École de gestion TELFER School of Management

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Mid Term Exam
Intermediate Financial Accounting II
Winter 2012
ADM3340

(SUGGESTED SOLUTIONS)

Name: _____ **ID#:** _____

INSTRUCTIONS:

- Write your name and student ID number above.
- Turn off all cell phones.
- This examination "SUGGESTED SOLUTION" comprises **4** multi-part questions over **20** numbered pages. Answer all questions in this booklet. Booklet is **not** to be removed from the examination room. You may not separate the pages.
- Limit your answer to the space provided. Blank sheets for rough work are provided at the back of this booklet. Any 'rough work' on pages **19** and **20** will not be marked.
- 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.
- Present value tables are provided.
- 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
Chapter 12	1: part 1	Goodwill	/6
	1: part 2	Impairment: ASPE	/7
	1: part 3	Impairment: IFRS	/9
Chapter 13	2: part 1	Premiums	/9
	2: part 2	Warranties	/6
	2: part 3	Refinancing short term debt	/5
Chapter 14	3: part 1	Bond liabilities: issuance	/9
	3: part 2	Bond liabilities: interest expense	/9
	3: part 3	Bond liabilities: retirement	/6
	3: part 4	Troubled debt restructuring	/12
Chapter 15	4: part 1	True/false	/4
	4: part 2	Shareholders' equity	/4
	4: part 3	Cash dividends	/5
	4: part 4	Share retirement & stock dividends	/9
	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 (or 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 (22 marks)

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

PART 1: (6 marks)

Carswell Manufacturing Company decided to expand further by purchasing Fisher Company. The balance sheet of Fisher Company as of December 31, 2011 was as follows:

Fisher Company
Balance Sheet
December 31, 2011

Assets		Equities	
Cash	$ 210,000	Accounts payable	$ 325,000
Receivables	450,000	Common shares	800,000
Inventory	275,000	Retained earnings	835,000
Plant assets (net)	1,025,000		
Total assets	$1,960,000	Total equities	$1,960,000

An appraisal, agreed to by the parties, indicated that the fair market value of the inventory was $320,000 and that the fair market value of the plant assets was $1,225,000. The fair market value of the receivables is equal to the amount reported on the balance sheet. The agreed purchase price was $3 million, and this amount was paid in cash to the previous owners of Fisher Company. The $3 million includes $100,000 paid for Fisher's internally developed customer lists.

Required
Determine the amount of goodwill (if any) implied in the purchase price of $3 million. Show calculations.

Purchase price		**$3,000,000**
Less tangible net assets acquired:		
Book value	**$1,635,000**	
Appraisal increment—inventory	**45,000**	
Appraisal increment—plant assets	**200,000**	
Total fair market value of tangible net assets acquired	**1,880,000**	
Less fair value of intangible asset acquired (customer lists)	**100,000**	
Total fair market value of tangible and intangible net assets acquired		**1,980,000**
Goodwill		**$1,020,000**

Question 1 (22 marks) (continued)

PART 2: (7 marks)

	Limited-Life Intangible Assets.	Indefinite-Life Intangible Assets (excluding Goodwill).	Goodwill [the values below pertain to the Reporting Unit, including its Goodwill].
Carrying amount	$4,000,000	$5,000,000	$16,000,000
Fair value	3,400,000	4,500,000	15,500,000
Undiscounted future cash flows from use and eventual sale	3,800,000	4,800,000	14,500,000
Present value of the future cash flows from use and eventual sale	3,000,000	4,350,000	12,800,000
Costs to sell	20,000	20,000	250,000

Required
Using the above data complete the following grid, applying ASPE:

	Under ASPE		
	Limited-Life Intangible Assets.	Indefinite-Life Intangible Assets (excluding Goodwill).	Goodwill [the values below pertain to the Reporting Unit, including its Goodwill].
Is the asset impaired? Show supporting calculations.	Yes: the impairment test indicates the asset is impaired because its carrying amount of $4,000,000 exceeds $3,800,000, the sum of the undiscounted cash flows expected to result from its use and eventual disposition.	Yes: the impairment test indicates the asset is impaired because its carrying amount of $5,000,000 exceeds $4,500,000, its fair value	Yes: the impairment test indicates impairment because the carrying amount of $16,000,000 exceeds $15,500,000, the fair value.
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.	An impairment loss of $600,000 is recognized: this is the amount by which the $4,000,000 carrying amount exceeds the $3,400,000 fair value.	An impairment loss of $500,000 is recognized: this is the amount by which the $5,000,000 carrying amount exceeds the $4,500,000 fair value.	An impairment loss of $500,000 is recognized: this is the amount by which the $16,000,000 carrying amount exceeds the $15,500,000 fair value.
	[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.]		
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.	No. ASPE Section 3063.06: An impairment loss shall not be reversed if the fair value subsequently increases.		

