



**McGill**

School of  
Continuing Studies

École  
d'éducation permanente

Department of Career Professional Development

SUMMER 2013

FINAL EXAMINATION

STUDENT NAME

STUDENT NUMBER

## Advanced Financial Accounting III CCFC 513-771

Lecturer: Jim Wilson

Date: Wednesday July 31, 2013

Time: 6:00 – 9:00 pm

### INSTRUCTIONS:

- This is a **CLOSED BOOK** examination.
- **RECORD ALL YOUR ANSWERS IN THE EXAM BOOKLET**
- Handheld devices capable of storing text (e.g. Smartphones, tablets, etc.) are **NOT** permitted.
- **NON-PROGRAMMABLE CALCULATORS ARE PERMITTED.**
- This examination consists **5** pages *including* this cover page. Please ensure that you have a complete examination paper before starting.

**THIS EXAMINATION IS PRINTED ON BOTH SIDES OF THE PAPER  
THIS EXAMINATION PAPER MUST BE RETURNED**

Pen Ltd. acquired an 85% interest in Silk Corp. on December 31, Year 1, for \$650,000. On that date Silk had common stock of \$500,000 and retained earnings of \$100,000. The purchase discrepancy was allocated \$78,200 to inventory, with the balance to patents being amortized over 10 years. Silk reported net income of \$30,000 in Year 2 and \$52,000 in Year 3. While no dividends were declared in Year 2, Silk declared a dividend of \$15,000 in Year 3.

Pen, which uses the cost method, reported a net income of \$28,000 in Year 2 and a net loss of \$45,000 in Year 3. Pen's retained earnings on December 31, Year 3, were \$91,000.

**Required:**

Compute the following:

- a) Noncontrolling interest in net income for Year 2 and Year 3.
- b) Consolidated net income for Year 2 and Year 3.
- c) Consolidated retained earnings on December 31, Year 3.
- d) Noncontrolling interest on December 31, Year 3.
- e) Investment in Silk on December 31, Year 3, if Pen had used the equity method.
- f) Consolidated patents on December 31, Year 3.

6-7

Question #2

28 Marks

50 Minutes

On January 1, Year 3, the Most Company purchased 80% of the outstanding voting shares of the Least Company for \$1.6 million in cash. On that date, Least's balance sheet and the fair values of its identifiable assets and liabilities were as follows:

	<i>Carrying</i>	<i>Fair</i>
Cash	\$ 25,000	\$ 25,000
Accounts receivable	310,000	290,000
Inventories	650,000	600,000
Plant and equipment (net)	<u>2,015,000</u>	2,050,000
Total assets	<u>\$3,000,000</u>	
Current liabilities	\$ 300,000	\$ 300,000
Long-term liabilities	1,200,000	1,100,000
Common stock	500,000	
Retained earnings	<u>1,000,000</u>	
Total liabilities & shareholders' equity	<u>\$3,000,000</u>	

On January 1, Year 3, Least's plant and equipment had a remaining useful life of eight years. Its long-term liabilities matured on January 1, Year 7. Goodwill, if any, is to be tested yearly for impairment.

The balance sheets as at December 31, Year 9, and the retained earnings statements for the year ending December 31, Year 9, for the two companies are as follows:

**BALANCE SHEETS**  
December 31, Year 9

	<i>Most</i>	<i>Least</i>
Cash	\$ 500,000	\$ 40,000
Accounts receivable	1,700,000	500,000
Inventories	2,300,000	1,200,000
Plan and equipment (net)	8,200,000	4,000,000
Investment in Least	1,600,000	--
Land	<u>700,000</u>	<u>260,000</u>
Total assets	<u>\$ 15,000,000</u>	<u>\$ 6,000,000</u>
Current liabilities	\$ 600,000	\$ 200,000
Long-term liabilities	3,000,000	3,000,000
Common stock	1,000,000	500,000
Retained earnings	<u>10,400,000</u>	<u>2,300,000</u>
Total liabilities & shareholders' equity	<u>\$ 15,000,000</u>	<u>\$ 6,000,000</u>

Question #2 (cont'd)

RETAINED EARNINGS -- Year 9

Balance, January 1, Year 9	\$ 9,750,000	\$ 2,000,000
Net income, Year 9	<u>1,000,000</u>	<u>400,000</u> ✓
	10,750,000	2,400,000
Dividends, Year 9	<u>350,000</u>	<u>100,000</u>
Balance, December 31, Year 9	<u>\$ 10,400,000</u>	<u>\$ 2,300,000</u>

