École de gestion TELFER School of Management

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Mid Term Exam (SUGGESTED SOLUTIONS)
Intermediate Financial Accounting II
Fall 2014
ADM3340 Sections A, B, & C

Section	Class time/day	Tick one
Section A	Tuesday 8:30am & Friday 10:00am	
Section B	Tuesday 7:00pm	
Section C	Wednesday 10:00am & Friday 8:30am	

Name: _____ **ID#:** _____

INSTRUCTIONS

- Write your name and student ID number above. Display your student ID on your desk during the exam.
- Reminder: it is an offence to have a cell phone or any other communication device in your possession during this exam's three hours. (see the Statement of Academic integrity on page 2 of this exam).
- This examination "SUGGESTED SOLUTION" comprises **4** multi-part questions over **18** numbered pages. Answer all questions in this booklet. 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 the right to ask that your exam be remarked.
- Limit your answer to the space provided. Blank sheets for rough work and supporting calculations are given at the end of each question.
- This exam will be marked out of **100** marks (for convenience) and is 2½ hours long. You should budget approximately **1.5** minutes per mark. The exam is worth 40% 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.
- This exam paper must remain stapled: do not take this exam paper apart.
- Present value tables are provided on pages 17 and 18.
- Language (non-electronic) dictionaries are allowed with the proctor's permission.
- You ***must*** sign the Statement of Academic integrity on page 2 of this exam.

	Question		Marks
Ch 12	1: part 1	Goodwill; acquisition, impairment, ASPE & IFRS	/10
	1: part 2	Internally generated intangibles	/8
	1: part 3	Intangibles: definition	/3
Ch 13	2: part 1	Warranties	/7
	2: part 2	Promotions/premiums	/9
	2: part 3	Refinancing current liabilities	/5
Ch 14	3: part 1	Bond liabilities: issuance	/10
	3: part 2	Bond liabilities: retirement	/14
	3: part 3	Troubled debt restructuring	/14
Ch 15	4: part 1	Retained earnings	/5
	4: part 2	Treasury stock	/6
	4: part 3	Various	/9
	TOTAL		/100

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 (21 marks)
Answer ALL parts to this question. Each part is independent.

PART 1: (10 marks)

On July 1, 2014, Zoe Corporation purchased the net assets of Soorya Company by paying $415,000 cash and issuing a $50,000 note payable to Soorya Company. At July 1, 2014, the statement of financial position of Soorya Company was as follows:

Cash	$ 75,000	Accounts payable	$300,000
Accounts receivable	102,000	Shareholders' Equity	239,000
Inventory	98,000		
Land	50,000		
Buildings (net)	75,000		
Equipment (net)	90,000		
Trademarks (net)	49,000		
	$539,000		$539,000

The recorded amounts all approximate current values except for land (worth $60,000), inventory (worth $125,000), and trademarks (worthless). The receivables are shown net of an allowance for doubtful accounts of $12,000. The amounts for buildings, equipment, and trademarks are shown net of accumulated amortization of $14,000, $23,000, and $47,000, respectively.

Required

(a) Prepare the July 1, 2014 journal entry for Zoe Corporation to record the purchase.

(a)	Cash	75,000	
	Accounts Receivable	114,000	
	Inventory	125,000	
	Land	60,000	
	Buildings	75,000	
	Equipment	90,000	
	Goodwill	238,000	
	Allowance for Doubtful Accounts		12,000
	Accounts Payable		300,000
	Notes Payable		50,000
	Cash		415,000

It is likely that only cash of $415,000 – $75,000 = $340,000 would actually change hands. Note that the building and equipment would be recorded at the 1/July/2014 cost to Zoe; accumulated amortization accounts would not be recognized.

(b) Assume that Zoe is a private entity and tested its goodwill for impairment on December 31, 2015. Management determined that the reporting unit's carrying amount (including goodwill) was $500,000 and that the reporting unit's fair value (including goodwill) was $450,000. Determine if there is any impairment and prepare any necessary entry on December 31, 2015. Zoe applies ASPE.

(b)	Loss on Impairment	50,000	
	Accumulated Impairment Losses (Goodwill)		50,000

Carrying amount (incl. goodwill)	$500,000
Fair value of unit	450,000
	$50,000

(c) Repeat part (a), assuming that the purchase price was $204,000, all paid in cash.

(c)

Note that a purchase price of $204,000 is less than the fair value of the net assets of Soorya, resulting in negative goodwill of $23,000. Current standards (IFRS 3.34-36 & ASPE 1582.36) require the excess to be recognized as a gain in net income. However, this cannot be done without a thorough reassessment of all the variables, values, and measurement procedures used that resulted in this gain. [see Page 65 of RIM's 2011 Annual Report for a real example of a "bargain purchase"].

If the review reveals no overstatement of assets, record as follows:

	Cash	75,000	
	Accounts Receivable	114,000	
	Inventory	125,000	
	Land	60,000	
	Buildings	75,000	
	Equipment	90,000	
	Allowance for Doubtful Accounts		12,000
	Accounts Payable		300,000
	Cash		204,000
	Gain		23,000

Alternatively (not required in your solution): if the review reveals an overstatement of inventory of $23,000, say, record as follows:

Cash	75,000	
Accounts Receivable	114,000	
Inventory ($125,000 – $23,000)	102,000	
Land	60,000	
Buildings	75,000	
Equipment	90,000	
Allowance for Doubtful Accounts		12,000
Accounts Payable		300,000
Cash		204,000

(d) Based on part (a), assume now that Zoe is a public entity and tested its goodwill for impairment on December 31, 2015. The cash-generating unit's values (including goodwill) are as follows:

Carrying amount	$500,000
Value in use	475,000
Fair value	450,000
Disposal costs	25,000

Determine if there is any impairment and prepare any necessary journal entry on December 31, 2015.

(d) Impairment test under IFRS

Loss on Impairment	25,000	
Accumulated Impairment Losses (Goodwill)		25,000

Carrying amount (incl. goodwill)	500,000
Recoverable amount	475,000*
	25,000

*** Recoverable amount:**
Higher of VIU (value in use) of 475,000 and FV-DC (fair value less disposal costs) of 425,000 (450,000-25,000)
VIU = the present value of the asset's future cash flows from use and eventual sale.

QUESTION 1 (21 marks) (continued)
Answer ALL parts to this question. Each part is independent.

