

## UW Cover Page

**AFM 291**  
**Intermediate Financial Accounting I**

**Instructions:**

1. This is a closed note, closed book examination. You may use pen/pencil and a calculator during the examination.
2. The examination includes 20 pages (including the cover page) - please ensure that all the pages have been included. If any pages are detached, they must be re-attached to the examination before the exam is handed in, to receive marks for work shown on these pages.
3. Show all your work and calculations. We cannot give partial credit if we cannot see the work you have done. No partial credit is given for multiple choice questions.
4. Unless otherwise stated, assume that the fiscal year end is December 31.
5. For parts C thru G of the examination, round your final answers to the nearest dollar.
6. Good Luck!

**Grading**

**Examination Breakdown:**

<b>Part</b>		<b>Your Points</b>	<b>Total Points</b>
<b>A</b>	<b>Multiple Choice</b>		<b>/ 10</b>
<b>B</b>	<b>Multiple Choice</b>		<b>/ 20</b>
<b>C</b>	<b>Inventory Estimation</b>		<b>/ 8</b>
<b>D</b>	<b>Investments</b>		<b>/ 12</b>
<b>E</b>	<b>Tangible Assets</b>		<b>/ 18</b>
<b>F</b>	<b>Intangible Assets</b>		<b>/ 20</b>
<b>G</b>	<b>Intangible Assets and Impairments</b>		<b>/ 12</b>
<b>Total</b>			<b>/100</b>

**Part A: Multiple Choice (1 Point Each – No Partial Credit Will be Awarded)**

1. Which of the following is a change in accounting principle?
  - a. A change in the estimated service life of machinery
  - b. A change from FIFO to weighted average for inventory
  - c. A change in the estimated future warranty expense
  - d. A change estimated allowance for bad debts
  
2. Which of these is generally an example of an extraordinary item?
  - a. Loss incurred because of a strike by employees.
  - b. Write-off of deferred marketing costs believed to have no future benefit.
  - c. Gain resulting from the devaluation of the Canadian dollar.
  - d. Gain resulting from the government expropriating a piece of land used as a parking lot.
  
3. In preparing a statement of cash flows, cash flows from operating activities:
  - a. are always equal to accrual accounting income.
  - b. are calculated as the difference between revenues and expenses.
  - c. can be calculated by appropriately adding to or deducting from net income those items in the income statement that do not affect cash.
  - d. can be calculated by appropriately adding to or deducting from net income those items in the income statement that do affect cash.
  
4. For inventory, net realizable value is:
  - a. acquisition cost plus costs to complete and sell.
  - b. selling price.
  - c. selling price less costs to complete and sell.
  - d. selling price plus costs to complete and sell.
  
5. Under the cost recovery method of revenue recognition:
  - a. income is recognized on a proportionate basis as the cash is received on the sale of the product.
  - b. income is recognized when the cash received from the sale of the product is greater than the cost of the product.
  - c. income is recognized immediately.
  - d. none of these.

6. Under the percentage-of-completion method, how should the balances of progress billings and construction in process be shown on the Balance Sheet at reporting dates prior to the completion of a long-term contract?
- Progress billings as deferred income, construction in progress as a deferred expense.
  - Progress billings as income, construction in process as inventory.
  - Net, as a current asset if debit balance and current liability if credit balance.
  - Net, as income from construction if credit balance, and loss from construction if debit balance.
7. Cash dividends declared out of current earnings were distributed to an investor. How would the investor's Balance Sheet investment account be affected by those dividends under each of the following accounting methods:
- |    | <u>Fair value method</u> | <u>Equity Method</u> |
|----|--------------------------|----------------------|
| a. | decrease                 | no effect            |
| b. | no effect                | no effect            |
| c. | decrease                 | decrease             |
| d. | no effect                | decrease             |
8. A building donated by the City of Waterloo to a manufacturer that plans to open a new factory there should be recorded on the manufacturer's books at:
- the nominal cost of taking title to it.
  - its market value.
  - one dollar (since the site cost nothing but should be reported on the balance sheet).
  - the value assigned to it by the company's directors.
9. For natural resources, depletion expense:
- eventually becomes part of cost of goods sold.
  - includes tangible equipment costs in the depletion base.
  - excludes intangible development costs from the depletion base.
  - excludes restoration costs from the depletion base.
10. Operating losses incurred during the start-up years of a new business should be:
- accounted for and reported like the operating losses of any other business.
  - written off directly against retained earnings.
  - capitalized as a deferred charge and amortized over five years.
  - capitalized as an intangible asset and amortized over a period not to exceed 20 years.

