

Core 1 Self-Assessed Entrance Exam Solution

1. Genette Inc. (GI) reports under ASPE. The controller of GI is about to record a journal entry to account for a related party transaction. The transaction in question was not in the normal course of operations for GI and resulted in no substantive change in ownership interests. How should the controller account for this transaction?

a. Measure the transaction at the carrying amount and record any gain or loss in income.

@ Answer a) is incorrect. Answer b) is correct because, per Section 3840 *Related Party Transactions*, paragraphs 8 and 9: “A related party transaction shall be measured at the carrying amount, except as specified in paragraphs 3840.18 and 3840.29. When a related party transaction is measured at the carrying amount, any difference between the carrying amounts of items exchanged, together with any tax amounts related to the items transferred, shall be included as a charge or credit to equity.” Refer to the decision tree in Section 3840.

*b. Measure the transaction at the carrying amount and record any gain or loss in equity.

@ Answer b) is correct. Per Section 3840 *Related Party Transactions*, paragraphs 8 and 9: “A related party transaction shall be measured at the carrying amount, except as specified in paragraphs 3840.18 and 3840.29. When a related party transaction is measured at the carrying amount, any difference between the carrying amounts of items exchanged, together with any tax amounts related to the items transferred, shall be included as a charge or credit to equity.” Refer to the decision tree in Section 3840.

c. Measure the transaction at the exchange amount and record any gain or loss in income.

@ Answer c) is incorrect. Answer b) is correct because, per Section 3840 *Related Party Transactions*, paragraphs 8 and 9: “A related party transaction shall be measured at the carrying amount, except as specified in paragraphs 3840.18 and 3840.29. When a related party transaction is measured at the carrying amount, any difference between the carrying amounts of items exchanged, together with any tax amounts related to the items transferred, shall be included as a charge or credit to equity.” Refer to the decision tree in Section 3840.

d. Measure the transaction at the exchange amount and record any gain or loss in equity.

@ Answer d) is incorrect. Answer b) is correct because, per Section 3840 *Related Party Transactions*, paragraphs 8 and 9: "A related party transaction shall be measured at the carrying amount, except as specified in paragraphs 3840.18 and 3840.29. When a related party transaction is measured at the carrying amount, any difference between the carrying amounts of items exchanged, together with any tax amounts related to the items transferred, shall be included as a charge or credit to equity." Refer to the decision tree in Section 3840.

2. Spare parts that have a lifespan of less than one year:

a. Include items such as a spare engine for a car.

@ Answer a) is incorrect. A spare engine would be considered a major spare part with a lifespan greater than one year and classified as property, plant, and equipment.

Answer d) is correct because spare parts that have a lifespan of one year do not qualify as PP&E and are, therefore, classified as inventory.

b. Require an assessment to determine whether depreciation should commence.

@ Answer b) is incorrect. Major spare parts that will be used over more than one period would be classified as property, plant, and equipment, and would require an assessment to determine whether depreciation should commence. Answer d) is correct because spare parts that have a lifespan of less than one year do not qualify as PP&E and are, therefore, classified as inventory.

c. Are also known as standby equipment.

@ Answer c) is incorrect. Standby equipment is considered property, plant, and equipment. Answer d) is correct because spare parts that have a lifespan of less than one year do not qualify as PP&E and are, therefore, classified as inventory.

*d. Are classified as inventory.

@ Answer d) is correct. Spare parts that have a lifespan of less than one year do not qualify as PP&E and are, therefore, classified as inventory.

3. The following accounts were taken from Blue Monkey Inc.'s unadjusted trial balance at December 31, 20X6:

Accounts receivable	\$850,000
Opening allowance for doubtful accounts (AFDA) January 1, 20X6	(\$11,000)
Net credit sales	\$2,950,000

Blue Monkey estimates that 1.5% of the gross accounts receivable will become uncollectable. At December 31, 20X6, AFDA should have a credit balance of what amount?

a. \$1,750

@ Answer a) is incorrect. This is the balance of bad debt expense for the year (ending AFDA of \$12,750 less opening balance of \$11,000). Answer c) is correct. The balance of AFDA would be calculated as $\$850,000 \times 1.5\% = \$12,750$.

b. \$11,000

@ Answer b) is incorrect. This answer does not take into account the change in the AFDA balance. Answer c) is correct. The balance of AFDA would be calculated as $\$850,000 \times 1.5\% = \$12,750$.

