b)		
(c)		
(d)		
(e)		

Question 1 (21 marks) (continued)

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

PART 3: (6 marks)

	Limited-life intangibles	Indefinite-life intangibles (excluding goodwill)	Goodwill [the values below pertain to the Reporting Unit/Cash-Generating-Unit, including its Goodwill].
Has management observed events & circumstances indicating that there might be an impairment?	Yes	No	Yes
Carrying amount	\$8,000,000	\$8,000,000	\$32,000,000
Fair value	\$7,000,000	\$7,000,000	\$30,000,000
Costs of disposal	\$40,000	\$40,000	\$500,000
Undiscounted future cash flows from use and eventual sale	\$9,000,000	\$7,600,000	\$40,000,000
Present value of the future cash flows from use and eventual sale	\$6,000,000	\$7,200,000	\$33,000,000

Required

Using the above data complete the following grid, applying ASPE. [Input the above data into www.impairmentlonglivednonfinancialassets.com](http://www.impairmentlonglivednonfinancialassets.com) for the suggested solution.

		Under ASPE		
		Limited-Life Intangible Assets.	Indefinite-Life Intangible Assets.	Goodwill.
(a)	Should the asset be tested for impairment? You must explain your answer.			
(b)	Ignore your answer to 1 above. Is the asset impaired? You must show supporting calculations.			
(c)	If the asset is deemed to be impaired, what is the amount of the impairment loss to be recognized in the income statement? You must show supporting calculations.			
(d)	Can an impairment loss reversal be recognized in a subsequent period, and if so, is there a limit to the reversal? Assume the company uses the cost model (i.e., not the revaluation model) subsequent to acquisition. You must explain your answer.			

Question 1 (21 marks) (continued)

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

	A	B	C	D	E	F	G	H	I	J	K	L
1	Impairment of Long-Lived Non-Financial Assets											
2	<p>Instructions: this screen reflects the data-sets you define in the INPUT screen's yellow-shaded cells and the Canadian ASPE and U.S. GAAP treatment.</p>			Property, Plant & Equipment (PP&E).		Limited-Life Intangible Assets.		Indefinite-Life Intangible Assets (excluding Goodwill).		Goodwill [the values below pertain to the Reporting Unit/Cash-Generating-Unit, including its Goodwill].		
3	Has management observed events & circumstances indicating that there might be an impairment?			Yes		Yes		No		Yes		
4	Carrying amount			\$8,000,000		\$8,000,000		\$8,000,000		\$32,000,000		
5	Fair value			\$7,000,000		\$7,000,000		\$7,000,000		\$30,000,000		
6	Costs of disposal			\$40,000		\$40,000		\$40,000		\$40,000		
7	Undiscounted future cash flows from use and eventual sale			\$9,000,000		\$9,000,000		\$7,600,000		\$40,000,000		
8	Present value of the future cash flows from use and eventual sale			\$6,000,000		\$6,000,000		\$7,200,000		\$33,000,000		
11	Canadian ASPE and U.S. GAAP*											
12	<p>Should the asset be tested for impairment?</p> <p>Use Ctrl+ and Ctrl+ to zoom in and out.</p>			<p>Yes, because ASPE 3063.09 states 'A long-lived asset shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable' and management in this case has observed such events or circumstances.</p> <p>[Comment: ASPE Section 3063 Impairment of Long-Lived Assets deals with the impairment of various long-lived assets including (i) PP&E and (ii) Limited-Life Intangible Assets. ASPE Section 3064 Goodwill and Intangible Assets deals with the impairment of (i) Goodwill and (ii) Indefinite-Life Intangible Assets.]</p>		<p>Yes, because ASPE 3063.09 states 'A long-lived asset shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable' and management in this case has observed such events or circumstances.</p> <p>[Comment: ASPE Section 3063 Impairment of Long-Lived Assets deals with the impairment of various long-lived assets including (i) PP&E and (ii) Limited-Life Intangible Assets. ASPE Section 3064 Goodwill and Intangible Assets deals with the impairment of (i) Goodwill and (ii) Indefinite-Life Intangible Assets.]</p>		<p>No: while ASPE 3064.65 states 'An intangible asset that is not subject to amortization shall be tested for impairment whenever events or changes in circumstances indicate that its carrying amount may exceed its fair value', in this case management has not observed any such events or circumstances and hence there is no requirement to test the asset for impairment.</p> <p>However, given that the carrying amount of \$8,000,000 exceeds the \$7,000,000 fair value, perhaps events & circumstances do actually exist indicating that there might be an impairment and management may be negligent by its failure to observe these events and circumstances.</p> <p>[Comment: ASPE Section 3064 Goodwill and Intangible Assets deals with the impairment of (i) Goodwill and (ii) Indefinite-Life Intangible Assets. ASPE Section 3063 Impairment of Long-Lived Assets deals with the impairment of various long-lived assets including (i) PP&E and (ii) Limited-Life Intangible Assets.]</p>		<p>Yes, because ASPE Section 3064.72 states: 'Goodwill shall be tested for impairment whenever events or changes in circumstances indicate that the carrying amount of the reporting unit to which the goodwill is assigned may exceed the fair value of the reporting unit.' and management in this case has observed such events or circumstances.</p> <p>[Comment: ASPE Section 3064 Goodwill and Intangible Assets deals with the impairment of (i) Goodwill and (ii) Indefinite-Life Intangible Assets. ASPE Section 3063 Impairment of Long-Lived Assets deals with the impairment of various long-lived assets including (i) PP&E and (ii) Limited-Life Intangible Assets.]</p>		
13	<p>Is the asset impaired?</p> <p>Use Ctrl+ and Ctrl+ to zoom in and out.</p>			<p>No, because the carrying amount \$8,000,000 does not exceed \$9,000,000, the sum of the undiscounted cash flows expected to result from its use and eventual disposition of.</p> <p>[Comment - see Note 11: Section 3063's approach to impairment testing and recognition is used for both PP&E and Limited-Life Intangible Assets but not for Indefinite-Life Intangibles or Goodwill.]</p>		<p>No, because the carrying amount \$8,000,000 does not exceed the sum of the undiscounted cash flows expected to result from its use and eventual disposition of \$9,000,000.</p> <p>[Comment - see Note 11: Section 3063's approach to impairment testing and recognition is used for both PP&E and Limited-Life Intangible Assets but not for Indefinite-Life Intangibles or Goodwill.]</p>		<p>No: since management has not observed events and circumstances indicating there might be an impairment, no impairment testing is required and the asset is therefore regarded as not impaired.</p> <p>[Comment: Section 3064's approach to impairment testing differs from Section 3063's. Section 3064's testing approach seeks only to determine if the indefinite-life intangible asset's carrying amount exceeds its fair value: the data provided for (i) the \$7,600,000 undiscounted future cash flows from use and eventual sale, (ii) the \$7,200,000 present value of the future cash flows from use and eventual sale, and (iii) the \$40,000 costs of disposal are not used under this approach. Section 3063's approach is not used for Indefinite-Life Intangibles or Goodwill and is used only for PP&E and Limited-Life Intangible Assets. Both Sections 3063 & 3064 employ what is called the 'cost recovery method'.]</p>		<p>Yes: the impairment test indicates impairment because the carrying amount of \$32,000,000 exceeds \$30,000,000, the fair value (see notes 13 & 17 below).</p> <p>[Comment: Section 3064's approach to impairment testing differs from Section 3063's. Section 3064's testing approach seeks only to determine if the reporting unit's (including goodwill) carrying amount exceeds its fair value: the data provided for (i) the \$40,000,000 undiscounted future cash flows from use and eventual sale, (ii) the \$33,000,000 present value of the future cash flows from use and eventual sale, and (iii) the \$40,000 costs of disposal are not used under this approach. Section 3063's approach is not used for Indefinite-Life Intangibles or Goodwill and is used only for PP&E and Limited-Life Intangible Assets.]</p>		
14	<p>If testing deems the asset impaired, what is the amount of the impairment loss that should be recognised in the income statement?</p>			<p>Not applicable: no impairment identified (see above).</p>		<p>Not applicable: no impairment identified (see above).</p>		<p>Not applicable: no impairment identified (see above).</p>		<p>An impairment loss of \$2,000,000 is recognized: this is the amount by which the \$32,000,000 carrying amount exceeds the \$30,000,000 fair value. (see Notes 14 & 17 below).</p> <p>[Comment: under ASPE, for (i) PP&E, (ii) Limited-Life Intangible Assets, and (iii) Indefinite-Life Intangible Assets and Goodwill, an impairment loss is measured as the excess of the carrying amount over the fair value.]</p>		
15	<p>Can an impairment loss reversal be recognized in a subsequent period, and if so, what is the limit, if any, to the amount of the reversal?</p>			<p>No.</p> <p>ASPE Section 3063.06: An impairment loss shall not be reversed if the fair value subsequently increases.</p>		<p>No.</p> <p>ASPE Section 3063.06: An impairment loss shall not be reversed if the fair value subsequently increases.</p>		<p>No.</p> <p>ASPE Section 3063.06: An impairment loss shall not be reversed if the fair value subsequently increases.</p>		<p>No.</p> <p>ASPE Section 3063.06: An impairment loss shall not be reversed if the fair value subsequently increases.</p>		
16	<p>* Canadian ASPE (Accounting Standards for Private Enterprises) are very similar to current U.S. GAAP in the measurement and recognition of the impairment of long-lived non-financial assets. (See U.S. Codification Topics 360 Property, Plant and Equipment, and 350 Intangibles - Goodwill and Other).</p>											
17	<p>ASPE Section 3063 Impairment of Long-Lived Assets deals with the impairment of various long-lived assets including (i) PP&E and (ii) Limited-Life Intangible Assets. ASPE Section 3064 Goodwill and Intangible Assets deals with the impairment of (i) Goodwill and (ii) Indefinite-Life Intangible Assets.</p>											
18	<p>ASPE Section 3063, paragraph 09: A long-lived asset shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.</p>											
19	<p>ASPE Section 3063, paragraph 05, excerpt: The carrying amount of a long-lived asset is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition....</p>											
20	<p>[Comment: this impairment testing reflects a 'cost recovery approach', and contrasts with the 'rational entity approach' used by IFRS. See Note 9 on the IFRS screen.]</p>											
21	<p>ASPE Section 3063, paragraph 04: An impairment loss shall be recognized when the carrying amount of a long-lived asset (i) is not recoverable and (ii) exceeds its fair value. (numbering added)</p>											
22	<p>ASPE Section 3063, paragraph 06, excerpt: An impairment loss shall be measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value....</p>											
23	<p>ASPE Section 3064.64: An intangible asset that is not subject to amortization shall be tested for impairment in accordance with the provisions of IMPAIRMENT OF LONG-LIVED ASSETS, Section 3063.</p>											
24	<p>ASPE Section 3064.65: An intangible asset that is not subject to amortization shall be tested for impairment whenever events or changes in circumstances indicate that its carrying amount may exceed its fair value.</p>											
25	<p>ASPE Section 3064.08(f): Fair value is the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.</p>											
26	<p>ASPE Section 3064.66: When the carrying amount of the intangible asset exceeds its fair value, an impairment loss shall be recognized in an amount equal to the excess.</p>											
27	<p>ASPE Section 3064.72: Goodwill shall be tested for impairment whenever events or changes in circumstances indicate that the carrying amount of the reporting unit to which the goodwill is assigned may exceed the fair value of the reporting unit.</p>											
28	<p>ASPE Section 3064.76: When goodwill and another asset (or asset group) of a reporting unit are tested for impairment at the same time, the other asset (or asset group) is tested for impairment before goodwill. For example, when a significant asset group is to be tested for impairment (thus potentially requiring a goodwill impairment test), the impairment test for the significant asset group is performed before the goodwill impairment test. When the asset group is impaired, the impairment loss is recognized prior to goodwill being tested for impairment. [Comment: The Accounting Onion (viewed 26 June 2011) argues that under U.S. GAAP, the last long-lived asset to be tested for impairment, and written down, is always goodwill; but under IFRS, all long-lived assets are tested together, and the first asset to be written down is generally goodwill.] See The Accounting Onion at:</p>											
29	<p>http://accountingonion.typepad.com/theaccountingonion/2011/05/goodwill-impairment-accounting-could-become-less-costly-and-earnings-manager.html</p>											
30	<p>Use Ctrl+ and Ctrl+ to zoom in and out.</p>											