**Part B: Multiple Choice (2 Points Each – No Partial Credit Will be Awarded)**

11. Williams Corp.'s trial balance reflected the following account balances at December 31, 2006:

Accounts receivable (net)	\$28,000
Trading securities	6,000
Accumulated amortization on equipment and furniture	15,000
Cash	11,000
Inventory	30,000
Equipment	25,000
Patent	4,000
Prepaid expenses	2,000
Land held for future business site	18,000

In Williams' December 31, 2006 balance sheet, the current assets total is

- a. \$94,000.  
b. \$86,000.  
c. \$81,000.  
d. \$77,000.
12. In 2006, Raymond Corporation began construction work under a three-year contract. The contract price is \$3,000,000. Raymond uses the percentage-of-completion method for financial accounting purposes. The income to be recognized each year is based on the proportion of costs incurred to total estimated costs for completing the contract. The financial statement presentations relating to this contract at December 31, 2006, follow:

Balance Sheet

Accounts receivable—construction contract billings		\$100,000
Construction in progress	\$375,000	
Less contract billings	<u>300,000</u>	
Costs and recognized profit in excess of billings		75,000

Income Statement

Income (before tax) on the contract recognized in 2006	\$75,000
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How much cash was collected in 2006 on this contract?

- a. \$100,000.  
b. \$200,000.  
c. \$ 25,000.  
d. \$300,000.

13. Lian Co., which began operations on January 1, 2006, appropriately uses the instalment method of accounting. The following information pertains to Lian's operations for the year 2006:

Instalment sales	\$1,250,000
Regular sales	500,000
Cost of instalment sales	750,000
Cost of regular sales	300,000
General and administrative expenses	100,000
Collections on instalment sales	300,000

The deferred gross profit account in Lian's December 31, 2006 balance sheet should be

- a. \$120,000.
  - b. \$200,000.
  - c. \$380,000.
  - d. \$500,000.
14. Before year-end adjusting entries, Bass Company's account balances at December 31, 2006, for accounts receivable and the related allowance for uncollectible accounts were \$500,000 dr. and \$45,000 cr., respectively. An aging of accounts receivable indicated that \$62,500 of the December 31 receivables are expected to be uncollectible. The net realizable value of accounts receivable after adjustment is
- a. \$482,500.
  - b. \$437,500.
  - c. \$392,500.
  - d. \$455,000.

15. Iron Co. has the following data related to an item of inventory:

Inventory, March 1	100 units @ \$4.20
Purchase, March 7	350 units @ \$4.40
Purchase, March 16	70 units @ \$4.50
Inventory, March 31	150 units

The value assigned to ending inventory if Iron uses LIFO and a periodic method is

- a. \$667.
- b. \$640.
- c. \$630.
- d. \$675.

16. Von Distribution Co. has determined its December 31, 2006 inventory on a FIFO basis at \$240,000. Information pertaining to that inventory follows:

Estimated selling price	\$255,000
Estimated cost of disposal	10,000
Normal profit margin	30,000

Von records losses that result from applying the lower of cost and market rule, where market is defined as net realizable value. At December 31, 2006, the loss that Von should recognize is

