



VOTRE LIEN AVEC CE QUI COMPTE — CONNECTS YOU TO WHAT MATTERS

**Mid Term Exam #1 (2 hours = 120 minutes)**  
**Intermediate Financial Accounting I**  
**Winter 2017**  
**ADM2342**

**(SUGGESTED SOLUTIONS)**

**Name:** \_\_\_\_\_

**ID#:** \_\_\_\_\_

**Instructions:**

- Write your name and student ID number above. Display your student ID on your desk during the exam.
- Turn off all cell phones.
- This examination “**SUGGESTED SOLUTION**” comprises **6** questions over **19** numbered pages.
- Answer all questions in this booklet.
- The booklet is **not** to be removed from the examination room. You may not separate the pages.
- Do not answer questions using a pencil or erasable pen: if you do you will forfeit your right to request a review of your exam.
- Limit your answer to the space provided. Blank space for rough work and supporting calculations are given at the end of each question. All supporting calculations **must** be shown.
- This exam will be marked out of 100 marks (for convenience) and is **2 hours (120 minutes)** long. You should budget approximately 1.2 minutes per mark. The exam is worth **30%** 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.
- Language (non-electronic) dictionaries are allowed but only after permission has been given by the proctors at the start of the examination.
- You **must** sign the Statement of Academic Integrity on page 2 of this exam.

Question			Marks
Q 1	Chapters 1 & 2	10 x 1 mark MCQs	/10
Q 2	Chapter 2		/10
Q3	Chapter 3		/12
Q4	Chapter 4	Part 1	/15
		Part 2	/6
Q 5	Chapter 5	Part 1	/13
		Part 2	/12
Q 6	Chapter 6	Part 1	/11
		Part 2	/11
		<b>TOTAL</b>	<b>/100</b>

Section	X
Section M: (Professor Conheady, Monday 11:30-1:00pm & Thursday 1:00-2:30pm)	
Section N: (Professor Li, Tuesday & Thursday, 5:30-7:00pm)	
Section P: (Professor Conheady, Monday 8:30-10:00am & Thursday 10:00-11:30am)	

**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 (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 (10 marks)**

Answer ALL parts to this question. Each part is independent. **Circle** the answer you choose. Choose only one answer per question.

**1. Objectives of financial reporting do not include**

- a. providing information about the liquidation value of an enterprise.
- b. providing information about changes in an entity's economic resources, obligations, and equity/net assets.
- c. providing information about an entity's economic resources, obligations, and equity/net assets.
- d. providing information that is useful to users in making resource allocation decisions.

**2. Which of the following does not describe a cause of management bias?**

- a. The need to comply with contracts, such as debt covenants.
- b. The desire for all stakeholders to have access to all information.
- c. The tendency to downplay negative events.
- d. The desire to meet financial analysts' expectations.

**3. Which of the following are factors contributing to fraudulent financial reporting?**

- a. Weak internal controls
- b. Unrealistic internal budgets
- c. Unrealistic expectations
- d. All of the above (all of the above are factors that contribute to fraudulent financial reporting)

**4. In providing information with the qualitative characteristics that make it useful, two overriding constraints that must be considered are:**

- a. relevance and representational faithfulness.
- b. comparability and understandability.
- c. matching and control.
- d. cost-benefit relationship and materiality.

**5. Companies and their auditors have adopted a general rule of thumb that anything above 5% of \_\_\_\_\_ is considered material.**

- a. assets
- b. liabilities
- c. pretax income from continuing operations
- d. revenues

**6. In order to be relevant, financial information must have all of the following ingredients of fundamental qualities except**

- a. be free from error.

- b. have predictive value.
- c. be material.
- d. have confirmatory value.

**QUESTION 1 (10 marks)**

**Answer ALL parts to this question. Each part is independent. Circle the answer you choose. Choose only one answer per question.**

**7. Which of the following (a-c) are not true concerning a conceptual framework in accounting?**

- a. It should be a basis for standard-setting.
- b. It should allow practical problems to be solved more quickly by reference to it.
- c. It should be based on fundamental truths that are derived from the laws of nature.**
- d. All of the above (a-c) are true.

**8. Fundamental qualitative characteristics include**

- a. verifiability and relevance.
- b. relevance and representational faithfulness.**
- c. relevance and comparability.
- d. representational faithfulness and timeliness.