PART 2: (8 marks)

Good Foods Incorporated (GFI) is a worldwide diversified food manufacturing and distribution company that is listed on a public stock exchange, and thus must follow IFRS. In the 2014 fiscal year, the company is involved in a significant amount of research and development activity in order to develop recipes for new food products. Currently, it is working on two projects.

The first project is the development of techniques for baking a carbohydrate-free bread product. The company has sufficient resources to complete this project, intends to complete this project, and has determined through previous market research that the current interest in low carbohydrate diets has resulted in a large market for products low in carbohydrates. The company has also acquired the patent for a process that is a technically feasible way to produce the bread product.

The second project is new and untested: the company is attempting to determine if there is a market for vegetable-enhanced soft drinks. These potential new beverages would provide the flavour of soft drinks with vitamin enhancement, which GFI feels may be popular with consumers.

Costs incurred during the year include:

Purchase of new ovens for the bread product development lab	$500,000
Market research into vegetable-enhanced soft drinks	$250,000
Salary costs for staff working on the bread product	$100,000
Share of overhead related to bread product development lab	$50,000
Depreciation of bread product development lab assets	$25,000
Amortization of bread-making process patent	$50,000

Required

Provide the journal entries necessary to record the above costs.

The research and development costs should be handled as follows. The costs associated with the new soft drinks are considered research. Research costs are expensed as costs of the period in which they are incurred. In this situation, these would include:

Market research expense (vegetable-enhanced soft drinks)	**$250,000**		
Cash			**$250,000**

The remainder of the cost incurred is considered to be development costs that are eligible for deferral because the bread product and its market are clearly defined and it is technically feasible. These costs include:

Bread making ovens	**$500,000**	
Cash		**$500,000**

The ovens are a capital asset related to development. They would be capitalized and depreciation on these ovens would be charged to the development lab and treated as a development cost. It is assumed that the depreciation of development lab assets includes depreciation of these ovens. Therefore, the total development costs for the year are:

Salary costs for staff working on the bread product	$100,000
Share of overhead related to product development lab	50,000
Depreciation of development lab assets	25,000
Amortization of bread-making process patent	50,000
Total development costs	$225,000

Under IFRS these development costs must be capitalized and deferred.

Bread project development a/c	**225,000**	
Cash/payables		**150,000**
Accumulated depreciation (lab assets)		**25,000**
Accumulated amortization (patent)		**50,000**

Question 1 (21 marks) (continued)
Answer ALL parts to this question. Each part is independent.

PART 3: (3 marks)

Provide clear, concise answers for the following.
What are intangible assets, according to generally accepted accounting principles?

Solution (see also pages 737 & 742 in Kieso et al, 10th Can Ed.)

Intangible assets are assets that are:

1. individually identifiable (results from contractual or other legal rights, or can be separated or divided from the entity and sold, transferred, rented, or exchanged);
2. have a non-physical existence; and
3. are non-monetary in nature.

QUESTION 2 (21 marks)
Answer ALL parts to this question. Each part is independent.

PART 1: (7 marks)

Raindrop Corporation manufactures a line of amplifiers that carry a three-year warranty. Based on experience, the estimated warranty costs related to dollar sales are as follows: during the year of sale, 0%; first year after sale , 2% of sales; second year after sale, 3% of sales; and third year after sale, 4% of sales. Sales and actual warrant expenditures duirng the first three years of business were:

Sales-year	Sales revenue	Cumulative actual warranty expenditures between date of sale and 31/12/2014
2012	$ 810,000	$ 6,500
2013	1,070,000	67,200
2014	1,036,000	162,000

Required (show all supporting calculations)

Assume that all sales are made evenly throughout each year and that warranty expenditures are also evenly spaced according to the rates above. Raindrop Corporation uses the expense approach when accounting for its warranties.

a) Calculate the amount Raindrop Corporation should report as a warranty expense on its 2014 income statement.

b) Calculate the amount Raindrop Corporation should report as a warranty liability on its December 31, 2014 balance sheet.

(a) Estimated warranty expense for 2014:

On 2014 sales: $1,036,000 X .09* = $ 93,240

* (2% of sales first year + 3% of sales second year + 4% of sales third year = 9% of sales)

(b) Estimated warranty costs:

On 2012 sales $ 810,000 X .09	$ 72,900
On 2013 sales $1,070,000 X .09	96,300
On 2014 sales $1,036,000 X .09	93,240
Total estimated potential costs	262,440
Total actual warranty expenditures	235,700*
Balance of liability, 31/12/14	$26,740

*2012—$6,500; 2013—$67,200, and 2014—$162,000.

The liability account has a balance of $26,740 at 31/12/14 based on the difference between the estimated warranty costs (totaling $262,440) for the three years' sales and the actual warranty expenditures (totaling $235,700) during that same period.

OR

Estimated warranty costs:

On 2012 sales $ 810,000 X .09	$ 72,900
On 2013 sales $1,070,000 X .09	96,300
On 2014 sales $1,036,000 X .09	93,240
Total estimated potential costs	262,440
Total actual warranty expenditures	162,000
Balance of liability, 31/12/14	$100,440

The liability account has a balance of $100,440 at 31/12/14 based on the difference between the estimated warranty costs (totaling $262,440) for the three years' sales and the actual warranty expenditures (totaling $162,000) during that same period.

QUESTION 2 (21 marks)
Answer ALL parts to this question. Each part is independent.

PART 2: (9 marks)

In 2014 Subban Corporation sold 700,000 boxes of pies-mix under a new sales promotion program. Each box contains one coupon that entitles the customer to a baking pan when the coupon is submitted with an additional $4.75 from the customer. Subban pays $5.00 per pan and $1.25 for shipping and handling to the customer. Subban estimates that 60% of the coupons will be redeemed even though only 105,000 coupons had been processed during 2014. Each box of pie-mix is sold for $4.50 and Subban estimates that $1.00 of the $4.50 sale price relates to the baking pan to be awarded. Subban follows IFRS and accounts for its promotional programs in accordance with the revenue approach.

Required (show all supporting calculations)

Prepare any necessary 2014 journal entries for Subban Corporation to record revenue, the liability, and coupon redemptions.