- a. \$0.
  - b. \$5,000.
  - c. \$15,000.
  - d. \$25,000.
17. On July 1, 2005, Ryan Corporation purchased \$150,000 of three-year, 9% bonds when the market interest rate was 8%. Interest is payable annually on June 30. The price of the bonds on July 1, 2005 was:
- a. \$146,202
  - b. \$150,000
  - c. \$153,865
  - d. \$163,500
18. Red Corporation started construction on a new office building with an estimated total cost of \$5 million. Construction began on January 1, 2005, and was expected to take 3 years. To finance construction, Red borrowed \$5 million at a 10% annual interest rate on January 1, 2005. During 2005, Red incurred construction expenditures of \$2 million on April 1 and \$1 million on July 1. What amount of interest should Red Corp. capitalize for 2005?
- a. \$200,000
  - b. \$225,000
  - c. \$300,000
  - d. \$500,000

19. Vincent Co. purchased machinery that was installed and ready for use on January 3, 2006, at a total cost of \$115,000. Residual value was estimated at \$15,000. The machinery will be amortized over five years using the double declining-balance method. For the year 2007, Vincent should record amortization expense on this machinery of
- a. \$24,000.
  - b. \$27,600.
  - c. \$30,000.
  - d. \$46,000.
20. Johnson Software Company has capitalized development costs of \$3.6 million related to its new spreadsheet software product. The software is expected to have a four-year economic life and generate future revenues of \$25 million. Revenues generated by this software during 2006 (first year) amounted to \$7.5 million. The proper amount of software costs amortized to be recognized by Johnson in 2006 should be
- a. \$900,000.
  - b. \$3,600,000.
  - c. \$2,812,000.
  - d. \$1,080,000.



**Part C – Inventory Estimation (8 Points)**

Eastway Mall housed the premises of the Minter Hardware Company. On the morning of November 1, 2005, fire gutted the hardware store and some of the other tenants. Minter Hardware had been a popular and profitable store – the company reported an average gross profit percentage of 40%.

Appropriate data covering the period from January 1, 2005, until the date of the fire are as follows:

Sales	\$1,220,000
Purchases	750,000
Purchase returns	18,000
Sales returns	16,000
Freight-in	12,000
Inventory, January 1, 2005	100,000
Advertising expense	20,250
Sales discounts	5,000

**Required:**

Calculate the estimated inventory on November 1, 2005 using the Gross Profit Method.





**Part E – Tangible Assets (18 Points)**

On July 2, 2006, CBH Company purchased for \$720,000 a machine having an estimated useful life of six years with an estimated residual value of \$30,000. The company uses the double declining-balance method to compute depreciation, and computes depreciation to the nearest month.

**Instructions:**

- (a) Complete the following table for CBH Company for the years ended December 31, 2006 and 2007:

<u>Double Declining-Balance Method</u>	<u>2006</u>	<u>2007</u>
Equipment	\$720,000	\$720,000
Less: Accumulated Depreciation	_____	_____
Year-End Net Book Value	_____	_____
Depreciation Expense for the Year	_____	_____

*Show your calculations here*

(This question is continued on the next page.)

**Part E – Tangible Assets (continued)**

- (b) On January 1, 2008, CBH Company exchanged the machine for a brand-new, smaller machine. The new machine incorporated the latest technology and had an estimated useful life of 11 years. At the time of the exchange, the new machine had a fair value of \$425,000; the fair value of the old machine was not known.

Prepare the journal entry to record the exchange on January 1, 2008.

- (c) Briefly describe how your response to (b) would change if the company had used straight-line depreciation rather than the double declining-balance method.

## Part F – Intangible Assets (20 Points)

The Havemeyer Corporation commenced operations early in 2006. A number of expenditures were made during 2006 that were debited to one account called *Intangible Assets*. A recap of the \$208,000 balance in the account at the end of 2006 is as follows:

Jan. 2, 2006	Incorporation Fees	\$7,000
Mar. 1, 2006	Fire insurance premium for three-year period	6,000
Mar. 30, 2006	Goodwill	120,000
Apr. 30, 2006	Research and development costs	40,000
Sept. 1, 2006	Legal fees for filing a patent on a new product “X”	3,000
Sept. 30, 2006	Design costs for a new company trademark	12,000
Oct. 1, 2006	Legal fees for registering the trademark	4,000
Oct. 30, 2006	Advertising Costs	16,000
	<i>Total Intangible Assets</i>	<u>\$208,000</u>

