SECTION A – 50 MARKS

QUESTION 1 [4 marks]

You are the independent auditor engaged to audit the December 31, 2012 financial statements of Star Products Incorporated, a manufacturer of household appliances. You are currently examining the Contingent Liability and Provisions section of the audit file, and since the objective of IAS 37 is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets; and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount, the following irregularities in the contingent liabilities have been noted:

1. The company’s attorney, Morgan Freeman, Esq., has informed you that Star Products Incorporated has been cited for dumping toxic waste into the Kawasaki River. Clean-up costs and fines amount to $2,750,000. Although the case is still being contested, Freeman is certain that Star Products Incorporated will most probably have to pay the fine and clean-up costs. No disclosure of this situation was found in the financial statements.

2. Star Products Incorporated is the defendant in a patent infringement lawsuit brought by Megan Ryan over Star Products Incorporated’s use of a hydraulic compressor in several of its products. Freeman claims that, if the suit goes against Star Products Incorporated, the loss may be as much as $5,000,000; however, Freeman believes the loss of this suit to be only reasonably possible. Again, no mention of this suit is made in the financial statements.

For each of the situations detailed above prepare the following:

a) Briefly discuss the correct accounting treatment required for the situation as prescribed by IAS37, (Provisions, Contingent Liabilities and Contingent Assets).
QUESTION 2 [16 marks]

Swinton Company has the following securities in its trading portfolio of securities on December 31, 2012.

<table>
<thead>
<tr>
<th>Investments (Trading)</th>
<th>Cost</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,500 shares of Parker, Inc., Common</td>
<td>$71,500</td>
<td>$69,000</td>
</tr>
<tr>
<td>5,000 shares of Bellman Corp., Common</td>
<td>$180,000</td>
<td>$175,000</td>
</tr>
<tr>
<td>400 shares of Duncan, Inc., Preferred</td>
<td>$60,000</td>
<td>$61,600</td>
</tr>
<tr>
<td>Total</td>
<td>$311,500</td>
<td>$305,600</td>
</tr>
</tbody>
</table>

All of the securities were purchased in 2012.

In 2013, Swanson completed the following securities transactions.

March 1  Sold the 1,500 shares of Parker, Inc., Common, @ $45 per share less fees of $1,200.
April 1  Purchased 700 shares of McDowell Corp., Common, @ $75 per share plus fees of $1,300.

Swinton Company’s portfolio of trading securities appeared as follows on December 31, 2013.

<table>
<thead>
<tr>
<th>Investments (Trading)</th>
<th>Cost</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>5,000 shares of Bellman Corp., Common</td>
<td>$180,000</td>
<td>$175,000</td>
</tr>
<tr>
<td>700 shares of McDowell Corp., Common</td>
<td>$53,800</td>
<td>$50,400</td>
</tr>
<tr>
<td>400 shares of Duncan, Inc., Preferred</td>
<td>$60,000</td>
<td>$58,800</td>
</tr>
<tr>
<td>Total</td>
<td>$293,800</td>
<td>$283,400</td>
</tr>
</tbody>
</table>

Required
Prepare the general journal entries for Swinton Company for:
(a) The adjusting entry at December 31, 2012. (2 marks)
(b) The sale of the Parker stock on March 1, 2013. (3 marks)
(c) The purchase of the McDowell stock on April 1, 2013. (2 marks)
(d) The adjusting entry for the trading portfolio at December 31, 2013. (9 marks)

QUESTION 3 [30 marks]

Whirltron Corporation is preparing the comparative financial statements for the annual report to its shareholders for fiscal year end December 31, 2012.

i. The income from operations (before interest and taxes) for December 31, 2012 was $250,000.
ii. The company incurs a 10% interest expense on $240,000 of debt, an obligation that requires interest-only payments for 5 years.
iii. The company experienced an extraordinary loss of $36,000 (net of tax) from a fire in its Brighton facility in September 2012.
iv. The company uses a 40% effective tax rate for income taxes.
v. The capital structure of Whirltron Corporation on January 1, 2012:
   a. 100,000 shares of common stock outstanding; and
   b. 2,000 shares of $50 par value, 6%, cumulative preferred stock.
vi. There were no preferred dividends in arrears, and the company had not issued any convertible securities, options, or warrants.
vii. Additional transactions:
   a. May 1, 2012 - sold an additional 50,000 shares of the common stock at $20 per share.
   b. October 1, 2012 - distributed a 20% stock dividend on the common shares outstanding.
viii. These were the only common stock transactions that occurred during the two fiscal years.

Required
(a) Identify whether the capital structure at Whirltron Corporation is a simple or complex capital structure, and briefly explain why. (2 marks)
QUESTION 3 continued...

