



## **BUSI 2001R – Intermediate Accounting I**

**Mid-Term Examination – November 3, 2018**

**Noon – 14:00**

### **Question 2 (9 marks) (18 minutes)**

On December 31, 20x5, an entity made a sale of inventory. The entity agreed on the following payment terms:

- 10% downpayment of \$20,000
- the remaining balance of \$180,000 payable on December 31, 20x7
- interest of 1.5% payable on the face value of the note receivable (\$180,000) on December 31, 20x6 and 20x7.

The entity's incremental borrowing rate is 5% and the customer to which the inventory was sold has an incremental borrowing rate of 7%.

#### ***Required -***

- (a) Write all journal entries on the books of the entity who sold the equipment at December 31, 20x5 through December 31, 20x7.
- (b) Assume now that this inventory normally sells for \$220,000. What discount rate would you use?

### **Question 3 (11 marks) (22 minutes)**

On December 31, 20x0, an entity purchased land for \$500,000. The purpose of the land is to store chemicals for a period of 30 years. At the end of the 30 years, the entity expects to spend \$2,000,000 in order to decontaminate the land and resell it.

#### ***Required –***

- (a) Write the journal entries to record the above transactions for the year ended December 31, 20x0 and 20x1. Assume a discount rate of 4%.
- (b) During 20x18, the entity estimates that due to advances in technology, that the cost to decontaminate the land will be \$500,000. The discount rate has changed to 6%. Prepare all journal entries in 20x18.

Note: the ARO component of the asset should be recorded in a separate account from land. i.e. Land (ARO). Only the ARO component of the land can be depreciated. Remember that land does not depreciate.

**Question 4 (6 marks) (12 minutes)**

On December 31, 20x1 an entity purchased a building at a cost of \$20,000,000. The useful life of the building is 40 years with no residual value. The entity elects to use the revaluation model for buildings. The fair value of the building was assessed as follows:

December 31, 20x5	\$17,500,000
December 31, 20x11	16,000,000

**Required –**

Prepare the journal entries relative to this building for the years ended December 31, 20x5 and 20x11 only.

**Question 5 (4 marks) (8 minutes)**

An entity exchanged land (outgoing asset) with a building (incoming asset) with another entity. The fair value of the land is estimated at \$600,000 and the fair value of the building is estimated at \$620,000. The carrying value of the land is \$450,000.

**Required –**

- (a) Do you believe this transaction has commercial substance or not? Explain why.
- (b) Based on your conclusion in part (a), write the journal entry to record the exchange.

**SOLUTION****Question 2 – 9 marks**

(a) Present value of note:

N = 2, I = 7, PMT = 2,700, FV = 180,000

PV = 162,101 **2 marks**

Dec 31, 20x5	Cash	\$20,000	
	Note Receivable	162,101	
	Revenue		\$182,101
	<b>1 mark</b>		
Dec 31, 20x6	Cash	2,700	
	Note Receivable	8,647	
	Interest revenue (\$162,101 x 7%)		11,347
	<b>1 mark</b>		
Dec 31, 20x6	Cash	2,700	
	Note Receivable	9,252	
	Interest revenue		
	(\$162,101 + 8,647) x 7%		11,952
	<b>2 marks</b>		
	Cash	180,000	
	Note Receivable		180,000
	<b>1 mark</b>		

(b) N = 2, PV = -200,000, PMT = 2,700, FV = 180,000

I/Y = 3.75% **2 marks**

**Question 3 – 11 marks**

- (a) Present value of ARO  
 $N = 30, I = 4, FV = 2,000,000$   
 $PV = 616,637$  2 marks

Dec 31, 20x0	Land	\$500,000	
	Cash		\$500,000
	Land (ARO Component)	616,637	
	ARO		616,637
	<b>1 mark for both entries (note that the two land accounts could be combined)</b>		
Dec 31, 20x1	Depreciation expense	20,555	
	Accumulated depreciation		20,555
	$\$616,637 / 30$		
	<b>1 mark</b>		
	Interest expense	24,665	
	ARO		24,665
	$\$616,637 \times 4\%$		
	<b>1 mark</b>		

- (b) PV of ARO using new estimates @ beginning of 20x18  
 $N = 13, I = 6, FV = 500,000$   
 $PV = 234,420$  2 marks

Carrying value of Land (ARO) =  $\$616,637 \times 13/30 = 267,209$  1 mark

ARO (\$267,209 – 234,420)	32,789	
Land (ARO Component)		32,789
<b>1 mark</b>		
Interest expense (\$234,420 x 6%)	14,065	
ARO		14,065
<b>1 mark</b>		
Depreciation expense (\$234,420 / 13)	18,032	
Accumulated depreciation`		18,032
<b>1 mark</b>		

**Question 4 – 6 marks**

Dec 31, 20x5	Depreciation expense	500,000	
	Accumulated depreciation		500,000
	<b>0.5 marks</b>		
	Accumulated Depreciation	2,000,000	
	Building		2,000,000
	\$20,000,000 / 40 x 3		
	<b>1 mark</b>		
	Loss on Revaluation of Building (P&L)	500,000	
	Building		500,000
	<b>1 mark</b>		
Dec 31, 20x11	Depreciation expense	486,111	
	Accumulated depreciation		486,111
	\$17,500,000 / 36		
	<b>1 mark</b>		
	Accumulated Depreciation	2,916,666	
	Building		2,916,666
	\$486,111 x 6		
	<b>1 mark</b>		
	Building	1,416,666	
	Gain on revaluation of building (P&L)		500,000
	Gain on revaluation of building (OCI)		916,666
	<b>1.5 marks</b>		

**Question 5 – 4 marks**

- (a) Because the building's cash flows configuration are likely to be significantly different from those of the land, the transaction has commercial substance.

**2 marks**

- (b) *Assuming commercial substance -*

Building	\$600,000	
Gain on exchange		\$150,000
Land		450,000

*Assuming no commercial substance -*

Building	450,000	
Land		450,000

**2 marks**