Additional information:

- Goodwill arose from the acquisition of a competitor in the same industry. Goodwill was correctly computed as the purchase price of the competitor less the fair value of the net identifiable assets of the competitor.
- The research and development (R&D) costs were incurred for the development of a new product “X”. The technical feasibility of the product was established after virtually all of the R&D costs had been incurred.
- The patent for product “X” was expected to have a useful life of 8 years, beginning on September 1, 2006.
- The trademark was developed by the company for use in marketing and promotion of its products. The company was confident that the future benefits of the trademark were reasonably assured. The trademark had a legal life of 20 years, but could be renewed indefinitely at a very low cost. Havemeyer intended to use the trademark indefinitely.
- Advertising costs related to a newspaper ad campaign that ran through October 2006.

### **Required:**

Prepare the necessary journal entries to clear the *Intangible Assets* account and to set up accounts for separate intangibles, other types of assets, and expenses indicated by the transactions. Include journal entries to record amortization of individual intangible assets, where appropriate, for the year ended December 31, 2006.



**Part G – Intangible Assets and Impairments (12 Points)**

Rocky Road Chocolate Corporation decided to expand by purchasing Guittarde Chocolate Company on December 31, 2006 for \$2.4 million, making Guittarde a division of Rocky Road. Guittarde reported the following balance sheet at the time of the acquisition:

**Guittarde Chocolate Company  
Balance Sheet  
December 31, 2006**

<u>Assets</u>		<u>Liabilities and Equities</u>	
Cash	\$ 210,000	Accounts payable	\$ 325,000
Receivables	450,000	Common shares	800,000
Inventory	275,000	Retained earnings	<u>835,000</u>
Plant assets (net)	<u>1,025,000</u>		
Total assets	<u>\$1,960,000</u>	Total equities	<u>\$1,960,000</u>

It was determined that the fair market value of Guittarde’s inventory was \$320,000 and that the fair market value of the plant assets was \$1,225,000 on December 31, 2006 – the fair values of the remaining assets and liabilities were the same as the amounts reported on the balance sheet.

During 2007, the newly purchased division experienced public relations problems when a bacterial contamination sparked a significant product recall. Over the year, the company experienced operating losses that were expected to continue for some time. At December 31, 2007, the estimated fair value of the Guittarde division was \$1,700,000, the estimated fair value of the net identifiable assets was \$1,600,000, and the carrying value of the division was \$1,830,000.

(This question is continued on the next page.)



**Part G – Intangible Assets (continued)**

**Required:**

(a) Determine the amount of goodwill (if any) at the acquisition date of December 31, 2006.

(b) Determine the amount of impairment loss, if any, to be recognized at December 31, 2007. Prepare the corresponding journal entry to record the impairment loss, if any.

(c) Describe briefly how goodwill impairment losses would be classified on the Income Statement.

**Part G – Intangible Assets (continued)**

Present Value of \$1 (Present Value of a Single Sum)

