

PART A – 20 MC Questions (26 marks, 37 minutes)

1. Gifts-for-All Inc (GFA) is a small, online business that is run by Margie Lee. Margie is the sole-shareholder of GFA and there is no debt holders in the company. GFA brings in gifts from around the world, packages them in gift baskets and sells to consumers in Canada. The business started 14 months ago. When preparing GFA's financial statements, which of the following is most likely to be Margie's reporting objective: **(1 mark)**

- a) Assessing and predicting cash flow
- b) **Income tax minimization**
- c) Performance evaluation
- d) Minimum compliance

2. JIF Inc is a medium size private enterprise. JIF's management has identified the objective of assessing and predicting cash flows as the number one objective of financial reporting. Which of the following policies is JIF most likely to adopt: **(1 mark)**

- a) Match expenses to revenues.
- b) Recognize revenue only when cash is collected and match expenses accordingly
- c) **Revenues and expenses recognized close to the related cash flows**
- d) Maximize cash flows by minimizing bookkeeping costs resulting in minimum disclosures in the financial statement notes

3. Which of the following statements about Comprehensive Income is NOT true? **(1 mark)**

- a) **Comprehensive income equals Retained Earnings plus Other Comprehensive Income**
- b) Comprehensive income is closed to a balance sheet account called Accumulated Other Comprehensive Income
- c) Comprehensive income exists only in IFRS and does not exist in ASPE
- d) Comprehensive income includes all gains and losses recognized during the year

4. Which of the following qualities does the historical cost principle primarily support? **(1 mark)**

- a) Faithful representation
- b) Conservatism
- c) **Verifiability**
- d) Timeliness

5. Markers Inc manufactures markers for retail stores with annual net profit of \$2,000,000. Mr. Markers, one of the company's shareholders, arranges to transport 100 markers to his children's school because all parents have been asked to make a donation to the school in the amount of \$50 or less. Mr. Markers has asked the bookkeeper to write-off the markers as obsolete. Which of the following qualitative characteristics of accounting information has **not** been **violated**? **(1 mark)**

- a) the entity concept
- b) **materiality**
- c) faithful representation
- d) all of the above have been violated

6. Mr. Fail owns two different businesses—a recycling plant and a private school. Since the recycling plant has recently caught fire and is in financial difficulty, Mr. Fail would like to pay some overhead expenses of the plant through the private school's bank account and report

as 'other' on the school's financial statements. Which accounting principle is violated? (1 mark)

- a) Full disclosure
- b) Reliability
- c) Periodic-reporting assumption
- d) the entity concept

7. A pharmaceutical company would not capitalize the potential value of its workforce (such as their research and development team, scientists, experienced management etc) due to which principle? (1 mark)

- a) Relevance.
- b) Unit-of-measure assumption.
- c) Going-concern assumption.
- d) Periodic-reporting assumption.

8. Which of the following is not one of explicit steps of revenue recognition under IFRS 15? (1 mark)

- a) Identify the contract with a customer.
- b) Identify the performance obligations of the contract.
- c) Identify the expenses incurred in the contract.
- d) Determine the transaction price.

9. Net sales divided by average total assets is called (1 mark):

- a) inventory turnover.
- b) receivables turnover.
- c) rate of return on assets.
- d) asset turnover.

10. Ratios that measure the degree of protection for long-term creditors and investors or the ability to meet long-term obligations are called (1 mark):

- a) liquidity ratios.
- b) activity ratios.
- c) solvency ratios.
- d) profitability ratios.

11. In preparing a statement of cash flows, the conversion of bonds into common shares will be reported in the (1 mark):

- a) financing activities section.
- b) notes to the financial statements.
- c) investing activities section.
- d) shareholders' equity section.