Inventory (pans)	$XXX	
Accounts Payable/Cash		$XXX

Cash	3,150,000	
Sales Revenue (700,000 X $3.50)		2,450,000
Unearned Revenue (700,000 x $1.00)		700,000

Cash (105,000 X $4.75)	498,750	
Premium Expense (105,000 X [$5.00 + $1.25 - $4.75])	157,500	
Inventory of Baking Pans (105,000 X $5.00)		525,000
Cash/Accounts Payable (105,000 X $1.25)		131,250

Unearned Revenue (700,000 X $1.00 X 25%*)	175,000	
Sales Revenue		175,000

*105,000/(60% x 700,000) = 25%

The calculations below are not required in your answer:

Boxes sold	700,000
Sale price per unit related to premium	X $1.00
Unearned revenue recorded in 2014	$700,000
Total coupons expected to be redeemed (700,000 x 60%)	420,000
Less: coupons redeemed during 2014	105,000
Coupons still to be redeemed, 31/12/14	315,000
Total coupons expected to be redeemed	÷ 420,000
% of unearned revenue to be earned after 2014	75%
Unearned revenue recorded in 2014	$700,000
% of unearned revenue to be earned after 2014	X 75%
Unearned revenue (adjusted), 31/12/14	$525,000
Total coupons redeemed in 2014	105,000
Cost per redemption [($5.00 + $1.25) – $4.75]	$1.50
Premium expense	$157,500

QUESTION 2 (21 marks)
Answer ALL parts to this question. Each part is independent.

PART 3: (5 marks)

On December 31, 2014, Rostec Corporation has $7.9 million of short-term debt in the form of notes payable that will be due periodically in 2015 to EuroOne Bank. On January 28, 2015, Rostec enters into an agreement with the bank that will permit Rostec to refinance the notes payable by borrowing up to 60% of the gross amount of its accounts receivable. Receivables are expected to range between a low of $5.7 million in May and a high of $7 million in October during the year 2015. The interest cost of the maturing short-term debt is 15%, and the new agreement calls for a fluctuating interest rate at 1% above the prime rate on notes payable due in 2017. Rostec's December 31, 2014 balance sheet is issued on February 15, 2015.

Required

(a) Assuming that Rostec follows ASPE, prepare a partial balance sheet for Rostec Corporation at December 31, 2014, that shows how its $7.9 million of short-term debt should be presented, including any necessary note disclosures.

Rostec Corporation
Partial Balance Sheet
December 31, 2014

Current liabilities:	
Notes payable (Note 1)	$4,480,000
Long-term debt:	
Notes payable expected to be refinanced in 2015 (Note 1)	3,420,000

Note 1.
Under a financing agreement with EuroOne Bank the company may borrow up to 60% of the gross amount of its accounts receivable at an interest cost of 1% above the prime rate. The company intends to issue notes maturing in 2017 to replace $3,420,000 of short-term, 15%, notes due periodically in 2015. Because the amount that can be borrowed may range from $3,420,000* to $4,200,000**, only $3,420,000 of the $7,900,000 of currently maturing debt has been reclassified as long-term debt.

Expected range of receivables:
* low in May: $5,700,000 X 60% = $3,420,000
** high in October: $7,000,000 X 60% = $4,200,000

(b) Assuming that Rostec follows IFRS, prepare a partial balance sheet for Rostec Corporation at December 31, 2014, that shows how its $7.9 million of short-term debt should be presented, including any necessary note disclosures.

Not required in your solution: Under IFRS, since the debt is due within 12 months from the reporting date, the whole amount ($7.9 million) is classified as a current liability. This classification holds even if a long-term refinancing has been completed before the financial statements are released. The only exception accepted for continuing long-term classification is if, at the balance sheet date, the entity expects to refinance it or roll it over under an existing agreement for at least 12 months and the decision is solely at its discretion. The international standard has a stringent requirement that the agreement must be firm at the balance sheet date.

Rostec Corporation
Partial Balance Sheet
December 31, 2014

Current liabilities:	
Notes payable (Note 1)	$7,900,000

Note 1.
Under a financing agreement with EuroOne Bank the company may borrow up to 60% of the gross amount of its accounts receivable at an interest cost of 1% above the prime rate. The company intends to issue notes maturing in 2017 to replace $3,420,000 of short-term, 15%, notes due periodically in 2015.

QUESTION 3 (38 marks)
Answer ALL parts to this question. Each part is independent.

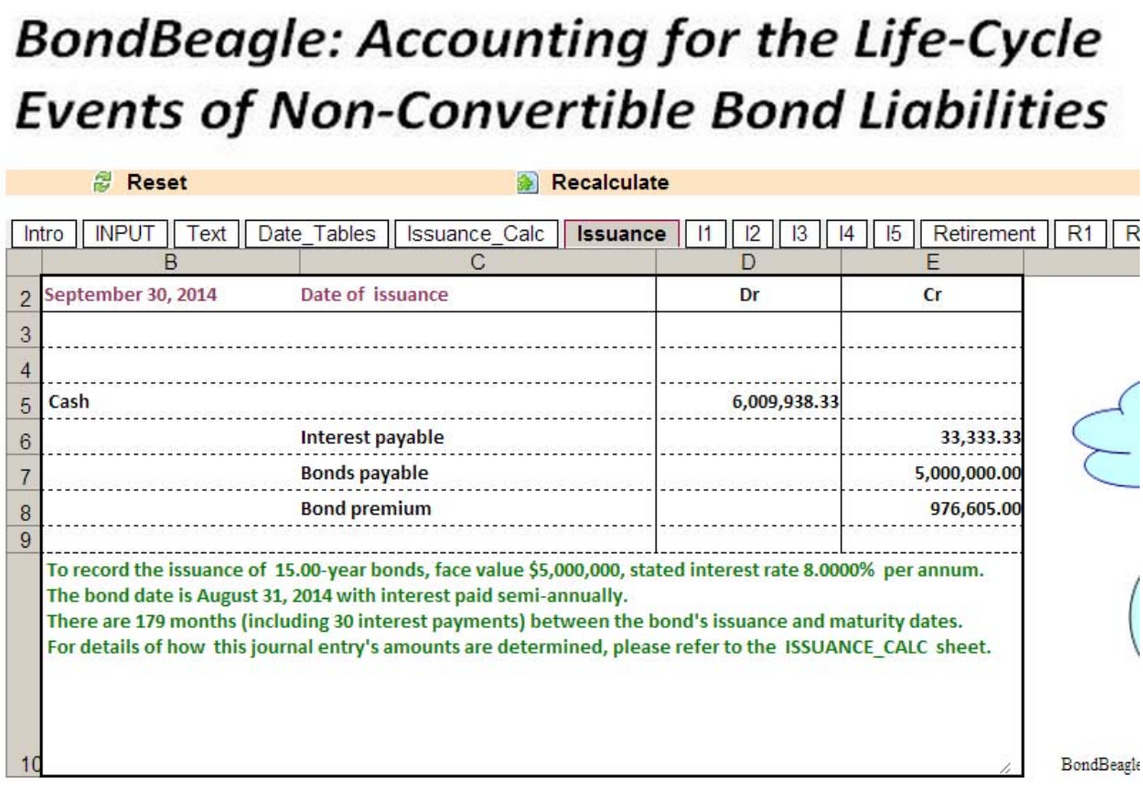
PART 1: (10 marks)

On September 30, 2014 BondBeagle Inc. issues $5,000,000 face value bonds. The bond date is August 31, 2014, and the bonds carry a coupon rate of 8% per year, payable semi-annually on August 31 and February 28. The bonds' maturity date is August 31, 2029. The bonds provide an annual yield of 6%.