$$PV = FV / (1+r)^n$$

(n) Periods	2%	2.5%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	15%
0.25	0.99506	0.99385	0.99264	0.99024	0.98788	0.98554	0.98323	0.98094	0.97869	0.97645	0.97425	0.97207	0.96566
0.5	0.99015	0.98773	0.98533	0.98058	0.97590	0.97129	0.96674	0.96225	0.95783	0.95346	0.94916	0.94491	0.93250
0.75	0.98526	0.98165	0.97807	0.97101	0.96407	0.95724	0.95052	0.94391	0.93741	0.93101	0.92471	0.91852	0.90049
1	0.98039	0.97561	0.97087	0.96154	0.95238	0.94340	0.93458	0.92593	0.91743	0.90909	0.90090	0.89286	0.86957
2	0.96117	0.95181	0.94260	0.92456	0.90703	0.89000	0.87344	0.85734	0.84168	0.82645	0.81162	0.79719	0.75614
3	0.94232	0.92860	0.91514	0.88900	0.86384	0.83962	0.81630	0.79383	0.77218	0.75131	0.73119	0.71178	0.65752
4	0.92385	0.90595	0.88849	0.85480	0.82270	0.79209	0.76290	0.73503	0.70843	0.68301	0.65873	0.63552	0.57175
5	0.90573	0.88385	0.86261	0.82193	0.78353	0.74726	0.71299	0.68058	0.64993	0.62092	0.59345	0.56743	0.49718
6	0.88797	0.86230	0.83748	0.79031	0.74622	0.70496	0.66634	0.63017	0.59627	0.56447	0.53464	0.50663	0.43233
7	0.87056	0.84127	0.81309	0.75992	0.71068	0.66506	0.62275	0.58349	0.54703	0.51316	0.48166	0.45235	0.37594
8	0.85349	0.82075	0.78941	0.73069	0.67684	0.62741	0.58201	0.54027	0.50187	0.46651	0.43393	0.40388	0.32690
9	0.83676	0.80073	0.76642	0.70259	0.64461	0.59190	0.54393	0.50025	0.46043	0.42410	0.39092	0.36061	0.28426
10	0.82035	0.78120	0.74409	0.67556	0.61391	0.55839	0.50835	0.46319	0.42241	0.38554	0.35218	0.32197	0.24718
11	0.80426	0.76214	0.72242	0.64958	0.58468	0.52679	0.47509	0.42888	0.38753	0.35049	0.31728	0.28748	0.21494
12	0.78849	0.74356	0.70138	0.62460	0.55684	0.49697	0.44401	0.39711	0.35553	0.31863	0.28584	0.25668	0.18691
13	0.77303	0.72542	0.68095	0.60057	0.53032	0.46884	0.41496	0.36770	0.32618	0.28966	0.25751	0.22917	0.16253
14	0.75788	0.70773	0.66112	0.57748	0.50507	0.44230	0.38782	0.34046	0.29925	0.26333	0.23199	0.20462	0.14133
15	0.74301	0.69047	0.64186	0.55526	0.48102	0.41727	0.36245	0.31524	0.27454	0.23939	0.20900	0.18270	0.12289
16	0.72845	0.67362	0.62317	0.53391	0.45811	0.39365	0.33873	0.29189	0.25187	0.21763	0.18829	0.16312	0.10686
17	0.71416	0.65720	0.60502	0.51337	0.43630	0.37136	0.31657	0.27027	0.23107	0.19784	0.16963	0.14564	0.09293
18	0.70016	0.64117	0.58739	0.49363	0.41552	0.35034	0.29586	0.25025	0.21199	0.17986	0.15282	0.13004	0.08081
19	0.68643	0.62553	0.57029	0.47464	0.39573	0.33051	0.27651	0.23171	0.19449	0.16351	0.13768	0.11611	0.07027
20	0.67297	0.61027	0.55368	0.45639	0.37689	0.31180	0.25842	0.21455	0.17843	0.14864	0.12403	0.10367	0.06110