Question 1 (22 marks) (continued)

Part 3: (9 marks)

	Limited-Life Intangible Assets.	Indefinite-Life Intangible Assets (excluding Goodwill).	Goodwill [the values below pertain to the Cash-Generating-Unit, including its Goodwill].
Carrying amount	$4,000,000	$5,000,000	$16,000,000
Fair value	3,400,000	4,500,000	15,500,000
Undiscounted future cash flows from use and eventual sale	3,800,000	4,800,000	14,500,000
Present value of the future cash flows from use and eventual sale	3,000,000	4,350,000	12,800,000
Costs to sell	20,000	20,000	250,000

Required:
Using the above data complete the following grid, applying IFRS:

	Under IFRS		
	Limited-Life Intangible Assets.	Indefinite-Life Intangible Assets (excluding Goodwill).	Goodwill [the values below pertain to the Cash-Generating-Unit, including its Goodwill].
Is the asset impaired? Show supporting calculations.	Yes, because the carrying amount of $4,000,000 exceeds the recoverable amount (defined by IAS 36.6) of $3,380,000 [which is the higher of the fair value $3,400,000 less the costs to sell of $20,000, and the present value of the future cash flows from use and eventual sale $3,000,000].	Yes, because the carrying amount of $5,000,000 exceeds the recoverable amount (defined by IAS 36.6) of $4,480,000 [which is the higher of the fair value $4,500,000 less the costs to sell of $20,000, and the present value of the future cash flows from use and eventual sale $4,350,000].	Yes, because the carrying amount of $16,000,000 exceeds the recoverable amount (defined by IAS 36.6) of $15,250,000 [which is the higher of the fair value $15,500,000 less the costs to sell of $250,000, and the present value of the future cash flows from use and eventual sale $12,800,000].
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.	$620,000 [= the carrying amount of $4,000,000 less the recoverable amount of $3,380,000 (= higher of $3,400,000 - $20,000 and $3,000,000)]	$520,000 [= the carrying amount of $5,000,000 less the recoverable amount of $4,480,000 (= higher of $4,500,000 - $20,000 and $4,500,000)]	$750,000 [= the carrying amount of $16,000,000 less the recoverable amount of $15,250,000 (= higher of $15,500,000 - $250,000 and $12,800,000)]. The $750,000 loss is allocated to the assets in accordance with IAS 36.104 and IAS 36.105.
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.	Yes, under both the cost and revaluation models. 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.	Yes, under both the cost and revaluation models. 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].	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.

Comments in red not required in students' answers.

QUESTION 2 (20 marks)

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

PART 1: (9 marks)

In 2011 Creamy Candy Company started a promotion offering 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 2011 and 2012 are as follows (assume all purchases and sales are for cash):

	2011	2012
Coffee mugs purchased	480,000	400,000
Candy bars sold	3,750,000	4,500,000
Wrappers redeemed	1,900,000	2,800,000
2011 wrappers expected to be redeemed in 2012	1,300,000	
2012 wrappers expected to be redeemed in 2013		1,800,000

Required
Prepare the general journal entries that should be made in 2011 and 2012 related to the above plan by Creamy Candy.

