THE UNIVERSITY OF THE WEST INDIES
CAVE HILL

EXAMINATIONS OF APRIL/MAY 2011.

CODE AND NAME OF COURSE: ACCT2015 - FINANCIAL ACCOUNTING II

DATE AND TIME: DURATION: 2 HOURS

INSTRUCTIONS TO CANDIDATES: This paper has 4 pages and 4 questions.

THIS EXAMINATION PAPER HAS TWO (2) SECTIONS.
SECTION A IS COMPULSORY AND YOU MUST ANSWER ALL QUESTIONS.
SECTION B HAS THREE QUESTIONS; ANSWER TWO (2) QUESTIONS ONLY.

SECTION A - COMPULSORY [30 Marks]

Question 1. [30 Marks]

a) Terraco Co. undertakes a project to construct an office building in Bridgetown over a 3 year period at a price of $50,000,000. The contract begins on January 1, 2008. The following information is available regarding the contract:

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Costs incurred</td>
<td>$12,000,000</td>
<td>$20,000,000</td>
<td>$13,000,000</td>
</tr>
<tr>
<td>Estimated costs</td>
<td>$28,000,000</td>
<td>$10,000,000</td>
<td>$20,000,000</td>
</tr>
<tr>
<td>Complete at year end</td>
<td>$10,000,000</td>
<td>$10,000,000</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>Progress billings</td>
<td>$10,000,000</td>
<td>$10,000,000</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>Collections on</td>
<td>$8,000,000</td>
<td>$17,000,000</td>
<td>$22,000,000</td>
</tr>
<tr>
<td>billings during the</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>year</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Required

i) Assuming that Terraco Co. uses the percentage of completion method, calculate the gross profit to be recognised in 2008 and 2009. (10 Marks)

ii) Assuming that Terraco Co. uses the percentage of completion method, indicate how the contract would be presented on Terraco Co.'s income statement for the year ended December 31, 2009. (3 Marks)

iii) Assuming that Terraco Co. uses the completed contract method, calculate the gross profit to be recognised in 2009 and 2010. (3 Marks)

TURN OVER
Question 1 (cont’d)

b) Discuss the accounting procedures for and illustrate the following:

i) Change in estimate (3 Marks)
ii) Change in entity (2 Marks)
iii) Correction of an error (3 Marks)

c) Differentiate between a ‘Defined- Contribution Pension Plan’ and a ‘Defined-Benefit Pension Plan’. Explain how the employer’s obligation differs between the two types of plans. (6 Marks)

SECTION B
ANSWER ANY TWO QUESTIONS ONLY.

Question 2. [20 Marks]

a) Korman Company has the following securities in its portfolio of trading equity securities on December 31, 2010:

<table>
<thead>
<tr>
<th>Security Description</th>
<th>Cost</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>5,000 shares of Thomas Corp., Common</td>
<td>$155,000</td>
<td>$139,000</td>
</tr>
<tr>
<td>10,000 shares of Gant, Common</td>
<td>$337,000</td>
<td>$329,000</td>
</tr>
</tbody>
</table>

All of the securities had been purchased in 2010. In 2011, Korman completed the following securities transactions:

March 1  Sold 5,000 shares of Thomas Corp., Common @ $31 less fees of $1,500.
April 1  Bought 600 shares of Werth Stores, Common @ $45 plus fees of $50.

The Korman Company portfolio of trading equity securities appeared as follows on December 31, 2011:

<table>
<thead>
<tr>
<th>Security Description</th>
<th>Cost</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>10,000 shares of Gant, Common</td>
<td>$182,000</td>
<td>$195,500</td>
</tr>
<tr>
<td>600 shares of Werth Stores, Common</td>
<td>27,550</td>
<td>25,500</td>
</tr>
<tr>
<td></td>
<td>$209,550</td>
<td>$221,000</td>
</tr>
</tbody>
</table>

Required

Prepare the following journal entries for Korman Company:

i) the adjusting entry(ies) at December 31, 2010. (4 Marks)
ii) the sale of the Thomas Corp. stock on March 1, 2011. (5 Marks)
iii) the purchase of the Werth Stores’ stock on April 1, 2011. (3 Marks)
iv) the adjusting entry(ies) at December 31, 2011. (4 Marks)

b) i) With reference to the time value of money concept, what are the primary characteristics of an annuity? (2 Marks)
ii) Differentiate between an ‘ordinary annuity’ and an ‘annuity due’. (2 Marks)
Question 3. [20 Marks]

a) Eubank Company, as lessee, enters into a lease agreement on July 1, 2010, for equipment. The following data are relevant to the lease agreement:

1. The term of the noncancelable lease is 4 years, with no renewal option. Payments of $422,689 are due on June 30 of each year.
2. The fair value of the equipment on July 1, 2010 is $1,400,000. The equipment has economic life of 6 years with no salvage value.
3. Eubank depreciates similar machinery it owns on the sum-of-the-years'-digits basis.
4. The lessee pays all executory costs.
5. Eubank's incremental borrowing rate is 10% per year. The lessee is aware that the lessor used an implicit rate of 8% in computing the lease payments (present value factor for 4 periods at 8%, 3.31213; at 10%, 3.16986).

Required

Determine the type of lease Eubank Company has entered into and what accounting treatment is applicable. (8 Marks)

b) Parker Corporation has issued 2,000 shares of common stock and 400 shares of preferred stock for a lump sum of $72,000 cash.

Required

i) Give the entry for the issuance assuming the par value of the common was $5 and the market value $30, and the par value of the preferred was $40 and the market value $50. (Each valuation is on a per share basis and there are ready markets for each stock) (8 Marks)

ii) Give the entry for the issuance assuming the same facts as (a) above except the preferred stock has no ready market and the common stock has a market value of $25 per share. (4 Marks)

TURN OVER
Question 4. [20 Marks]

a) AnRoc Co. is a publicly traded company on the Barbados Stock Exchange. Its common shares trade on a daily basis. The market value of the shares on January 1, 2010 was $50 per share. AnRoc Co. entered into the following transactions during the year:

   January 15: Issued 1,000 common shares for land, the market value for each share on this date was $52. The land was appraised at $60,000 by a reputable real estate company.

   March 30: Retired 5,000 shares for $210,000. The book value of these shares was $200,000. There is a credit balance of $3,000 in the additional paid in capital account due to these common shares at this time.

   June 30: The board of directors authorised a stock dividend of 12%, to be recorded a the stated value of $45 per share. On this date, 54,000 common shares are outstanding.

Required:

Prepare the journal entries to record the above transactions. (12 Marks)

b) When is debt security considered impaired? Explain how to account for the impairment of an available for sale debt security. (4 Marks)

c) Explain the differences between a 'stock split' and a 'stock dividend', noting the impact of each on the number of shares outstanding, the share price, the effect on retained earnings, the effect on the par value of the shares. (4 Marks)

END OF QUESTION PAPER