Present Value of an Ordinary Annuity of 1

$$PV_A = [1 - 1/(1+r)^n]/r$$

(n) Periods	2%	2.5%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	15%
0.25	0.24692	0.24617	0.24542	0.24393	0.24247	0.24103	0.23961	0.23820	0.23682	0.23546	0.23411	0.23279	0.22891
0.5	0.49262	0.49082	0.48902	0.48548	0.48200	0.47857	0.47519	0.47187	0.46860	0.46537	0.46220	0.45907	0.44997
0.75	0.73711	0.73396	0.73084	0.72468	0.71862	0.71268	0.70683	0.70108	0.69543	0.68988	0.68441	0.67904	0.66343
1	0.98039	0.97561	0.97087	0.96154	0.95238	0.94340	0.93458	0.92593	0.91743	0.90909	0.90090	0.89286	0.86957
2	1.94156	1.92742	1.91347	1.88609	1.85941	1.83339	1.80802	1.78326	1.75911	1.73554	1.71252	1.69005	1.62571
3	2.88388	2.85602	2.82861	2.77509	2.72325	2.67301	2.62432	2.57710	2.53129	2.48685	2.44371	2.40183	2.28323
4	3.80773	3.76197	3.71710	3.62990	3.54595	3.46511	3.38721	3.31213	3.23972	3.16987	3.10245	3.03735	2.85498
5	4.71346	4.64583	4.57971	4.45182	4.32948	4.21236	4.10020	3.99271	3.88965	3.79079	3.69590	3.60478	3.35216
6	5.60143	5.50813	5.41719	5.24214	5.07569	4.91732	4.76654	4.62288	4.48592	4.35526	4.23054	4.11141	3.78448
7	6.47199	6.34939	6.23028	6.00205	5.78637	5.58238	5.38929	5.20637	5.03295	4.86842	4.71220	4.56376	4.16042
8	7.32548	7.17014	7.01969	6.73274	6.46321	6.20979	5.97130	5.74664	5.53482	5.33493	5.14612	4.96764	4.48732
9	8.16224	7.97087	7.78611	7.43533	7.10782	6.80169	6.51523	6.24689	5.99525	5.75902	5.53705	5.32825	4.77158
10	8.98259	8.75206	8.53020	8.11090	7.72173	7.36009	7.02358	6.71008	6.41766	6.14457	5.88923	5.65022	5.01877
11	9.78685	9.51421	9.25262	8.76048	8.30641	7.88687	7.49867	7.13896	6.80519	6.49506	6.20652	5.93770	5.23371
12	10.57534	10.25776	9.95400	9.38507	8.86325	8.38384	7.94269	7.53608	7.16073	6.81369	6.49236	6.19437	5.42062
13	11.34837	10.98318	10.63496	9.98565	9.39357	8.85268	8.35765	7.90378	7.48690	7.10336	6.74987	6.42355	5.58315
14	12.10625	11.69091	11.29607	10.56312	9.89864	9.29498	8.74547	8.24424	7.78615	7.36669	6.98187	6.62817	5.72448
15	12.84926	12.38138	11.93794	11.11839	10.37966	9.71225	9.10791	8.55948	8.06069	7.60608	7.19087	6.81086	5.84737
16	13.57771	13.05500	12.56110	11.65230	10.83777	10.10590	9.44665	8.85137	8.31256	7.82371	7.37916	6.97399	5.95423
17	14.29187	13.71220	13.16612	12.16567	11.27407	10.47726	9.76322	9.12164	8.54363	8.02155	7.54879	7.11963	6.04716
18	14.99203	14.35336	13.75351	12.65930	11.68959	10.82760	10.05909	9.37189	8.75563	8.20141	7.70162	7.24967	6.12797
19	15.67846	14.97889	14.32380	13.13394	12.08532	11.15812	10.33560	9.60360	8.95011	8.36492	7.83929	7.36578	6.19823
20	16.35143	15.58916	14.87747	13.59033	12.46221	11.46992	10.59401	9.81815	9.12855	8.51356	7.96333	7.46944	6.25933

**Part A – Multiple Choice (1 point each – no partial credit)**

1. b
2. d
3. c
4. c
5. b
6. c
7. d
8. b
9. a
10. a

**Part B – Multiple Choice (2 points each – no partial credit)**

11. d  $\$28,000 + \$6,000 + \$11,000 + \$30,000 + \$2,000 = \$77,000$
12. b  $\$300,000 - \$100,000 = \$200,000$
13. c  $\$1,250,000 - \$750,000 = \$500,000$  gross profit (40% gross profit rate)  
 $(\$1,250,000 - \$300,000) * .4 = \$380,000$
14. b  $\$500,000 - 62,500 = \$437,500$
15. b  $640 = (100 * 4.20) + (50 * 4.40)$
16. a  $NRV = \$255,000 - \$10,000 = \$245,000$ ; Cost = \$240,000; Therefore no loss.
17. c  $153,865 = 150,000 (.79383) + 13,500 (2.57710)$
18. a  $((2,000,000 * 9/12) + (1,000,000 * 6/12)) * 10\% = \$200,000$
19. b  $\$27,600 = (115,000 - (115,000 * .4)) * .4$
20. d  $1,080,000 = 3,600,000 * (7.5m/25m)$