2011

Inventory of Premium Mugs (480,000 × $.90 = $432,000)	**432,000**	
Cash		**432,000**
Cash	**1,875,000**	
Sales (3,750,000 × $.50 = $1,875,000)		**1,875,000**
Cash [1,900,000 ÷ 10 = 190,000 × ($1.00 – $.60) = $76,000]	**76,000**	
Premium Expense	**95,000**	
Inventory of Premium Mugs (190,000 × $.90 = $171,000)		**171,000**
Premium Expense (1,300,000 ÷ 10 = 130,000 × $.50 = $65,000)	**65,000**	
Estimated Liability for Premiums		**65,000**

2012

Inventory of Premium Mugs (400,000 × $.90 = $360,000)	**360,000**	
Cash		**360,000**
Cash	**2,250,000**	
Sales (4,500,000 × $.50 = $2,250,000)		**2,250,000**
Cash [2,800,000 ÷ 10 = 280,000 × ($1.00 – $.60) = $112,000]	**112,000**	
Estimated Liability for Premiums	**65,000**	
Premium Expense	**75,000**	
Inventory of Premium Mugs (280,000 × $.90 = $252,000)		**252,000**
Premium Expense	**90,000**	
Estimated Liability for Premiums		**90,000**
(1,800,000 ÷ 10 = 180,000 × $.50 = $90,000)		

Question 2 (20 marks) (continued)

PART 2: (6 marks)

Canada Computer Company sells computers for $2,000 each which includes a 3-year warranty that requires the company to perform periodic services and to replace defective parts. During 2011, the company sold 500 computers. Based on past experience, the company has estimated the total 3-year warranty costs for each computer sold as $40 for parts and $80 for labour. (Assume sales all occur at December 31, 2011.)

In 2012, Canada Computer Company incurred actual warranty costs relative to 2011 computer sales of $5,000 for parts and $12,000 for labour.

Required
Using the expense warranty approach, prepare the entries to reflect the above transactions for 2011 and 2012.

2011		
Accounts Receivable	**1,000,000**	
Sales		**1,000,000**
Warranty Expense	**60,000**	
Estimated Liability Under Warranties		**60,000**
2012		
Estimated Liability Under Warranties	**17,000**	
Inventory		**5,000**
Accrued Payroll or Cash		**12,000**

PART 3: (5 marks)

At their last year end, December 31, 2011, the liabilities outstanding of Diamond Corp included the following:

1. Cash dividends on common shares, $100,000, payable on January 15, 2012.
2. Note payable to Manitoba Bank, $850,000, due January 20, 2012.
3. Serial bonds, $2,000,000, of which $500,000 matures during 2012.
4. Note payable to Victoria Bank, $200,000, due January 27, 2012.

The following transactions occurred early in 2012:

January 15: The cash dividends were paid.

January 20: The note payable to Manitoba Bank was paid.

January 25: Diamond entered into a financing agreement with Saskatchewan Bank, enabling it to borrow up to $1,000,000 at any time through the end of 2014. 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. The corporation immediately borrowed $800,000 to replace the cash used in paying its January 20 note to Manitoba Bank.

January 26: 40,000 common shares were issued for $300,000. $200,000 of the proceeds was used to pay off the note payable to Victoria Bank.

February 1: The financial statements for 2011 were issued.

Required
Prepare a partial balance sheet for Diamond Corp, showing the manner in which the above liabilities should be presented at December 31, 2011. The liabilities should be properly classified between current and long-term, and any appropriate note disclosure should be included. Diamond Corp follows IFRS.

Question 2 (20 marks) (continued)

Current liabilities:		
Dividends payable on common shares	**$ 100,000**	
Notes payable—Manitoba Bank	**850,000**	
Note payable—Victoria Bank—Note 1	**200,000**	
Currently maturing portion of serial bonds	**500,000**	
Total current liabilities		**$1,650,000**
Long-term debt:		
Serial bonds not maturing currently	**1,500,000**	
Total long-term debt		**1,500,000**
Total liabilities		**$3,150,000**

Note 1: On January 26, 2012, the corporation issued 40,000 common shares and received proceeds totalling $300,000, of which $200,000 was used to liquidate a note payable that matured on January 27, 2012.

QUESTION 3 (36 marks)

PART 1: (9 marks)

On December 1, 2012 BondBeagle Inc. issues $1,500,000 face value bonds. The bond date is February 1, 2012, and the bonds carry a coupon rate of 6% per year, payable semi-annually on January 31 and July 31. The bonds' maturity date is January 31, 2017. The bonds provide an annual yield of 4%.

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

Required
Present BondBeagle's journal entry to record the issuance of the bonds: show all supporting calculations.