BondBeagle Inc. uses the effective interest rate method to amortize any bond premium or discount and its accounting year-end is June 30.

Required

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



	B	C	D	E
2	September 30, 2014	Date of issuance	Dr	Cr
3				
4				
5	Cash		6,009,938.33	
6		Interest payable		33,333.33
7		Bonds payable		5,000,000.00
8		Bond premium		976,605.00
9				
10	To record the issuance of 15.00-year bonds, face value $5,000,000, stated interest rate 8.0000% per annum. The bond date is August 31, 2014 with interest paid semi-annually. There are 179 months (including 30 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 sheet.			

The following table is not required in your solution:

		If the bonds were issued on:	
21		August 31, 2014	February 28, 2015
22		There would be 30 semi-annual interest payments (180 months) between August 31, 2014 and the maturity date, August 31, 2029	There would be 29 semi-annual interest payments (174 months) between February 28, 2015 and the maturity date, August 31, 2029
23	Present value of the bond's 30.00 semi-annual interest payments of $200,000 (= $5,000,000 x 8.0000%/2) at 3.0000% effective interest rate [$3,920,088 = 19.60044 x $200,000]	3,920,088.00	
24	Present value of the maturity value of $5,000,000 at the end of 30.00 periods at 3.0000% effective interest rate [$2,059,950 = 0.41199 x $5,000,000]	2,059,950.00	
25	Present value of the bond's 29.00 semi-annual interest payments of $200,000 (= $5,000,000 x 8.0000%/2) at 3.0000% effective interest rate [$3,837,690 = 19.18845 x $200,000]		3,837,690.00
26	Present value of the maturity value of $5,000,000 at the end of 29.00 periods at 3.0000% effective interest rate [$2,121,750 = 0.42435 x $5,000,000]		2,121,750.00
27	Total	5,980,038.00	5,959,440.00
28	Bond proceeds, excluding any accrued interest and issuance cost, on September 30, 2014 (which lies between August 31, 2014 and February 28, 2015). $5,976,605 = $5,980,038 + {[($5,959,440 - $5,980,038)/6months] x 1months}	5,976,605.00	

Question 3 (38 marks) (continued)
Answer ALL parts to this question. Each part is independent.

PART 2: (14 marks)

On September 30, 2014 BondBeagle Inc. issues $1,000,000 face value bonds. The bond date is August 31, 2014, and the bonds carry a coupon rate of 6% per year, payable semi-annually on August 31 and February 28. The bonds' maturity date is August 31, 2024. Proceeds upon issuance, excluding accrued interest , were $864,860, and the bonds provide an annual yield of 8%.

BondBeagle Inc. uses the effective interest rate method to amortize any bond premium or discount. On July 31, 2019 BondBeagle Inc. retires 40% of the bonds at 102.50%, excluding accrued interest. BondBeagle Inc.'s accounting year-end is June 30.

Required

Present all necessary journal entries for the retired bonds on July 31, 2019. Show all supporting calculations.

To answer this question you must first determine the amortized cost (carrying value) of the bond at February 28, 2019 (shown as $912,395 below).

February 28, 2019 to August 31, 2024: 11 interest pymt periods remaining periods to maturity.

$30,000 x 8.760477 =		$262,814
$1,000,000 x 0.6495809 =		649,581
Amortized cost at February 28, 2019 =		$912,395 (rounded)

Intro | INPUT | Text | Date_Tables | Issuance_Calc | Issuance | I1 | I2 | I3 | I4 | I5 | **Retirement** | R1 | R2 | R3 | R4 | R5 | Maturity | Amort_Ta

Instructions:
Enter your data in the INPUT screen: all other screens are "Output screens".

	Date of retirement	Dr	Cr	
3	July 31, 2019			
4	Interest expense	2,433.05		= $912,395 (net bond liability at beginning of March 01, 2019) x 4.000000% (semi-annual yield) x 1/6 months x 40.0000% retired.
5	Bond discount		433.05	= $2,433 - $2,000
6	Interest payable		2,000.00	= $1,000,000 x 40.0000% retired x 1/12 months x 6.0000%
7				
8	To record interest expense incurred on 40.0000% of the bonds between June 30, 2019 (the closest preceding accounting year-end date to the retirement date) and July 31, 2019. Effective interest rate method. [Note: July 31, 2019 is neither an accounting year-end or a bond interest payment anniversary date.]			
12	Loss on retirement	42,876.64		= ($420,000 - $10,000 + $32,877) - ($400,000)
13	Interest payable	10,000.00		= $2,000 (see above journal entry) + $8,000 (= $1,000,000 x 40.0000% retired x 4/12 months x 6.0000% accrued at June 30, 2019) February 28, 2019 is the closest preceding interest payment date to the date of retirement.
14	Bond payable	400,000.00		= $1,000,000 x 40.0000% retired
15	Bond discount		32,876.64	= $87,605 x 40.00% (unamortized at beginning of March 01, 2019) - $2,165 [$2,165 = ($912,395 x 4.000000% yield x 5/6 x 40.00%) - ($1,000,000 x 3.0000% interest paid x 5/6 x 40.00%) amortization, February 28, 2019 to July 31, 2019 on the 40.00% retired)]. February 28, 2019 is the closest preceding interest payment date to the date of retirement.
16				
17	Cash		420,000.00	= $410,000 (=$1,000,000 x 40.0000% x 102.5000%) + $2,000 accrued (as appears in the journal entry above) + $8,000 accrued at June 30, 2019
18				
19	To record the retirement at 102.5000% of 10.00 year 6.0000% bonds, issued September 30, 2014, face value $400,000.			

Use Ctrl+ and Ctrl- to zoom in and out.

Question 3 (38 marks) (continued)
Answer ALL parts to this question. Each part is independent.