*c. \$12,750

@ Answer c) is correct. The balance of AFDA would be $\$850,000 \times 1.5\% = \$12,750$.

d. \$44,250

@ Answer d) is incorrect. This answer calculates the AFDA using total sales rather than the accounts receivable balance ($\$2,950,000 \times 1.5\%$). Answer c) is correct. The balance of AFDA would be calculated as $\$850,000 \times 1.5\% = \$12,750$.

4. Kima Inc. had credit sales of \$600,000 and cash collections of \$450,000 last year. The ending balance in accounts receivable was \$175,000. The allowance for doubtful accounts (AFDA) has a current credit balance of \$2,600. Based on an aging analysis, Kima has estimated that the allowance for doubtful accounts is 4% of the gross amount of outstanding receivables. What is the bad debt expense for the year?

*a. \$4,400

@ Answer a) is correct. The allowance for doubtful accounts should be $4\% \times \$175,000 = \$7,000$. Therefore, the journal entry required is Dr. Bad debts \$4,400 ($\$7,000 - \$2,600$) and Cr. AFDA \$4,400.

b. \$6,000

@ Answer b) is incorrect. This response incorrectly uses the total sales less cash collections multiplied by 4% to calculate bad debt expense $(\$600,000 - \$450,000) \times 4\% = \$6,000$. Answer a) is correct. The allowance for doubtful accounts should be $4\% \times \$175,000 = \$7,000$. Therefore, the journal entry required is Dr. Bad debts \$4,400 ($\$7,000 - \$2,600$) and Cr. AFDA \$4,400.

c. \$7,000

@ Answer c) is incorrect. This response gives the ending balance of AFDA and not the adjustment to correct the balance. Answer a) is correct. The allowance for doubtful accounts should be $4\% \times \$175,000 = \$7,000$. Therefore, the journal entry required is Dr. Bad debts \$4,400 ($\$7,000 - \$2,600$) and Cr. AFDA \$4,400.

d. \$9,600

@ Answer d) is incorrect. This response incorrectly takes the current balance of the AFDA of \$2,600 and adds the new balance ($\$2,600 + \$7,000$). Answer a) is correct. The allowance for doubtful accounts should be $4\% \times \$175,000 = \$7,000$. Therefore, the journal entry required is Dr. Bad debts \$4,400 ($\$7,000 - \$2,600$) and Cr. AFDA \$4,400.

5. In order to qualify for separate presentation on the income statement, a discontinued operation must be considered a component of an entity.

Which of the following would be considered a component of an entity?

*a. A hotel in a hotel chain

@ Answer a) is correct. A hotel in a hotel chain is considered a component of an entity because it is a group of assets directly generating cash flows that are clearly distinguishable from the rest of the entity.

b. The administration building of a large manufacturing company

@ Answer b) is incorrect. The administration building of a large manufacturing company is not considered a component of an entity because it is a single asset not directly generating its own cash flows and its operations and financial elements are not clearly distinguishable from the rest of the entity. Answer a) is correct because a hotel in a hotel chain is considered a component of an entity, as it is a group of assets directly generating cash flows that are clearly distinguishable from the rest of the entity.

c. A truck stop for a national trucking company

@ Answer c) is incorrect. A truck stop for a national trucking company is not considered a component of an entity because it is a group of assets that is not a separate legal entity, and it does not have financial elements that are clearly distinguishable from the rest of the entity. Answer a) is correct because a hotel in a hotel chain is considered a component of an entity, as it is a group of assets directly generating cash flows that are clearly distinguishable from the rest of the entity.

d. The warehouse of a communications company

@ Answer d) is incorrect. The warehouse of a communications company is not considered a component of an entity because it is not a group of assets comprising an operating segment that directly generates cash flows, nor are its operations and financial elements clearly distinguishable from the rest of the entity. Answer a) is correct because a hotel chain is considered a component of an entity, as it is a group of assets directly generating cash flows that are clearly distinguishable from the rest of the entity.

6. Under IFRS, assets are considered held for sale when several criteria have been met. Which of the following criteria must be met in order to define an asset as held for sale?

a. The asset is available for immediate sale in its present condition.

@ Answer a) is incorrect. This is a criterion that must be met in order to define an asset as held for sale, but so is answer b), there being an authorized plan to sell the asset. Therefore, answer d) is correct because both a) and b) are correct.

b. There is an authorized plan to sell the asset.

@ Answer b) is incorrect. This is a criterion that must be met in order to define an asset as held for sale, but so is answer a), the asset being available for immediate sale in its present condition. Therefore, answer d) is correct because both a) and b) are correct.

c. The asset is actively marketed and expected to be sold within two years.

