EXAMINATIONS OF APRIL/MAY 2012

CODE AND NAME OF COURSE: ACCT2015 – FINANCIAL ACCOUNTING II

DATE AND TIME: DURATION: 2 Hours

INSTRUCTIONS TO CANDIDATES: This paper has 6 pages and 7 questions.

This paper has two sections – Section A and Section B. Section A is compulsory and all questions in this section must be answered. Choose one question from Section B to answer.

SECTION A [45 Marks] – ALL QUESTIONS ARE COMPULSORY

Question 1 (5 Marks)

During 2011, the following transactions occurred in the two companies below:

Agee Corp.:
January 1, 2011 Acquired a 25% interest in Trent Co. for $500,000.

Trent Co.:
January 1, 2011 1,000,000, $1 par common stock issued and outstanding.
July 1, 2011 Paid cash dividends of $160,000 to stockholders
December 31, 2011 Declared and issued a 5% common stock dividend (market value $2 per share)
December 31, 2011 Net income for 2011 was $360,000

Required

Using the equity method of accounting for investments, calculate the balance in Agee’s investment account at the end of 2011? (Show your workings) (5 marks)

Question 2 (10 Marks)

The stockholders' equity section of Benton Corporation's balance sheet as of December 31, 2010 is as follows:

Stockholders' Equity
Common stock, $5 par value; authorized, 2,000,000 shares; issued, 400,000 shares $2,000,000
Paid-in capital in excess of par 850,000
Retained earnings 3,000,000 $5,850,000

TURN OVER
Question 2 - continued
The following events occurred during 2011:

1. Jan. 5 Issued 10,000 shares of common stock at $8 per share.

2. March 1 A 30% stock dividend was declared and issued. Market value per share is currently $15.

3. June 1 A two-for-one split was carried out. The par value of the stock was to be reduced to $2.50 per share. Market value on March 31 was $18 per share.

4. Dec. 16 Declared a cash dividend of 20 cents per share, payable February 15, 2012 to stockholders of record on December 5, 2011.

Required
a. Prepare the journal entries for the transactions above. (4 marks)
b. Prepare the stockholder's equity section of the balance sheet as at December 31, 2011. (6 marks)

Question 3 (10 Marks)
Price-Check Ltd. reported the following net income:

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>$186,000</td>
</tr>
<tr>
<td>2010</td>
<td>$189,000</td>
</tr>
<tr>
<td>2011</td>
<td>$180,000</td>
</tr>
</tbody>
</table>

In reviewing the accounts in 2012 after the books for the prior year have been closed, you find that the following errors have been made in summarizing activities:

<table>
<thead>
<tr>
<th>Year</th>
<th>Overstatement of ending inventory</th>
<th>Understatement of accrued advertising expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>$42,000</td>
<td>6,600</td>
</tr>
<tr>
<td>2010</td>
<td>$51,000</td>
<td>12,000</td>
</tr>
<tr>
<td>2011</td>
<td>$24,000</td>
<td>7,200</td>
</tr>
</tbody>
</table>

Required
(a) Determine correct net income for the years 2009, 2010, and 2011. (8 marks)
(b) Briefly discuss two approaches suggested for reporting changes in accounting policies. (2 marks)

Question 4 (20 marks)
Klunkit Company on January 1, 2011, enters into a five-year non-cancelable lease, with four renewal options of one year each, for equipment having an estimated useful life of 10 years and a fair value to the lessor, Doorly Corp., at the inception of the lease of $3,000,000. Klunkit's incremental borrowing rate is 8%. Klunkit uses the straight-line method to depreciate its assets. The lease contains the following provisions:
Question 4 - continued

1. Rental payments of $219,000 including $19,000 for property taxes, payable at the beginning of each six-month period.
2. A termination penalty assuring renewal of the lease for a period of four years after expiration of the initial lease term.
3. An option allowing the lessor to extend the lease one year beyond the last renewal exercised by the lessee.
4. A guarantee by Klunkit Company that Doorly Corp. will realize $100,000 from selling the asset at the expiration of the lease. However, the actual residual value is expected to be $50,000.

Notes:
PV factor for annuity due of 20 semi-annual payments at 4% annual rate, 14.13394;
PV factor for amount due in 20 interest periods at 4% annual rate, .45639.

Required
(a) Explain what kind of lease this is to Klunkit Company? 
(b) Calculate the lease term?
(c) Calculate the minimum lease payments?
(d) What is the present value of the minimum lease payments?
(e) Prepare an amortisation schedule from January 1, 2011 through to 1 January 2012 (round to the nearest dollar)
(f) Using the information calculated at (d) and (e), what journal entries would Klunkit record January 1, 2011?

SECTION B [25 Marks] - ANSWER 1 QUESTION ONLY

Question 5 (25 Marks)
Goblin Industries, Inc. issued $600,000 of 8% debentures on January 1, 2010 and received cash totaling $569,547. The bonds pay interest semiannually on June 30 and December 31. The maturity date on these bonds is December 31, 2012. The firm uses the effective-interest method of amortizing discounts and premiums. The bonds were sold to yield an effective-interest rate of 10%.