Part 4: (6 marks)

	Limited-life intangibles	Indefinite-life intangibles (excluding goodwill)	Goodwill [the values below pertain to the Reporting Unit/Cash-Generating-Unit, including its Goodwill].
Has management observed events & circumstances indicating that there might be an impairment?	Yes	No	Yes
Carrying amount	\$8,000,000	\$8,000,000	\$32,000,000
Fair value	\$7,000,000	\$7,000,000	\$30,000,000
Costs to sell	\$40,000	\$40,000	\$500,000
Undiscounted future cash flows from use and eventual sale	\$9,000,000	\$7,600,000	\$40,000,000
Present value of the future cash flows from use and eventual sale	\$6,000,000	\$7,200,000	\$33,000,000

Required: Using the above data complete the following grid, applying IFRS. [Input the above data into www. impairmentlonglivednonfinancialassets.com](http://www impairmentlonglivednonfinancialassets.com) for the suggested solution.

		Under IFRS		
		Limited-Life Intangible Assets.	Indefinite-Life Intangible Assets.	Goodwill.
(a)	Should the asset be tested for impairment? You must explain your answer.			
(b)	Ignore your answer to 1 above. Is the asset impaired? Show supporting calculations.			
(c)	If the asset is deemed to be impaired, what is the amount of the impairment loss to be recognized in the income statement? Show supporting calculations.			
(d)	Can an impairment loss reversal be recognized in a subsequent period, and if so, is there a limit to the reversal? Assume the company uses the cost model (i.e., not the revaluation model) subsequent to acquisition. You must explain your answer.			