@ Answer c) is incorrect. While it is true that the asset must be actively marketed in order to define the asset as held for sale, the asset should be expected to qualify for recognition as a completed sale within one year from the date of classification. Answer d) is correct because both answers a) and b) above are correct because the asset being available for immediate sale in its present condition and there being an authorized plan to sell the asset are both criteria that must be met in order to define an asset as held for sale.

*d. Both a) and b) above.

@ Answer d) is correct. Both answers a) and b) above are correct because the asset being available for immediate sale in its present condition and there being an authorized plan to sell the asset are both criteria that must be met in order to define an asset as held for sale.

7. Which of the following statements is FALSE?

a. Consolidated ending retained earnings is impacted by amortization to date of fair value differentials that arose at acquisition.

@ Answer a) is incorrect. This statement is true. Consolidated retained earnings is adjusted for amortization to date of fair value differentials that arose at acquisition. Answer c) is correct. The statement that consolidated retained earnings is impacted by intercompany management fees recognized in the current year is false.

b. Consolidated retained earnings is impacted by unrealized profit in closing inventory on intercompany inventory sales.

@ Answer b) is incorrect. This statement is true. Consolidated retained earnings is reduced for unrealized profit in closing inventory as a result of intercompany sales. Answer c) is correct. The statement that consolidated retained earnings is impacted by intercompany management fees recognized in the current year is false.

*c. Consolidated retained earnings is impacted by intercompany management fees recognized in the current year.

@ Answer c) is correct. This statement is false. One of the companies will have reported management fee revenue while the other company will have reported an expense in the same amount. The net impact on net income and retained earnings is nil.

d. Consolidated retained earnings is impacted by an unrealized loss on an intercompany sale of equipment.

@ Answer d) is incorrect. This statement is true. Consolidated retained earnings is increased for unrealized losses on an intercompany equipment sale. Answer c) is correct. The statement that consolidated retained earnings is impacted by intercompany management fees recognized in the current year is false.

8. On November 1 of the current year, Bait Co. sold inventory to its wholly owned subsidiary, Tackle Ltd. 80% of these goods were then sold by Tackle to customers of Tackle prior to the December 31 year end.

What are all of the consolidation adjustments required for the preparation of the consolidated financial statements related to this transaction? (Ignore the effects of income taxes.)

*a. Decrease sales and cost of sales by the intercompany selling price, and increase cost of sales and decrease inventory by the unrealized profit in ending inventory.

@ Answer a) is correct. Sales are overstated by the full intercompany selling price. The required adjustment to cost of sales is a net decrease equal to the intercompany selling price less unrealized profit in ending inventory. Inventory is correctly reduced by the unrealized profit in ending inventory.

b. Decrease cost of sales by the unrealized profit in ending inventory and increase inventory by the same amount.

@ Answer b) is incorrect. Inventory should be reduced by the unrealized profit in ending inventory, and cost of sales should be increased by the same amount. An additional entry is required to adjust sales and cost of sales for the full current-year intercompany selling price. Answer a) is correct. Sales are overstated by the full intercompany selling price. The required adjustment to cost of sales is a net decrease equal to the intercompany selling price less unrealized profit in ending inventory. Inventory is correctly reduced by the unrealized profit in ending inventory.

c. Increase cost of sales by the unrealized profit in ending inventory and decrease inventory by the same amount.

@ Answer c) is incorrect. The adjustment to cost of sales and ending inventory is correct. However, an additional entry is required to adjust sales and cost of sales for the full current-year intercompany selling price. Answer a) is correct. Sales are overstated by the full intercompany selling price. The required adjustment to cost of sales is a net decrease equal to the intercompany selling price less unrealized profit in ending inventory. Inventory is correctly reduced by the unrealized profit in ending inventory.

d. Decrease sales and cost of sales by the intercompany selling price of the inventory.

@ Answer d) is incorrect. The entry to reduce sales and cost of sales by the intercompany selling price of the inventory is correct. However, an additional entry is required to adjust cost of sales and ending inventory for the unrealized profit in ending inventory. Answer a) is correct. Sales are overstated by the full intercompany selling price. The required adjustment to cost of sales is a net decrease equal to the intercompany selling price less unrealized profit in ending inventory. Inventory is correctly reduced by the unrealized profit in ending inventory.