PART 3: (14 marks)

On January 1, 2012 Harper Limited issued a 3 year 8.00% $1,000,000 bond payable to Trudeau Bank. Interest payment dates are June 30 and December 31 and the bonds were issued to provide a semi-annual yield of 6.00%. By December 2014 Harper Limited is in financial difficulties and is about to miss the December 31, 2014 interest payment. Harper Limited negotiates an arrangement with Trudeau Bank whereby Trudeau Bank agrees to waive the December 31, 2014 interest payment and to replace, effective December 31, 2014, the above bond with a 7 year $1,100,000 face value bond bearing 14.00% annual interest, payable semi-annually. Due to Harper Limited's precarious situation, lenders would normally seek a semi-annual return of 10.00% on this 'bail-out' financing.

Required

(a) Is this troubled debt restructuring a *settlement* (*substantial* in accordance with IFRS 9.3.3.2 and ASPE 3856.27) or a *modification* ? Support your answer with all necessary calculations.

(b) Answer either i or ii:

i If in part (a) you deem this restructuring to be a *settlement* provide any journal entries on Harper Limited Inc's books that may be necessary on 31/12/2014.

ii If in part (a) you deem this restructuring to be a *modification*, what is the total of the interest expense that will be recognized by Harper Limited during the 7 year life of the $1,100,000 bond.

Derecognition of financial liabilities through (i) an exchange with an existing lender or (ii) modification of terms, in accordance with IFRS 9 and Canadian ASPE.

Reset Recalculate

TDR | **Steps1and2** | Step3_Substantial | Step3_NotSubstantial | IRR | IFRS_9 | ASPE_3856 | OtherApps

	A	B	C	D	E	F	G
1	**Step 1:**	Compare the new financing arrangement and the old financial liability using the old financial liability's original effective interest rate.					
2	Step 1(a):	Calculate the PV of the old 3 year bond at December 31, 2014, using the old bond's historic 6.00% semi-annual yield:					
3	PV Annuity, 0 semi-annual periods, 6.00%, $40,000:		$40,000	6.00%	0	0.000000000	$0
4	PV, 0 semi-annual periods, 6.00%, $1,000,000:		$1,000,000	6.00%	0	1.000000000	1,000,000
5							1,000,000
6	December 31, 2014 interest payable:						40,000
7	PV of the old financial liability owed at December 31, 2014, using its 6.00% original effective interest rate:						$1,040,000
8	The unamortized premium on the old financial liability:						$0
9							
10	Step 1(b)	Calculate the PV of the new 7 year financing arrangement at December 31, 2014, using the old bond's historic 6.00% semi-annual yield:					
11	PV Annuity, 14 semi-annual periods, 6.00%, $77,000:		$77,000	6.00%	14	9.294983927	$715,714
12	PV, 14 semi-annual periods, 6.00%, $1,100,000:		$1,100,000	6.00%	14	0.442300964	486,531
13	PV of the new financiing arrangement at December 31, 2014, using the old financial liability's 6.00% original effective interest rate:						$1,202,245
14							
15	**Step 2:**	Apply the '10%' test to determine if the old financial liability and the new financial arrangement differ SUBSTANTIALLY from one another.					
16	Difference ($1,040,000 - $1,202,245):						$162,245
17	Difference as a percentage of $1,040,000:						15.60%
18							
19	Conclusion: in accordance with IFRS 9.3.3.2, IFRS 9.B3.3.6, ASPE 3856.27, and ASPE 3856.A52 because the difference as a percentage of $1,040,000 is at least 10% (i) the old financial liability must be derecognized, (ii) a new financial liability recognized, and (iii) a gain/loss recorded.						

TDR | Steps1and2 | **Step3_Substantial** | Step3_NotSubstantial | IRR | IFRS_9 | ASPE_3856 | OtherApps

	A	B	C	D	E	F	G
1	Step 3: when Step 2's 'difference' is SUBSTANTIAL [i.e., is at least 10% (this type of financial arrangement is called a 'settlement' by some textbooks)] and therefore, in accordance with IFRS 9.3.3.2 and ASPE 3856.27, requires (i) derecognition of the old financial liability, (ii) recognition of a new financial liability, and (iii) recognition of any gain/loss on the transaction.						
2	Step 3(a): calculate the PV of the new 7 year financial arrangement at 31/12/2014, using the prevailing 10.00% semi-annual effective interest rate for financial liabilities with similar risk & maturity.						
3	PV Annuity, 14 semi-annual periods, 10.00%, $77,000:		$77,000	10.00%	14	7.366687457	$567,235
4	PV, 14 semi-annual periods, 10.00%, $1,100,000:		$1,100,000	10.00%	14	0.263331254	289,664
5	PV of the new bond:						$856,899
6	Face value of the new 7 year bond:						1,100,000
7	Therefore, the discount on the (new) bond is:						$243,101
8							
9	Step 3(b): record the 31/12/2014 journal entry required to (i) derecognize the old financial liability, (ii) recognize a new financial liability, and (iii) recognize any gain/loss on the transaction:						
10				Dr	Cr		
11	(Old) Bond payable			1,000,000			
12						[=$1,000,000 - $1,000,000].	
13	Interest payable (on Old Bond)			40,000			
14	(New) Bond discount			243,101			
15		(New) Bond payable			1,100,000		
16		Gain on bond restructuring			183,101	[= $1,040,000 - $856,899].	

Question 3 (38 marks) (continued)
Answer ALL parts to this question. Each part is independent.

<u>PART 3:</u> (14 marks) (continued)

Step 3(c): record the interest expense during the life of the new financial liability in the normal fashion:

Beginning of period	Face value (new bond)	Unamortized bond discount	Beginning of period amortized cost of new bond	CREDIT: 7.00% interest paid per 6 months	DEBIT: 10.00% interest expense per 6 months	CREDIT: amortized cost of the new bond	End of period amortized cost	End of period	
31-Dec-14	1,100,000	243,101	856,899	77,000	85,690	8,690	865,589	30-Jun-15	1
30-Jun-15	1,100,000	234,411	865,589	77,000	86,559	9,559	875,148	31-Dec-15	2
31-Dec-15	1,100,000	224,852	875,148	77,000	87,515	10,515	885,663	30-Jun-16	3
30-Jun-16	1,100,000	214,337	885,663	77,000	88,566	11,566	897,229	31-Dec-16	4
31-Dec-16	1,100,000	202,771	897,229	77,000	89,723	12,723	909,952	30-Jun-17	5
30-Jun-17	1,100,000	190,048	909,952	77,000	90,995	13,995	923,947	31-Dec-17	6
31-Dec-17	1,100,000	176,053	923,947	77,000	92,395	15,395	939,342	30-Jun-18	7
30-Jun-18	1,100,000	160,658	939,342	77,000	93,934	16,934	956,276	31-Dec-18	8
31-Dec-18	1,100,000	143,724	956,276	77,000	95,628	18,628	974,904	30-Jun-19	9
30-Jun-19	1,100,000	125,096	974,904	77,000	97,490	20,490	995,394	31-Dec-19	10
31-Dec-19	1,100,000	104,606	995,394	77,000	99,539	22,539	1,017,934	30-Jun-20	11
30-Jun-20	1,100,000	82,066	1,017,934	77,000	101,793	24,793	1,042,727	31-Dec-20	12
31-Dec-20	1,100,000	57,273	1,042,727	77,000	104,273	27,273	1,070,000	30-Jun-21	13
30-Jun-21	1,100,000	30,000	1,070,000	77,000	107,000	30,000	1,100,000	31-Dec-21	14
Totals				1,078,000	1,321,101	243,101			

Total expense if the new financial arrangement results in the derecognition of the old financial liability and the recognition of a new liability (i.e., the new financial arrangement is deemed SUBSTANTIALLY different from the old) [$1,078,000 interest payments + $243,101 (new) bond discount]:	1,321,101
Total expense if the new financial arrangement is NOT deemed SUBSTANTIALLY different from the old and does not result in the derecognition of the old financial liability (see Row 53 on the 'Step3_NotSubstantial' sheet):	1,138,000
Difference. [Remember: this equals the gain that is recognized if the new financial arrangement is deemed SUBSTANTIALLY different from the old]:	183,101

Not required in your

QUESTION 4 (20 marks)
Answer ALL parts to this question. Each part is independent.

<u>PART 1:</u> (5 marks)

a) What are the items that increase retained earnings?

Items that increase retained earnings are:

- net income,
- prior period adjustments (error corrections),
- financial reorganization, and
- certain changes in accounting principle.

b) What are the items that decrease retained earnings?

Items that decrease retained earnings are:

- net loss,
- cash, property and most stock dividends,
- some share retirement transactions,
- some treasury shares transactions,
- prior period adjustments (error corrections), and
- certain changes in accounting principle.

Question 4 (20 marks) (continued)
Answer ALL parts to this question. Each part is independent.

<u>PART 2:</u> (6 marks)

Tianjin Corporation's last year-end balance sheet reported the following in its shareholders' equity section:

Common shares, no par, outstanding 5,000 shares	$115,000
Retained earnings	200,000

The following transactions occurred this year:
(a) Purchased 70 common shares at $30 per share, to be held as treasury shares.
(b) Sold 60 of the treasury shares at $32 per share.
(c) Sold the remaining treasury shares at $15 per share.

Required

Prepare Tianjin Corporation's journal entries for these transactions.

(a)	Treasury Shares (70 x $30)	2,100	
	Cash		2,100
(b)	Cash (60 x $32)	1,920	
	Treasury Shares (60 x $30)		1,800
	Contributed Surplus		120
(c)	Cash (10 x $15)	150	
	Contributed Surplus	120	
	Retained Earnings……..	30	
	Treasury Shares (10 x $30)		300

Question 4 (20 marks) (continued)
Answer ALL parts to this question. Each part is independent.

PART 3: (9 marks)

Falkon Corp. reported the following amounts in the shareholders' equity section of its December 31, 2013 statement of financial position:

Preferred shares, $8 dividend (10,000 shares authorized, 2,000 shares issued)	$200,000
Common shares (100,000 authorized, 25,000 issued)	100,000
Contributed surplus	155,000
Retained earnings	250,000
Accumulated other comprehensive income	75,000
Total	$780,000

During 2014, the company had the following transactions that affect shareholders' equity.

1. January 4, 2014: Paid the annual 2013 $8 per share dividend on preferred shares and a $3 per share dividend on common shares. These dividends had been declared on December 31, 2013.
2. February 12, 2014: Purchased 3,700 shares of its own outstanding common shares for $35 per share and cancelled them.
3. January 1, 2014: Issued 1,000 preferred shares at $105 per share.
4. June 12, 2014: Declared a 10% stock dividend on the outstanding common shares when the shares were selling for $45 per share.
5. July 12, 2014: Issued the stock dividend.
6. December 14, 2014: Declared the annual 2014 $8 per share dividend on preferred shares and a $2 per share dividend on common shares. These dividends are payable in 2015.

The $155,000 contributed surplus arose from net excess of proceeds over cost on a previous cancellation of common shares. Total assets at December 31, 2013, were $940,000, and total assets at December 31, 2014, were $916,000. The company follows IFRS.

Required

Prepare journal entries to record the transactions above.

(a)

1.	Dividends Payable (Preferred - 2,000 X $8)	16,000	
	Dividends Payable (Common - 25,000 X $3)	75,000	
	Cash		91,000
2.	Common Shares	14,800	
	Contributed Surplus	114,700	
	Cash (3,700 X $35)		129,500
	($100,000 / 25,000 X 3,700 = $14,800)		
3.	Cash (1,000 X $105)	105,000	
	Preferred Shares		105,000
4.	Retained Earnings	95,850	
	Common Stock Dividends Distributable		95,850
	[(25,000 – 3,700) X 10% = 2,130 X $45]		
5.	Common Stock Dividends Distributable	95,850	
	Common Shares		95,850
6.	Retained Earnings	70,860	
	Dividends Payable (Preferred - 3,000 X $8)		24,000
	Dividends Payable [(Common - 25,000 – 3,700 + 2,130) X $2]		46,860

Financial Tables

Table 2: PRESENT VALUE of $1.00 that is received in the future.