*Additional Information*

- The inventories of both companies have a maximum turnover period of one year. Receivables have a maximum turnover period of 62 days.
- On July 1, Year 7, Most sold a parcel of land to Least for \$100,000. Most had purchased this land in Year 4 for \$150,000. On September 30, Year 9, Least sold the property to another company for \$190,000.
- During Year 9, \$2 million of Most's sales were to Least. Of these sales, \$500,000 remain in the December 31, Year 9, inventories of Least. The December 31, Year 8, inventories of Least contained \$312,500 of merchandise purchased from Most. Most's sales to Least are priced to provide it with a gross profit of 20%.
- During Year 9, \$1.5 million of Least's sales were to Most. Of these sales, \$714,280 remain in the December 31, Year 9, inventories of Most. The December 31, Year 8, inventories of Most contained \$857,140 of merchandise purchased from Least. Least's sales to Most are priced to provide it with a gross profit of 30%.
- Dividends declared on December 31, Year 9, were:

Most	\$350,000
Least	100,000
- Goodwill impairment tests resulted in losses of \$52,200 in Year 4, and \$8,700 in Year 9.

**Required:**

- Prepare the consolidated retained earnings statement.
- Prepare the consolidated balance sheet.

Income statements of M Co. and K Co. for the year ended December 31, Year 6, are presented below:

	M Co.	K Co.
Sales	\$ 600,000	\$ 350,000
Rent revenue	--	50,000
Interest revenue	6,700	--
Income from subsidiary	30,700	--
Gain on land sale	--	8,000
	<u>\$ 636,770</u>	<u>\$ 408,000</u>
Cost of goods sold	\$ 334,000	\$ 225,000
Depreciation expense	20,000	70,000
Administrative expense	207,000	74,000
Interest expense	1,700	6,000
Income tax expense	20,700	7,500
	<u>\$ 583,400</u>	<u>\$ 382,500</u>
Net income	<u>\$ 53,370</u>	<u>\$ 25,500</u>

#### Additional Information

- M Co. uses the equity method to account for its investment in K Co.
- M Co. acquired its 80% interest in K Co. on January 1, Year 1. On that date the purchase discrepancy of \$25,000 was allocated entirely to buildings; it is being amortized over a 20-year period.  $25,000 / 20 = 1,250$
- M Co. made an advance of \$100,000 to K Co. on July 1, Year 6. This loan is due on call and requires the payment of interest at 12% per year.  $100,000 \times 12\% \div 2 = 6,000$
- M Co. rents marine equipment from K Co. during Year 6, \$50,000 rent was paid and was charged to administrative expense.  $Rent\ Revenue\ and\ admin\ expense = 50,000$
- In Year 4, M Co. sold land to K Co. and recorded a profit of \$10,000 on the sale. K Co. held the land until October, Year 6, when it was sold to an unrelated company.
- During Year 6, K Co. made sales to M Co. totalling \$90,000. The December 31, Year 6, inventories of M Co. contain an unrealized profit of \$5,000. The January 1, Year 6, inventories of M Co. contained an unrealized profit of \$12,000.
- On January 1, Year 4, M Co. sold machinery to K Co. and recorded a profit of \$13,000. The remaining useful life on that date was 5 years. Assume straight-line depreciation.

#### Required:

Prepare consolidated income statement for Year 6.

5-4

**Question #4**

**10 Marks**

**18 Minutes**

Summarized balance sheets of Corner Company and its subsidiary Brook Corporation on December 31, Year 4, are as follows :

	<u>Corner</u>	<u>Brook</u>	<u>Consolidated</u>
Current Assets	\$ 160,000	\$ 700,000	\$ 860,000
Investment in Brook (cost)	640,000	--	--
Other assets	<u>600,000</u>	<u>900,000</u>	<u>1,500,000</u>
	<u>\$1,400,000</u>	<u>\$1,600,000</u>	<u>\$2,360,000</u>
Liabilities	\$ 800,000	\$ 200,000	\$1,000,000
Non-controlling interest	--	--	280,000 <sup>a)</sup>
Common stock	900,000	600,000	900,000
Retained earnings	<u>(300,000)</u>	<u>800,000</u>	<u>180,000</u> <sup>b)</sup>
	<u>\$1,400,000</u>	<u>\$1,600,000</u>	<u>\$2,360,000</u>

On the date that Corner acquired its interest in Brook, there was no purchase discrepancy and the book values of Brook's net assets were equal to fair market values. During Year 4, Corner reported a net loss of \$60,000 while Brook reported a net income of \$140,000. No dividends were declared by either company during Year 4. Corner uses the cost method to account for its investment.

a)  $\frac{280,000}{1,400,000} = \text{NCI}$   
 $\frac{280}{1400} = \frac{2}{14} = \frac{1}{7}$   
 Answer:  $\frac{1}{7}$  (circled)

**Required :**

b) Brook's net income = 140,000  
 Corner's net loss  $\times \frac{1}{7} = 60,000$   
 Consolidated net income = 52,000

Compute the following :

