

Mid Term Exam

Intermediate Financial Accounting II

Winter 2008

ADM3340

(SOLUTIONS)

Instructions:

1. Write your name and student ID number above.
2. Turn off all cell phones.
2. This examination comprises **3** questions over **12** numbered pages. Answer all questions in this booklet. Booklet is **not** to be removed from the examination room. You may not separate the pages.
3. Limit your answer to the space provided. Blank sheets for rough work and supporting calculations are given at the end of each question.
4. This exam is out of 75 marks and is 2½ hours long. You should budget approximately 2 minutes per mark.
5. 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.
6. Present value tables are provided on page 12/12.
7. Language (non-electronic) dictionaries are allowed.
8. You ***must*** sign the Statement of Academic integrity on page 2 of this exam.

Question		Marks
1	Investments	/25
2	Liabilities	/25
3	Shareholders Equity	/25
TOTAL		/75

Statement of Academic Integrity

The 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 a final exam grade of zero.

Question 1 (25 marks)
Answer all four (4) parts. Each part is independent.

Part 1 (10 marks)
On April 1, 2006, Sean Co. purchased \$120,000 of six percent bonds for \$124,725 plus accrued interest as a held-to-maturity investment. Interest is paid on July 1 and January 1 and the bonds mature on July 1, 2011.

- Instructions**
- (a) Prepare the journal entry on April 1, 2006.
 - (b) The bonds are sold on November 1, 2007 at 103 plus accrued interest. Amortization was recorded when interest was received by the straight-line method (by months and round to the nearest dollar). Prepare all entries required to properly record the sale.

(a) Investment in Bonds	124,725	
Interest Revenue* (\$120,000 × .06 × 3/12 Jan, Feb & March)	1,800	
Cash		126,525
* or Interest Receivable		
(b) Interest Revenue (\$4,725 × 4 ÷ 63)	300	
Investment in Bonds		300
Cash (\$120,000 × .06 × 4/12 July, Aug, Sept, & Oct)	2,400	
Interest Revenue		2,400
Cash	123,600	
Gain on Sale of Securities		300
Investment in Bonds		123,300
\$124,725 – [(\$4,725 ÷ 63) × 19*]		
* 19 months between purchase and sale dates.		

Part 2 (4 marks)
Londrina Corp holds one available-for-sale investment, a \$100,000 face value bond from S.P. Electric. After accounting for amortization and interest to date, the bond has a carrying value of \$96,300 and there is a balance of \$2,400 in unrealized holding gain on available-for-sale investments. Londrina sells this bond for \$98,000.

- Instructions**
Show the entry to record the sale.

The entry is as follows:

Cash	98,000	
(Unrealized) Holding Gain on Available-for-Sale Investments	2,400	
Available-for-Sale Investments		96,300
(Realized) Gain on Sale of Bonds		4,100

Part 3 (6 marks)
Quebec Inc. issued a note with a face value of \$100,000 with a three-year term and paying annual interest of \$3,000. The current market interest rate is 6%.

- Instructions**
Prepare the discount amortization schedule for Quebec Inc., using the effective interest rate method.

Face value of note		\$100,000
Present value of the principal:		
\$100,000 (PVF* _{3,6%}) =	\$83,962	
Present value of the interest:		
\$3,000 (PVF*OA- _{3,6%}) =	<u>8,019</u>	
Present value of the note		<u>91,981</u>
Difference		<u>\$ 8,019</u>

Quebec Inc.
Discount Amortization Schedule
3% Note Discounted at 6%

<u>Date of Issue</u>	<u>Cash Received</u>	<u>Interest Revenue</u>	<u>Discount Amortization</u>	<u>Carrying Value</u>
				\$91,981
End of Year 1	\$3,000	\$ 5,519	\$2,519	94,500
End of Year 2	3,000	5,670	2,670	97,170
End of Year 3	<u>3,000</u>	<u>5,830</u>	<u>2,830</u>	100,000
	<u>\$9,000</u>	<u>\$17,019</u>	<u>\$8,019</u>	

Part 4 (5 marks)

On 1 January 2007 Labrador Ltd. purchased as a significant influence investment 40% of Gull Corporation for \$30,000. At that time, Gull's owners' equity was \$4,000, and Gull had the following assets with market values exceeding book value by the following amounts:

- Land \$20,000
- Buildings \$30,000 (10 years life remaining)
- Patent 10,000 (5 years life remaining)

Gull earned \$10,000 in 2007 and paid \$20,000 dividends. Labrador Ltd amortizes all intangibles over 5 years.