Period/Per	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%
1	0.9900990	0.9803922	0.9708738	0.9615385	0.9523810	0.9433962	0.9345794	0.9259259	0.9174312	0.9090909	0.9009009	0.8928571
2	0.9802960	0.9611688	0.9425959	0.9245562	0.9070295	0.8899964	0.8734387	0.8573388	0.8416800	0.8264463	0.8116224	0.7971939
3	0.9705901	0.9423223	0.9151417	0.8889964	0.8638376	0.8396193	0.8162979	0.7938322	0.7721835	0.7513148	0.7311914	0.7117802
4	0.9609803	0.9238454	0.8884870	0.8548042	0.8227025	0.7920937	0.7628952	0.7350299	0.7084252	0.6830135	0.6587310	0.6355181
5	0.9514657	0.9057308	0.8626088	0.8219271	0.7835262	0.7472582	0.7129862	0.6805832	0.6499314	0.6209213	0.5934513	0.5674269
6	0.9420452	0.8879714	0.8374843	0.7903145	0.7462154	0.7049605	0.6663422	0.6301696	0.5962673	0.5644739	0.5346408	0.5066311
7	0.9327181	0.8705602	0.8130915	0.7599178	0.7106813	0.6650571	0.6227497	0.5834904	0.5470342	0.5131581	0.4816584	0.4523492
8	0.9234832	0.8534904	0.7894092	0.7306902	0.6768394	0.6274124	0.5820091	0.5402689	0.5018663	0.4665074	0.4339265	0.4038832
9	0.9143398	0.8367553	0.7664167	0.7025867	0.6446089	0.5918985	0.5439337	0.5002490	0.4604278	0.4240976	0.3909248	0.3606100
10	0.9052870	0.8203483	0.7440939	0.6755642	0.6139133	0.5583948	0.5083493	0.4631935	0.4224108	0.3855433	0.3521845	0.3219732
11	0.8963237	0.8042630	0.7224213	0.6495809	0.5846793	0.5267875	0.4750928	0.4288829	0.3875329	0.3504939	0.3172833	0.2874761
12	0.8874492	0.7884932	0.7013799	0.6245970	0.5568374	0.4969694	0.4440120	0.3971138	0.3555347	0.3186308	0.2858408	0.2566751
13	0.8786626	0.7730325	0.6809513	0.6005741	0.5303214	0.4688390	0.4149644	0.3676979	0.3261786	0.2896644	0.2575143	0.2291742
14	0.8699630	0.7578750	0.6611178	0.5774751	0.5050680	0.4423010	0.3878172	0.3404610	0.2992465	0.2633313	0.2319948	0.2046198
15	0.8613495	0.7430147	0.6418619	0.5552645	0.4810171	0.4172651	0.3624460	0.3152417	0.2745380	0.2393920	0.2090043	0.1826963
16	0.8528213	0.7284458	0.6231669	0.5339082	0.4581115	0.3936463	0.3387346	0.2918905	0.2518698	0.2176291	0.1882922	0.1631217
17	0.8443775	0.7141626	0.6050164	0.5133732	0.4362967	0.3713644	0.3165744	0.2702690	0.2310732	0.1978447	0.1696326	0.1456443
18	0.8360173	0.7001594	0.5873946	0.4936281	0.4155207	0.3503438	0.2958639	0.2502490	0.2119937	0.1798588	0.1528222	0.1300396
19	0.8277399	0.6864308	0.5702860	0.4746424	0.3957340	0.3305130	0.2765083	0.2317121	0.1944897	0.1635080	0.1376776	0.1161068
20	0.8195445	0.6729713	0.5536758	0.4563869	0.3768895	0.3118047	0.2584190	0.2145482	0.1784309	0.1486436	0.1240339	0.1036668
21	0.8114302	0.6597758	0.5375493	0.4388336	0.3589424	0.2941554	0.2415131	0.1986557	0.1636981	0.1351306	0.1117423	0.0925596
22	0.8033962	0.6468390	0.5218925	0.4219554	0.3418499	0.2775051	0.2257132	0.1839405	0.1501817	0.1228460	0.1006687	0.0826425
23	0.7954418	0.6341559	0.5066917	0.4057263	0.3255713	0.2617973	0.2109469	0.1703153	0.1377814	0.1116782	0.0906925	0.0737880
24	0.7875661	0.6217215	0.4919337	0.3901215	0.3100679	0.2469785	0.1971466	0.1576993	0.1264049	0.1015256	0.0817050	0.0658821
25	0.7797684	0.6095309	0.4776056	0.3751168	0.2953028	0.2329986	0.1842492	0.1460179	0.1159678	0.0922960	0.0736081	0.0588233
26	0.7720480	0.5975793	0.4636947	0.3606892	0.2812407	0.2198100	0.1721955	0.1352018	0.1063925	0.0839055	0.0663136	0.0525208
27	0.7644039	0.5858620	0.4501891	0.3468166	0.2678483	0.2073680	0.1609304	0.1251868	0.0976078	0.0762777	0.0597420	0.0468936
28	0.7568356	0.5743746	0.4370768	0.3334775	0.2550936	0.1956301	0.1504022	0.1159137	0.0895484	0.0693433	0.0538216	0.0418693
29	0.7493421	0.5631123	0.4243464	0.3206514	0.2429463	0.1845567	0.1405628	0.1073275	0.0821545	0.0630394	0.0484879	0.0373833
30	0.7419229	0.5520709	0.4119868	0.3083187	0.2313774	0.1741101	0.1313671	0.0993773	0.0753711	0.0573086	0.0436828	0.0333779
31	0.7345771	0.5412460	0.3999871	0.2964603	0.2203595	0.1642548	0.1227730	0.0920160	0.0691478	0.0520987	0.0393539	0.0298017
32	0.7273041	0.5306333	0.3883370	0.2850579	0.2098662	0.1549574	0.1147411	0.0852000	0.0634384	0.0473624	0.0354540	0.0266087
33	0.7201031	0.5202287	0.3770262	0.2740942	0.1998725	0.1461862	0.1072347	0.0788889	0.0582003	0.0430568	0.0319405	0.0237577
34	0.7129733	0.5100282	0.3660449	0.2635521	0.1903548	0.1379115	0.1002193	0.0730453	0.0533948	0.0391425	0.0287752	0.0212123
35	0.7059142	0.5000276	0.3553834	0.2534155	0.1812903	0.1301052	0.0936629	0.0676345	0.0489861	0.0355841	0.0259236	0.0189395
36	0.6989249	0.4902232	0.3450324	0.2436687	0.1726574	0.1227408	0.0875355	0.0626246	0.0449413	0.0323492	0.0233546	0.0169103
37	0.6920049	0.4806109	0.3349829	0.2342968	0.1644356	0.1157932	0.0818088	0.0579857	0.0412306	0.0294083	0.0210402	0.0150985
38	0.6851534	0.4711872	0.3252262	0.2252854	0.1566054	0.1092389	0.0764569	0.0536905	0.0378262	0.0267349	0.0189551	0.0134808
39	0.6783697	0.4619482	0.3157535	0.2166206	0.1491480	0.1030555	0.0714550	0.0497134	0.0347030	0.0243044	0.0170767	0.0120364
40	0.6716531	0.4528904	0.3065568	0.2082890	0.1420457	0.0972222	0.0667804	0.0460309	0.0318376	0.0220949	0.0153844	0.0107468