**Part C: (8 points)**

**BI + Purchases – Estimated COGS = Estimated EI**

**1 point – formula**

**1 point - BI**

$$100,000 + 744,000 - 719,400 = \boxed{\$ 124,600}$$

Purchases = Purchases – Purchase returns + Freight-in  
= \$750,000 - 18,000 + 12,000  
= \$744,000

**2 points - Purchases**

Net Sales = Sales – Sales Returns – Sales Discounts  
= 1,220,000 – 16,000 – 5,000  
= \$1,199,000

Est. COGS = Net Sales \* (1 – Gross Profit %)  
= 1,199,000 \* (1 - .40)  
= \$719,400

**4 points - Est. COGS**

**1 pt. deduction for incorrectly including advertising expense in formula**

**Part D: (12 Points)**

Situation 1

**3 Points – deduct 1 for each incorrect component**

Cost	\$500,000
Share of net income (.3 X \$480,000)	144,000
Share of dividends (.3 X \$220,000)	<u>(66,000)</u>
Balance in investment account	<u>\$578,000</u>

Situation 2

**(9 Points)**

<u>Account Name</u>	<u>Dr</u>	<u>Cr</u>	<u>Points Calculation</u>	<u>Points Account names</u>
Cash	140,000			<b>1</b>
Loss on sale of AFS Investment (I/S)	60,000		<b>1</b>	<b>1</b>
AFS Investment		200,000	<b>1</b>	<b>1</b>
<u>FV Allowance on AFS Investments</u>	130,000		<b>2</b>	<b>1</b>
<u>Unrealized Holding Gain/Loss on AFS Investments (OCI)</u>		130,000		<b>1</b>

(A) Computation of unrealized holding gain / loss

FV Allowance – Opening Balance: dr. 210,000 = (960,000 – 750,000)

FV Allowance – Closing Balance: dr. 340,000 = (890,000 – 550,000)

Required adjustment = 130,000 = 340,000 – 210,000

- **important components of account names should be present for point, including I/S and OCI**
- **alternate terms permitted if they convey appropriate meaning (e.g. “Adjustment” for “Allowance”)**

**Part E (18 Points)**

**(a) (7 Points)**

<u>Double Declining-Balance Method</u>	<u>2006</u>	<u>2007</u>
Accumulated Depreciation	<u>\$120,000</u>	<u>\$320,000</u>
Net Book Value	<u>600,000</u>	<u>400,000</u>
Depreciation Expense	<u>120,000</u>	<u>200,000</u>

Accumulated Depreciation = \$120,000 (1 Point)  
Net Book value at the end of 2006 = \$720,000 – 120,000 = \$600,000 (1 Point)  
Depreciation for 2006 = \$720,000 \* (100%/6 \* 2) x 6/12 = 120,000 (2 Points)

Accumulated Depreciation = \$120,000 + 200,000 = \$320,000 (1 Point)  
Net Book value at the end of 2006 = \$600,000 – 200,000 = \$400,000 (1 Point)  
Depreciation for 2007 = \$600,000 \* (100%/6 \* 2) = 200,000 (1 Point)

**Only penalize for error once**

**(b) (8 points) Exchange of Assets:**

Nonmonetary exchange with commercial substance (new machine has significantly longer life – therefore the configuration of the cash flows underlying the assets has changed.)