9. How should acquisition-related costs, such as due diligence and legal costs, be accounted for?

*a. Expensed as incurred

@ Answer a) is correct. Paragraph 53 of IFRS 3 *Business Combinations* states that the acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received. The same treatment is required under paragraph 55 of ASPE Section 1582 *Business Combinations*.

b. As part of the total consideration

@ Answer b) is incorrect. According to paragraph 53 of IFRS 3 *Business Combinations*, these costs are expensed as incurred. These costs are not accounted for as an addition to the total consideration because there is no future economic benefit as the costs are not likely to result in an increase in future cash inflows. Answer a) is correct. IFRS 3.53 states that the acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received. The same treatment is required under paragraph 55 of ASPE Section 1582 *Business Combinations*.

c. As a reduction in equity

@ Answer c) is incorrect. These costs do not meet the definition of equity. According to paragraph 53 of IFRS 3 *Business Combinations*, these costs are expensed as incurred. Answer a) is correct. IFRS 3.53 states that the acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received. The same treatment is required under paragraph 55 of ASPE Section 1582 *Business Combinations*.

d. As a deferred asset

@ Answer d) is incorrect. These costs do not meet the definition of an asset. According to paragraph 53 of IFRS 3 *Business Combinations* and paragraph 55 of ASPE Section 1582 *Business Combinations*, these costs are expensed as incurred. Answer a) is correct. IFRS 3.53 states that the acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received. The same treatment is required under ASPE 1582.55.

10. A bargain purchase arises when the price paid to acquire a controlling interest in another company is less than the acquirer's share of the fair value of net assets of the company being acquired. At the end of your preliminary analysis, you believe that a business combination results in a bargain purchase. What is your next step?

a. Recognize an immediate gain in the consolidated statement of profit and loss without any further analysis.

@ Answer a) is incorrect. While a bargain purchase could result in a gain, another step is required first. Answer d) is correct. Under paragraph 36 of IFRS 3 *Business Combinations*, the acquirer is required to reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed, and shall recognize any additional assets or liabilities that are identified in that review. In addition, the acquirer must then review the fair values assigned to individual assets and liabilities of the subsidiary company to determine whether any of the fair values have been incorrectly measured.

b. Recognize a liability in the consolidated balance sheet.

@ Answer b) is incorrect. The result is not a liability according to the definition of a liability. Answer d) is correct. Under paragraph 36 of IFRS 3 *Business Combinations*, the acquirer is required to reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed, and shall recognize any additional assets or liabilities that are identified in that review. In addition, the acquirer must then review the fair values assigned to individual assets and liabilities of the subsidiary company to determine whether any of the fair values have been incorrectly measured.

c. Contact the acquiree to confirm its intention.

@ Answer c) is incorrect. You would not contact the acquiree. The purchase price is established in the purchase and sale agreement and is not subject to revision after both parties have agreed to it. Answer d) is correct. Under paragraph 36 of IFRS 3 *Business Combinations*, the acquirer is required to reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed, and shall recognize any additional assets or liabilities that are identified in that review. In addition, the acquirer must then review the fair values assigned to individual assets and liabilities of the subsidiary company to determine whether any of the fair values have been incorrectly measured.

*d. Reassess each step of your analysis to confirm your preliminary finding.

@ Answer d) is correct. Under paragraph 36 of IFRS 3 *Business Combinations*, the acquirer is required to reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed, and shall recognize any additional assets or liabilities that are identified in that review. In addition, the acquirer must then review the fair values assigned to individual assets and liabilities of the subsidiary company to determine whether any of the fair values have been incorrectly measured.

11. Which of the following statements is true?

a. Under IFRS, publicly traded bonds with a maturity less than or equal to six months are considered cash and cash equivalents.

@ Answer a) is incorrect. Publicly traded bonds are generally excluded from cash and cash equivalents unless they have a maturity date of three months or less from the date of acquisition and there is an insignificant risk of change in value. Answer b) is correct. There are no significant differences between IFRS and ASPE in the treatment of cash and cash equivalents.

*b. There are no significant differences between IFRS and ASPE in the treatment of cash and cash equivalents.

@ Answer b) is correct. There are no significant differences between IFRS and ASPE in the treatment of cash and cash equivalents.

c. Under ASPE, redeemable preferred shares with a maturity less than or equal to three months are considered cash and cash equivalents.

@ Answer c) is incorrect. Redeemable preferred shares with a maturity date less than three months are considered cash and cash equivalents under IFRS but not ASPE. Answer b) is correct. There are no significant differences between IFRS and ASPE in the treatment of cash and cash equivalents.

d. Under ASPE, minimum balance requirements in bank accounts are considered cash and cash equivalents.