Table 4: PRESENT VALUE of Annuity of $1.00 in arrears.												
Period/Per	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%
1	0.990099	0.980392	0.970874	0.961538	0.952381	0.943396	0.934579	0.925926	0.917431	0.909091	0.900901	0.892857
2	1.970395	1.941561	1.913470	1.886095	1.859410	1.833393	1.808018	1.783265	1.759111	1.735537	1.712523	1.690051
3	2.940985	2.883883	2.828611	2.775091	2.723248	2.673012	2.624316	2.577097	2.531295	2.486852	2.443715	2.401831
4	3.901966	3.807729	3.717098	3.629895	3.545951	3.465106	3.387211	3.312127	3.239720	3.169865	3.102446	3.037349
5	4.853431	4.713460	4.579707	4.451822	4.329477	4.212364	4.100197	3.992710	3.889651	3.790787	3.695897	3.604776
6	5.795476	5.601431	5.417191	5.242137	5.075692	4.917324	4.766540	4.622880	4.485919	4.355261	4.230538	4.111407
7	6.728195	6.471991	6.230283	6.002055	5.786373	5.582381	5.389289	5.206370	5.032953	4.868419	4.712196	4.563757
8	7.651678	7.325481	7.019692	6.732745	6.463213	6.209794	5.971299	5.746639	5.534819	5.334926	5.146123	4.967640
9	8.566018	8.162237	7.786109	7.435332	7.107822	6.801692	6.515232	6.246888	5.995247	5.759024	5.537048	5.328250
10	9.471305	8.982585	8.530203	8.110896	7.721735	7.360087	7.023582	6.710081	6.417658	6.144567	5.889232	5.650223
11	10.367628	9.786848	9.252624	8.760477	8.306414	7.886875	7.498674	7.138964	6.805191	6.495061	6.206515	5.937699
12	11.255077	10.575341	9.954004	9.385074	8.863252	8.383844	7.942686	7.536078	7.160725	6.813692	6.492356	6.194374
13	12.133740	11.348374	10.634955	9.985648	9.393573	8.852683	8.357651	7.903776	7.486904	7.103356	6.749870	6.423548
14	13.003703	12.106249	11.296073	10.563123	9.898641	9.294984	8.745468	8.244237	7.786150	7.366687	6.981865	6.628168
15	13.865053	12.849264	11.937935	11.118387	10.379658	9.712249	9.107914	8.559479	8.060688	7.606080	7.190870	6.810864
16	14.717874	13.577709	12.561102	11.652296	10.837770	10.105895	9.446649	8.851369	8.312558	7.823709	7.379162	6.973986
17	15.562251	14.291872	13.166118	12.165669	11.274066	10.477260	9.763223	9.121638	8.543631	8.021553	7.548794	7.119630
18	16.398269	14.992031	13.753513	12.659297	11.689587	10.827603	10.059087	9.371887	8.755625	8.201412	7.701617	7.249670
19	17.226008	15.678462	14.323799	13.133939	12.085321	11.158116	10.335595	9.603599	8.950115	8.364920	7.839294	7.365777
20	18.045553	16.351433	14.877475	13.590326	12.462210	11.469921	10.594014	9.818147	9.128546	8.513564	7.963328	7.469444
21	18.856983	17.011209	15.415024	14.029160	12.821153	11.764077	10.835527	10.016803	9.292244	8.648694	8.075070	7.562003
22	19.660379	17.658048	15.936917	14.451115	13.163003	12.041582	11.061240	10.200744	9.442425	8.771540	8.175739	7.644646
23	20.455821	18.292204	16.443608	14.856842	13.488574	12.303379	11.272187	10.371059	9.580207	8.883218	8.266432	7.718434
24	21.243387	18.913926	16.935542	15.246963	13.798642	12.550358	11.469334	10.528758	9.706612	8.984744	8.348137	7.784316
25	22.023156	19.523456	17.413148	15.622080	14.093945	12.783356	11.653583	10.674776	9.822580	9.077040	8.421745	7.843139
26	22.795204	20.121036	17.876842	15.982769	14.375185	13.003166	11.825779	10.809978	9.928972	9.160945	8.488058	7.895660
27	23.559608	20.706898	18.327031	16.329586	14.643034	13.210534	11.986709	10.935165	10.026580	9.237223	8.547800	7.942554
28	24.316443	21.281272	18.764108	16.663063	14.898127	13.406164	12.137111	11.051078	10.116128	9.306567	8.601622	7.984423
29	25.065785	21.844385	19.188455	16.983715	15.141074	13.590721	12.277674	11.158406	10.198283	9.369606	8.650110	8.021806
30	25.807708	22.396456	19.600441	17.292033	15.372451	13.764831	12.409041	11.257783	10.273654	9.426914	8.693793	8.055184
31	26.542285	22.937702	20.000428	17.588494	15.592811	13.929086	12.531814	11.349799	10.342802	9.479013	8.733146	8.084986
32	27.269589	23.468335	20.388766	17.873551	15.802677	14.084043	12.646555	11.434999	10.406240	9.526376	8.768600	8.111594
33	27.989693	23.988564	20.765792	18.147646	16.002549	14.230230	12.753790	11.513888	10.464441	9.569432	8.800541	8.135352
34	28.702666	24.498592	21.131837	18.411198	16.192904	14.368141	12.854009	11.586934	10.517835	9.608575	8.829316	8.156564
35	29.408580	24.998619	21.487220	18.664613	16.374194	14.498246	12.947672	11.654568	10.566821	9.644159	8.855240	8.175504
36	30.107505	25.488842	21.832252	18.908282	16.546852	14.620987	13.035208	11.717193	10.611763	9.676508	8.878594	8.192414
37	30.799510	25.969453	22.167235	19.142579	16.711287	14.736780	13.117017	11.775179	10.652993	9.705917	8.899635	8.207513
38	31.484663	26.440641	22.492462	19.367864	16.867893	14.846019	13.193473	11.828869	10.690820	9.732651	8.918590	8.220993
39	32.163033	26.902589	22.808215	19.584485	17.017041	14.949075	13.264928	11.878582	10.725523	9.756956	8.935666	8.233030
40	32.834686	27.355479	23.114772	19.792774	17.159086	15.046297	13.331709	11.924613	10.757360	9.779051	8.951051	8.243777