**9. Which of the following is true about understandability as a qualitative characteristic of financial statements?**

- a. Users with no knowledge of business and financial accounting matters are expected to understand the financial statements.
- b. The onus to prepare understandable statements and to be able to understand them lies with the preparer and the user.**
- c. The onus to prepare understandable statements and to be able to understand them lies with the preparer.
- d. Where the underlying transactions or economic events are more complex, the user is expected to understand them without the assistance of an advisor.

**10. The role of provincial securities commissions in Canada in relation to financial reporting is to**

- a. ensure that investors have access to the information they need to make informed decisions.**
- b. make recommendations for financial accounting standards
- c. form professional judgements regarding overall adherence to GAAP.
- d. develop standards for financial reporting by publicly traded companies.

**QUESTION 2 (10 marks)**

**Define the following financial statement elements**

**Asset**

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**Revenue**

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**Gain**

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**Discontinued operations**

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**QUESTION 2 (10 marks) (continued)**

**Define the following financial statement elements**

**Assets** have three essential characteristics:

1. There is some economic benefit to the entity.
2. The entity has control over that benefit.
3. The benefits result from a past transaction or event

**Revenues** are increases in economic resources, either by inflows or other enhancements of an entity's assets or by settlement of its liabilities, which result from an entity's **ordinary (operating) activities**.

**Gains** are increases in equity (net assets) from an entity's **peripheral or incidental transactions** and from all other transactions and other events and circumstances affecting the entity during a period, except those that result from revenues or investments by owners.

**Discontinued operations** include **components of an enterprise** that have been **disposed of** (by sale, abandonment, or spinoff) or are classified as *held for sale* where:

1. they represent (or are part of a plan to dispose of) a major line of business or geographical area; or
2. they are a subsidiary acquired for resale.

**QUESTION 3 (12 marks)**

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

Data relating to the balances of various accounts affected by adjusting or closing entries appear below. (The journal entries, which caused the changes in the balances, are not given.) You are asked to supply the missing journal entries, which would logically account for the changes in the account balances.

1. Interest Receivable at January 1, 20XX was \$1,000. During 20XX, cash received from debtors for interest on outstanding notes receivable was \$5,800. The 20XX statement of comprehensive income showed Interest Revenue of \$4,900. You are to prepare the missing adjusting entry that must have been made, assuming reversing entries are not made.

<b>Interest Receivable</b> .....	<b>100</b>	
<b>Interest Revenue</b> .....		<b>100</b>
<b>Interest revenue per books</b>	<b>\$4,900</b>	
<b>Interest revenue received related to 20XX</b>		
(\$5,800 – \$1,000)	<u><b>4,800</b></u>	
<b>Interest accrued</b>	<u><b>\$ 100</b></u>	

2. Unearned Rent at January 1, 20XX was \$5,300, and at December 31, 20XX was \$6,000. The records indicate cash receipts from rental sources during 20XX were \$45,000, all of which were credited to the Unearned Rent Account. You are to prepare the missing adjusting entry which would logically account for the change in the Unearned Rent account balance.

<b>Unearned Rent Revenue</b> .....	<b>44,300</b>	
<b>Rent Revenue</b> .....		<b>44,300</b>
<b>Cash receipts</b>	<b>\$45,000</b>	
<b>Beginning balance</b>	<b>5,300</b>	
<b>Ending balance</b>	<u><b>(6,000)</b></u>	
<b>Rent revenue</b>	<u><b>\$44,300</b></u>	

3. Accumulated Depreciation—Equipment at January 1, 20XX was \$230,000, and at December 31, 20XX was \$280,000. During 20XX, one piece of equipment was sold. The equipment had an original cost of \$40,000 and was 3/4 depreciated when sold. You are to prepare the missing adjusting entry that must have been made.

<b>Depreciation Expense</b> .....	<b>80,000</b>	
<b>Accumulated Depreciation —Equipment</b> .....		<b>80,000</b>
<b>Ending balance</b>	<b>\$280,000</b>	
<b>Beginning balance</b>	<u><b>230,000</b></u>	
<b>Difference</b>	<b>50,000</b>	
<b>Write-off at time of sale 3/4 × \$40,000</b>	<u><b>30,000</b></u>	
	<u><b>\$ 80,000</b></u>	

**QUESTION 3 (12 marks) (continued)**

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

4. Allowance for doubtful accounts on January 1, 20XX was \$50,000. The balance in the allowance account on December 31, 20XX after making the annual adjusting entry was \$65,000. During 20XX bad debts of \$30,000 were written off. You are to provide the missing adjusting entry that must have been made.