Journal entry:

Dr. Equipment (new)	\$425,000	(2 amt; 1 a/c)
Accumulated Depreciation	\$320,000	(1 for amt and a/c)
Cr. Equipment (old)	\$720,000	(1 for amt and a/c)
Gain of disposal of equipment	\$25,000	(2 amt; 1 a/c)

Gain = Proceeds \$425,000 – CV \$400,000

**(c) (3 points) Straight-line rather than double declining-balance:**

- Double declining-balance depreciation is a much more conservative method of accounting.
- Therefore, the net book value of the assets declines more quickly in the early years under the DDB method than under the straight-line method. (2 Points)
- As a result, the gain on disposal is higher under the DDB method than under the straight-line method. (1 Point)
- In fact, had the straight-line method been used, the company would have recorded a loss of \$122,500 on the exchange. [Loss = \$425,000 - (\$720,000 – (57,500 + 115,000)) = 122,500]



**Part F: (20 Points)**

dr. Organization Costs	7,000		<b>1 pt for amt; 1 for a/c's</b>
cr. Intangible Assets		7,000	
dr. Amortization expense - Org. Costs*	1,400		<b>1 pt for amt; 1 for a/c's</b>
cr. Accumulated amortization - Org. Costs		1,400	(see different possible nos)
*Amortize over 3-5 years: 3 years = 2,333 4 years = 1,750 5 years = 1,400			
dr. Prepaid insurance	4,333		<b>2 pts for amts; 1 for a/c's</b>
Insurance expense	1,667		
cr. Intangible Assets		6,000	
Prepaid insurance - (6,000 / 36) * 26 months remaining		4,333	
Insurance expense - (6,000 / 36) * 10 months		1,667	
dr. Goodwill	120,000		<b>1 pt for amt and a/c's</b>
cr. Intangible Assets		120,000	
dr. R&D expense	40,000		<b>1 pts for amt; 1 for a/c's</b>
cr. Intangible Assets		40,000	
dr. Patent	3,000		<b>1 pts for amt; 1 for a/c's</b>
cr. Intangible Assets		3,000	
dr. Amortization expense - patent	125		<b>2 pts for amts; 1 for a/c's</b>
cr. Accumulated amortization		125	
Amortize over 8 years beginning on Sept. 1 = (3,000 / 96) * 4 months = 125			
dr. Trademark	12,000		<b>1 pts for amt; 1 for a/c's</b>
cr. Intangible Assets		12,000	
dr. Trademark	4,000		<b>1 pts for amt; 1 for a/c's</b>
cr. Intangible Assets		4,000	
<b>(the two entries above can be combined)</b>			
dr. Advertising expense	16,000		<b>1 pts for amt and a/c's</b>
cr. Intangible Assets		16,000	

**Part G: (12 Points)**

(a) Goodwill at acquisition (December 31, 2006):

$$\begin{aligned} &= \text{Purchase Price} - \text{FV Net Identifiable Assets} \\ &= 2,400,000 - (210,000 + 450,000 + 320,000 + 1,225,000 \\ &\quad - 325,000) \\ &= 2,400,000 - 1,880,000 \\ &= \$520,000 \end{aligned}$$

**4 Points**

(b) Two-step impairment test:

- Step 1: compare the FV of the reporting unit to the CV – if less, then proceed to Step 2

$$\text{FV Reporting Unit } \$1,700,000 < \text{CV Reporting Unit } \$1,830,000$$

**1 Point**  
**(to recognize first step)**

- Step 2: calculate the implied FV of GW:

Calculation of loss:

$$\begin{aligned} \text{implied FV of GW} &= \text{FV Reporting Unit} - \text{FV NIA} \\ &= \$1,700,000 - \$1,600,000 \\ &= \$100,000 \end{aligned}$$

**2 Points**

compute the impairment of goodwill:

$$\begin{aligned} \text{impairment} &= \text{implied FV of GW} - \text{CV of GW} \\ &= \$100,000 - \$520,000 \\ &= \$(420,000) \text{ impairment loss} \end{aligned}$$

**3 Points**

Journal entry:

		<b>1 Point</b>
		<b>(for a/c names)</b>
Dr. Loss on Impairment of Goodwill	\$420,000	
Cr. Goodwill		\$420,000

(c) - Loss on impairment would be part of “income from continuing operations”  
(not an extraordinary item; not discontinued operations)

**1 Point**