

ADM 2342 X
INTERMEDIATE FINANCIAL ACCOUNTING 1
Spring/Summer 2013
Quiz No. 3
Solutions

..... / 35 marks

NAME: _____

STUDENT #: _____

Statement of Academic Integrity:

The 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.

Name: _____ (signature)

Note:

A quiz received without the signature of the student will not be graded and will receive a score of zero.

Question No. 1 (13 marks)

On April 1, 2013 Lorimax Star Corporation (LSC) purchased \$200,000 of Fox Company 2%, 10-year bonds. LSC accounts for this investment using the amortized cost model and follows IFRS. Interest is payable each April 1 and October 1. The market rate of interest at the time the bonds were initially purchased was 4%. LSC has a December year-end.

Required: (Show all computations. Narrative explanations are not required)

Prepare the necessary journal entry (entries) on the books of Lorimax Star Corporation on the following dates:

- (a) April 1, 2013
- (b) December 31, 2013

Answer:

(a) *PV of \$200,000 due in 20 semiannual periods years at 2% per semiannual period*
 $= \$200,000 / (1.02)^{20} + PVOA \$2,000_{n=20; i=2\%}$
 $= \$200,000 / 1.485947 + \$2,000 (16.351433)$
 $= \$134,597.27 + \$32,702.87 = \$167,300$ (rounded)

April 1, 2013

<i>Investment in Fox Company bonds</i>	167,300	
<i>Cash</i>		167,300

<u>Date</u>	<u>Cash Received</u> (1%)	<u>Interest Income</u> (2%)	<u>Bond Discount</u> <u>Amortization</u>	<u>Carrying Value</u> <u>of Bond</u>
04/01/13	—	—	—	\$167,300
10/01/13	2,000	\$3,346	\$1,346	168,646
04/01/14	2,000	3,372	1,373	170,019
10/01/14	2,000	3,400	1,400	171,419
<i>etc</i>	<i>etc</i>	<i>etc</i>	<i>etc</i>	<i>etc</i>

(b)

December 31, 2013

<i>Interest Receivable (2,000 x 3/6)</i>	1,000	
<i>Investment in Fox Company bonds (1,373 x 3/6)</i>	686.5	
<i>Interest Revenue</i>		1,686.5

Question No. 2 (11 marks)

On January 1, 2012, Falkirk Company bought 30,000 shares of the available 100,000 voting common shares of Cassandra Corporation, a publicly traded firm. Falkirk follows ASPE.

This acquisition provided Falkirk with significant influence. Falkirk paid \$700,000 cash for the investment. At the time of the acquisition, Cassandra reported assets of \$2,500,000 and liabilities of \$1,200,000 on its Statement of Financial Position. All asset values reflected fair market value except for capital assets that had a net book value of \$500,000 and a fair market value of \$730,000. These assets had a remaining useful life of five years. For 2012, Cassandra reported net income of \$400,000 and paid cash dividends of \$100,000.

On May 16, 2013, Falkirk sold 9,000 of its shares in Cassandra Corporation for \$200,000. Falkirk has no immediate plans to sell the remaining shares of this investment.

Per share stock price information for Cassandra Corporation is shown as follows: January 1, 2012 - \$23; December 31, 2012 - \$22; January 1, 2013 - \$21

Required:

- (a) Compute the amount of goodwill that was paid for by Falkirk in this investment.
- (b) At the end of 2012, calculate the balance of the investment account that would appear on Falkirk's Statement of Financial Position on December 31, 2012.
- (c) Provide the journal entry to account for Falkirk's sale of the shares on May 16, 2013.
- (d) Under ASPE, how should Falkirk account for its remaining investment in Cassandra?