	A	B	C	D	E	F	G	H	I	J	K	L
1	Impairment of Long-Lived Non-Financial Assets											
2	Instructions: this screen reflects the data-sets you define in the INPUT screen's yellow-shaded cells and the IFRS treatment.		Property, Plant & Equipment (PP&E).	Limited-Life Intangible Assets.	Indefinite-Life Intangible Assets (excluding Goodwill).	Goodwill [the values below pertain to the Reporting Unit/Cash-Generating-Unit, including its Goodwill].						
3	Has management observed events & circumstances indicating that there might be an impairment?		Yes	Yes	No	Yes						
4	Carrying amount		A	\$8,000,000	\$8,000,000	\$8,000,000	\$32,000,000					
5	Fair value		B(i)	\$7,000,000	\$7,000,000	\$7,000,000	\$30,000,000					
6	Costs of disposal		B(ii)	\$40,000	\$40,000	\$40,000	\$40,000					
7	Undiscounted future cash flows from use and eventual sale		C	\$9,000,000	\$9,000,000	\$7,600,000	\$40,000,000					
8	Present value of the future cash flows from use and eventual sale		D	\$6,000,000	\$6,000,000	\$7,200,000	\$33,000,000					

IFRS and IFRS-SMEs**												
			Note	Note	Note	Note						
32	Should the asset be tested for impairment?		Yes: IAS 36.9 stipulates 'An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.' After carrying out this assessment, management in this case has observed such an indication, and hence the asset should be tested for impairment. [Comment: IAS 36.9 is more directive than ASPE 3063.09 which states 'A long-lived asset shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable'.]	Yes: IAS 36.9 stipulates 'An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.' After carrying out this assessment, in this case management has observed such an indication, and hence the asset should be tested for impairment. [Comment: IAS 36.9 is more directive than ASPE 3063.09 which states 'A long-lived asset shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable'.]	Yes, because IAS 36.9 includes the following requirement: 'Irrespective of whether there is any indication of impairment...an entity shall test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount.'	Yes, because IAS 36.10 and IAS 36.90 include the following requirements: IAS 36.10: 'Irrespective of whether there is any indication of impairment...an entity shall...test goodwill acquired in a business combination for impairment annually...' IAS 36.90: 'A cash-generating unit to which goodwill has been allocated shall be tested for impairment annually, and whenever there is an indication that the unit may be impaired, by comparing the carrying amount of the unit, including the goodwill, with the recoverable amount of the unit. If the recoverable amount of the unit exceeds the carrying amount of the unit, the unit and the goodwill allocated to that unit shall be regarded as not impaired. If the carrying amount of the unit exceeds the recoverable amount of the unit, the entity shall recognise the impairment loss in accordance with paragraph 104.'****	Use Ctrl+ and Ctrl- to zoom in and out.					
33	Is the asset impaired?		Yes, because the carrying amount of \$8,000,000 exceeds the recoverable amount (defined by IAS 36.6 - see Note 7 below) of \$6,960,000 [which is the higher of the fair value \$7,000,000 less the costs of disposal of \$40,000 and the present value of the future cash flows from use and eventual sale \$6,000,000]. IAS 36's approach to impairment testing is sometimes called the 'rational entity impairment model' and is used for (i) PP&E, (ii) Limited-Life Intangible Assets, and (iii) Indefinite-Life Intangible Assets and Goodwill.	Yes, because the carrying amount of \$8,000,000 exceeds the recoverable amount (defined by IAS 36.6 - see Note 7 below) of \$6,960,000 [which is the higher of the fair value \$7,000,000 less the costs of disposal of \$40,000, and the present value of the future cash flows from use and eventual sale \$6,000,000]. IAS 36's approach to impairment testing is sometimes called the 'rational entity impairment model' and is used for (i) PP&E, (ii) Limited-Life Intangible Assets, and (iii) Indefinite-Life Intangible Assets and Goodwill.	Yes, because the carrying amount of \$8,000,000 exceeds the recoverable amount (defined by IAS 36.6 - see Note 7 below) of \$7,200,000 [which is the higher of the fair value \$7,000,000 less the costs of disposal of \$40,000, and the present value of the future cash flows from use and eventual sale \$7,200,000]. IAS 36's approach to impairment testing is sometimes called the 'rational entity impairment model' and is used for (i) PP&E, (ii) Limited-Life Intangible Assets, and (iii) Indefinite-Life Intangible Assets and Goodwill.	No, because the carrying amount \$32,000,000 does not exceed the recoverable amount \$33,000,000 [which is the higher of the fair value \$30,000,000 less the costs of disposal of \$40,000 and the present value of the future cash flows from use and eventual sale \$33,000,000]. IAS 36's approach to impairment testing is sometimes called the 'rational entity impairment model' and is used for (i) PP&E, (ii) Limited-Life Intangible Assets, and (iii) Indefinite-Life Intangible Assets and Goodwill.	This PP&E column not asked by the question.					
34	If testing deems the asset impaired, what is the amount of the impairment loss that should be recognised in comprehensive income?		\$1,040,000 [= the carrying amount of \$8,000,000 less the recoverable amount of \$6,960,000 (= higher of \$7,000,000 - \$40,000 and \$6,000,000)]	\$1,040,000 [= the carrying amount of \$8,000,000 less the recoverable amount of \$6,960,000 (= higher of \$7,000,000 - \$40,000 and \$6,000,000)]	\$800,000 [= the carrying amount of \$8,000,000 less the recoverable amount of \$7,200,000 (= higher of \$7,000,000 - \$40,000 and \$7,200,000)]	Not applicable: no impairment identified (see above).	Use Ctrl+ and Ctrl- to zoom in and out.					
35	Can an impairment loss reversal be recognized in a subsequent period, and if so, what is the limit, if any, to the amount of the reversal?		Yes, an impairment loss reversal can be recognized in a subsequent period under both the cost and revaluation models. IAS 36.114: An impairment loss recognised in prior periods for an asset other than goodwill shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset shall, except as described in paragraph 117, be increased to its recoverable amount. That increase is a reversal of an impairment loss. IAS 36.117: The increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined less the amortisation or depreciation had no impairment loss been recognised for the asset in prior years. IAS 36.119: A reversal of an impairment loss for an asset other than goodwill shall be recognised immediately in profit or loss, unless the asset is carried at revalued amount in accordance with another IFRS (for example, the revaluation model in IAS 16). Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase in accordance with that other IFRS. See Note 24 and www.capitalassetrevaluation.com at:	Yes, an impairment loss reversal can be recognized in a subsequent period under both the cost and revaluation models. IAS 36.114: An impairment loss recognised in prior periods for an asset other than goodwill shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset shall, except as described in paragraph 117, be increased to its recoverable amount. That increase is a reversal of an impairment loss. IAS 36.117: The increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined less the amortisation or depreciation had no impairment loss been recognised for the asset in prior years. IAS 36.119: A reversal of an impairment loss for an asset other than goodwill shall be recognised immediately in profit or loss, unless the asset is carried at revalued amount in accordance with another IFRS (for example, the revaluation model in IAS 16). Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase in accordance with that other IFRS. See Note 24 and www.capitalassetrevaluation.com at:	Yes, an impairment loss reversal can be recognized in a subsequent period under both the cost and revaluation models. IAS 36.114: An impairment loss recognised in prior periods for an asset other than goodwill shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset shall, except as described in paragraph 117, be increased to its recoverable amount. That increase is a reversal of an impairment loss. IAS 36.117: The increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined less the amortisation or depreciation had no impairment loss been recognised for the asset in prior years. [Comment: remember that an indefinite-life asset would have \$0 accumulated amortization]. IAS 36.119: A reversal of an impairment loss for an asset other than goodwill shall be recognised immediately in profit or loss, unless the asset is carried at revalued amount in accordance with another IFRS (for example, the revaluation model in IAS 16). Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase in accordance with that other IFRS. See Note 24 and www.capitalassetrevaluation.com at:	No: IAS 36.124: An impairment loss recognised for goodwill shall not be reversed in a subsequent period. IAS 36.125: IAS 38 Intangible Assets prohibits the recognition of internally generated goodwill. Any increase in the recoverable amount of goodwill in the periods following the recognition of an impairment loss for that goodwill is likely to be an increase in internally generated goodwill, rather than a reversal of the impairment loss recognised for the acquired goodwill.	Use Ctrl+ and Ctrl- to zoom in and out.					
36	Full IFRS and IFRS for SMEs use the same measurement and recognition principles for impairment of long-lived non-financial assets. Significantly less disclosure is required by IFRS for SMEs (see IAS 36 Impairment of Assets and IFRS-SME Section 27 Impairment of Assets).											
37	IAS 36.104: The impairment loss shall be allocated to reduce the carrying amount of the assets of the unit (group of units) in the following order: (a) first, to reduce the carrying amount of any goodwill allocated to the cash-generating unit (group of units); and (b) then, to the other assets of the unit (group of units) pro rata on the basis of the carrying amount of each asset in the unit (group of units). IAS 36.105: In allocating an impairment loss in accordance with paragraph 104, an entity shall not reduce the carrying amount of an asset below the highest of: (a) its fair value less costs of disposal (if determinable); (b) its value in use (if determinable); and (c) zero. The amount of the impairment loss that would otherwise have been allocated to the asset shall be allocated pro rata to the other assets of the unit (group of units).											
38	***											