- The percentage of Brook's shares owned by Corner
- Consolidated net income for Year 4.
- Corner's December 31, Year 3, retained earnings if it had used the equity method to account for its investment.
- The retained earnings of Brook on the date that Corner acquired its interest in Brook.

d)  $\frac{640,000}{1,400,000} = \frac{800,000}{1,400,000}$   
 CS  
 RE

c) Dec 31, Yr. 4 (RE end) = 180,000  
 less: net income = (52,000)  
 RE beg. Jan 1 Yr. 4  
 (R.E. end Dec 31 Yr. 3) = 128,000

On October 1, Year 6, Versatile Company contracted to sell merchandise to a customer in Switzerland at a selling price of SF400,000. The contract called for the merchandise to be delivered to the customer on December 1, Year 6, with payment to be received in francs on January 31, Year 7. On October 1, Year 6, Versatile arranged a forward contract to deliver SF400,000 on January 31, Year 7, at a rate of SF1 = \$1.20. Versatile's year-end is December 31.

The merchandise was delivered on December 1, Year 6; SF400,000 were received and delivered to the bank on January 31, Year 7.

Exchange rates were as follows:

	<i>Spot Rates</i>	<i>Forward Rates</i>
October 1, Year 6	SF1 = \$1.18	SF1 = \$1.20
December 1, Year 6	SF1 = \$1.17	SF1 = \$1.21
December 31, Year 6	SF1 = \$1.21	SF1 = \$1.22
January 31, Year 7	SF1 = \$1.19	SF1 = \$1.19

**Required:**

Prepare the journal entries that Versatile should make to record the events described assuming that hedge accounting is applied and the forward contract is designated as a cash flow hedge.

Jaap Corp., located in the Netherlands, is a 90% owned subsidiary of a Canadian parent. The company was incorporated on January 1, Year 1, and issued its no-par common shares for 5.0 million guilders (G). The Canadian parent acquired 90% of these shares this time for \$2.25 million when the exchange rate was CDN\$1 = G2. The financial statements for Jaap on December 31, Year 2, are shown below.

**BALANCE SHEET**

December 31, Year 2

	<i>Year 2</i>	<i>Year 1</i>
Cash	G 1,000,000	G 500,000
Accounts receivable	2,710,000	2,550,000
Inventory	1,050,000	1,155,000
Plant assets	6,000,000	6,000,000
Accumulated depreciation	<u>(1,000,000)</u>	<u>(500,000)</u>
	<u>G 9,760,000</u>	<u>G 9,705,000</u>
Accounts payable	G 50,000	G 850,000
Accrued liabilities	50,000	350,000
Bonds payable – due January 3, Year 11	2,500,000	2,500,000
Common shares	5,000,000	5,000,000
Retained earnings	<u>2,160,000</u>	<u>1,005,000</u>
	<u>G 9,760,000</u>	<u>G 9,705,000</u>

**INCOME STATEMENT**  
for the Year ended December 31, Year 2

Sales	<u>G 35,000,000</u>
Cost of sales	<u>G 28,150,000</u>
Depreciation	500,000
Interest	200,000
Selling	1,940,000
Miscellaneous expenses	800,000
Income tax	<u>1,045,000</u>
	<u>G 32,635,000</u>
Net income	<u>G 2,365,000</u>

Chapter 11

Question #6 (cont'd)

**STATEMENT OF RETAINED EARNINGS**  
for the Year Ended December 31, Year 2

Balance, January 1	G 1,005,000
Net income	<u>2,365,000</u>
	3,370,000
Dividends	<u>1,210,000</u>
Balance, December 31	<u>G 2,160,000</u>

**Other Information**

- On January 3, Year 1, Jaap issued bonds for G2.5 million.
- Jaap acquired the plant assets on February 1, Year 1, for G6.0 million. The plant assets are being depreciated on a straight-line basis over a 10-year life.
- Jaap uses the FIFO basis to value inventory. The December 31, Year 1, inventory was acquired on October 1, Year 1. The inventory on hand on December 31, Year 2, was acquired on November 15, Year 2.
- Jaap did not pay dividends in Year 1, and the Year 2 dividends were declared and paid on December 31, Year 2.
- Under the temporal method, Jaap's December 31, Year 1, retained earnings were translated as \$561,169.
- Exchange rate information:

January 3, Year 1	CDN\$1 = G1.98
February 1, Year 1	CDN\$1 = G1.96
October 1, Year 1	CDN\$1 = G1.94
Average, Year 1	CDN\$1 = G1.95
December 31, Year 1	CDN\$1 = G1.91
November 15, Year 2	CDN\$1 = G1.80
Average, Year 2	CDN\$1 = G1.86
December 31, Year 2	CDN\$1 = G1.82

**Required:**

- Translate Jaap's Year 2 financial statements into dollars, assuming that it is an integrated foreign operation.
- Translate Jaap's Year 2 financial statements into dollars, assuming that it is a self-sustaining foreign operation.