@ Answer d) is incorrect. Minimum balance requirements in bank accounts are considered restricted cash. Answer b) is correct. There are no significant differences between IFRS and ASPE in the treatment of cash and cash equivalents.

12. Which of the following is considered restricted cash?

a. Foreign currency where there is a limited market for exchange into the company's operating currency

@ Answer a) is incorrect. This is an example of an exclusion from cash and cash equivalents, but is not considered restricted cash. Answer d) is correct. Both b) and c) are correct because minimum balance requirements in bank accounts and donations provided for a specific purpose in a not-for-profit are both examples of restricted cash.

b. Minimum balance requirements in bank accounts

@ Answer b) is incorrect. While a minimum balance requirement in a bank account is considered restricted cash, answer c) is also correct because donations provided for a specific purpose in a not-for-profit organization are also considered restricted cash. Therefore, answer d) is correct because both b) and c) are correct.

c. Donations provided for a specific purpose in a not-for-profit organization

@ Answer c) is incorrect. While donations provided for a specific purpose are considered restricted cash, answer b) is also correct because minimum balance requirements in bank accounts are also considered restricted cash. Therefore, answer d) is correct because both b) and c) are correct.

*d. Both b) and c)

@ Answer d) is correct. Both b) and c) are correct because minimum balance requirements in bank accounts and donations provided for a specific purpose in a not-for-profit are both examples of restricted cash.

13. Kevin, an audit associate at your firm, Stanford and Poor LLP, is reviewing accounting changes. Which of the following statements is correct?

a. If a company decides to change the amortization period of kitchen equipment from three years to five years because the equipment is lasting longer than originally intended, this change should be accounted for retrospectively.

@ Answer a) is incorrect. This statement is incorrect. The change in the amortization period of the kitchen equipment is a change in estimate because the amortization period is an estimate of the asset's useful life. Changes in estimates are applied prospectively, not retrospectively. Answer c) is correct. Where a change to the company's accounting policies is required by a primary source of GAAP that permits or requires prospective application, the company can account for the policy change prospectively. Changes made to existing standards and new standards will provide transitional guidance.

b. If a company changes any of its accounting policies, it should include a note to the financial statements indicating the effect of the change on the current period and prior periods, but a description of the change is not required.

@ Answer b) is incorrect. This statement is incorrect. When a company changes its accounting policies, full disclosure of both the effect and a description of the change is required so that readers of the financial statements can understand the impact of the change on both the current and prior periods. Answer c) is correct. Where a change to the company's accounting policies is required by a primary source of GAAP that permits or requires prospective application, the company can account for the policy change prospectively. Changes made to existing standards and new standards will provide transitional guidance.

*c. A company can account for changes in accounting policies prospectively if the change is required by a primary source of GAAP that permits or requires prospective application.

@ Answer c) is correct. This statement is true. Where a change to the company's accounting policies is required by a primary source of GAAP that permits or requires prospective application, the company can account for the policy change prospectively. Changes made to existing standards and new standards will provide transitional guidance.

d. Under ASPE, a company may account for a change in its revenue recognition policy prospectively if the financial data needed to determine the impact on previous periods is readily available.

@ Answer d) is incorrect. This statement is not true. ASPE requires opening balances of assets, liabilities, and equity for the earliest prior period presented to be restated except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the change. Answer c) is correct. Where a change to the company's accounting policies is required by a primary source of GAAP that permits or requires prospective application, the company can account for the policy change prospectively. Changes made to existing standards and new standards will provide transitional guidance.

14. Which of the following describes a change in accounting policy?

a. Inventory was sold below its carrying amount even though the inventory had been previously written down to what was believed to be the net realizable value.

@ Answer a) is incorrect. This would be considered a change in estimate, as the net realizable value was previously management's best estimate of what the company would receive for the inventory. Answer b) is correct. A change from the cost model to the revaluation model for measuring the value of land is an acceptable change in accounting policy under IFRS.

*b. A public company changes from the cost model to the revaluation model for measuring the value of land.

@ Answer b) is correct. A change from the cost model to the revaluation model for measuring the value of land is an acceptable change in accounting policy under IFRS.

c. Development costs were capitalized when only five of six criteria for capitalization had been satisfied.

@ Answer c) is incorrect. This would be an error; the costs should have been expensed, as not all the criteria were met. Answer b) is correct. A change from the cost model to the revaluation model for measuring the value of land is an acceptable change accounting policy under IFRS.

d. The company miscalculated the weighted average number of ordinary shares outstanding because it used the wrong date for a share issuance.