QUESTION 2 (22 marks)

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

PART 1: (9 marks)

Perth Corp., which began operations in 2012, sells its products in expensive, reusable containers. The customer is charged a deposit for each container that is delivered and receives a refund for each container that is returned within two years after the year of delivery. When a container is not returned within the time limit, Perth accounts for the container as being sold at the deposit amount. Information for 2014 is as follows:

Deposits on containers held by customers at December 31, 2013, from deliveries in:	2012	\$170,000	
	2013	\$480,000	\$650,000
Deposits on containers delivered in 2014			\$894,000
Refunds for containers returned in 2014 from deliveries in:	2012	\$115,000	
	2013	\$280,000	
	2014	\$310,400	\$705,400

Required

- (a) Prepare all journal entries required for Perth Corp. for the reusable containers during 2014.
- (b) Calculate the total amount that Perth should report as a liability for reusable containers at December 31, 2014.
- (c) Should the liability calculated in part (b) be reported as current or long-term? Explain.

(a)	Cash	894,000	
	Liability for Returnable Containers		894,000
	Liability for Returnable Containers	705,400	
	Cash.....		705,400
	Liability for Returnable Containers	55,000	
	Sales Revenue		55,000
	(\$170,000 – \$115,000)		

(b)		<u>Liability for Returnable Containers</u>	
		\$650,000	31/12/13 liability
		894,000	2014 deliveries
	2014 returns	\$705,400	
	2012 expired deposits	<u>55,000</u>	<u>(760,400)</u>
		<u>\$783,600</u>	31/12/14 liability

- (c) The classification of this liability as current or long-term depends upon the length of the company’s operating cycle. If the company’s operating cycle is one year or less, then the portion of the liability that is expected to be settled within one year is classified as current. The remaining deposits would be classified as long-term. If the company’s operating cycle is between one year and two years, the portion of the liability that is expected to be settled within one operating cycle is classified as current. If the company’s operating cycle is two years or more, the entire liability (\$783,600) is classified as current.

PART 2: (8 marks)

At their last year end, December 31, 2012, the liabilities outstanding of Jewel Corp included the following:

1. Cash dividends on common shares, \$100,000, payable on January 15, 2013.
2. Note payable to Rockland Bank, \$850,000, due January 20, 2013.
3. Serial bonds, \$2,000,000, of which \$500,000 matures during 2013.
4. Note payable to Terenure Bank, \$200,000, due January 27, 2013.

The following transactions occurred early in 2013:

- January 15: The cash dividends were paid.
- January 20: The note payable to Rockland Bank was paid.

- January 25: Jewel entered into a financing agreement with Terenure Bank, enabling it to borrow up to \$1,000,000 at any time through the end of 2015. Amounts borrowed under the agreement would bear interest at 1% above the bank's prime rate and would mature 3 years from the date of the loan.
- January 27: 40,000 common shares were issued to settle (extinguish) the note payable to Terenure Bank.
- February 1: The financial statements for 2012 were issued.

Required

Prepare a partial balance sheet in good form for Jewel Corp, showing the manner in which the above liabilities should be presented at December 31, 2012. Any appropriate note disclosure should be included. Jewel Corp. uses ASPE.

Current liabilities:

Dividends payable on common shares	\$ 100,000	
Notes payable—Rockland Bank	850,000	
Currently maturing portion of serial bonds	<u>500,000</u>	
Total current liabilities		\$1,450,000

Long-term debt:

Note payable—Terenure Bank - Note 1	200,000	
Serial bonds not maturing currently	<u>1,500,000</u>	
Total long-term debt		<u>1,700,000</u>

Total liabilities		<u>\$3,150,000</u>
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- Note 1: On January 27, 2013, the corporation issued 40,000 common shares in exchange for the \$200,000 note.
- [Not required in your answer: see ASPE 1510.13 or the second paragraph on page 818 of Kieso et al (10th Can Ed): Under ASPE, currently maturing debt can be classified as long-term if there is irrefutable evidence at time of issuing financial statements that debt **has been or will be** replaced by or converted to long-term debt or the company's own share capital.]

PART 3: (5 marks)

Provide a definition of *liability*. (2 marks)

A liability is

an obligation that arises from past transactions or events, which may result in a transfer of assets or provision of services.

Not required in your answer: Liabilities have three essential characteristics:

1. They embody a **duty or responsibility**.
2. The entity has **little or no discretion to avoid the duty**.
3. The **transaction** or event that obliges the entity **has occurred**.

Provide a definition of *financial liability*. (2 marks)

A financial liability is any liability that is:

1. a contractual obligation
2. i. to deliver cash or other financial assets to another entity;
or
ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity.

QUESTION 3 (38 marks)

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

PART 1: (10 marks)

On June 1, 2013 BondBeagle Inc. issues \$3,000,000 face value bonds. The bond date is March 31, 2013, and the bonds carry a coupon rate of 8% per year, payable semi-annually on March 31 and September 30. The bonds' maturity date is March 31, 2033. The bonds provide an annual yield of 6%.

BondBeagle Inc. uses the effective interest rate method to amortize any bond premium or discount. BondBeagle Inc.'s accounting year-end is April 30.

Required

Present the journal entry to record the issuance of the bonds: show all supporting calculations.

Intro	INPUT	Text	Date Tables	Issuance Calc	Issuance	I1	I2	I3	I4	I5	Retireme
		B	C		D		E				
2	June 01, 2013	Date of issuance			Dr						Cr
3											
4											
5	Cash					3,730,380.40					
6		Interest payable									40,000.00
7		Bonds payable									3,000,000.00
8		Bond premium									690,380.40
9											

To record the issuance of 20.00-year bonds, face value \$3,000,000, stated interest rate 8.0000% per annum. The bond date is March 30, 2013 with interest paid semi-annually. There are 238 months (including 40 interest payments) between the bond's issuance and maturity dates. For details of how this journal entry's amounts are determined, please refer to the ISSUANCE_CALC sheet.