Instructions

Calculate the 2007 ending balance in Kabrador’s investment in Gull Corporation.

Ans:

Purchase price	\$30,000	\$30,000
Proportionate market value net assets (4,000 + 60,000) X 40 %	<u>25,600</u>	
Excess over market value assigned to goodwill (not amortized)	<u>\$4,400</u>	
Proportionate amortization of excess on building (30,000 X 40% /10)		(1,200)
Proportionate amortization of excess on patent (10,000 X 40% /5)		(800)
Proportionate income for 2007 (10,000 x 40 %)		4,000
Less proportionate dividends received (20,000 x 40 %)		<u>(8,000)</u>
Ending balance in investment account		<u>\$24,000</u>
		=====

Question 2 (25 marks)

Answer all three (3) parts. Each part is independent.

Part 1 (7 marks)

On November 1, 2007 BondBeagle Inc. issues \$1,000,000 face value bonds. The bond date is April 1, 2007 and the bonds carry a coupon rate of 6% per year, payable semi-annually on March 31 and September 30. The bonds' maturity date is March 31, 2012. The bonds provide an annual yield of 4%. Bond issuance costs amounted to \$5,000 and are amortized using the straight-line method.

BondBeagle Inc. uses the effective interest rate method to amortize any bond premium or discount. BondBeagle Inc.'s accounting year-end is August 31.

Instructions

Present the journal entry to record the issuance of the bonds: show all supporting calculations.

November 01, 2007	Date of issuance	Dr	Cr
Bond issue costs		5,000	
		0	
Cash		1,080,232	
	Interest payable		5,000
	Bonds payable		1,000,000
	Bond premium		80,232
To record the issuance of 5.00-year bonds, face value \$1,000,000, stated interest rate 6.00% per annum. The bond date is April 01, 2007 with interest paid semi-annually. There are 53 months (including 9 interest payments) between the bond's issuance and maturity dates. For details of how this journal entry's amounts are determined, please refer to the ISSUANCE_CALC worksheet.			

Face value	\$1,000,000
Stated interest rate	6.00% per year = 3.00% semi-annually.
Effective interest rate (Yield)	2.00% semi-annually.
Issue date	November 1, 2007, 1 month after September 30, 2007, the closest preceding interest payment date.
Maturity date	March 31, 2012, 6 months after September 30, 2011, the closest preceding interest payment date.

Accrued interest payable on the issuance date	5,000	= \$1,000,000 x 6.00% x 1/12 months
Bond proceeds, excluding any accrued interest and issuance costs (see detailed calculation below)	1,080,232	= \$1,081,627 + [(\$1,073,254 - \$1,081,627) x 1/6 months]
Face value of bonds	1,000,000	
Bond premium	80,232	= \$1,080,232 - \$1,000,000
Bond issue costs	-5,000	
Total proceeds on issuance, including accrued interest payable	1,080,232	= \$1,080,232 + \$5,000 - \$5,000

The closest preceding interest payment date to the issuance date is	September 30, 2007	(1 month before November 1, 2007)
Issuance date	November 1, 2007	
The first interest payment date after the issuance date is	March 31, 2008	(5 months after November 1, 2007)