(b) Determine the weighted-average number of shares that Whirltron Corporation would use in calculating earnings per share for the fiscal year ended December 31, 2012.

(c) Prepare, in good form the income statement for the year ended December 31, 2012, beginning with income from operations (before interest and taxes), for Whirltron Corporation. Show the correct format of this statement which should include the appropriate earnings per share presentations.

SECTION B

ANSWER ONLY ONE (1) QUESTION FROM THIS SECTION

QUESTION 4 (20 marks)

On February 1, 2012, ABC Construction Company obtained a contract to build a new pavilion for the University. The pavilion was to be built at a total cost of $540,000 and was scheduled for completion by September 1, 2014. One clause of the contract stated that ABC was to deduct $1,500 from the $660,000 billing price for each week that completion was delayed. In 2014, completion was delayed 6 weeks, which resulted in a $9,000 penalty. Below are the data pertaining to the construction period.

<table>
<thead>
<tr>
<th>Costs to date</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimated costs to complete</td>
<td>$162,000</td>
<td>$385,000</td>
<td>$550,000</td>
</tr>
<tr>
<td>Progress billings to date</td>
<td>$378,000</td>
<td>$165,000</td>
<td>$0</td>
</tr>
<tr>
<td>Cash collected to date</td>
<td>$120,000</td>
<td>$330,000</td>
<td>$651,000</td>
</tr>
<tr>
<td>$100,000</td>
<td>$280,000</td>
<td>$651,000</td>
<td></td>
</tr>
</tbody>
</table>

**Required**

(a) Using the percentage-of-completion method as recommended in IAS 11 - Construction Contracts, compute the estimated gross profit to be recognized for the years 2012, 2013 and 2014. (15 marks)

(b) Prepare a partial balance sheet for December 31, 2013, showing the balances in the receivables and inventory accounts. (5 marks)

QUESTION 5 (20 marks)

A] – (10 marks)

Tele-Tron Company sells televisions at an average price of $900 and also offers to each customer a separate 3-year warranty contract for $90 that requires the company to perform periodic services and to replace defective parts.

During 2012, the company sold 300 televisions and 270 warranty contracts for cash. It estimates the 3-year warranty costs as $250 for parts and $40 for labor and accounts for warranties separately.

In 2013, Tele-Tron Company incurred actual costs relative to 2012 television warranty sales of $2,000 for parts and $4,000 for labor. Assume sales occurred on December 31, 2012, and straight-line recognition of warranty revenues occurs.

**Required**

(a) Record any necessary journal entry for the warranty in 2012. (4 marks)

(b) What amounts relative to the 2012 television warranties should appear on the December 31, 2012, balance sheet and how should they be classified? (3 marks)

(c) Briefly discuss how current liabilities are related to a company's operating cycle. (3 marks)

Cont'd...
Question 5 continued...

B] – (10 marks)
The Heliconia Company has two classes of capital stock outstanding: 8%, $20 par preference and $5 par ordinary.

At December 31, 2012, the following accounts were included in stockholders' equity.

Preference shares, 15,000 shares $300,000
Ordinary shares, 200,000 shares $1,000,000
Share premium — Preference shares $20,000
Share premium — Ordinary shares $270,000
Retained Earnings $450,000

The following transactions affected stockholders’ equity during 2013.
Jan. 1 3,000 shares of preference shares issued at $22 per share.
Feb. 1 5,000 shares of ordinary shares issued at $8 per share.
June 1 2-for-1 ordinary share stock split (par value reduced to $2.50).
July 1 3,000 shares of ordinary treasury stock purchased at $10 per share (use the cost method).
Dec. 31 The preference dividend is declared, and no dividend is declared on the ordinary shares.
Dec. 31 Net income is $210,000.

Required
Prepare the journal entries for 2013. Show all supporting computations. (10 marks)

QUESTION 6 (20 marks)
A] – (13 marks)
In the following cases the company closes its books on December 31.

1. Sanford Co. sells $500,000 of 10% bonds on January 1, 2012. The bonds pay interest on June 30 and December 31. The due date of the bonds is December 31, 2015. The bonds yield 12%.

Required
a) Using the future and present value tables (given at the end of the paper), calculate the proceeds from the sale of the bonds, along with the bond discount or premium. (7 marks)

b) Using the effective-interest method, prepare the amortization table for the bond. (4 marks)

c) Prepare journal entries for:
   a. January 1, 2012 – to record the issuance of the bond;
   b. June 30, 2012 – to record the first interest payment on the bond. (2 marks)

B] – (7 marks)
SimpCo leases an automobile with a fair value of $10,906 from Courtney-McAl Motors, Inc., on the following terms:

1. Nencancellable term of 50 months.
2. Rental of $250 per month at end of each month. (The present value at 1% per month is $9,800.)
3. Estimated residual value after 50 months is $1,180. (The present value at 1% per month is $715.) SimpCo guarantees the residual value of $1,180.
4. Estimated economic life of the automobile is 60 months.
5. SimpCo’s incremental borrowing rate is 12% a year (1% a month). Courtney-McAl’s implicit rate is unknown.