12. JKL Inc used the FIFO method for calculating its cost of goods sold and ending inventory in 2014 and switched to the average cost method for 2015. Management is planning to switch back to the FIFO method in the 2016 since it believes that method better represented the economic activity of the organization. Which accounting principle is violated? (1 mark)

- a) reliability
- b) comparability
- c) consistency

d) going-concern assumption

13. Which of the following statements about the going concern assumption is true? (1 mark)

- a) The going concern assumption means that a corporation's ongoing cash flows from operations are expected to increase
- b) The going concern assumption only applies to IFRS but does not apply to ASPE
- c) The going concern assumption means that a corporation does not have a definite ending date
- d) The going concern assumption is true for all private companies since they are inherently riskier

14. A project was correctly accounted for under the percentage-of-completion method. At the end of the project, the Construction-in-Process account includes total debits and credits of \$7,000,000. Assuming that total gross profit of \$2,400,000 was recognized throughout the contract, total construction costs were (2 marks):

- a) \$9,200,000.
- b) \$7,000,000.
- c) \$4,600,000.
- d) \$4,200,000.

15. Beaver Builders Ltd. is using the completed-contract method for a \$2,000,000 contract that will take two years to complete. Data at December 31, 2014, the end of the first year, are (2 marks):

Costs incurred to date	\$925,000
Estimated costs to complete in 2015	1,100,000
Billings to date	850,000
Collections to date	700,000

The gross profit or loss that should be recognized for 2014 is

- a) \$50,000 gross profit.
- b) \$25,000 gross profit.
- c) \$25,000 loss.
- d) \$ 0.

16. Cornet Construction Corp. uses the percentage-of-completion method. In 2014, Cornet began work on a contract for \$1,650,000 which was completed in 2015. Data on the costs are (2 marks):

	Year Ended December 31	
	2014	2015
Costs incurred	\$585,000	\$420,000
Estimated costs to complete	390,000	—

For the calendar years 2014 and 2015, Cornet should recognize gross profit of

- | | 2014 | 2015 |
|--------------|------|-----------|
| a) \$0 | | \$645,000 |
| b) \$387,000 | | \$258,000 |
| c) \$405,000 | | \$240,000 |
| d) \$405,000 | | \$645,000 |

17. Chris' Supply Co. suffered a fire loss on April 20, 2015. The company's last physical inventory was taken January 30, 2015, at which time the inventory totaled \$440,000. Sales

from January 30 to April 20 were \$1,200,000 and purchases during that time were \$900,000. Howard's consistently reports a 30% gross profit. The estimated inventory loss is? **(2 marks)**

- a) \$980,000
- b) \$476,000
- c) \$500,000
- d) None of the above

18. On January 1, 2015, Lulu Inc decided to discontinue its paper making division. The division was sold on September 1, 2015. The assets were sold for \$1,000,000 (carrying value was \$1,300,000 at the time of sale). Operating income from January 1 to August 31 was \$100,000. Lulu's tax rate is 40%. What amount should be reported on Lulu's income statement under the line item "discontinued operations"? **(2 mark):**

- a) \$80,000 loss.
- b) \$200,000 loss
- c) \$300,000 loss.
- d) \$100,000 gain.

19. UnionVilla Inc has a pre-tax income of \$500,000. You, a new Controller at UnionVilla, just found out that the company's beginning inventory was overstated by \$25,000 and ending inventory was understated by \$30,000. What is UnionVilla's corrected pre-tax income? **(1 mark)**

- a) \$495,000
- b) \$525,000
- c) \$530,000
- d) \$555,000

20. The following information is provided for QMark Inc. Calculate basic the basic EPS for 2015. **(2 marks):**

- 5% cumulative preferred shares, 50,000 shares outstanding – shares issued on January 1, 2014
- 100,000 common shares outstanding – shares issued on January 1, 2014
- Income from continuing operations before tax \$270,000
- Common dividends declared \$25,000 in 2015
- No preferred share dividends declared in 2014.
- Effective tax rate 40%

- a) 1.57
- b) 1.60
- d) 2.65
- c) 2.68

Part B (22 marks; 32 minutes)

In January 2014, Rock-On Inc is to create an advertising campaign for a client for \$300,000. Work started in early 2015 and will be completed in 2016. The following additional

information is available:

	<u>2015</u>	<u>2016</u>
Costs incurred	\$121,500	\$135,000
Estimated costs to complete	130,000	—
Collections during the year	120,000	180,000
Billings to customer during the year	125,000	175,000

Rock-On Inc uses the percentage-of-completion method under ASPE.