	If the bonds were issued on:	
	September 30, 2007	March 31, 2008
	There would be 9 semi-annual interest payments (54 months) between September 30, 2007 and the maturity date, March 31, 2012	There would be 8 semi-annual interest payments (48 months) between March 31, 2008 and the maturity date, March 31, 2012
Present value of the bond's 9.00 semi-annual interest payments of \$30,000 (= \$1,000,000 x 6.00%/2) at 2.00% effective interest rate [\$244,867 = 8.16224 x \$30,000]	244,867.20	
Present value of the maturity value of \$1,000,000 at the end of 9.00 periods at 2.00% effective interest rate [\$836,760 = 0.83676 x \$1,000,000]	836,760.00	
Present value of the bond's 8.00 semi-annual interest payments of \$30,000 (= \$1,000,000 x 6.00%/2) at 2.00% effective interest rate [\$219,764 = 7.32548 x \$30,000]		219,764.40
Present value of the maturity value of \$1,000,000 at the end of 8.00 periods at 2.00% effective interest rate [\$853,490 = 0.85349 x \$1,000,000]		853,490.00
Total	1,081,627.20	1,073,254.40
Bond proceeds, excluding any accrued interest and issuance cost, on November 01, 2007 (which lies between September 30, 2007 and March 31, 2008). \$1,080,232 = \$1,081,627 + {[((\$1,073,254 - \$1,081,627)/6months] x 1months}	1,080,231.73	

Part 2 (9 marks)

On November 1, 2007 BeachBall Inc. issues \$1,500,000 face value bonds. The bond date is February 1, 2007 and the bonds carry a coupon rate of 12% per year, payable semi-annually on January 31 and July 31. The bonds' maturity date is January 31, 2012 (these are 5 year bonds). Proceeds upon issuance, excluding accrued interest and issuance costs, were \$1,601,784, and the bonds provide an annual yield of 10%. Bond issuance costs amounted to \$100,000 and are amortized using the straight-line method. BeachBall Inc. uses the effective interest rate method to amortize any bond premium or discount.

Instructions

Present the journal entry for these bonds on July 31, 2009.

\$90,000 X 5.0757 = \$ 456,813

\$1,500,000 x .7462 = 1,119,300

Amortized cost at 31 January 2009 = \$1,576,113

Difference between \$1,576,113 and \$1,576,135 is due to rounding (tables using only 4 places of decimal).

To answer this question you must first determine the amortized cost (carrying value) of the bond at 31 January 2009 (shown as \$1,576,135 below).

July 31, 2009	The fourth interest payment date after the issuance date	Dr	Cr	
Interest expense		78,807		= \$1,576,135 (see amortization table's semi-annual period 4) x 5.00% (semi-annual yield) x 6/6 months
Bond premium		11,1930		= \$90,000 - \$78,807
Interest payable			90,000	= \$1,500,000 x 6/12 months x 12.00%
To record bond interest expense incurred between January 31, 2009 (the third interest payment date after the issuance date) and July 31, 2009. Effective interest rate method.				
Bond issue expense		11,765		
Bond issue costs		0	11,765	= \$100,000 x 6/51 months
To record the amortization of bond issue costs - straight line method.				
Interest payable		90,000		
Cash			90,000	
To record the bond interest payment.				

Part 3 (9 marks)

Below is the amortization table for \$5,000,000 face value bonds that Snowy Mountains Inc. issued on October 1, 2007. Interest is paid annually.

Snowy Mountains Inc.'s accounting year-end is September 30. On July 31, 2010 Snowy Mountains Inc. retires 25% of the bonds at 102%, excluding accrued interest.

Date at beginning of period	Date at end of period	Period	Unamortized bond discount, beginning of the period.	Net bond liability (book or carrying value, or amortized cost), beginning of the period.	12.000% (=yield) interest expense per interest payment period.	10.00% [10.00%/1] interest payment per period.	Bond discount amortization.	Net bond liability (amortized cost) at the end of the period.
		A	B	C	D	E	F	G
					C x 12.00% (See Notes below this table for period 1's \$272,617 calculation)	\$250,000 in period 1 does not include repayment by the company of the \$250,000 paid by lenders on October 01, 2007, the date of issuance ($\$250,000 + \$250,000 = \$500,000$)	D - E	C + F (See Notes below this table for period 1's \$4,588,859 calculation)
01-Oct-07	31-Mar-08	1	433,758	4,566,243	272,617	250,000	22,617	4,588,859
01-Apr-08	31-Mar-09	2	411,141	4,588,859	550,663	500,000	50,663	4,639,522
01-Apr-09	31-Mar-10	3	360,478	4,639,522	556,743	500,000	56,743	4,696,265
01-Apr-10	31-Mar-11	4	303,735	4,696,265	563,552	500,000	63,552	4,759,817
01-Apr-11	31-Mar-12	5	240,183	4,759,817	571,178	500,000	71,178	4,830,995
01-Apr-12	31-Mar-13	6	169,005	4,830,995	579,719	500,000	79,719	4,910,714
01-Apr-13	30-Mar-14	7	89,286	4,910,714	589,286	500,000	89,286	5,000,000