December 01, 2012	Date of issuance	Dr	Cr
Cash		1,644,068.00	
	Interest payable		30,000.00
	Bonds payable		1,500,000.00
	Bond premium		114,068.00
To record the issuance of 5.00-year bonds, face value $1,500,000, stated interest rate 6.0000% per annum. The bond date is February 01, 2012 with interest paid semi-annually. There are 50 months (including 9 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:	
	July 31, 2012	January 31, 2013
	There would be 9 semi-annual interest payments (54 months) between July 31, 2012 and the maturity date, January 31, 2017	There would be 8 semi-annual interest payments (48 months) between January 31, 2013 and the maturity date, January 31, 2017
Present value of the bond's 9.00 semi-annual interest payments of $45,000 (=$1,500,000 x 6.0000%/2) at 2.0000% effective interest rate [$367,301 = 8.16224 x $45,000]	367,300.80	
Present value of the maturity value of $1,500,000 at the end of 9.00 periods at 2.0000% effective interest rate [$1,255,140 = 0.83676 x $1,500,000]	1,255,140.00	
Present value of the bond's 8.00 semi-annual interest payments of $45,000 (=$1,500,000 x 6.0000%/2) at 2.0000% effective interest rate [$329,647 = 7.32548 x $45,000]		329,646.60
Present value of the maturity value of $1,500,000 at the end of 8.00 periods at 2.0000% effective interest rate [$1,280,235 = 0.85349 x $1,500,000]		1,280,235.00
Total	1,622,440.80	1,609,881.60
Bond proceeds, excluding any accrued interest and issuance cost, on December 01, 2012 (which lies between July 31, 2012 and January 31, 2013). $1,614,068 = $1,622,441 + {[($1,609,882 - $1,622,441)/6months] x 4months}	1,614,068.00	

Question 3 (36 marks) (continued)

PART 2: (9 marks)

On May 31, 2011 Gunung Leuser Incorporated issues $1,000,000 face value bonds. The bond date is March 30, 2011, and the bonds carry a coupon rate of 6% per year, payable semi-annually on March 31 and September 30. The bonds' maturity date is March 30, 2031. Proceeds upon issuance, excluding accrued interest, were $657,769 and the bonds provide an annual yield of 10%.

Gunung Leuser Inc. uses the effective interest rate method to amortize any bond premium or discount. Gunung Leuser Inc.'s accounting year-end is October 31.

Required
Prepare Gunung Leuser's journal entry for these bonds on October 31, 2012 to update accrued interest and any bond discount amortization. (Show all relevant computations)

To answer this question you must first determine the amortized cost (carrying value) of the bond at September 30, 2012 (shown as $665,774 below), the interest payment date immediately preceding October 31, 2012..

2012	3
2013-2030	216 (18yrs x 12)
2031	3
	222 months

222/6 = 37 periods

30 Sept 2012 to 30 March 2031: 37 interest payment periods (does not include 30 Sept 2012)

$30,000	x 16.711287 =	$ 501,339
$1,000,000 x	0.1644356 =	164,435
Amortized cost at Sept 30, 2012	=	$665,774 (rounded)

October 31, 2012 — The second accounting year-end after the issuance date	Dr	Cr	
Interest expense	5,548.12		= $665,774 (see amortization table's semi-annual period 4) x 5.0000% (semi-annual yield) x 1/6 months
Bond discount		548.12	= $5,548 - $5,000
Interest payable		5,000.00	= $1,000,000 x 1/12 months x 6.0000%
To record bond interest expense incurred between September 30, 2012 (the third interest payment date after the issuance date) and October 31, 2012. Effective interest rate method.			

PART 3: (6 marks)

The December 31, 2011 balance sheet of Toews Corp. included the following items:

7.5% bonds payable due December 31, 2019 $576,000

The bonds have a face value of $600,000, and were issued on December 31, 2009 at 95. Interest is payable semi-annually on June 30 and December 31. The company uses straight-line amortization.

On April 1, 2012, Toews retired $120,000 of these bonds at 101 plus accrued interest.

Required
Prepare journal entries to record the retirement. Show calculations and round values to the nearest dollar.