The following table is not required in your solution:

	If the bonds were issued on:		
	March 31, 2013	September 30, 2013	
	There would be 40 semi-annual interest payments (240 months) between March 31, 2013 and the maturity date, March 30, 2033	There would be 39 semi-annual interest payments (234 months) between September 30, 2013 and the maturity date, March 30, 2033	
22	Present value of the bond's 40.00 semi-annual interest payments of \$120,000 (= \$3,000,000 x 8.0000%/2) at 3.0000% effective interest rate [\$2,773,772 = 23.11477 x \$120,000]	2,773,772.40	
23	Present value of the maturity value of \$3,000,000 at the end of 40.00 periods at 3.0000% effective interest rate [\$919,680 = 0.30656 x \$3,000,000]	919,680.00	
24	Present value of the bond's 39.00 semi-annual interest payments of \$120,000 (= \$3,000,000 x 8.0000%/2) at 3.0000% effective interest rate [\$2,736,986 = 22.80822 x \$120,000]		2,736,986.40
25	Present value of the maturity value of \$3,000,000 at the end of 39.00 periods at 3.0000% effective interest rate [\$947,250 = 0.31575 x \$3,000,000]		947,250.00
26	Total		
27		3,693,452.40	3,684,236.40
28	Bond proceeds, excluding any accrued interest and issuance cost, on June 01, 2013 (which lies between March 31, 2013 and September 30, 2013). \$3,690,380 = \$3,693,452 + {[(3,684,236 - 3,693,452)/6months] x 2months}		3,690,380.40

Question 3 (38 marks) (continued)

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

PART 2: (12 marks)

On June 1, 2013 BondBeagle Inc. issues \$10,000,000 face value bonds. The bond date is January 1, 2013, and the bonds carry a coupon rate of 4% per year, payable semi-annually on January 1 and July 1. The bonds' maturity date is December 31, 2042. Proceeds upon issuance, excluding accrued interest, were \$5,491,145, and the bonds provide an annual yield of 8%.

BondBeagle Inc. uses the effective interest rate method to amortize any bond premium or discount. On May 31, 2028 BondBeagle Inc. retires 60% of the bonds at 103%, excluding accrued interest. BondBeagle Inc.'s accounting year-end is April 30.

Required

Present all necessary journal entries for the retired bonds on May 31, 2028. Show all supporting calculations.

To answer this question you must first determine the amortized cost (carrying value) of the bond at January 2, 2028 (shown as \$1,844,278 below).

Jan 2, 2028 to Dec 31, 2042: 30 interest pymt periods remaining periods to maturity.

$$\$200,000 \times 17.292033 = \$3,458,406$$

$$\$10,000,000 \times 0.3083187 = 3,083,187$$

$$\text{Amortized cost at Jan 2, 2028} = \$6,541,593 \text{ (rounded)}$$

Intro	INPUT	Text	Date	Tables	Issuance	Calc	Issuance	I1	I2	I3	I4	I5	Retirement	R1	R2	R3	R4	R5	Maturity	Amort
	B				C		D							F						
2																				
3																				
4																				
5																				
6																				
7																				
8																				

Date of retirement

May 31, 2028

Dr **Cr**

Interest expense 26,166.37

Bond discount 6,166.37

Interest payable 20,000.00

Instructions:
Enter your data in the INPUT screen; all other screens are "Output screens".

Calculations:
 = \$6,541,593 (net bond liability at beginning of January 02, 2028) x 4.000000% (semi-annual yield) x 1/6 months x 60.0000% retired.
 = \$26,166 - \$20,000
 = \$10,000,000 x 60.0000% retired x 1/12 months x 4.0000%

To record interest expense incurred on 60.0000% of the bonds between April 30, 2028 (the closest preceding accounting year-end date to the retirement date) and May 31, 2028. Effective interest rate method.
 [Note: May 31, 2028 is neither an accounting year-end or a bond interest payment anniversary date.]

12																				
13																				
14																				
15																				
16																				
17																				
18																				
19																				
20																				

Loss on retirement 2,224,212.13

Interest payable 100,000.00

Bond payable 6,000,000.00

Bond discount 2,044,212.13

Cash 6,280,000.00

Calculations:
 = (\$6,280,000 - \$100,000 + \$2,044,212) - (\$6,000,000)
 = \$20,000 (see above journal entry) + \$80,000 (= \$10,000,000 x 60.0000% retired x 4/12 months x 4.0000% accrued at April 30, 2028) January 01, 2028 is the closest preceding interest payment date to the date of retirement.
 = \$10,000,000 x 60.0000% retired
 = \$3,458,407 x 60.00% (unamortized at beginning of January 02, 2028) - \$30,832 [\$30,832 = (\$6,541,593 x 4.000000% yield x 5/6 x 60.00%) - (\$10,000,000 x 2.0000% interest paid x 5/6 x 60.00%) amortization, January 01, 2028 to May 31, 2028 on the 60.00% retired].
 January 01, 2028 is the closest preceding interest payment date to the date of retirement.
 = \$6,180,000 (= \$10,000,000 x 60.0000% x 103.0000%) + \$20,000 accrued (as appears in the journal entry above) + \$80,000 accrued at April 30, 2028

To record the retirement at 103.0000% of 30.00 year 4.0000% bonds, issued June 01, 2013, face value \$6,000,000.

Question 3 (38 marks) (continued)

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

PART 3: (12 marks)

On 1/1/2011 Kingston Inc. issued a 5 year 10% \$1,000,000 bond payable to the Bank of Good Hope. Interest payment dates are June 30 and December 31 and the bonds were issued to provide a semi-annual yield of 6%. By December 2013 Kingston Inc. is in financial difficulties and is about to miss the 31/12/2013 interest payment. Kingston Inc. negotiates an agreement with the Bank of Good Hope whereby the Bank agrees to waive the 31/12/2013 interest payment and to replace, effective 31/12/2013, the above bond with an 8 year \$800,000 bond bearing 14% annual interest, payable semi-annually. Due to Kingston Inc.'s precarious situation, lenders would normally seek an 10% semi-annual return on this 'bail-out' financing.

Required

(a) Is this troubled debt restructuring a *settlement* or a *modification*? Support your answer with all necessary calculations.

(b) Answer either i or ii:

i If in part (a) you deem this restructuring to be a *settlement* provide any journal entries on Kingston Inc's books that may be necessary on 31/12/2013.

ii If in part (a) you deem this restructuring to be a *modification*, what is the total of the interest expense that will be recognized by Kingston Inc. during the 8 year life of the \$800,000 bond.