Required (Round your answer to the nearest percent and dollar)

Under the earnings approach,

- How much revenue should Rock-On report for 2015 and 2016?
- Prepare all journal entries (cost incurred, billings to customer, payment from customer, year end revenue recognition) for 2015 for this contract.
- Assume that during 2014 management became aware of more information resulting in a revision to the estimated costs to complete the construction of the building and the costs have increased by an additional \$115,000. **Calculate the Revenue and Construction Expense that should be recognized in 2015.**
- Explain qualitatively how in general the contract approach under IFRS will be different in terms of revenue recognition for long term contracts.

	Full price for contract	300,000.0	
		2015	2016
	Costs incurred	121,500.0	135,000.0
	Estimated costs to complete	130,000.0	-
	Collections during the year	120,000.0	180,000.0
	Billings to customer during the year	125,000.0	175,000.0
part a			
2 marks	Revenue for 2015 $(121.5K/251.5K) = 48\%$ $48\% \times 300K$	48%	
		144,930	
2 marks	Revenue for 2016 $(300K - 144.93K)$		100%
			155,070
part b			
2 marks	J/E for 2015		
	Dr. Construction in process	121,500	
	Cr. Cash	121,500	
2 marks	Dr. AR	125,000	
	Cr. Billings on Construction	125,000	
2 marks	Dr. Cash	120,000	
	Cr. AR	120,000	
3 marks	Dr. Construction in process	-	23,430

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Dr. Costs incurred	121,500
Cr. Revenue	144,930

c)

Full price for contract	300,000.0	
		2015
Costs incurred	121,500.0	
Estimated costs to complete	245,000.0	
Collections during the year	120,000.0	
Billings to customer during the year	125,000.0	
Revenue for 2015(121.5K/366.5K)		33%
(300Kx33%)	99,000	
Expected loss in 2016	- 44,000	=300000-99000-245000
Construction expense in 2015	165,500	=121,500-(-44,000)

5 marks

d) There is no construction-in-progress account on the books of the contractor because the asset under construction is under the control of the customer.

The contractor records a contract asset on the SFP that reflects the difference between revenue recognized and any progress billings to date on the contract.

The contract asset effectively represents the contract value of work-in-progress that is now controlled by the customer but has not yet been fully invoiced

(acceptable answers: outlining IFRS 15 5-step model and explaining that control is key to recognition.)

4 marks

Part C (27 marks; 39 minutes)

Luke's Dinners Inc balance sheet for the year ended December 31, 2014 and December 31, 2015 and income statement are as follows:

Luke's Dinners Inc
Comparative Balance Sheet
As of December 31, 2014 and 2015

	2015	2014
Assets		
Cash	5,040	3,600
Accounts Receivable	8,760	9,000
Short-term investment	4,800	1,800
Inventory	9,000	8,400
Land	6,000	7,200

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Property, plant and equipment (net of amortization)	52,200	39,000
	<u>85,800</u>	<u>69,000</u>
Liabilities		
Accounts payable	3,360	4,200
Salaries payable	240	600
Interest payable	600	360
Income tax payable	1,080	1,440
Notes payable	-	3,600
Bonds payable	19,200	12,000
Shareholder's Equity		
Common stock	45,120	36,000
Retained Earnings	16,200	10,800
	<u>85,800</u>	<u>69,000</u>

Luke's Dinners Inc
Income statement
For the year ended December 31, 2015

Revenues	
Sales revenue	45,600
Expenses	
Cost of goods sold	15,600
Salaries expense	5,400
Depreciation expense	4,800
Interest expense	1,440
Loss on sale of land	360
Income tax expense	8,400
Net income	<u>9,600</u>

Other Information:

1. Luke's Dinners did not purchase any land during the year.
2. Luke's Dinners did not dispose of any property, plant and equipment during the year.
3. For 2014, beginning amortization for PPE was \$9,000 and ending accumulated amortization was \$13,800.
4. Dividends paid are considered part of finance activities.