@ Answer d) is incorrect. This is an error in the calculation of the earnings per share. Answer b) is correct. A change from the cost model to the revaluation model for measuring the value of land is an acceptable change in accounting policy under IFRS.

15. You, CPA, are the audit senior on the Louise's Landscaping (Louise's) file. The year-end financial statements of Louise's were prepared in accordance with ASPE. Which of the following items has been reported correctly?

a. Louise's has been sued by a customer to whom Louise inadvertently sold poison ivy instead of Virginia creeper. The lawsuit is for \$500,000. A liability for \$500,000 has been recognized. Louise's legal counsel believes that Louise's is liable, but is unable to estimate the amount.

@ Answer a) is incorrect. While the loss is likely, the amount cannot be estimated. A contingent loss is recognized in income and recorded as a liability only if it is likely that a liability has been incurred and the loss amount can be reasonably estimated. Answer b) is correct. Because the probability of loss is less than 50%, it is not likely and no accrual is required. Disclosure of the nature and estimate of the amount of the contingent loss is required.

*b. Louise's has been sued by a supplier for a disputed payment of \$280,000. Louise's legal counsel believes that there is a 35% probability that she will have to pay. There is no liability recognized on the statements, but a description of the lawsuit and an estimate of the amount of loss is disclosed.

@ Answer b) is correct. Because the probability of loss is less than 50%, it is not likely and no accrual is required. Disclosure of the nature and estimate of the amount of the contingent loss is required.

c. Louise's has sued Bruce's Manure, a supplier of bovine manure, for defamation. Louise's legal counsel has advised that Louise's is 95% certain to win the lawsuit and estimates the amount of the proceeds to be between \$300,000 and \$350,000. A receivable for \$300,000 has been recognized.

@ Answer c) is incorrect. Contingent gains are not recognized; however, the gain should be disclosed because the inflow of economic benefits is seen as probable. Answer b) is correct. Because the probability of loss is less than 50%, it is not likely and no accrual is required. Disclosure of the nature and estimate of the amount of the contingent loss is required.

d. Louise's has sued Rimmer's Reeds, a supplier of water flowers for \$400,000. Louise's legal counsel has advised that Louise's is 90% certain to win, but cannot accurately estimate the amount that Louise's will collect. A receivable for \$400,000 has been recognized.

@ Answer d) is incorrect. Contingent gains are not recognized; however, the gain should be disclosed as the inflow of economic benefits is seen as probable. Answer b) is correct. Because the probability of loss is less than 50%, it is not likely and no accrual is required. Disclosure of the nature and estimate of the amount of the contingent loss is required.

16. Academy Vending Machines Inc. (Academy), along with several other parties, is being sued for \$500,000 by a man who was badly burned when he spilled a cup of hot chocolate on himself at a skating rink.

Academy sold the hot chocolate machine to the rink during the year. At year end, Academy's lawyer and management team were unable to estimate the probability of a loss or the amount of the loss.

If Academy reports in accordance with ASPE, what is the appropriate treatment for the lawsuit in Academy's financial statements?

a. Accrue \$500,000 and disclose that the outcome of the lawsuit is not determinable.
@ Answer a) is incorrect. An accrual of \$500,000 is not appropriate if the outcome is not determinable and an estimate cannot be made. Answer d) is correct. Because the outcome is not determinable and the amount of the loss is not estimable, disclosure is appropriate.

b. Disclose \$500,000 and that the occurrence of the future event is unlikely.
@ Answer b) is incorrect. Academy's lawyer has not been able to determine whether or not Academy will lose the lawsuit; therefore, Academy cannot state that the loss is unlikely. Also, if the loss was unlikely, disclosure of the loss would not be required. Answer d) is correct. Because the outcome is not determinable and the amount of the loss is not estimable, disclosure is appropriate.

c. Accrue only a portion of the \$500,000, based on management's best estimate.
@ Answer c) is incorrect. An accrual of the losses is required only if the loss is likely and estimable. Neither of these conditions exists at the present time. Answer d) is correct. Because the outcome is not determinable and the amount of the loss is not estimable, disclosure is appropriate.

*d. Disclose \$500,000 and indicate that the result of the lawsuit is not determinable.
@ Answer d) is correct. Because the outcome is not determinable and the amount of the loss is not estimable, disclosure is appropriate.

17. Company A is a public company. They have:

- o A total of 100,000 common shares outstanding.
- o Six months before year end, Company A issued 20,000 debentures that are convertible into a total of 10,000 common shares.
- o All of these debentures are outstanding at year end.