<b>Bad Debt Expense .....</b>	<b>45,000</b>	
<b>    Allowance for Doubtful Accounts .....</b>		<b>45,000</b>
<b>Ending balance</b>	<b>\$65,000</b>	
<b>Beginning balance</b>	<b><u>50,000</u></b>	
<b>Difference</b>	<b>15,000</b>	
<b>Written off</b>	<b><u>30,000</u></b>	
	<b><u>\$45,000</u></b>	

**QUESTION 4 (21 marks)**

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

**Part 1 (15 marks)**

Spaniel Corporation's capital structure consists of 200,000 common shares. At December 31, 2017, the company's accounting year-end, an analysis of the accounts and discussions with company officials revealed the following information regarding its continuing operations:

Sales .....	\$1,200,000
Purchase discounts .....	18,000
Purchases .....	720,000
Earthquake loss (net of \$18,000 tax) .....	42,000
Selling expenses.....	128,000
Cash .....	60,000
Accounts receivable.....	90,000
Common shares.....	200,000
Accumulated depreciation .....	180,000
Dividend revenue.....	18,000
Inventory, January 1, 2017 .....	152,000
Inventory, December 31, 2017 .....	125,000
Unearned service revenue.....	4,400
Accrued interest payable.....	1,000
Land .....	370,000
Patents.....	100,000
Retained earnings, January 1, 2017 .....	270,000
Interest expense .....	17,000
General and administrative expenses.....	160,000
Dividends declared .....	29,000
Allowance for doubtful accounts.....	5,000
Notes payable (maturity July 1, 2020).....	200,000
Machinery and equipment .....	450,000
Materials and supplies .....	40,000
Accounts payable.....	60,000

On September 1, 2017, Spaniel sold its Mumbai division to Best Industries for a gain (pre tax) of \$300,000. This gain is not included in any of the numbers shown above. During the period January 1 to August 31, the discontinued operation incurred an operating loss (pre-tax) of \$500,000. This loss is not included in any of the numbers shown above.

Unless indicated otherwise, you may assume a 30% income tax rate. The company follows IFRS.

**Required**

Prepare, in good form, a multiple-step income statement for 2017.

**QUESTION 4 (21 marks) (continued)**

**SPANIEL CORPORATION**  
**Income Statement**  
**For the Year Ended December 31, 2017**

Sales .....		<b>\$1,200,000</b>
Cost of goods sold (see Schedule A) .....		<u><b>729,000</b></u>
Gross profit on sales .....		<b>471,000</b>
Operating expenses		
Selling expenses .....	<b>128,000</b>	
General and administrative expenses .....	<u><b>160,000</b></u>	
Total operating expenses .....		<u><b>288,000</b></u>
Operating income .....		<b>183,000</b>
Other revenue and gains		
Dividend revenue .....		<b>18,000</b>
Other expenses and losses		
Interest expense .....	<b>(17,000)</b>	
Loss from earthquake .....	<u><b>(60,000)</b></u>	<u><b>(77,000)</b></u>
Income from continuing operations before taxes .....		<b>124,000</b>
Income taxes .....		<u><b>37,200</b></u>
Income from continuing operations .....		<b>86,800</b>
Discontinued operations		
Loss from operations of the Mumbai division (net of tax of \$150,000) .....	<b>(\$350,000)</b>	
Gain on disposal of the Mumbai division (net of tax of \$90,000) .....	<u><b>210,000</b></u>	<u><b>(140,000)</b></u>
Net loss		<u><b>\$(53,200)</b></u>
Earnings per share:		
Income from continuing operations		<b>\$0.43</b> <sup>a</sup>
Discontinued operations		<u><b>(0.70)</b></u> <sup>b</sup>
Net income		<u><b>(\$0.27)</b></u> <sup>c</sup>

<sup>a</sup> \$86,800 / 200,000 shares

<sup>b</sup> (\$140,000) / 200,000 shares

<sup>c</sup> (\$53,200) / 200,000 shares

**Schedule A**  
**Calculation of Cost of Goods Sold**  
**For the Year Ended December 31, 2017**

Merchandise inventory, Jan. 1 .....		<b>\$152,000</b>
Purchases	<b>\$720,000</b>	
Less purchase discounts	<u><b>18,000</b></u>	
Net purchases .....		<u><b>702,000</b></u>
Merchandise available for sale .....		<b>854,000</b>
Less merchandise inventory, Dec. 31 .....		<u><b>125,000</b></u>
Cost of goods sold .....		<u><b>\$729,000</b></u>

**QUESTION 4 (21 marks) (continued)**

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

**Part 2 (6 marks)**

Xiao Ltd. reported the following balances at January 1, 2017:

Common shares.....	\$420,000
Retained earnings.....	30,000
Accumulated other comprehensive income.....	58,000

During the year Xiao earned net income of \$200,000 and generated other comprehensive income of \$70,000.