Required:

- 1) Prepare the cash flow statement in good form, using the indirect method, for Luke's Dinners inc for the year ended December 31, 2015.
- 2) Calculate the following two ratios (Please show your calculations):

- a. Times Interest Earned for 2015
b. Inventory turnover for 2015

Part 1) (24 marks)

Cash flows from operating activities:

Net income	9600	0.5 mark
Add: Depreciation expense	4800	1 mark
Add: Loss on sale of land	360	1 mark
Add: Decrease in AR	240	1 mark
Deduct: Increase in Inventory	-600	1 mark
Deduct: Decrease in AP	-840	1 mark
Deduct: Decrease in Salaries payable	-360	1 mark
Add: Increase in interest payable	240	1 mark
Deduct: decrease in income tax payable	-360	1 mark
	<u>13080</u>	

Cash flows from investing activities:

Sale of land	840	2 marks
Purchase of PPE	-18000	2 marks
Purchase of short-term investment	-3000	2 marks
	<u>-20160</u>	

Cash flows from financing activities

Payment of notes payable	-3600	2 marks
Sale of bonds	7200	2 marks
Common Stock	9120	2 marks
Payment of dividends	-4200	2 marks
	<u>8520</u>	

Beginning	3,600	0.5 mark
Change in cash flows	1440	0.5 mark
Ending cash	5,040	0.5 mark

Notes to solution:**1. Land**

Decrease in Land	1200
Loss on land	360
Sold for	840

2. Dividends

Beginning RE	10800
Plus Net income	9600

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Less: Dividends	4200
Ending RE	16200

3. PPE

2014

PPE	48000
Accumulated amortization	9000
Net PPE	39000

2015

PPE	66000
Accumulated amortization	13800
Net PPE	52200

Purchase of PPE	18000
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Part 2) (3 marks)

Times Interest Earned = $\text{Income before interest exp and tax exp} / \text{interest exp}$

13.5 $= (9600 + 1440 + 8400) / 1440$

Inventory turnover = $\text{COGS} / \text{Avg Inventory}$

1.79 $= 15600 / ((9000 + 8400) / 2)$

Part D (12 marks; 17 minutes)

On December 31, 2014, GGI had 600,000 shares of common stock and 300,000 shares of 8%, preferred stock issued and outstanding.

The following transactions occurred during the year:

- 1) On March 15, 2015, GGI sold 60,000 common shares;
- 2) On April 1, declared and issued a two-for-one reverse stock split (i.e. 2 shares are converted into 1 share);
- 3) On July 1st, purchased back 2,000 shares;
- 4) On August 15, GGI issued a 4% common stock dividend;
- 5) On December 30, 2015, preferred stock dividend of \$24,000 was declared.

Required:

Part 1) Calculate GGI's weighted average number of common shares.

Part 2) **Ignore your answer in part 1)** and assume GGI's weighted average number of common shares is 150,000. GGI's net income is \$2,000,000. GGI's tax rate is 45%. Calculate and show GGI's EPS presentation as required by IFRS.

Part 1) SOLUTION

		total	adjustment	adjusted #	# of months/12	Final Calc
Jan 1 - March 15	600,000	600,000	x1.04 /2	312,000.0	2.5	65,000.00
Mar 15 - April 1	+60000	660,000	x1.04 /2	343,200	0.5	14,300
Apr 1 - July 1	/2	330,000	x1.04	343,200	3	85,800
July 1 - Aug 15	-2000	328,000	x1.04	341,120	1.5	42,640
Aug 15 - Dec 31	x1.04	341,120		341,120	4.5	127,920
						335,660

(10 marks)

Part 2) SOLUTION

Net income after tax 1100000 =2,000,000 x (1-0.45)

Pref share dividends 24000 =300000*0.08

EPS 7.173333 =(1,100,000-24,000)/150,000

Also accept (2,000,000-24,000)/150,000=\$13.17

(2 marks)

Part E (8 marks; 12 minutes)

The following information is provided for PNP Inc.

