John Molson School of Business
Department of Accountancy
ACCO 320 – Intermediate Accounting II
Summer 2010

Midterm Examination
Friday, May 21, 2010

Student Name:____________________________ **Student ID:**_________________ **Section**:________

	Estimated time	Marks
Part 1. Multiple Choice Questions	59 minutes	33 Marks
Part 2. Long-Term Liabilities	50 minutes	28 Marks
Part 3. Shareholders' Equity	49 minutes	27 Marks
Part 4. Current Liabilities	22 minutes	12 Marks
TOTAL	**180 minutes**	**100 Marks**

Instructions:

1) Make sure you put your name, student ID, and section above (as well as on the electronic answer sheet and the exam booklet) AND put your ID on your desk, face up.

2) For multiple choice questions, make sure to circle the alphabet related to one answer you consider best. Answers MUST BE on the exam booklet itself or else it will not be marked.

3) There is partial credit available on parts 2 to 4 so make sure you **show ALL your work and computations**.

4) Tables of time value of money are attached at the end of the exam.

5) Allocate your time [1] wisely…You have 3 hours to complete this exam. **You MUST STOP all your work** and turn in the exam when the invigilator says the time is up.

6) You MUST return (1) this document, (2) your exam booklet.

READ EACH PROBLEM AND THINK CAREFULLY.
GOOD LUCK!! I WISH YOU WELL

Part 1. Multiple Choice Questions (22 x 1.5 marks each = 33 marks)

INSTRUCTIONS: Answer **THIS QUESTION** on **THIS BOOKLET**. Answers written anywhere else **WILL NOT BE GRADED.** There are 24 questions. You may **Attempt ALL** but your **best 22** answers will be graded. Circle the alphabet corresponding to the one statement which best answers each question. Multiple markings on any question will be marked as an incorrect response.

1. Which of these is not included in an employer's payroll tax expense?
   a. Corporate income taxes
   b. Employment insurance taxes
   c. CPP/QPP contributions
   d. Workers' compensation payments

2. Accrued liabilities are disclosed in financial statements by
   a. a footnote to the statements.
   b. showing the amount among the liabilities but not extending it to the liability total.
   c. an appropriation of retained earnings.
   d. appropriately classifying them as liabilities in the balance sheet.

3. A liability for compensated absences such as vacations, for which it is expected that employees will be paid, should:
   a. be accrued during the period when the compensated time is expected to be used by employees.
   b. be accrued during the period following vesting.
   c. be accrued during the period when earned.
   d. not be accrued unless a written contractual obligation exists.

4. Which of the following is the proper way to report a gain contingency?
   a. As an accrued amount
   b. As deferred revenue
   c. As an account receivable with additional disclosure explaining the nature of the contingency
   d. As a disclosure only

5. Crystal Co. is being sued for illness caused to local residents as a result of negligence on the company's part in permitting the local residents to be exposed to highly toxic chemicals from its plant. Crystal's lawyer states that it is likely that Crystal will lose the suit and be found liable for a judgement costing Crystal anywhere from $600,000 to $3,000,000. However, the lawyer states that the most likely cost is $1,800,000. As a result of the above facts, Crystal should accrue
   a. a loss contingency of $600,000 and disclose an additional contingency of up to $2,400,000.
   b. a loss contingency of $1,800,000 and disclose an additional contingency of up to $1,200,000.
   c. a loss contingency of $1,800,000 but not disclose any additional contingency.
   d. no loss contingency but disclose a contingency of $600,000 to $3,000,000.

6. On December 31, 2007, Main Co. has $4,000,000 of short-term notes payable due on February 14, 2008. On February 2, 2008, Main borrowed a long-term loan of $2,400,000 from National Bank and used $1,000,000 additional cash to pay $3,400,000 of the short-term notes payable. The amount of the short-term notes payable that should be reported as current liabilities on the December 31, 2007 balance sheet that is issued on March 5, 2008 is
   a. $0.
   b. $600,000.
   c. $1,000,000.
   d. $1,600,000.

7. An expense for a premium or coupon should
   a. be recorded for the total actual redemption cost in the year of the related sale.
   b. be recorded for the estimated redemption cost in the year of the related sale.
   c. not be recorded.
   d. be recorded in the year(s) that the premium or redemption is expected to be redeemed.