Required
(a) Briefly explain what type of lease this is to SimpCo and why? (2 marks)
(b) What is the present value of the minimum lease payments? (3 marks)
(c) Record the lease on SimpCo’s books at the date of inception. (2 marks)
FAIR & PRESENT VALUE TABLES:

FUTURE VALUE OF 1 (FUTURE VALUE OF A SINGLE SUM)

<table>
<thead>
<tr>
<th>Periods</th>
<th>2%</th>
<th>3%</th>
<th>4%</th>
<th>5%</th>
<th>6%</th>
<th>8%</th>
<th>10%</th>
<th>11%</th>
<th>12%</th>
<th>15%</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>1.0000</td>
<td>1.0400</td>
<td>1.0800</td>
<td>1.1200</td>
<td>1.1600</td>
<td>1.2400</td>
<td>1.3200</td>
<td>1.3900</td>
<td>1.4600</td>
<td>1.6500</td>
</tr>
<tr>
<td>6</td>
<td>1.0000</td>
<td>1.0609</td>
<td>1.1332</td>
<td>1.2066</td>
<td>1.2800</td>
<td>1.4520</td>
<td>1.6325</td>
<td>1.7700</td>
<td>1.9050</td>
<td>2.2500</td>
</tr>
<tr>
<td>10</td>
<td>1.0000</td>
<td>1.0810</td>
<td>1.1618</td>
<td>1.2425</td>
<td>1.3231</td>
<td>1.5254</td>
<td>1.7355</td>
<td>1.9422</td>
<td>2.1487</td>
<td>2.6202</td>
</tr>
<tr>
<td>12</td>
<td>1.0000</td>
<td>1.0951</td>
<td>1.1881</td>
<td>1.3101</td>
<td>1.4322</td>
<td>1.7075</td>
<td>2.0304</td>
<td>2.4250</td>
<td>2.9046</td>
<td>3.6393</td>
</tr>
</tbody>
</table>

PRESENT VALUE OF 1 (PRESENT VALUE OF A SINGLE SUM)

<table>
<thead>
<tr>
<th>Periods</th>
<th>2%</th>
<th>3%</th>
<th>4%</th>
<th>5%</th>
<th>6%</th>
<th>8%</th>
<th>10%</th>
<th>11%</th>
<th>12%</th>
<th>15%</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>1.0000</td>
<td>0.9804</td>
<td>0.9612</td>
<td>0.9423</td>
<td>0.9237</td>
<td>0.8857</td>
<td>0.8485</td>
<td>0.8115</td>
<td>0.7751</td>
<td>0.7065</td>
</tr>
<tr>
<td>6</td>
<td>1.0000</td>
<td>0.9713</td>
<td>0.9422</td>
<td>0.9135</td>
<td>0.8853</td>
<td>0.8380</td>
<td>0.7916</td>
<td>0.7463</td>
<td>0.7020</td>
<td>0.6481</td>
</tr>
<tr>
<td>10</td>
<td>1.0000</td>
<td>0.9335</td>
<td>0.8982</td>
<td>0.8636</td>
<td>0.8296</td>
<td>0.7861</td>
<td>0.7433</td>
<td>0.7012</td>
<td>0.6600</td>
<td>0.5987</td>
</tr>
<tr>
<td>12</td>
<td>1.0000</td>
<td>0.9091</td>
<td>0.8772</td>
<td>0.8462</td>
<td>0.8154</td>
<td>0.7763</td>
<td>0.7389</td>
<td>0.7028</td>
<td>0.6671</td>
<td>0.6031</td>
</tr>
</tbody>
</table>

FUTURE VALUE OF AN ORDINARY ANNUITY OF 1

<table>
<thead>
<tr>
<th>Periods</th>
<th>2%</th>
<th>3%</th>
<th>4%</th>
<th>5%</th>
<th>6%</th>
<th>8%</th>
<th>10%</th>
<th>11%</th>
<th>12%</th>
<th>15%</th>
</tr>
</thead>
</table>

PRESENT VALUE OF AN ORDINARY ANNUITY OF 1

<table>
<thead>
<tr>
<th>Periods</th>
<th>2%</th>
<th>3%</th>
<th>4%</th>
<th>5%</th>
<th>6%</th>
<th>8%</th>
<th>10%</th>
<th>11%</th>
<th>12%</th>
<th>15%</th>
</tr>
</thead>
</table>

END OF QUESTION PAPER