Required
a. Prepare a bond amortisation table using the following headings (round to zero decimal places):

<table>
<thead>
<tr>
<th>Date</th>
<th>Interest paid</th>
<th>Expense</th>
<th>Amortised</th>
<th>Carrying Amount</th>
</tr>
</thead>
</table>

(11 marks)

b. Prepare journal entries for the following dates:
   i. January 1, 2010
   ii. June 30, 2010

(3 marks) (3 marks)

TURN OVER
Question 5 - continued

c. Assuming the bond were retired at 0.95 on December 31, 2011:
   i. calculate the gain or loss on retirement
   ii. Prepare the journal entry for the bond retirement

(4 marks)  (4 marks)

Question 6 (25 Marks)

A. A student entered a school competition winning a prize which should pay her $2,000 every 3 months for 3 years and $1,500 for the following 23 quarters. All payments will be made at the end of each quarter.

Required
If the current interest rate is 12% per year, calculate the present value of the prize. (please show your workings clearly).

(13 marks)

B. You have been hired as the Accountant for AMERBrit Construction Inc. The 2011 year end has approached for the company and it is your job to determine the amount of gross profit or loss to be reported in the financial statements for each construction job outstanding. The company uses the percentage-of-completion method to account for long-term contracts. Each contract is an independent job with a different customer. All jobs are expected to be completed in 2012.

<table>
<thead>
<tr>
<th>Project</th>
<th>Total contract Price</th>
<th>Contract costs Incurred through Dec. 31, 2011</th>
<th>Estimated Additional costs to Complete</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>$150,000</td>
<td>$124,000</td>
<td>$36,000</td>
</tr>
<tr>
<td>B</td>
<td>175,000</td>
<td>33,900</td>
<td>135,600</td>
</tr>
<tr>
<td>C</td>
<td>140,000</td>
<td>93,000</td>
<td>-</td>
</tr>
<tr>
<td>D</td>
<td>120,000</td>
<td>95,000</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>$585,000</td>
<td>$345,900</td>
<td>$176,600</td>
</tr>
</tbody>
</table>

Required:
Showing your workings, calculate the following for each job:
   a. The overall anticipated profit/loss
   b. The percentage of the job completed to date
   c. The gross profit/loss to be recorded for the year

(4 marks)  (4 marks)  (4 marks)

Question 7 (25 Marks)

A. Santana Corporation has 400,000 shares of common stock outstanding throughout 2011. In addition, the corporation has 5,000, 20-year, 7% bonds (worth $1,000 each) issued at par in 2008. Each $1,000 bond is convertible into 20 shares of common stock after September 23, 2012. During the year 2011, the corporation had net income of $600,000. The tax rate was 30%.

Required
a) Calculate basic earnings per share.

(4 marks)

TURN OVER
Question 7 - continued

b) Assuming the bonds were converted during the year, calculate the diluted earnings per share. (8 marks)
c) Is the conversion of the bonds 'dilutive' or 'anti-dilutive', and why? (3 marks)
d) Which earnings per share should be reported in the financial statements? (2 marks)

B. Briefly explain the following terms:
a) Service cost. (2 marks)
b) Vested benefits. (2 marks)
c) Market-related asset value. (2 marks)
d) Actual return on plan assets. (2 marks)

END OF QUESTION PAPER
Selected Data - Present Value Tables

Present value interest factor of $1 per period at i% for n periods, \((PVF_{n,i})\)

<table>
<thead>
<tr>
<th>n</th>
<th>4%</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>0.4563</td>
</tr>
</tbody>
</table>

Present value interest factor of an ordinary annuity per period at i% for n periods, \((PVF-OA_{n,i})\)

<table>
<thead>
<tr>
<th>n</th>
<th>3%</th>
<th>4%</th>
<th>12%</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>2.82861</td>
<td>2.77509</td>
<td>2.40183</td>
</tr>
<tr>
<td>4</td>
<td>3.71710</td>
<td>3.62990</td>
<td>3.03735</td>
</tr>
<tr>
<td>12</td>
<td>9.95400</td>
<td>9.38507</td>
<td>6.19437</td>
</tr>
<tr>
<td>23</td>
<td>16.44361</td>
<td>14.85684</td>
<td>7.71843</td>
</tr>
<tr>
<td>35</td>
<td>21.48722</td>
<td>18.66461</td>
<td>8.17550</td>
</tr>
</tbody>
</table>

Present value interest factor of an annuity due per period at i% for n periods, \((PVF-AD_{n,i})\)

<table>
<thead>
<tr>
<th>n</th>
<th>4%</th>
</tr>
</thead>
<tbody>
<tr>
<td>16</td>
<td>12.11839</td>
</tr>
<tr>
<td>17</td>
<td>12.65230</td>
</tr>
<tr>
<td>18</td>
<td>13.16567</td>
</tr>
<tr>
<td>19</td>
<td>13.65930</td>
</tr>
<tr>
<td>20</td>
<td>14.13394</td>
</tr>
</tbody>
</table>