8. During 2008, PSG Co. introduced a new product carrying a two-year warranty against defects. The estimated warranty costs related to dollar sales are 3% within 12 months following sale and 6% in the second 12 months following sale. Sales and actual warranty expenditures for the years ended December 31, 2008 and 2009 are as follows:

	Sales	**Actual Warranty Expenditures**
2008	$ 800,000	$18,000
2009	1,000,000	45,000
	$1,800,000	$63,000

   At December 31, 2009, PSG should report a maximum estimated warranty liability of
   a. $0.
   b. $15,000.
   c. $45,000.
   d. $99,000.

9. An asset retirement obligation should be recognized when
   a. an asset is impaired and is available for sale.
   b. operation of an asset has resulted in an additional obligation such as the cost of cleaning up an oil spill.
   c. there is a legal obligation to make expenditures to restore the site of the asset at the time of closure.
   d. an obligation exists to purchase a long-lived asset.

10. How would the amortization of discount on bonds payable affect each of the following?

	Book value bond	**Interest expense**
a.	Increase	Decrease
b.	**Increase**	**Increase**
c.	Decrease	Decrease
d.	Decrease	Increase

11. Oro Puro Inc. has developed a new gold mine in 2007 and is required by provincial law to reclaim the site once mining operations are completed. The company estimates that the mine will close in 20 years and that the mine reclamation will cost $5,000,000. Oro Puro uses a 6% discount rate.
    The entry to record the asset retirement obligation is as follows:

a. Reclamation Expense	93,541	
Asset Retirement Obligation		93,541
b. Reclamation Expense	250,000	
Asset Retirement Obligation		250,000
c. Gold Mine	5,000,000	
Asset Retirement Obligation		5,000,000
d. Gold Mine	**1,559,024**	
Asset Retirement Obligation		**1,559,024**

12. On January 2, 2011, Boles Co., Ltd., a publicly traded corporation, issued 10-year bonds with detachable warrants at 105. During 2012, the warrants were converted into common stock selling for $50. At conversion, the market price of Boles' warrants was $10. On January 2, 2011, cash proceeds from the issuance of the bonds with detachable warrants should be reported as:
    a. contributed surplus for the entire proceeds.
    b. a liability for the entire proceeds.
    c. a liability for the face amount of the bonds and contributed surplus for the premium over the face amount.
    d. as a liabilityfor the portion of the proceeds attributable to the fair market value of the bonds and as contributed surplus for the balance.

13. Sellmer Corporation had two issues of securities outstanding: common shares and an 8% convertible bond issue in the face amount of $8,000,000. Interest payment dates of the bond issue are June 30 and December 31. The conversion clause in the bond indenture entitles the bondholders to receive forty (40) no par value common shares in exchange for each $1,000 bond. The value of the equity portion of the bond issue is $60,000. On June 30, 2008, the holders of $1,200,000 face value bonds exercised the conversion privilege. The market price of the bonds on that date was $1,100 per bond and the market price of the common shares was $35. The total unamortized bond discount at the date of conversion was $500,000. In applying the book value method, what amount should Sellmer credit to the account Common Shares as a result of this conversion?
    a. $1,284,000.
    b. $1,134,000.
    c. $1,125,000.
    d. $1,116,000.

14. Total shareholders' equity represents
    a. a claim to specific assets contributed by the owners.
    b. the maximum amount that can be borrowed by the enterprise.
    c. a claim against a portion of the total assets of an enterprise.
    d. only the amount of earnings that have been retained in the business.

Use the following information for questions 15 and 16.

On May 1, 2008, Jenks Co., a small local company, issued $500,000 of 7% bonds at 103, which are due on April 30, 2018. Twenty detachable stock warrants were attached to each $1,000 bond. Each warrant entitles the holder to purchase one share of Jenks' no par value common shares at a price of $40. The fair market value of the bonds without the warrants was unknown. On May 1, 2008, the fair value of Jenks' one common share and warrant was $35 and $2, respectively.

15. On May 1, 2008, Jenks should credit Contributed Surplus from Stock Warrants for
    a. $19,200.
    b. $20,000.
    c. $20,600.
    d. $35,000.