Interest Expense	**2,400**	
Cash ($120,000 × 7.5% × 3/12)		**2,250**
Bonds Payable ($24,000 × 1/5 × 1/8 × 3/12)		**150**
Bonds Payable	*** 115,350**	
Loss on Redemption of Bonds	**5,850**	
Cash		**121,200**

*** $120,000 less discount of [(1/5 × $24,000) – $150] = $4,650**

Question 3 (36 marks) (continued)

PART 4: (12 marks)

Shahani Corporation is having financial difficulty and has therefore asked Bajwa National Bank to restructure its $3-million note outstanding: the note has three years remaining and pays a current interest rate of 10%. The current market rate for a loan of this nature (risk & duration) is 12%. The note was issued at its face value.

Required

For each of the following independent situations related to the above scenario, prepare the journal entry that Shahani would make for the restructuring that is described.

(a) Bajwa National Bank agrees to take an equity interest in Shahani by accepting common shares valued at $2.2 million in exchange for relinquishing its claim on this note.

(b) Bajwa National Bank agrees to accept land in exchange for relinquishing its claim on this note. The land has a carrying amount of $1,050,000 and a fair value of $2.5 million.

(c) Bajwa National Bank agrees to modify the terms of the note so that Shahani does not have to pay any interest on the note over the three-year period.

(a)

On the books of Shahani Corporation:

Notes payable	**3,000,000**	
Common Shares		**2,200,000**
Gain on Restructuring of Debt		**800,000**

Fair value of equity	**$2,200,000**
Carrying amount of debt	**3,000,000**
Gain on restructuring of debt	**$ 800,000**

(b)

On the books of Shahani:

Notes Payable	**3,000,000**	
Land		**1,050,000**
Gain on Disposition of Real Estate		**1,450,000**
Gain on Restructuring of Debt		**500,000**

Fair value of land	**$2,500,000**
Carrying amount of land	**1,050,000**
Gain on disposition of real estate	**$1,450,000**

Note payable (carrying amount)	**$3,000,000**
Fair value of land	**2,500,000**
Gain on restructuring of debt	**$ 500,000**

(c)

The first step is to determine the economic substance of the debt renegotiation and determine if it should be accounted as a settlement or a modification/exchange regarding the old debt. In this case, the creditor is the same and so is the currency and therefore the test to establish whether there is a settlement or not revolves around the cash flows. The present value of the cash flow streams of the new debt are calculated using the historical interest rate of 10% for consistency and comparability.

Present value of old debt is $3,000,000.

Present value of new debt is calculated as follows:

Question 3 (36 marks) (continued)

Using tables:

		10% Factor	Present Value
Single amount	**$ 3,000,000**	**0.75132**	**$ 2,253,960**

Excel formula =PV(rate,nper,pmt,fv,type)

Using a financial calculator:

PV	**$?**	**Yields $2,253,944**
I	**10%**	
N	**3**	
PMT	**$ 0**	
FV	**$ (3,000,000)**	
Type	**0**	

Since the present value of the future cash flows of the new debt differs by an amount larger than 10% of the present value of the future cash flows of the old debt in the amount of $3,000,000, the renegotiated debt is considered a settlement and a gain is recorded by Shahani as calculated below:

The amount of the new debt is recorded at the new cash flows at the market rate of interest, which is 12%.

Using a financial calculator:

PV	**$?**	**Yields $2,135,341**
I	**12%**	
N	**3**	
PMT	**$ 0**	
FV	**$ (3,000,000)**	
Type	**0**	

Note Payable	**3,000,000**	
Gain on Restructuring of Debt		**864,659**
Note Payable		**2,135,341**

QUESTION 4 (22 marks)

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

PART 1: (4 marks)

Required
Indicate True or False by writing *T* or *F* in the space provided.

___ (a) Common Shares Subscribed is a shareholders' equity account.

___ (b) A stock split does not require a formal journal entry.

___ (c) Bad debt expense is recognized on defaulted subscriptions.

___ (d) The date of declaration for a dividend precedes the date of payment, but follows the date of record.

___ (e) Retained earnings is one of the three major categories of contributed capital.

___ (f) Stock dividends distributable should be classified as current liabilities.

___ (g) Stock dividends always involve the transfer of some per-share amount of retained earnings to share capital.

___ (h) At one time a nationally known distillery annually distributed a bottle of "its finest" to its shareholders for every 10 shares outstanding; this was a property dividend.

a. T **c. F** **e. F** **g. T**
b. T **d. F** **f. F** **h. T**

PART 2: (4 marks)

Indicate the effect of each of the following transactions on *total* shareholders' equity by placing an "X" in the appropriate column.