Instructions

Provide all entries required on July 31, 2010 to record the bond retirement.

Date of retirement				
July 31, 2010		Dr	Cr	
Interest expense	46,963			= \$4,696,265 (net bond liability at beginning of April 01, 2010) x 12.000000% (annual yield) x 4/12 months x 25.00% retired.
				= \$46,963 - \$41,667
Bond discount	0		5,296	
				= \$5,000,000 x 25.00% retired x 4/12 months x 10.00%
Interest payable	0		41,667	
			0	
To record interest expense incurred on 25.00% of the bonds between March 31, 2010 (the closest preceding interest payment date to the retirement date) and July 31, 2010. Effective interest rate method. [Note: July 31, 2010 is neither an accounting year-end or a bond interest payment anniversary date.]				

Loss on retirement	95,638			= (\$1,316,667 - \$41,667 + \$70,638) - (\$1,250,000)
				= See above journal entry. March 31, 2010 is the closest preceding interest payment date to the date of retirement.
Interest payable	41,667			
Bond payable	1,250,000			= \$5,000,000 x 25.00% retired
				= [\$303,735 (unamortized at beginning of April 01, 2010) x 25.00% retired - \$5,296 (amortization between March 31, 2010 and July 31, 2010 on the 25.00% retired)] March 31, 2010 is the closest preceding interest payment date to the date of retirement.
Bond discount	0		70,638	
			0	
				= \$1,275,000 (= \$5,000,000 x 25.00% x 102.00%) + \$41,667 accrued interest
Cash			1,316,667	
			0	
To record the retirement at 102.00% of 7.00 year 10.00% bonds, issued October 01, 2007, face value \$1,250,000.				

Question 3 (25 marks)
Answer all two (2) parts. Each part is independent.

Part 1 (16 marks)
The following are comparative shareholders’ equity sections of the balance sheet of CL Limited:

	20X6	20X5
\$4 preferred shares, no par, 50,000 shares at the end of 20X6	\$ 80,000	\$100,000
Common shares, 100,000 shares at the end of 20X6	960,000	660,000
Donated capital, value of art donated to the corporation	50,000	--
Retained earnings	660,000	400,000
Treasury stock (10,000 common shares bought but 2,000 have been resold)	(50,000)	--
Contributed capital on sale of treasury stock	12,000	--

Additional information:

Preferred shares were retired at a price of \$8,000 over initial issuance price.
Only preferred dividends were declared at the end of the period.

Instructions
Prepare entries in the T-accounts below to account for the changes in the various shareholders’ equity accounts.

Part 2 (9 marks)

Shareholders’ equity has the following sub-classifications:

- A. Share capital
- B. Additional contributed capital
- C. Retained earnings unappropriated
- D. Retained earnings appropriated
- E. Accumulated other comprehensive income
- F. Contra to shareholders’ equity

Instructions

For each item in the right-hand column below, identify the letter above that corresponds to its proper classification within shareholders’ equity. Place the letter in the left-hand column. Use NA if the above classifications are not applicable (give brief explanations if needed):

A	Proceeds on share issuance.
A or C (reduces balance)	Share issue costs.
NA (not recorded when declared)	Stock dividends declared, not issued. Dividend is not recorded until issuance.
E	Gain on translating the financial statements of a foreign subsidiary to Canadian dollars.
F	Treasury shares held pending resale.
C (negative)	Net loss.
D [also reduces unappropriated retained earnings - C]	Restriction on retained earnings.
NA [an asset]	Goodwill
NA [income statement; will be part of C]	Extraordinary item.
C [decrease]	Cash dividends declared, not paid.
NA [an asset]	Bond sinking fund.
B or C [B, if any in appropriate share classification, then C]	Excess of retirement price over original issue proceeds, retired shares.
B [recorded at mkt vale – also an asset]	Plant site donated by shareholder.
C [also on income statement]	Net income.
C [restates beginning balance]	Correction of accounting error affecting prior year’s earnings.
B [retired shares for less than original proceeds]	Excess of average original issue proceeds over retirement price, retired shares.