	A	B	C	D	E	F	G	H	I	J
3	Step 1									
4	PV of the old 5 year bond at 31/12/2013, using the old bond's historic 6% semi-annual yield:									
5	PVA, 4 periods, 6%, \$50,000	\$ 50,000	6.00%	4	3.465105613		\$173,255			
6	PV, 4 periods, 6%, \$1,000,000	\$ 1,000,000	6.00%	4	0.792093663		792,094			
7							965,349			
8	31/12/2013 interest payment						50,000			
9	PV of old debt owed at 31/12/2013, using the old bond's historic 6% semi-annual yield:						\$1,015,349			
10										
11	PV of the new 8 year bond at 31/12/2013, using the old bond's historic 6% semi-annual yield:									
12	PVA, 16 periods, 6%, \$56,000	\$ 56,000	6.00%	16	10.105895271		\$565,930			
13	PV, 16 periods, 6%, \$700,000	\$ 800,000	6.00%	16	0.393646284		314,917			
14	PV of new debt at 31/12/2013, using the old bond's historic 6% semi-annual yield:						\$880,847			
15										
16	Step 2									
17	Difference (\$1,015,349 - \$880,847).						\$134,502			
18	Difference as a percentage of \$1,015,349						13.25%			
19	Greater than 10% and thus this is a 'settlement' and the old bond is derecognized.									
20										
21	Step 3									
22	As this is a 'settlement' calculate the PV of the new bond using the prevailing 10% required semi-annual rate of return for bonds with similar risk and maturity.									
23										
24	PV of the new 8 year bond at 31/12/2013, using the prevailing rate of return for bonds with similar risk and maturity:									
25	PVA, 16 periods, 10%, \$56,000	\$ 56,000	10.00%	16	7.823708642		\$438,128			
26	PV, 16 periods, 10%, \$800,000	\$ 800,000	10.00%	16	0.217629136		174,103			
27	PV of new debt at 31/12/2013, using the prevailing 10% required semi-annual rate of return for bonds with similar risk and maturity.									
28	Face value of the new 8 year bond:						\$612,231			
29	Therefore, bond discount is:						\$187,769			
30										
31	31/12/2013 J/E to record the bond restructuring									
32	(Old) Bond payable			Dr	1,000,000	Cr				
33	(Old) Bond discount					34,651		[= \$1,000,000 - \$965,349 (PV of the old 5 year bond at 31/12/2013, using the old bond's historic 6% semi-annual yield:)]		
34	Interest payable				50,000					
35	(New) Bond discount				187,769					
36	(New) Bond payable					800,000				
37	Gain on bond restructuring					403,118				
38										
39										
40	This amortization table (assumes semi-annual interest payments) is not required:									
41	Beginning of period	Face value	Bond discount	Beginning of period amortized cost	7% interest paid per 6 months	10% interest expense per 6 months	Bond discount amortization	End of period amortized cost	End of period	
42	31-Dec-13	800,000	187,769	612,231	56,000	61,223	5,223	617,454	30-Jun-14	1
43	30-Jun-14	800,000	182,546	617,454	56,000	61,745	5,745	623,200	31-Dec-14	2
44	31-Dec-14	800,000	176,800	623,200	56,000	62,320	6,320	629,519	30-Jun-15	3
45	30-Jun-15	800,000	170,481	629,519	56,000	62,952	6,952	636,471	31-Dec-15	4
46	31-Dec-15	800,000	163,529	636,471	56,000	63,647	7,647	644,119	30-Jun-16	5
47	30-Jun-16	800,000	155,881	644,119	56,000	64,412	8,412	652,530	31-Dec-16	6
48	31-Dec-16	800,000	147,470	652,530	56,000	65,253	9,253	661,783	30-Jun-17	7
49	30-Jun-17	800,000	138,217	661,783	56,000	66,178	10,178	671,962	31-Dec-17	8
50	31-Dec-17	800,000	128,038	671,962	56,000	67,196	11,196	683,158	30-Jun-18	9
51	30-Jun-18	800,000	116,842	683,158	56,000	68,316	12,316	695,474	31-Dec-18	10
52	31-Dec-18	800,000	104,526	695,474	56,000	69,547	13,547	709,021	30-Jun-19	11
53	30-Jun-19	800,000	90,979	709,021	56,000	70,902	14,902	723,923	31-Dec-19	12
54	31-Dec-19	800,000	76,077	723,923	56,000	72,392	16,392	740,316	30-Jun-20	13
55	30-Jun-20	800,000	59,684	740,316	56,000	74,032	18,032	758,347	31-Dec-20	14
56	31-Dec-20	800,000	41,653	758,347	56,000	75,835	19,835	778,182	30-Jun-21	15
57	30-Jun-21	800,000	21,818	778,182	56,000	77,818	21,818	800,000	31-Dec-21	16
58				Totals	896,000	1,083,769	▲ 187,769			
59										
60										
61										
62	If this restructuring were deemed a modification then the total of the interest expense that will be recognized by Kingston Inc. during the 8 year life of the \$800,000 bond is \$680,651.									
63	Total interest expense if the restructuring were deemed a <i>settlement</i> (as above)					1,083,769				
64	Gain on <i>settlement</i>					403,118				
65	Total interest expense if the restructuring were (incorrectly) deemed a <i>modification</i>					680,651				

Or: \$680,651 = interest paid of \$896,000 [\$800,000 x 14% x 8 years] less the total \$215,349 amortization [\$1,015,349 - \$800,000] that would appear on the post-modification amortization table.

Question 3 (38 marks) (continued)

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

PART 4: (4 marks)

Assume that Fredericton Limited issued bonds at par during 2013 in the amount of \$100,000. The company has chosen to apply the fair value option in accounting for this liability. At the end of 2013, the company's *credit risk* has increased and the fair value of the bond is \$95,000. Assume the change in fair value is due solely to the change in credit risk.

Required

- (a) Assume Fredericton Limited follows IFRS 9. Prepare the journal entry to record the change in the fair value of the bond.
- (b) Assume Fredericton Limited follows ASPE. Prepare the journal entry to record the change in the fair value of the bond.

See page 899 of Kieso et al, 10th Can Ed.

(a)			
Bonds payable.....	5,000		
Other Comprehensive Income		5,000	
(b)			
Bonds payable.....	5,000		
Unrealized gain/loss*			5,000

* an income statement account

QUESTION 4 (19 marks)

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

PART 1: (4 marks)

(a) What are the items that increase retained earnings?

Items that increase retained earnings are:

- net income,
- prior period adjustments (error corrections),
- financial reorganization, and
- certain changes in accounting principle.

(b) What are the items that decrease retained earnings?

Items that decrease retained earnings are:

- net loss,
- cash, property and most stock dividends,
- some treasury shares transactions,
- prior period adjustments (error corrections), and
- certain changes in accounting principle.

PART 2: (9 marks)

In each of the following independent cases, it is assumed that the corporation has outstanding 20,000, \$0.80, preferred shares, with a carrying value of \$200,000, and 80,000 common shares, with a carrying value of \$800,000. No dividends have been declared for 2011 or 2012.

- (a) At December 31, 2013, the board of directors wants to distribute \$125,000 in dividends. How much will the preferred shareholders receive if their shares are cumulative and non-participating? Show all supporting calculations.
- (b) At December 31, 2013, the board of directors wants to distribute \$210,000 in dividends. How much will the preferred shareholders receive if their shares are cumulative and participating up to a 15% return in total? Show all supporting calculations.
- (c) On December 31, 2013, the preferred shareholders received an \$80,000 dividend on their shares, which are cumulative and fully participating. How much money was distributed in total for dividends to the preferred and common shares? Show all supporting calculations.

(a) Preferred: \$48,000. $[(\$0.80 \times 20,000) \times 2 \text{ yrs arrearages}] + [(\$0.80 \times 20,000) \text{ for 2013}]$.
Common: \$77,000 = \$125,000 - \$48,000. Not Asked.

(b) Preferred: \$62,000 = $[(\$0.80 \times 20,000) \times 2 \text{ yrs arrearages}] + (\$200,000 \times 15\%)$.
Common: \$148,000 = \$210,000 - \$62,000. [\$148,000 is an 18.5% return on \$800,000]. Not Asked.

(c) \$272,000 (\$192,000 to common and \$80,000 to preferred: Not Asked).

- $\$80,000 - [(\$0.80 \times 20,000) \times 2 \text{ yrs arrearages}] = \$48,000$;
- $\$48,000 / \$200,000 = 24\%$.
- $24\% \times (\$200,000 + \$800,000) = \$240,000$;
- Total dividend declared = $\$240,000 + [(\$0.80 \times 20,000) \times 2 \text{ yrs arrearages}] = \$272,000$.