	Increase	Decrease	No Effect
1. Declaration of a cash dividend.	_____	_____	_____
2. Operating loss for the period.	_____	_____	_____
3. Retirement of bonds at more than carrying value.	_____	_____	_____
4. Declaration of a stock dividend.	_____	_____	_____
5. Exchanging common shares for machinery.	_____	_____	_____
6. Conversion of bonds into common shares.	_____	_____	_____
7. Not declaring a dividend on cumulative preferred shares.	_____	_____	_____
8. Payment of a cash dividend.	_____	_____	_____

Question 4 (22 marks) (continued)

	Increase	Decrease	No Effect	
1.	Declaration of a cash dividend.		X	
2.	Operating loss for the period.		X	
3.	Retirement of bonds at more than carrying value.		X	
4.	Declaration of a stock dividend.			X
5.	Exchanging common shares for machinery.	X		
6.	Conversion of bonds into common shares.	X		
7.	Not declaring a dividend on cumulative preferred shares.			X
8.	Payment of a cash dividend.			X

Question 4 (22 marks) (continued)

PART 3: (5 marks)

Tracey Inc has the following shares outstanding:

40,000, $0.80, no par value preferred shares	$400,000
60,000 no par value common shares	$600,000

All shares were sold for $100 each.

No dividends have been declared since December 31, 2009. It is now December 31, 2012, and the board of directors wants to distribute $204,000 in dividends.

Instructions
Calculate how much the preferred and common shareholders will receive under each of the following assumptions:

(a) The preferred is noncumulative and non-participating.
(b) The preferred is cumulative and participating to maximum of 12%.

(a)

	Preferred	Common	Total
Current year's dividend ($.80 × 40,000)	$32,000	$ —	$ 32,000
Remainder to common		172,000	172,000
	$32,000	$172,000	$204,000

(b)

	Preferred	Common	Total
Dividends in arrears, $.80 × 40,000 for two years	$ 64,000	$ —	$ 64,000
Current year's dividend	32,000	48,000	80,000
*Participating dividend (additional 4%)	16,000	24,000	40,000
Remainder to common	—	20,000	20,000
	$112,000	$92,000	$204,000

* basic PFD dividend is $.80/$100 = 8%

Question 4 (22 marks) (continued)

PART 4: (9 marks)

Renfrew Enterprises reported the following shareholder's equity at December 31, 2011.

Contributed Capital	
Preferred shares, $1, no par value, 100,000 shares authorized, cumulative, callable at $107 plus dividends in arrears; issued and outstanding, 20,000 shares	$2,040,000
Common shares, no par, 100,000 shares authorized, 80,000 issued and outstanding	640,000
Contributed surplus (retirement of common shares)	120,000
Retained earnings	1,600,000

The following transactions took place in 2012:

Jan 20 Redeemed 1,000 preferred shares at the call price. There were no dividends in arrears.
Jan 28 Declared $100,000 in dividends. Use separate accounts for each class of dividends.
Feb 28 Retired 8,000 common shares at $12 per share.
Mar 2 Declared and distributed a 3% common stock dividend. The market value of the shares at that time was $11.50.

Required
Prepare journal entries for the 2012 transactions.

Jan 20:		
Preferred shares ($2,040,000 ÷ 20,000) × 1,000	**102,000**	
Retained earnings	**5,000**	
Cash ($107 × 1,000)		**107,000**
Jan 28:		
Retained earnings	**100,000**	
Preferred dividends payable (19,000 × $1)		**19,000**
Common dividends payable ($100,000 – $19,000)		**81,000**
Feb 28:		
Common shares (8,000 × ($640,000 ÷ 80,000))	**64,000**	
Contributed surplus (retirement of common shares)	**32,000**	
Cash (8,000 × $12)		**96,000**
Mar 2:		
Retained earnings (72,000 × 3% × $11.50)	**24,840**	
Common shares		**24,840**

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	0.0294083	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

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