	Unit	Unit cost	
Beginning Inventory	6000	8	
Purchases			
Date	Units	Unit Cost	Total Cost
Jan 10	5000	9	45000
Jan 18	6000	10	60000
Sales			
Date	Units		
Jan 5	3000		
Jan 12	2000		
Jan 20	4000		

Required

Calculate the COGS and Ending Inventory for PNP using the average cost (perpetual method) and FIFO.

FIFO (2 marks + 2 marks)

Cost of goods sold		Ending inventory
24000	Jan 5	18000
16000	Jan 12	60000
35000	Jan 20	
75000		78000

**Avg cost (perpetual)
(3 marks + 1 mark)**

	Cost of goods sold	Ending inventory
	24000	
WA:	8.625	Jan 5
	17250	Jan 10
		Jan 12
WA:	9.313	Jan 18
	37250	Jan 20
	78500	74500

Part F (30 marks; 43 minutes)

Dahlia inc (DI) grew from a single-store operation, selling high-quality postcards and stationary (such as agendas, calendars etc) into a chain retailer. Currently, DI has six corporate-owned stores in Ontario. Products are ordered on a custom basis and purchased from the finest manufacturers. That is, DI sources inventory from manufacturers in Europe and brings it to Canada for resale. However, DI also has a small manufacturing facility producing high-end pens. DI's founder, Dorothy Soto, is set to retire from running the day-to-day business. Luckily, she recently received an offer from a young entrepreneur, Lilly Water. DI follows IFRS and has early adopted IFRS 15 for revenue recognition purposes. Dorothy has asked for your help in recording the following transactions that occurred during the 2015 fiscal year which ends on October 31, 2015:

Role, reporting constraints, stakeholders

Dorothy (preparer of the f/s); Lilly – purchaser who is interested in assessing profitability and cash flows of the business; constraint - IFRS

4 marks

DI signed a contract with Hero Inc to produce 1000 units of high-end pens. DI will produce the pens over a period of 2 months (from October 1 to November 30). Based on the customer's request, DI will engrave Hero's logo on all pens. Hero paid an upfront deposit of \$12,000 which is 75% of the total sales price for the order. DI offers a one-year warranty on all pens purchased directly from the company in case the pens break or stop working.

Step 1. Identify the contract with the customer (1 mark) – DI has a contract to deliver 1000 units (1 mark)

Step 2. Identify separate performance obligations (1 mark) – only one performance obligation. Warranty is not considered to be separate performance obligation since it's not offered separately to customers. (1 mark)

Step 3. Determine the overall contract price (1 mark) – \$12,000 is 75%, therefore, the purchase price is \$16,000 . (1 mark)

Step 4. Allocate the price to the separate performance obligation (1 mark) – In this case, there is only one performance obligation (1 mark)

Step 5. Determine when the performance obligation is complete and revenue can be recognized (1 mark) - the question is whether control passes when pens are delivered or if it passes with the passage of time as the product is delivered. Since the pens will have Hero's logo engraved, DI will not be able to sell it to another customer without substantial rework. Therefore, control is transferred over time and therefore revenue can be recognized as pens are produced. From October 1 to October 31, we can assume that approximately half of the pens was produced and therefore approximately \$8000 can be recognized. (2 marks)

Another major decision Dorothy made in the current fiscal year was to close four stores across Ontario. All of these stores were located in the suburbs of the GTA. After these stores were closed, only two physical DI locations are remaining which are all located in the downtown core. These stores were less profitable than the remaining two and were bringing in only 20% of total revenues while incurring 60% of total operating costs of DI. The move was announced to the Board in September and by December 15th all four will be closed. The

retail spaces/facilities were corporately owned by DI and have been put up for sale with the help of a real estate agent. The stores' equipment, such as shelving units and cash registers, has been placed in temporary storage. Since the equipment is not being used anymore, Dorothy instructed the accounting department to stop amortizing it. While Dorothy does not have plans to see the equipment immediately, she does want to put it up for sale as the business has no further use for this equipment. Dorothy says that she will put the equipment up for sale on a trading site when she has more time to price it correctly etc which will likely happen within the next 6 months or so.