Question 4 (19 marks) (continued)

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

PART 3: (6 marks)

Luongo Corporation's last year-end balance sheet reported the following in its shareholders equity section:

Common shares, no par, outstanding 5,000 shares	\$115,000
Retained earnings	200,000

The following transactions occurred this year:

- (a) Purchased 70 common shares at \$30 per share, to be held as treasury shares.
- (b) Sold 60 of the treasury shares at \$32 per share.
- (c) Sold the remaining treasury shares at \$15 per share.

Required

Prepare the journal entries for these transactions.

(a) Treasury Shares (70 x \$30)	2,100	
Cash		2,100
(b) Cash (60 x \$32)	1,920	
Treasury Shares (60 x \$30)		1,800
Contributed Surplus		120
(c) Cash (10 x \$25)	150	
Contributed Surplus	120	
Retained Earnings	30	
Treasury Shares (10 x \$30)		300

Financial Tables

Table 2: PRESENT VALUE of \$1.00 that is received in the future.

Period/Per	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%
1	0.9900990	0.9803922	0.9708738	0.9615385	0.9523810	0.9433962	0.9345794	0.9259259	0.9174312	0.9090909	0.9009009	0.8928571
2	0.9802960	0.9611688	0.9425959	0.9245562	0.9070295	0.8899964	0.8734387	0.8573388	0.8416800	0.8264463	0.8116224	0.7971939
3	0.9705901	0.9423223	0.9151417	0.8889964	0.8638376	0.8396193	0.8162979	0.7938322	0.7721835	0.7513148	0.7311914	0.7117802
4	0.9609803	0.9238454	0.8884870	0.8548042	0.8227025	0.7920937	0.7628952	0.7350299	0.7084252	0.6830135	0.6587310	0.6355181
5	0.9514657	0.9057308	0.8626088	0.8219271	0.7835262	0.7472582	0.7129862	0.6805832	0.6499314	0.6209213	0.5934513	0.5674269
6	0.9420452	0.8879714	0.8374843	0.7903145	0.7462154	0.7049605	0.6663422	0.6301696	0.5962673	0.5644739	0.5346408	0.5066311
7	0.9327181	0.8705602	0.8130915	0.7599178	0.7106813	0.6650571	0.6227497	0.5834904	0.5470342	0.5131581	0.4816584	0.4523492
8	0.9234832	0.8534904	0.7894092	0.7306902	0.6768394	0.6274124	0.5820091	0.5402689	0.5018663	0.4665074	0.4339265	0.4038832
9	0.9143398	0.8367553	0.7664167	0.7025867	0.6446089	0.5918985	0.5439337	0.5002490	0.4604278	0.4240976	0.3909248	0.3606100
10	0.9052870	0.8203483	0.7440939	0.6755642	0.6139133	0.5583948	0.5083493	0.4631935	0.4224108	0.3855433	0.3521845	0.3219732
11	0.8963237	0.8042630	0.7224213	0.6495809	0.5846793	0.5267875	0.4750928	0.4288829	0.3875329	0.3504939	0.3172833	0.2874761
12	0.8874492	0.7884932	0.7013799	0.6245970	0.5568374	0.4969694	0.4440120	0.3971138	0.3555347	0.3186308	0.2858408	0.2566751
13	0.8786626	0.7730325	0.6809513	0.6005741	0.5303214	0.4688390	0.4149644	0.3676979	0.3261786	0.2896644	0.2575143	0.2291742
14	0.8699630	0.7578750	0.6611178	0.5774751	0.5050680	0.4423010	0.3878172	0.3404610	0.2992465	0.2633313	0.2319948	0.2046198
15	0.8613495	0.7430147	0.6418619	0.5552645	0.4810171	0.4172651	0.3624460	0.3152417	0.2745380	0.2393920	0.2090043	0.1826963
16	0.8528213	0.7284458	0.6231669	0.5339082	0.4581115	0.3936463	0.3387346	0.2918905	0.2518698	0.2176291	0.1882922	0.1631217
17	0.8443775	0.7141626	0.6050164	0.5133732	0.4362967	0.3713644	0.3165744	0.2702690	0.2310732	0.1978447	0.1696326	0.1456443
18	0.8360173	0.7001594	0.5873946	0.4936281	0.4155207	0.3503438	0.2958639	0.2502490	0.2119937	0.1798588	0.1528222	0.1300396
19	0.8277399	0.6864308	0.5702860	0.4746424	0.3957340	0.3305130	0.2765083	0.2317121	0.1944897	0.1635080	0.1376776	0.1161068
20	0.8195445	0.6729713	0.5536758	0.4563869	0.3768895	0.3118047	0.2584190	0.2145482	0.1784309	0.1486436	0.1240339	0.1036668
21	0.8114302	0.6597758	0.5375493	0.4388336	0.3589424	0.2941554	0.2415131	0.1986557	0.1636981	0.1351306	0.1117423	0.0925596
22	0.8033962	0.6468390	0.5218925	0.4219554	0.3418499	0.2775051	0.2257132	0.1839405	0.1501817	0.1228460	0.1006687	0.0826425
23	0.7954418	0.6341559	0.5066917	0.4057263	0.3255713	0.2617973	0.2109469	0.1703153	0.1377814	0.1116782	0.0906925	0.0737880
24	0.7875661	0.6217215	0.4919337	0.3901215	0.3100679	0.2469785	0.1971466	0.1576993	0.1264049	0.1015256	0.0817050	0.0658821
25	0.7797684	0.6095309	0.4776056	0.3751168	0.2953028	0.2329986	0.1842492	0.1460179	0.1159678	0.0922960	0.0736081	0.0588233
26	0.7720480	0.5975793	0.4636947	0.3606892	0.2812407	0.2198100	0.1721955	0.1352018	0.1063925	0.0839055	0.0663136	0.0525208
27	0.7644039	0.5858620	0.4501891	0.3468166	0.2678483	0.2073680	0.1609304	0.1251868	0.0976078	0.0762777	0.0597420	0.0468936
28	0.7568356	0.5743746	0.4370768	0.3334775	0.2550936	0.1956301	0.1504022	0.1159137	0.0895484	0.0693433	0.0538216	0.0418693
29	0.7493421	0.5631123	0.4243464	0.3206514	0.2429463	0.1845567	0.1405628	0.1073275	0.0821545	0.0630394	0.0484879	0.0373833
30	0.7419229	0.5520709	0.4119868	0.3083187	0.2313774	0.1741101	0.1313671	0.0993773	0.0753711	0.0573086	0.0436828	0.0333779
31	0.7345771	0.5412460	0.3999871	0.2964603	0.2203595	0.1642548	0.1227730	0.0920160	0.0691478	0.0520987	0.0393539	0.0298017
32	0.7273041	0.5306333	0.3883370	0.2850579	0.2098662	0.1549574	0.1147411	0.0852000	0.0634384	0.0473624	0.0354540	0.0266087
33	0.7201031	0.5202287	0.3770262	0.2740942	0.1998725	0.1461862	0.1072347	0.0788889	0.0582003	0.0430568	0.0319405	0.0237577
34	0.7129733	0.5100282	0.3660449	0.2635521	0.1903548	0.1379115	0.1002193	0.0730453	0.0533948	0.0391425	0.0287752	0.0212123
35	0.7059142	0.5000276	0.3553834	0.2534155	0.1812903	0.1301052	0.0936629	0.0676345	0.0489861	0.0355841	0.0259236	0.0189395
36	0.6989249	0.4902232	0.3450324	0.2436687	0.1726574	0.1227408	0.0875355	0.0626246	0.0449413	0.0323492	0.0233546	0.0169103
37	0.6920049	0.4806109	0.3349829	0.2342968	0.1644356	0.1157932	0.0818088	0.0579857	0.0412306	0.0294093	0.0210402	0.0150985
38	0.6851534	0.4711872	0.3252262	0.2252854	0.1566054	0.1092389	0.0764569	0.0536905	0.0378262	0.0267349	0.0189551	0.0134808
39	0.6783697	0.4619482	0.3157535	0.2166206	0.1491480	0.1030555	0.0714550	0.0497134	0.0347030	0.0243044	0.0170767	0.0120364
40	0.6716531	0.4528904	0.3065568	0.2082890	0.1420457	0.0972222	0.0667804	0.0460309	0.0318376	0.0220949	0.0153844	0.0107468

