

ADM 2342 X
INTERMEDIATE FINANCIAL ACCOUNTING 1
Spring/Summer 2012
Quiz No. 2
Solutions

..... / 25 marks

NAME: _____

STUDENT #: _____

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.

Name: _____ (signature)

Note:

A quiz received without the signature of the student will not be graded and will receive a score of zero.

Question No. 1 (5 marks)

Argyle Construction Ltd. (ACL) is a company that follows ASPE. Recently, ACL entered into a contract to construct a small building for a fee of \$500,000. Construction began in 2009 and was completed in 2011. Transactions related to the contract are summarized below:

| | 2009 | 2010 | 2011 |
|--------------------------------------|-----------|-----------|-----------|
| Cost incurred during the year..... | \$ 80,000 | \$166,000 | \$159,000 |
| Estimated costs to complete..... | 320,000 | 164,000 | -0- |
| Billings and collections during year | 75,000 | 200,000 | 225,000 |

Required:

Compute the income that should be recognized in 2011 using:

- (i) the percentage of completion method;
- (ii) the completed contract method.

Answer:

- (i) 2009: $\$100,000 \times (80,000 / 400,000) = \$20,000$
2010: $[(\$500,000 - \$410,000) \times (246,000 / 410,000)] - \$20,000 = \$34,000$
2011: $\$500,000 - \$80,000 - \$166,000 - \$159,000 - \$20,000 - \$34,000 = \underline{\$41,000}$
- (ii) 2011: $\$500,000 - \$80,000 - \$166,000 - \$159,000 = \underline{\$95,000}$

Question No. 2 (3 marks)

Zoran Industries Ltd. follows ASPE and builds custom racing cars. Each car requires at least 2 1/2 years to be completed. Zoran follows the completed contract method for revenue recognition. The following information is available for a particular contract covering a number of racing cars:

| Year | Annual Costs Incurred | Estimated Cost to Complete | Billings | Collections |
|-------|-----------------------|----------------------------|--------------|--------------|
| 2009 | \$ 2,000,000 | \$6,000,000 | \$ 3,500,000 | \$ 3,000,000 |
| 2010 | 4,000,000 | 4,000,000 | 4,900,000 | 4,000,000 |
| 2011 | 6,000,000 | -0- | 5,600,000 | 7,000,000 |
| Total | \$12,000,000 | | \$14,000,000 | \$14,000,000 |

Required:

- (a) What is the balance in the construction-in-process account at the end of 2010?
- (b) What is the balance in the accounts receivable account at the end of 2010?

Answer:

- (a) $\$2,000,000 + \$4,000,000 = \underline{\$6,000,000}$
- (b) $\$8,400,000 - \$7,000,000 = \underline{\$1,400,000}$

Question No. 3 (4 marks)

On January 1, 2011 Ranger Ltd. adopted a plan to formally discontinue its plastic-making division. The division, properly identified as business component, was sold on June 1, 2011. The division's net assets had a carrying value of \$800,000 and were sold for \$500,000 after disposal costs of \$50,000. Operating income for the division from January 1 until May 31, 2011 amounted to \$125,000. Ranger's income tax rate is 45%.

Required:

Using intraperiod tax allocation, calculate the overall income tax expense or income tax saving (recovery) relating to discontinued operations for Ranger Ltd. for the year ended December 31, 2011.

Answer:

| | |
|--|-----------------------|
| <i>Net proceeds from sale of plastic-making division</i> | <i>\$ 500,000</i> |
| <i>Carrying value of net assets sold</i> | <i><u>800,000</u></i> |
| <i>Loss on sale of plastic-making division</i> | <i>(300,000)</i> |
| <i>Operating income of plastic-making division</i> | <i><u>125,000</u></i> |
| <i>Gross loss on discontinued operations</i> | <i>(175,000)</i> |
| <i>Income tax savings at 45 %</i> | <i><u>78,750</u></i> |

Question No. 4 (4 marks)

The records of a corporation for year 3 reflected the following correct pretax amounts: gain from discontinued operations, \$50,000; cash dividends declared and paid, \$45,000; retained earnings, January 1, year 3, \$275,000, correction of accounting error, \$35,000 debit; income before income taxes and before discontinued operations, \$165,000. The average income tax rate of 40 % applies to all items except the dividends.

Required:

Calculate the balance in the retained earnings account on December 31, year 3. (It is not necessary to prepare a retained earnings statement).

Answer:

The balance in the retained earnings account on December 31, year 3 is \$338,000 as shown below:

| | |
|---|-------------------------|
| <i>Beginning balance – January 1, year 3</i> | <i>\$275,000</i> |
| <i>After-tax correction of error (\$35,000 x 60%)</i> | <i>(21,000)</i> |
| <i>After-tax income before discontinued operations (\$165,000) x 60%)</i> | <i>99,000</i> |
| <i>After-tax gain from discontinued operations (\$50,000 x 60%)</i> | <i>30,000</i> |
| <i>Dividends</i> | <i><u>(45,000)</u></i> |
| <i>Ending balance – December 31, year 3</i> | <i><u>\$338,000</u></i> |

Question No. 5 (9 marks)

On January 1, 2011, Dunn Company received layaway payments from two customers. Each customer paid \$50.00. On December 24, 2011, the layaway period expired. On that date, Dunn received the balance of \$300 from customer 1 and delivered the promised merchandise. The merchandise cost \$200.00. Customer 2 did not make the final payment and therefore forfeited the initial \$50 layaway payment. Dunn follows ASPE and uses a perpetual inventory system. Normal sales terms apply here.

Required:

Prepare journal entries to record: (1) the receipt of the two initial layaway payments; (2) the receipt of the final layaway payment and delivery of the goods to customer 1; and (3) the forfeit of the layaway payment from customer 2. Narrative explanations are not required.

Question No. 5 (continued) (9 marks)

Answer:

| | | | |
|----|--|------------|------------|
| 1. | <i>Cash (2 × \$50)</i> | <i>100</i> | |
| | <i>Deposits Received from Customers*</i> | | <i>100</i> |
| 2. | <i>Cash</i> | <i>300</i> | |
| | <i>Deposits Received from Customers*</i> | <i>50</i> | |
| | <i>Sales</i> | | <i>350</i> |
| | <i>Cost of Goods Sold</i> | <i>200</i> | |
| | <i>Inventory</i> | | <i>200</i> |
| 3. | <i>Deposits Received from Customers*</i> | <i>50</i> | |
| | <i>Revenue from Layaway Forfeitures</i> | | <i>50</i> |

* *could be also called "unearned revenue"*