**Required**

Prepare a statement of shareholders' equity for the year ended December 31, 2017.

**XIAO LTD.  
Statement of Shareholders' Equity  
For the Year Ended December 31, 2017**

	Total	Common Shares	Comprehensive Income	Retained Earnings	Accumulated Other Comprehensive Income
Beginning balance	\$508,000	\$420,000		\$ 30,000	\$58,000
Net income	200,000		\$200,000	200,000	
Other comprehensive income	70,000		70,000		70,000
Comprehensive income			\$270,000		
Ending balance	<u>\$778,000</u>	<u>\$420,000</u>		<u>\$230,000</u>	<u>\$128,000</u>

The Comprehensive Income Column may be omitted from your answer.

**QUESTION 5 (25 marks) (continued)**

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

**Part 1(13 marks)**

Scorpion Corporation prepares the operating section of its Statement of Cash Flows using the direct method, as follows:

**SCORPION CORPORATION**  
 Operation Section, Statement of Cash Flows  
 For the Year Ended December 31, 2017

Cash receipts from customers .....		\$380,000
Cash payments:		
Wages.....	\$150,000	
Income taxes .....	65,000	
Insurance.....	40,000	
Interest .....	<u>25,000</u>	<u>280,000</u>
Cash from operations .....		<u><u>\$100,000</u></u>

Additional information:

	Balances at Dec 31	
	2017	2016
Accounts receivable.....	\$50,000	\$30,000
Wages payable .....	15,000	25,000
Income taxes payable.....	14,000	19,000
Prepaid insurance.....	8,000	4,000
Accumulated depreciation - equipment .....	95,000	80,000
Interest payable.....	3,000	9,000

No equipment was sold during 2017.

**Required (to earn marks you must provide supporting calculations)**

Determine the amounts for the following items that would appear in Scorpion’s 2017 income statement.

Sales Revenue	
Wages expense	
Insurance expense	
Depreciation expense	
Interest expense	
Income tax expense	

**Note: your solution does not have to present the income statement displayed below. Your answer should provide its amounts and their supporting calculations.**

**SCORPION CORPORATION**  
**Income Statement (Accrual Basis)**  
**For the Year Ended December 31, 2017**

Revenue ( $\$380,000 + \$50,000 - \$30,000$ ) .....		<b>\$400,000</b>
<b>Expenses</b>		
Wages ( $\$150,000 + \$15,000 - \$25,000$ ) .....	<b>\$140,000</b>	
Insurance ( $\$40,000 + \$4,000 - \$8,000$ ) .....	<b>36,000</b>	
Depreciation ( $\$95,000 - \$80,000$ ).....	<b>15,000</b>	
Interest ( $\$25,000 + \$3,000 - \$9,000$ ) .....	<u><b>19,000</b></u>	
<b>Total expenses</b> .....		<u><b>210,000</b></u>
<b>Income before income tax</b> .....		<b>190,000</b>
<b>Income tax</b> ( $\$65,000 + \$14,000 - \$19,000$ ).....		<u><b>60,000</b></u>
<b>Net Income</b> .....		<u><u><b>\$130,000</b></u></u>

**QUESTION 5 (25 marks) (continued)**

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

**Part 1(13 marks) (continued)**

**QUESTION 5 (25 marks)**

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

**Part 2 (12 marks)**

The draft statement of financial position of Yellow Tail Corporation follows at December 31, 2017:

YELLOW TAIL CORPORATION			
Draft Statement of Financial Position			
December 31, 2017			
Current assets	\$ 485,000	Current liabilities	\$ 380,000
Investments	640,000	Long-term liabilities	1,000,000
Property, plant, and equipment	1,720,000	Shareholders' equity	1,770,000
Intangible assets	305,000		
	\$3,150,000		\$3,150,000

The following additional information is available:

1. The current assets section includes the following: cash \$150,000; accounts receivable \$170,000, less \$10,000 allowance for doubtful accounts; inventory \$180,000; and unearned revenue \$5,000. The cash balance is composed of \$190,000 and there is a bank overdraft of \$40,000. Inventory is stated at the lower of FIFO cost and net realizable value.
2. The investments section includes the following: note receivable from a related company, due in 2020, \$40,000; fair value—net income investments in shares, \$80,000 (fair value \$80,000); fair value—OCI investments in shares, \$125,000 (fair value \$155,000); bond sinking fund \$250,000; and patents \$115,000, net of accumulated amortization.
3. Property, plant, and equipment includes buildings \$1,040,000, less accumulated depreciation \$360,000; equipment \$450,000, less accumulated depreciation \$180,000; land \$500,000; and land held for future use \$270,000.
4. Intangible assets include the following: franchise, net of accumulated amortization \$165,000; goodwill \$100,000; and discount on bonds payable \$40,000.
5. Current liabilities include the following: accounts payable \$140,000; notes payable, short-term \$80,000, long-term \$120,000; and income tax payable \$40,000.
6. Long-term liabilities are composed solely of 7% bonds payable due in 2022.
7. Shareholders' equity has 70,000 preferred shares (200,000 authorized), which were issued for \$450,000, and 100,000 common shares (400,000 authorized), which were issued at an average price of \$10 per share. In addition, the corporation has retained earnings of \$290,000 and accumulated other comprehensive income of \$30,000.

**Required**

Prepare a classified statement of financial position in good form (adjust as necessary the amounts in each statement of financial position classification based on the additional information), and any relevant disclosure notes, at December 31, 2107.

**QUESTION 5 (25 marks) (continued)**

**Answer ALL parts to this question. Each part is independent. Part 1 (12 marks) (continued)**

**Yellow Tail Corporation  
Statement of Financial Position  
December 31, 2015**

Assets			
<b>Current assets</b>			
Cash			\$ 190,000
FV - NI investments			80,000
Accounts receivable	\$170,000		
Less allowance for doubtful accounts	10,000		160,000
Inventory, at lower of FIFO cost and net realizable value			<u>180,000</u>
Total current assets			<u>\$ 610,000</u>
<b>Long-term investments</b>			
FV – OCI investments	155,000		
Bond sinking fund	250,000		
Note receivable from related company due 2020	40,000		
Land held for future use	<u>270,000</u>		715,000
<b>Property, plant, and equipment</b>			
Land		500,000	
Buildings	\$1,040,000		
Less accumulated depreciation—buildings	360,000		680,000
Equipment	450,000		
Less accumulated depreciation—equipment	180,000	<u>270,000</u>	1,450,000
<b>Intangible assets</b>			
Patents (net of accumulated amortization)	115,000		
Franchise (net of accumulated amortization)	<u>165,000</u>		280,000
Goodwill			<u>100,000</u>
Total assets			<u><u>\$3,155,000</u></u>
<b>Liabilities and Shareholders' Equity</b>			
<b>Current liabilities</b>			
Accounts payable			\$ 140,000
Notes payable			80,000
Bank overdraft			40,000
Income tax payable			40,000
Unearned revenue			<u>5,000</u>
Total current liabilities			305,000
<b>Long-term liabilities</b>			
Notes payable		\$ 120,000	
7% bonds payable, due 2022	\$1,000,000		
Less discount on bonds payable	40,000	<u>960,000</u>	<u>1,080,000</u>
Total liabilities			1,385,000
<b>Shareholders' equity</b>			
<b>Capital shares</b>			
Preferred shares; 200,000 shares authorized, 70,000 issued	450,000		
Common shares; 400,000 shares authorized, 100,000 issued	<u>1,000,000</u>	1,450,000	
Retained earnings		290,000	
Accumulated other comprehensive income		<u>30,000</u>	
Total shareholders' equity			<u>1,770,000</u>
Total liabilities and shareholders' equity			<u><u>\$3,155,000</u></u>
<b>The yellow-shaded items may be displayed instead as notes at the bottom of the above statement.</b>			

**QUESTION 6 (22 marks)**

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

**Part 1 (11 marks)**

In 2017, the following transaction occurred between Senators Wholesale Corp. (consignor) and Canadiens Stores (consignee):

On March 2, 2017 Senators shipped merchandise costing \$52,000 to Canadiens. Senators paid \$4,000 for freight and Canadiens paid \$3,000 for advertising (to be reimbursed by Senators). By the end of the third quarter of 2017 (September 30, 2017), Canadiens advised Senators that all the merchandise has been sold for \$70,000, and forwarded the proceeds (net of a 15% commission and the outlay for advertising) to Senators.

