

Question 1

After finishing university, Mary and Anna spent years developing an innovative textile fabric. Combining their different backgrounds (biochemistry and engineering), they came up with a unique “intelligent” fabric that is waterproof and contains micro-sensors that heat up the fabric or cool it down based on outside temperature and body temperature. They won “Worldwide Inventor of the Year” award for their invention and were encouraged to commercialize their product. With this encouragement they started MaryAnne Company to manufacture and sell “Intelligent” trench coats. Their fabric makes these clothing items unique. They launched the “Intelligent” clothing line in October 2017 at a production cost of \$70 per unit.

On November 30, they signed their first contract. The buyer is BuildUp Ltd. a construction company with numerous building sites in Canada. BuildUp plans to use the trench coats as work gear for their construction workers. They agreed to purchase 1,000 trench coats at a price of \$100 per unit, which MaryAnne Company delivered immediately. However, the CEO of BuildUp was hesitant about whether the trench coats will actually work as intended so she negotiated ruthlessly to include a 90-day return clause in the contract as well as a clause stating that any return-shipping costs will be paid by MaryAnne Company. Additionally BuildUp has only agreed to pay for the trench coats 90 days after delivery.

By December 31, 2017, MaryAnne Company’s fiscal year end, BuildUp had not returned any of the trench coats. However, Mary and Anne realized that, to avoid damage to the micro-sensors, the trench coats need to be carefully packaged for shipping, with this realization, their estimate of return shipping cost rises to \$40 per trench coat. However, they are not able to estimate how many trench coats will be faulty and returned – it could be anywhere between 0% and 25%.

On December 13, 2017, MaryAnne Company signed a second contract, this time with Dion Constructions Inc. for the sale of 200 trench coats at \$100 per unit that Dion paid immediately. However, Dion doubted the endurance of the micro-sensors contained in the fabric so MaryAnne offered to repair or replace any trench coats that got damaged during the first year after Dion’s purchase. They expect repair costs to be about \$25 per trench coat, but have a hard time estimating how many of their coats are likely to get damaged over one year of use; their guess is between 10 and 30%.

Mary and Anne want to apply for a bank loan in January 2018 that will allow them to expand production. For that purpose, they need to finalize the financial statements for the firm’s first year of operations immediately after fiscal year end. It is now December 29, 2017. You (MaryAnne Company’s CFO) just had an email exchange with Mary and Anne. You informed them that for certain transactions IFRS 15 precludes the recognition of revenue. They are now concerned that they will not be able to secure the loan.

Requirement:

As CFO of the company, write a report to Mary and Anne explaining the possible accounting treatments for the two contracts and the implications for the 2017 income statement and balance sheet. Assume that MaryAnne Company follows IFRS.

Question 2

Laflamme Inc. follows IFRS and has adopted the policy of classifying interest paid as operating activities and dividends paid as financing activities.

Comparative statement of financial position accounts of Laflamme Inc., and its statement of income for the year ending December 31, 2017, follow:

Statement of Financial Position

December 31

	2017	2016	Change
Cash	\$46,000	\$56,000	\$(10,000)
Cash equivalents (Note 1)	36,000	45,000	(9,000)
Accounts receivable	348,000	271,000	77,000
Prepaid insurance	16,000	35,000	(19,000)
Inventory	398,000	350,000	48,000
Supplies	13,000	17,000	(4,000)
Dividends receivable	100,000	144,000	(44,000)
FV-NI Investments	318,000	256,000	62,000
Land (Note 6)	640,000	500,000	140,000
Buildings (Note 3)	1,310,000	1,280,000	30,000
Accumulated depreciation—buildings	(400,000)	(360,000)	(40,000)
Equipment (Note 4)	632,000	640,000	(8,000)
Accumulated depreciation—equipment	(160,000)	(135,000)	(25,000)
Patent	100,000	100,000	-0-
Accumulated amortization	(40,000)	(35,000)	(5,000)
Bank overdrafts (Note 1)	\$ -0-	\$93,000	\$(93,000)
Accounts payable	165,000	150,000	15,000
Income tax payable	26,000	35,000	(9,000)
Accrued liabilities	57,000	41,000	16,000
Dividends payable	20,000	50,000	(30,000)
Long-term notes payable	420,000	460,000	(40,000)
Bonds payable	999,000	995,000	4,000
Preferred shares	486,000	380,000	106,000
Common shares	746,000	666,000	80,000
Retained earnings	438,000	294,000	144,000

Income Statement		
Revenues		
Sales revenue	\$ 999,000	
Investment income	<u>90,000</u>	\$1,089,000
Expenses and Losses		
Cost of goods sold	314,000	
Sales commission expense	108,000	
Operating expenses (Note 5)	166,000	
Salaries and wages expense	104,000	
Interest expense	95,000	
Loss on sale of equipment (Note 4)	11,000	
Income tax expense	<u>96,000</u>	<u>894,000</u>
Net Income		\$195,000

The following is additional information about Laflamme's transactions during the year ended December 31, 2017.

1. The cash equivalents are typically term deposits that are very liquid and mature on average in 60 days. The bank overdrafts are at the same bank as the cash balance. The overdrafts are temporary and reverse within a few days.
2. During the year, preferred shares with a carrying amount of \$18,000 were converted to common shares.
3. There were no disposals of buildings during the year 2017.
4. Equipment with an original cost of \$46,000 and carrying amount of \$14,000 was sold during the year.
5. All depreciation and amortization expense is included in operating expenses.
6. During the year, Laflamme obtained land with a fair value of \$100,000 in exchange for its preferred shares.
7. Investment income includes an unrealized gain of \$62,000 from fair value through net income (FV-NI) Investments and \$28,000 from interest revenue on the short-term investments referred to in item 1 above.
8. Bonds were issued at a discount. No bonds were issued in the current year.

Required

- (a) Prepare the statement of cash flows for the year ended December 31, 2017 for Laflamme Inc. using the **indirect method**. Show your computations clearly in order to receive marks.
- (b) Prepare any additional disclosure notes that are required.
- (c) Does Laflamme Inc. have any options available to it concerning the classification of interest and dividends paid or received?