In computing diluted earnings per share calculation, the following would apply:

a. The common shares arising from the convertible debenture issued during the period would be included from the date the current fiscal period began.

@ Answer a) is incorrect. Potential common shares arising from a dilutive convertible security issued during the period are not included from the date the current fiscal period began. Answer c) is correct. In accordance with the IAS 33.36, potential common shares arising from a dilutive convertible security issued during the period are included from the date of issuance of the dilutive security. Therefore, they must be weighted for the period the convertible debentures were outstanding.

b. Only the current common shares outstanding would be included in the denominator of the calculation.

@ Answer b) is incorrect. Potential common shares arising from a dilutive convertible security are included in the denominator. Answer c) is correct. In accordance with the IAS 33.36, potential common shares arising from a dilutive convertible security issued during the period are included from the date of issuance of the dilutive security. Therefore, they must be weighted for the period the convertible debentures were outstanding.

*c. The common shares arising from the dilutive convertible debenture issued during the period would be included from the date of issuance of the debenture.

@ Answer c) is correct. In accordance with the IAS 33.36, potential common shares arising from a dilutive convertible security issued during the period are included from the date of issuance of the dilutive security. Therefore, they must be weighted for the period the convertible debentures were outstanding.

d. The common shares arising from the convertible debenture issued during the period would only be included once converted.

@ Answer d) is incorrect. The potential common shares issued upon conversion are included in the denominator of the diluted earnings per shares calculation. Answer c) is correct. In accordance with the IAS 33.36, potential common shares arising from a dilutive convertible security issued during the period are included from the date of issuance of the dilutive security. Therefore, they must be weighted for the period the convertible debentures were outstanding.

18. As a government business enterprise, which accounting standards must the entity follow?

a. *CPA Canada PSA Handbook*

@ Answer a) is incorrect. Answer c) is correct. Government business enterprises must follow *CPA Canada Handbook – Accounting* for publicly accountable enterprises (IFRS).

b. *CPA Canada PSA Handbook* for not-for-profit organizations or *CPA Canada PSA Handbook* (without 4200 series)

@ Answer b) is incorrect. Answer c) is correct. Government business enterprises must follow *CPA Canada Handbook – Accounting* for publicly accountable enterprises (IFRS).

*c. *CPA Canada Handbook – Accounting* for publicly accountable enterprises (IFRS)

@ Answer c) is correct. Government business enterprises must follow *CPA Canada Handbook – Accounting* for publicly accountable enterprises (IFRS).

d. *CPA Canada PSA Handbook* or IFRS

@ Answer d) is incorrect. There is no choice of standards to follow. Answer c) is correct. Government business enterprises must follow *CPA Canada Handbook – Accounting* for publicly accountable enterprises (IFRS).

19. Which of the following is an objective of management discussion and analysis (MD&A)?

a. To compare the company's results with industry benchmarks

@ Answer a) is incorrect. Answer b) is correct. To supplement and complement the information provided in the financial statements is one of the objectives of the MD&A.

*b. To supplement and complement the information in the financial statements by helping readers understand what the financial statements show and do not show

@ Answer b) is correct. To supplement and complement the information provided in the financial statements is one of the objectives of the MD&A.

c. To provide information on the management team — in particular, their experience

@ Answer c) is incorrect. Answer b) is correct. To supplement and complement the information provided in the financial statements is one of the objectives of the MD&A.

d. To provide facts on subsequent events that are material and relevant to the reader

@ Answer d) is incorrect. Subsequent events are provided in the notes to the financial statements. Answer b) is correct. To supplement and complement the information provided in the financial statements is one of the objectives of the MD&A.

20. Jeff has just joined a company that provides a defined contribution pension plan as a benefit for its employees. Jeff has come to you, CPA, to understand this pension plan and the obligations of the employer and employee.

Which of the following statements represents a defined contribution pension plan?

a. The employer has an obligation to ensure that the plan assets are sufficient to pay for the employee's pension benefit.

@ Answer a) is incorrect. Under a defined contribution pension plan, the employer has no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to make pension payments.

b. The pension expense includes the current service cost, interest costs, and any returns on the plan assets.

@ Answer b) is incorrect. The defined contribution pension expense does not include the returns on the plan assets. It does include the current service cost and any interest costs on discounted current service or past service costs. Answer c) is correct because the plan defines the amount of current service cost and past service costs that must be paid annually by the employer.

*c. Annually, the employer pays fixed amounts that have been defined by the plan.

@ Answer c) is correct. The plan defines the amount of current service cost and past service costs that must be paid annually by the employer.

d. The employer guarantees a set amount to be paid on the employee's retirement.