16. On May 1, 2008, Jenks should record the bonds with a
    a. discount of $20,000.
    b. discount of $5,000.
    c. discount of $5,600.
    d. premium of $15,000.

17. When non-par value shares are reacquired at a cost greater than their average issue price and cancelled, what account(s) should be debited?
    a. The share account for the total cost.
    b. The share account for the average issue price, contributed surplus for the additional amount, and lastly retained earnings for any remaining amount.
    c. The share account for the average per share amount, retained earnings for the additional amount, and lastly contributed surplus for any remaining amount.
    d. The share account for the average per share amount and a loss account for the additional amount.

18. Levi Corporation has 100,000 no par value common shares authorized, issued and outstanding. All 100,000 shares were issued at $90 each. Retained earnings of the company are $250,000. If 2,000 shares of Levi common were reacquired at $98 and cancelled, shareholders' equity would decrease by
    a. $150,000.
    b. $180,000.
    c. $196,000.
    d. $0.

19. The pre-emptive right of a common shareholder is the right to
    a. share proportionately in corporate assets upon liquidation.
    b. share proportionately in any new issues of shares of the same class.
    c. receive cash dividends before they are distributed to preferred shareholders.
    d. exclude preferred shareholders from voting rights.

20. Total shareholders' equity is ***not affected*** by the
    a. issuance of a stock dividend.
    b. creation of an appropriation for future income taxes.
    c. sale of treasury shares in excess of cost.
    d. issuance of a stock dividend *and* the creation of an appropriation for future income taxes.

21. Aida Corporation was organized on January 1, 2008, with an authorization of 400,000 no par value common shares. During 2008, the corporation had the following capital transactions:

January 5	issued 150,000 shares @ $10 per share
April 6	issued 50,000 shares @ $12 per share
June 8	issued 50,000 shares @ $14 per share
July 28	purchased 20,000 shares @ $11 per share and cancelled them
December 31	issued 20,000 shares @ $18 per share

What is the total amount of contributed surplus as of December 31, 2008?
a. $-0-.
b. $4,000.
c. $20,000.
d. $220,000.

22. On January 1, 2008, Dallas Inc., declared a 10% stock dividend on its common shares when the market value of the common shares was $20 per share. Shareholders' equity before the stock dividend was declared consisted of:

Common shares, no par value, authorized 200,000 shares issued and outstanding 120,000 shares	$1,350,000
Retained earnings	700,000
Total shareholders' equity	$2,050,000

What was the effect on Dallas' retained earnings as a result of the above transaction?
a. $120,000 decrease
b. $200,000 decrease
c. $400,000 decrease
d. $240,000 decrease

23. Nickel Mines International Ltd discovered a new bauxite deposit, the Fowl Bay Mine, and began production on January 1, 2008. The cost of discovering the mine was capitalized at $10,000,000. The province requires mining companies to return the land to a natural state at the end of mining activity. Nickel Mines International Ltd estimates that it will operate the mine for 3 years, at which time it will cost $2,500,000 for the land reclamation project. Nickel Mines International Ltd uses a 6% discount rate. The mine will generate equal revenues for the next 3 years. This company uses the straight-line method for the amortization of long-term assets. The net amount of the asset Fowl Bay Mine reported on the firm's December 31, 2008 (fiscal year end) balance sheet is

a. $8,066,033
b. $10,000,000
c. $12,500,000
d. $12,099,050

24. Which of the following is generally associated with payables classified as accounts payable?

	Periodic Payment of Interest	Secured by Collateral
a.	**No**	**No**
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

1. A
2. A
3. C
4. D
5. B
6. D
7. B
8. D
9. C
10. B
11. D
12. D
13. B
14. C
15. B
16. B
17. B
18. C
19. B
20. A
21. B
22. D
23. A
24. A

Part 2. Long-Term Liabilities (28 marks)

A) Selling price of bonds (4 Marks)

On January 1, 2009, Penguins, Inc. issued a bond with face value of $200,000 and a stated rate of 12% payable annually each December 31. The bond matures in 20 years and is sold to yield 10%.