Answer:

(a)

Purchase price (30%).....		\$700,000
Market value of identifiable assets acquired*.	\$2,730,000	
Less: liabilities	<u>(1,200,000)</u>	
Total market value of net assets acquired	1,530,000	
Portion purchased (30%) (.3 x \$1,530,000)....		<u>(459,000)</u>
Goodwill		<u>\$241,000</u>
*\$2,500,000 + (\$730,000 - \$500,000)		

or

Purchase price (30%).....		\$700,000
Investor's share of net assets acquired* (30% x \$1,300,000).....		<u>390,000</u>
Purchase price discrepancy		310,000
Investor's share of undervaluation of capital assets (30% x (\$730,000 - \$500,000)		<u>(69,000)</u>
Goodwill		<u>\$241,000</u>
*net assets = \$2,500,000 - \$1,200,000 = \$1,300,000		

(b)

Cost.....		\$700,000
Plus: share of investment income*		106,200
Less: share of dividends received (\$100,000 x 30%)		<u>(30,000)</u>
		<u>\$776,200</u>

Share of investment income:

$$(30\% \times \$400,000) + 30\% \times [(\$730,000 - \$500,000) / 5 \text{ years}] = \$106,200$$

Question No. 2 (continued) (11 marks)

(c)

Cash.....	200,000	
Loss on sale of investment.....	32,860	
Investment in Wong.....		232,860

To record the sale of the shares
 $\$776,200 \times 9,000/30,000 = \$232,860$

(d)

Under ASPE, either the cost method or the equity method is used for significantly influenced investments. The reduction in share ownership after the sale of the 9,000 shares on May 16, 2013 drops to 21,000 or 21% of the outstanding voting shares. . Technically, significant influence could still exist (however, we are not told in this question, so an assumption has to be made). If, on the other hand, significant influence is deemed to no longer exist after the May 16 sale, the cost method is used. One caveat: if the associate's shares are quoted in an active market, (we are not told about this in this question either), the cost method cannot be used. Instead, the fair value approach (FV-NI), with gains or losses recognized in income, is used. See page 549 for additional details.

Question No. 3 (6 marks)

Nomad General Store uses the conventional retail inventory method. Information relating to the calculation of the inventory at December 31, 2012, follows:

	<u>Cost</u>	<u>Retail</u>
Inventory, January 1, 2012	\$140,000	\$220,000
Purchases	480,000	720,000
Freight-in	80,000	
Sales		750,000
Net mark-ups		160,000
Net markdowns		60,000

Required:

Calculate the inventory at December 31, 2012, using the conventional retail inventory method. (Use two decimal places.)

Answer:

*Nomad General Store
December 31, 2012*

	<u>At Cost</u>	<u>At Retail</u>	<u>Ratio</u>
Inventory, January 1, 2010	\$140,000	\$ 220,000	
Purchases	480,000	720,000	
Freight-in	80,000		
Net mark-ups	<u>0</u>	<u>160,000</u>	
	700,000	1,100,000	63.64%
Net markdowns		<u>(60,000)</u>	
Totals	<u>\$700,000</u>	<u>1,040,000</u>	
Less sales		<u>750,000</u>	
Inventory, Dec. 31, 2010, at retail		<u>\$ 290,000</u>	

Estimated inventory, Dec. 31 ($\$290,000 \times .64$ rounded) \$185,600

Question No. 4 (5 marks)

Beringer Co. prepares monthly income statements. Inventory is counted only at year end; thus, month-end inventories must be estimated. All sales are made on account. The rate of mark-up on cost is 20%. The following information relates to the month of May.

Accounts receivable, May 1	\$21,000
Accounts receivable, May 31	27,000
Collections of accounts during May	84,000
Inventory, May 1	47,000
Net purchases during May	65,000

Required:

Use the gross profit method and calculate the estimated cost of the inventory on May 31. Ensure you convert the given mark-up on cost to a mark-up based on sales.

Answer:

GP% rate based upon sales (converted from cost) = $20\% / (100\% + 20\%) = 16.67\%$

Estimated gross profit on sales = $.1667 \times \$90,000^ = \$15,000$*

Estimated cost of goods sold = $\$90,000^ - \$15,000 = \$75,000$*

Cost of goods available for sale = $\$47,000 + \$65,000 = \$112,000$

Estimated ending inventory = $\$112,000 - \$75,000 = \underline{\$37,000}$.

Sales:

<i>Collections of accounts</i>	<i>\$ 84,000</i>
<i>Add accounts receivable, May 31</i>	<i>27,000</i>
<i>Deduct accounts receivable, May 1</i>	<i><u>(21,000)</u></i>
<i>Sales during May</i>	<i>\$ 90,000</i>