Table 4: PRESENT VALUE of Annuity of \$1.00 in arrears.												
Period/Per	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%
1	0.990099	0.980392	0.970874	0.961538	0.952381	0.943396	0.934579	0.925926	0.917431	0.909091	0.900901	0.892857
2	1.970395	1.941561	1.913470	1.886095	1.859410	1.833393	1.808018	1.783265	1.759111	1.735537	1.712523	1.690051
3	2.940985	2.883883	2.828611	2.775091	2.723248	2.673012	2.624316	2.577097	2.531295	2.486852	2.443715	2.401831
4	3.901966	3.807729	3.717098	3.629895	3.545951	3.465106	3.387211	3.312127	3.239720	3.169865	3.102446	3.037349
5	4.853431	4.713460	4.579707	4.451822	4.329477	4.212364	4.100197	3.992710	3.889651	3.790787	3.695897	3.604776
6	5.795476	5.601431	5.417191	5.242137	5.075692	4.917324	4.766540	4.622880	4.485919	4.355261	4.230538	4.111407
7	6.728195	6.471991	6.230283	6.002055	5.786373	5.582381	5.389289	5.206370	5.032953	4.868419	4.712196	4.563757
8	7.651678	7.325481	7.019692	6.732745	6.463213	6.209794	5.971299	5.746639	5.534819	5.334926	5.146123	4.967640
9	8.566018	8.162237	7.786109	7.435332	7.107822	6.801692	6.515232	6.246888	5.995247	5.759024	5.537048	5.328250
10	9.471305	8.982585	8.530203	8.110896	7.721735	7.360087	7.023582	6.710081	6.417658	6.144567	5.889232	5.650223
11	10.367628	9.786848	9.252624	8.760477	8.306414	7.886875	7.498674	7.138964	6.805191	6.495061	6.206515	5.937699
12	11.255077	10.575341	9.954004	9.385074	8.863252	8.383844	7.942686	7.536078	7.160725	6.813692	6.492356	6.194374
13	12.133740	11.348374	10.634955	9.985648	9.393573	8.852683	8.357651	7.903776	7.486904	7.103356	6.749870	6.423548
14	13.003703	12.106249	11.296073	10.563123	9.898641	9.294984	8.745468	8.244237	7.786150	7.366687	6.981865	6.628168
15	13.865053	12.849264	11.937935	11.118387	10.379658	9.712249	9.107914	8.559479	8.060688	7.606080	7.190870	6.810864
16	14.717874	13.577709	12.561102	11.652296	10.837770	10.105895	9.446649	8.851369	8.312558	7.823709	7.379162	6.973986
17	15.562251	14.291872	13.166118	12.165669	11.274066	10.477260	9.763223	9.121638	8.543631	8.021553	7.548794	7.119630
18	16.398269	14.992031	13.753513	12.659297	11.689587	10.827603	10.059087	9.371887	8.755625	8.201412	7.701617	7.249670
19	17.226008	15.678462	14.323799	13.133939	12.085321	11.158116	10.335595	9.603599	8.950115	8.364920	7.839294	7.365777
20	18.045553	16.351433	14.877475	13.590326	12.462210	11.469921	10.594014	9.818147	9.128546	8.513564	7.963328	7.469444
21	18.856983	17.011209	15.415024	14.029160	12.821153	11.764077	10.835527	10.016803	9.292244	8.648694	8.075070	7.562003
22	19.660379	17.658048	15.936917	14.451115	13.163003	12.041582	11.061240	10.200744	9.442425	8.771540	8.175739	7.644646
23	20.455821	18.292204	16.443608	14.856842	13.488574	12.303379	11.272187	10.371059	9.580207	8.883218	8.266432	7.718434
24	21.243387	18.913926	16.935542	15.246963	13.798642	12.550358	11.469334	10.528758	9.706612	8.984744	8.348137	7.784316
25	22.023156	19.523456	17.413148	15.622080	14.093945	12.783356	11.653583	10.674776	9.822580	9.077040	8.421745	7.843139
26	22.795204	20.121036	17.876842	15.982769	14.375185	13.003166	11.825779	10.809978	9.928972	9.160945	8.488058	7.895660
27	23.559608	20.706898	18.327031	16.329586	14.643034	13.210534	11.986709	10.935165	10.026580	9.237223	8.547800	7.942554
28	24.316443	21.281272	18.764108	16.663063	14.898127	13.406164	12.137111	11.051078	10.116128	9.306567	8.601622	7.984423
29	25.065785	21.844385	19.188455	16.983715	15.141074	13.590721	12.277674	11.158406	10.198283	9.369606	8.650110	8.021806
30	25.807708	22.396456	19.600441	17.292033	15.372451	13.764831	12.409041	11.257783	10.273654	9.426914	8.693793	8.055184
31	26.542285	22.937702	20.000428	17.588494	15.592811	13.929086	12.531814	11.349799	10.342802	9.479013	8.733146	8.084986
32	27.269589	23.468335	20.388766	17.873551	15.802677	14.084043	12.646555	11.434999	10.406240	9.526376	8.768600	8.111594
33	27.989693	23.988564	20.765792	18.147646	16.002549	14.230230	12.753790	11.513888	10.464441	9.569432	8.800541	8.135352
34	28.702666	24.498592	21.131837	18.411198	16.192904	14.368141	12.854009	11.586934	10.517835	9.608575	8.829316	8.156564
35	29.408580	24.998619	21.487220	18.664613	16.374194	14.498246	12.947672	11.654568	10.566821	9.644159	8.855240	8.175504
36	30.107505	25.488842	21.832252	18.908282	16.546852	14.620987	13.035208	11.717193	10.611763	9.676508	8.878594	8.192414
37	30.799510	25.969453	22.167235	19.142579	16.711287	14.736780	13.117017	11.775179	10.652993	9.705917	8.899635	8.207513
38	31.484663	26.440641	22.492462	19.367864	16.867893	14.846019	13.193473	11.828869	10.690820	9.732651	8.918590	8.220993
39	32.163033	26.902589	22.808215	19.584485	17.017041	14.949075	13.264928	11.878582	10.725523	9.756956	8.935666	8.233030
40	32.834686	27.355479	23.114772	19.792774	17.159086	15.046297	13.331709	11.924613	10.757360	9.779051	8.951051	8.243777