Required (SHOW ALL WORK):
Calculate the amount of cash received by Penguins, Inc.

B) Entries related to bonds (8 Marks)

On May 1, 2008 Crosby Corporation issued bonds with a face value of $5,000,000 and a coupon rate of 5% for $4,670,865. The effective rate on the bonds is 6%. The bonds pay interest each May 1 and November 1 and mature on November 1, 2016.

The company uses effective rate amortization method.

Required (SHOW ALL WORK):
Prepare all journal entries required from the date of issuance, that is May 1, 2008, to December 31, 2008. The company has a December 31 year-end. This company amortizes any bond premium or discount on the interest payment dates and at year end. Show all the relevant calculations.

C) Bond Repurchase (8 Marks)

HabZ, Inc., repurchased some of its bonds on the market on June 1, 2009.

Face value of the bonds repurchased: $2,300,000
Related unamortized discount recorded on March 1, 2009 (last interest payment date): $137,277
Effective rate: 6%
Coupon rate: 5%
Interest payment dates: March 1 and September 1
On June 1, 2009, bonds were repurchased at 103, which includes interest accrued.

Required (SHOW ALL WORK):
Record the necessary journal entries on June 1, 2009.

D) Convertible bonds (8 Marks)

Doyle Corp. issued $5,000,000 of 12%, 5-year convertible bonds on December 1, 2008 for $5,026,000 plus accrued interest. The bonds were dated April 1, 2008 with interest payable April 1 and October 1. If the bonds had not been convertible, they would have sold for $5,006,000. Bond premium/discount is amortized each interest period on a straight-line basis.

On October 1, 2009, $2,500,000 of these bonds were converted into 35,000 no par common shares. Accrued interest was paid in cash at the time of conversion.

Required (SHOW ALL WORK):

(a) Prepare the entry to record the interest expense at April 1, 2009. Assume that interest payable was credited when the bonds were issued (round to nearest dollar).

(b) Prepare the entry to record the conversion on October 1, 2009. Use the book value method. Assume that the entry to record amortization of the bond premium/discount and interest payment has been made.

Part 2. Long-Term Liabilities (28 marks)

A) Selling price of bonds (4 Marks)

Part A- 2 marks	**Factor**	**PV**
PV of the Principal = 200,000 x PVIF(10%,20)	0.14864	29,728
PV of Interest Payments = 24,000 x PVIFA (10%, 20)	8.51356	204,325
	Cash Received	234,053

B) Entries related to bonds (8 Marks)

Period	Cash interest paid	Int. expense (3%)	Amortization	Closing net liability
May 1, 2008 (open)				4670865
39752	125000	140,126	15,126	4685991
May1, 2009	125000	140,580	15,580	4701571
40117	125000	141047	16047	4717618

May, 1 2008 (2 Marks)

Cash	4,670,865	
Discount on bonds payable	329,135	
Bonds payable		5,000,000

OR

Cash	4,670,865	
Bonds payable		4,670,865

November 1, 2008 (3 Marks)

Interest expense	140,126	
Discount on bonds payable*		15,126
Cash		125,000

December 31, 2008 (3 Marks)

Interest expense ($140,580 x 2/6)	46,860	
Discount on bonds payable*		5,193
Interest payable ($125,000 × 2/6)		41,667

*** OR simply: "Bonds payable"**

C) <u>Bond repurchase (8 Marks)</u>

June 1, 09

<u>Accrual of Interest for 3 month</u>

Interest Expense **[2,162,723 x 0.03 x 3/6]**	32,441	
Discount		3,691
Int. payable / Cash (1/2)		
[2300K x 0.05 x 0.25]		28,750

<u>Extinguishment of Bond</u>

Bonds Payable	2,300,000	
Int. payable	28,750	
Loss	173,836	
Discount		*133,586
Cash		2,369,000

<u>OR</u>

Bonds payable	2,166,414	
Int. payable	28,750	
Loss	173,836	
Cash		2,369,000

Carrying Value of Bonds, June 1, 2009	
Face Value	230000
Less: Unamortized Discount	-137277
Carrying Value, June 1	2162723