**Required**

Prepare all journal entries for Senators Wholesale Corp. to account for this transaction. Senators follows IFRS 15 when accounting for revenue.

**Senators' journal entries:**

<b>Inventory on Consignment.....</b>	<b>52,000</b>	
<b>    Merchandise Inventory .....</b>		<b>52,000</b>
<b>    To record Shipment of consigned merchandise</b>		
<b>Inventory on Consignment.....</b>	<b>4,000</b>	
<b>    Cash.....</b>		<b>4,000</b>
<b>    To record Payment of freight costs</b>		
<b>Cash.....</b>	<b>56,500</b>	
<b>Advertising Expense .....</b>	<b>3,000</b>	
<b>Commission Expense .....</b>	<b>10,500</b>	
<b>    Revenue from Consignment Sales.....</b>		<b>70,000</b>
<b>    To record Remittance from consignee</b>		
<b>Cost of Goods Sold (52,000 + 4,000).....</b>	<b>56,000</b>	
<b>    Inventory on Consignment.....</b>		<b>56,000</b>
<b>    To record Cost of sales for consignment sales</b>		

**Not asked in this exam:**

**Canadiens' journal entries [Not asked in this exam]:**

<b>Receivable from Consignor.....</b>	<b>3,000</b>	
<b>    Cash.....</b>		<b>3,000</b>
<b>    To set up receivable for advertising</b>		
<b>Cash.....</b>	<b>70,000</b>	
<b>    Payable to Consignor.....</b>		<b>70,000</b>
<b>    To record sale</b>		
<b>Payable to Consignor.....</b>	<b>70,000</b>	
<b>    Receivable from Consignor.....</b>		<b>3,000</b>
<b>    Commission Revenue*.....</b>		<b>10,500</b>
<b>    *\$70,000 x 15% = \$10,500</b>		
<b>    Cash.....</b>		<b>56,500</b>
<b>    To record Remittance to consignor</b>		

**QUESTION 6 (22 marks)**

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

**Part 2 (11 marks)**

Periwinkle Company manufactures equipment and is listed on the Toronto Stock Exchange. Periwinkle's products range from simple automated machinery to complex systems containing numerous components. Unit selling prices range from \$140,000 to \$1,200,000 and are quoted inclusive of installation. The installation process does not involve changes to the features of the equipment to perform specifications.

On July 1, 2017 Periwinkle Company and Rose Inc. sign a contract with the following terms:

- Rose agrees to acquire equipment, to be delivered and installed by Periwinkle, for a price of \$200,000.
- Rose is obligated to pay Periwinkle the \$200,000 upon installation of the equipment.

Periwinkle delivers the equipment on August 1, 2017, and completes the installation of the equipment on October 1, 2017. Using market data, Periwinkle and Rose determine the installation service is estimated to have a fair value of \$20,000.

Periwinkle's cost of the equipment is \$78,000. The equipment has a useful life of 7 years. Assume the equipment and the installations are two distinct performance obligations that should be accounted for separately.

**Required**

- a) How should the transaction price of \$200,000 be allocated among the service obligations?

**Having been provided the market value of the installation, the *residual approach* is used here, and allocation is as follows:**

<b>\$20,000</b>	<b>Installation</b>
<b>\$180,000</b>	<b>Equipment</b>

- b) Prepare the necessary journal entries for Periwinkle for this revenue arrangement on July 1, 2017, August 1, 2017 and October 1, 2017, assuming Periwinkle receives payment when installation is completed.

**July 1, 2017: Contract signing**

**No journal entry is made: at this stage neither party has performed on the contract.**

**August 1, 2017: Equipment Delivery**

<b>Contract Asset.....</b>	<b>180,000</b>	
<b>Sales Revenue .....</b>		<b>180,000</b>
<b>Cost of Equipment Sold.....</b>	<b>78,000</b>	
<b>Equipment Inventory .....</b>		<b>78,000</b>

**October 1, 2017: Equipment Installation**

<b>Cash.....</b>	<b>200,000</b>	
<b>Installation Revenue .....</b>		<b>20,000</b>
<b>Contract Asset.....</b>		<b>180,000</b>

**If there was a cost of labour associated with installation, we would record that here, too; however, this information was not provided in the question.**

**ROUGH WORK**

**[this page will not be marked by the examiner]**