Per IFRS, Separate disclosure of discontinued ops is appropriate if a **discontinued operation is a component of an entity (1 mark)**– each store could be considered a separate component of an entity **(1 mark)** and

(a) represents a separate major line of business or geographical area of operations, (1 mark) - on the one hand, the stores do not represent a major line of business as only 20% of revenues but on the other hand, the closed stores did incur 60% of all expenses which is a substantial amount **(2 marks)**

(b) is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations (1 mark) – on the one hand, it appears that all of the stores in the suburbs of the GTA were disposed (which could be considered a separate geographical area), on the other hand, one could argue that the entire GTA is a separate geographical area as the operations of the stores in the suburbs are not likely to be drastically different than the operations of the stores in the downtown core **(2 marks)**

(c) is a subsidiary acquired exclusively with a view to resale." It is not

Conclusion: students should arrive at a concrete conclusion which is consistent with their discussion **(1 mark)**

Assets held for sale

- Assets do not need to be amortized and can be classified as held for sale if the following criteria are met:
- Authorized plan to sell exists **(0.5 mark)**– there is no mention of the BoD of directors and Dorothy represents management in this case. While there is no formal plan to sell, Dorothy did 'authorize' or 'plans to' sell the assets which, in absence of a board of directors, could be argued to be sufficient **(1 mark)**
- Asset available for immediate sale **(0.5 mark)** – they are available for immediate sale as they are stored away and not used **(1 mark)**
- Active search for a buyer **(0.5 mark)**– there is currently no search for a buyer. Dorothy only plans to start searching for a buyer **(1 mark)**
- Sale is probable within a year **(0.5 mark)** – it could be considered probable as Dorothy plans to put the equipment up for sale within the next six months and it's not specialty equipment so should sell fairly quickly **(1 mark)**
- Asset is reasonably priced and marketed **(0.5 mark)**– Dorothy has not priced the equipment yet **(1 mark)**
- Unlikely that plan to sell will change **(0.5 mark)** – it's unlikely for the plan to change as the stores are closed and DI has no use for this equipment. **(1 mark)**

Several criteria are not met so classifying the equipment as 'held-for-sale' would not be appropriate. Therefore, DI should continue amortizing the equipment.

In 2014, DI ordered 10,000 leather-bound, high-end desktop agendas for the calendar year 2015 from one of its suppliers. The cost of each agenda was \$10. DI started selling the agendas for \$30 a piece in December 2015. After the holiday sales, DI still had 4,000 of agendas left in February and DI discounted the agendas by 75%. Dorothy decided that further reduction in price would not be appropriate as it would be 'embarrassing' in front of customers. Since February until May, another 500 units were sold. The remaining are still available for sale but Dorothy admits sales have been 'few and far between'.

All inventory should be recorded at the lower of cost or NRV. Since the agendas have been discounted and have not been selling, a write-down is appropriate. **(0.5 mark)** The main question is by how much the agendas should be written off

Alternative 1: currently the agendas are priced at \$7.50 (75% off \$30) which is below cost of \$10. It could be argued that the agendas should be written down by \$2.50. **(2 marks)**

Alternative 2: however, the agendas sales have significantly slowed down which make sense as those customers who wanted to buy an agenda for calendar 2015 likely already did and it's unlikely that many customers would want to buy a 2015 agendas in the fall of 2015 (the company's year-end is October 31). **(2 marks)**

Conclusion: Therefore, the agendas should be written down to zero or a value that is close to zero as that is likely its NRV. **(0.5 mark)**

Required: Recommend the most appropriate way of recording these transactions related to Revenue Recognition, Inventory, and the Store Closure, taking into consideration the overall reporting environment.

Total available 38 marks
Mark out of 30