<u>Carrying Value of 2,300,000 @ June 1, 2009</u>

Discount on Retired Bonds @ March 1, 2009	137277
Amount amortized for March 1 to June 1 on Retired Bonds	3691
As @ June 1, 2009	133586

D) Convertible bonds (8 Marks)

(a)

Interest Payable.	100,000	
Interest Expense.	199,540	
Premium on Bonds Payable	460	
Cash		300,000

Calculations:

Issuance price	$5,026,000
Price without conversion	5,006,000
Contributed surplus-conversion	$ 20,000
Premium ($5,006,000 – $5,000,000)	$6,000
Months remaining	52
Premium per month	$115
Premium amortized (4 × $115)	$460

(b)

Bonds Payable.	2,500,000	
Premium on Bonds Payable	2,423	
Contributed Surplus—Conversion.	10,000	
Common Shares		2,512,423

Calculations:

Premium related to the bonds	$6,000	($6,000 ÷ 2)
Less premium amortized to date	1,154	[($6,000 ÷ 52) × 10]
Premium remaining	$4,846	
Premium related to ½ of the bonds	$2,423	($4,846 ÷ 2)

Part 3. Shareholders' Equity (27 Marks)
Estimated time: 49 minutes

I) Equity transactions (16 Marks)

Presented below is information related to Senators Company:

1. The company is granted a charter that authorizes issuance of 30,000 $10 par value preferred shares and 80,000 no par value common shares.

2. 5,000 common shares are issued to the founders of the corporation for land valued by the board of directors at $300,000. At the date of stock issuance, the reliable fair value of common shares is $55 per share.

3. 6,000 preferred shares are issued for cash at $120 per share.

4. The company issues 200 common shares to its attorneys for costs associated with starting the company. At that time, the common shares were selling at $60 per share.

5. Senators Company decides to issue shares on a subscription basis to selected individuals giving each individual the right to purchase 400 common shares at a price of $65 per share. Twenty-five individuals accept the company's offer and agree to pay 10% down and the remainder in three equal instalments over the next three months.

<u>Required (SHOW ALL WORK):</u>

A. Prepare the general journal entries necessary to record the transactions in [1] to [4] above.

B. For transaction 5, prepare all necessary journal entries (i) at the date of stock initial subscription, and (ii) at the date when the final instalment payment is received and the shares are issued.

C. In [5] above, assume for <u>this question only</u> that two persons defaulted on the second instalment. The company forfeited their deposits and cancelled the two subscription offers. Prepare the entry for recording the second instalment under these assumptions.

II) Dividends on preferred and common shares (11 Marks)

Capitals, Inc. has $600,000, $0.90, no par value preferred shares (60,000 shares) and $900,000 of no par value common shares outstanding (90,000 shares). No dividends have been paid or declared during 2008 and 2009. As of December 31, 2010, it is desired to distribute cash of $306,000 as dividends.

<u>Required (SHOW ALL WORK)</u>:

How much will the preferred and common shareholders each receive under each of the following assumptions:

A. The preferred is non-cumulative.
B. The preferred is cumulative and non-participating.
C. The preferred is cumulative and fully participating.

Part 3. Shareholders' Equity (27 Marks)

I. Equity transactions (16 Marks)

1. No entry necessary.

2.	Land ($55 × 5,000)	275,000	
	Common Shares ($55 × 5,000)		275,000
3.	Cash ($120 × 6,000)	720,000	
	Preferred Shares ($120 × 6,000)		720,000
4.	Organization Expense	12,000	
	Common Shares		12,000

B. (i) At the date of stock initial subscription

Subscriptions Receivable ($65 × 400 × 25)	650,000	
Common Shares Subscribed		650,000
Cash	65,000	
Subscriptions Receivable		65,000

(ii) At the date of the final settlement

Cash ($650,000 × 30%)	195,000	
Subscriptions Receivable		195,000
Common Shares Subscribed	650,000	
Common Shares		650,000

C. **Default of Second Instalment**

Cash ($19.5 x 400 x 23)	179,400	
Subscriptions Receivable		179,400
Common Shares Subscribed ($19.5 x 400 x 2 x 2)	31,200	
Subscriptions Receivable		31,200
Common Shares Subscribed ($26.0 x 400 x 2)	20,800	
Contributed Surplus - Common Shares		20,800