Financial Tables

	A	B	C	D	E	F	G	H	I	J	K	L
1	Table 2: PRESENT VALUE of \$1.00 that is received in the future.											
2												
3	Period/ Percent	1.00%	1.50%	2.00%	2.50%	3.00%	3.50%	4.00%	4.50%	5.00%	5.50%	6.00%
4	1	0.9901	0.9852	0.9804	0.9756	0.9709	0.9662	0.9615	0.9569	0.9524	0.9479	0.9434
5	2	0.9803	0.9707	0.9612	0.9518	0.9426	0.9335	0.9246	0.9157	0.9070	0.8985	0.8900
6	3	0.9706	0.9563	0.9423	0.9286	0.9151	0.9019	0.8890	0.8763	0.8638	0.8516	0.8396
7	4	0.9610	0.9422	0.9238	0.9060	0.8885	0.8714	0.8548	0.8386	0.8227	0.8072	0.7921
8	5	0.9515	0.9283	0.9057	0.8839	0.8626	0.8420	0.8219	0.8025	0.7835	0.7651	0.7473
9	6	0.9420	0.9145	0.8880	0.8623	0.8375	0.8135	0.7903	0.7679	0.7462	0.7252	0.7050
10	7	0.9327	0.9010	0.8706	0.8413	0.8131	0.7860	0.7599	0.7348	0.7107	0.6874	0.6651
11	8	0.9235	0.8877	0.8535	0.8207	0.7894	0.7594	0.7307	0.7032	0.6768	0.6516	0.6274
12	9	0.9143	0.8746	0.8368	0.8007	0.7664	0.7337	0.7026	0.6729	0.6446	0.6176	0.5919
13	10	0.9053	0.8617	0.8203	0.7812	0.7441	0.7089	0.6756	0.6439	0.6139	0.5854	0.5584

	A	B	C	D	E	F	G	H	I	J	K	L
1	Table 4: PRESENT VALUE of Annuity of \$1.00 in arrears.											
2												
3	Period/ Percent	1.00%	1.50%	2.00%	2.50%	3.00%	3.50%	4.00%	4.50%	5.00%	5.50%	6.00%
4	1	0.9901	0.9852	0.9804	0.9756	0.9709	0.9662	0.9615	0.9569	0.9524	0.9479	0.9434
5	2	1.9704	1.9559	1.9416	1.9274	1.9135	1.8997	1.8861	1.8727	1.8594	1.8463	1.8334
6	3	2.9410	2.9122	2.8839	2.8560	2.8286	2.8016	2.7751	2.7490	2.7232	2.6979	2.6730
7	4	3.9020	3.8544	3.8077	3.7620	3.7171	3.6731	3.6299	3.5875	3.5460	3.5052	3.4651
8	5	4.8534	4.7826	4.7135	4.6458	4.5797	4.5151	4.4518	4.3900	4.3295	4.2703	4.2124
9	6	5.7955	5.6972	5.6014	5.5081	5.4172	5.3286	5.2421	5.1579	5.0757	4.9955	4.9173
10	7	6.7282	6.5982	6.4720	6.3494	6.2303	6.1145	6.0021	5.8927	5.7864	5.6830	5.5824
11	8	7.6517	7.4859	7.3255	7.1701	7.0197	6.8740	6.7327	6.5959	6.4632	6.3346	6.2098
12	9	8.5660	8.3605	8.1622	7.9709	7.7861	7.6077	7.4353	7.2688	7.1078	6.9522	6.8017
13	10	9.4713	9.2222	8.9826	8.7521	8.5302	8.3166	8.1109	7.9127	7.7217	7.5376	7.3601