II) Dividends on preferred and common shares (11 Marks)

(a)

	Preferred	Common	Total
Current year's preferred dividend($.90 × 60,000)	$54,000	$ —	$ 54,000
Remainder to common		252,000	252,000
	$54,000	$252,000	$306,000

(b)

	Preferred	Common	Total
Dividends in arrears, ($.90 × 60K x 2)	$108,000	$ —	$ 108,000
Current year's dividend to preferred	54,000	—	54,000
Remainder to common		144,000	144,000
	$162,000	$144,000	$306,000

(c)

	Preferred	Common	Total
Dividends in arrears, ($.90 × 60K x 2)	$ 108,000	$ —	$ 108,000
Current year's dividend @9%	54,000	81,000	135,000
Excess dividend ($600 ÷ $1,500) x 63K	25,200	37,800	63,000
	$187,200	$118,800	$306,000

Part 4. Current Liabilities (12 Marks)
Estimated time: 22 minutes

INSTRUCTIONS: Attempt either [A] OR [B] **BUT NOT BOTH**. If both are attempted, **the first section will be graded**. ***No exceptions, whatsoever will be made for this condition***.

Section A - Premiums

Suki Candy Company offers a coffee mug as a premium for every ten 50-cent candy bar wrappers presented by customers together with $1.00. The purchase price of each mug to the company is 90 cents; in addition it costs 60 cents to mail each mug. The results of the premium plan for the years 2008 and 2009 are as follows (assume all purchases and sales are for cash):

	2008	**2009**
Coffee mugs purchased	480,000	400,000
Candy bars sold	3,750,000	4,500,000
Wrappers redeemed	1,900,000	2,800,000
2008 wrappers expected to be redeemed in 2009		1,300,000
2009 wrappers expected to be redeemed in 2010		1,800,000

Instructions

(a) Prepare the general journal entries that should be made in 2008 and 2009 related to the above plan by Suki Candy.

Section B - Warranties

Ellefson Equipment Company sells computers for $2,000 each and also gives each customer a 3-year warranty that requires the company to perform periodic services and to replace defective parts. During 2008, the company sold 500 computers. Based on past experience, the company has estimated the total 3-year warranty costs as $40 for parts and $80 for labour. (Assume sales all occur at December 31, 2008.)

In 2009, Ellefson incurred actual warranty costs relative to 2008 computer sales of $5,000 for parts and $12,000 for labour.

Instructions

(a) Under the expense warranty treatment, give the entries to reflect the above transactions (accrual method) for 2008 and 2009.
(b) Under the cash basis method, what are the Warranty Expense balances for 2008 and 2009?

Part 4. Current Liabilities (12 Marks)

Section A - Premiums

(a) **2008**

Premium Mugs Inventory (480 × $.90)K.	432,000	
Cash		432,000
Cash	1,875,000	
Sales (3,750K × $.50)		1,875,000
Cash [1,900K / 10]	190,000	
Premium Expense	95,000	
Premium Mugs Inventory (190K × $.90).		171,000
Cash (190K x 0.60)		114,000
Premium Expense (1,300K ÷ 10 = 130K × $.50).	65,000	
Estimated Liability for Premiums		65,000

2009

Inventory of Premium Mugs (400K × $.90).	360,000	
Cash		360,000
Cash	2,250,000	
Sales (4,500K × $.50)		2,250,000
Cash [2,800K ÷ 10 × $1.00)].	280,000	
Estimated Liability for Premiums	65,000	
Premium Expense	75,000	
Premium Mugs Inventory (280K × $.90).		252,000
Cash (280K x 0.60)		168,000
Premium Expense (1,800K / 10 = 180K × $.50).	90,000	
Estimated Liability for Premiums		90,000

<u>Section B</u> - <u>Warranties</u>

(a) **<u>2008</u>**

Accounts Receivable	1,000,000	
Sales		1,000,000
Warranty Expense	60,000	
Estimated Liability Under Warranties.		60,000

<u>2009</u>

Estimated Liability Under Warranties.	17,000	
Inventory		5,000
Accrued Payroll		12,000

(b) 2008 **$0.**
2009 **$17,000**.