@ Answer d) is incorrect. In a defined contribution pension plan, the employer does not guarantee a set pension amount and the employee bears the risk that there will be sufficient assets in the plan to fund retirement payments. Answer c) is correct because the plan defines the amount of current service cost and past service costs that must be paid annually by the employer.

21. Which of the following is considered a non-monetary item?

a. Accounts payable

@ Answer a) is incorrect. Accounts payable is a monetary item. Answer b) is correct. A customer list is an intangible asset and is considered a non-monetary item.

*b. Customer list

@ Answer b) is correct. A customer list is an intangible asset and is considered a non-monetary item.

c. Foreign exchange gain/loss

@ Answer c) is incorrect. This is the result of a translated monetary asset, but it is not a non-monetary item itself. As well, monetary and non-monetary items are typically balance sheet items, whereas a foreign exchange gain/loss is an income statement item. Answer b) is correct. A customer list is an intangible asset and is considered a non-monetary item.

d. Sales

@ Answer d) is incorrect. Sales is not a non-monetary item. As well, monetary and non-monetary items are typically balance sheet items, whereas a sales is an income statement item. Answer b) is correct. A customer list is an intangible asset and is considered a non-monetary item.

22. An entity's functional currency is the dollar (or equivalent) in the environment:

a. Where the largest purchases occurred

@ Answer a) is incorrect. Large purchases do not impact the entity's functional currency. Answer d) is correct because an entity's functional currency is the dollar (or equivalent) that it primarily uses in day-to-day operations.

b. In which its CEO resides

@ Answer b) is incorrect. The residence of the CEO does not impact the entity's functional currency. Answer d) is correct because an entity's functional currency is the dollar (or equivalent) that it primarily uses in day-to-day operations.

c. Where it has its head office located at the end of the year

@ Answer c) is incorrect. An entity cannot declare its own functional currency based on where its head office is located. Answer d) is correct because an entity's functional currency is the dollar (or equivalent) that it primarily uses in day-to-day operations.

*d. In which it operates day to day

@ Answer d) is correct. An entity's functional currency is the dollar (or equivalent) that it primarily uses in day-to-day operations.

23. On January 1, 20X3, Rider Corp. (Rider) issued share appreciation rights (SARs) to its management. The SARs will be cash settled.

What is the correct journal entry to derecognize the SARs assuming that they expire, and no payout is made?

a. Dr. SAR liability; Cr. Contributed surplus

@ Answer a) is incorrect. Compensation expense should be credited rather than contributed surplus. Answer c) is correct. The compensation expense that has been over stated in previous years is reversed in the current year.

b. Dr. Compensation expense; Cr SAR Liability

@ Answer b) is incorrect. This is to recognize the SAR, not to derecognize it. Answer c) is correct. The compensation expense that has been over stated in previous years is reversed in the current year.

*c. Dr. SAR Liability; Cr. Compensation expense

@ Answer c) is correct. The compensation expense that has been over stated in previous years is reversed in the current year.

d. Dr. SAR liability; Cr Cash

@ Answer d) is incorrect. As there was no payout, cash is not impacted. Answer c) is correct. The compensation expense that has been over stated in previous years is reversed in the current year.

24. Joe's Cycling Shop (Joe's), a private company selling both road and leisure bicycles, held a year-end sale. On December 31, Joe's year end, a customer wanted to purchase a road bike with a cost of \$3,000 and a sales price of \$3,500. The customer decided to pay \$200 to put the bike on hold under the agreement that he could walk away from the purchase within seven days and still have his money refunded. The accountant for Joe's recorded the following entry to recognize the arrangement on December 31:

Dr. Cash	\$200	
Dr. Accounts receivable	\$3,300	
Cr. Sales		\$3,500

You are performing the review engagement of Joe's. What adjusting entry, if any, would be required to account for this arrangement properly?

a. Dr. Cost of goods sold \$3,000; Cr. Inventory \$3,000

@ Answer a) is incorrect. This adjusting entry recognizes the costs related to \$3,500 in sales, but no sale has taken place. Joe's has only received a deposit to hold the bicycle, but there is no obligation for the customer to buy the bicycle. Control of the asset has not been transferred to the customer. Answer c) is correct. This adjusting entry (Dr. Sales \$3,500; Cr. Accounts receivable \$3,300, Cr. Deferred revenue \$200) properly accounts for the customer deposit as deferred revenue (a liability) and the cash received. The customer has only paid a deposit and has not agreed to buy the bicycle; therefore, no sale has taken place.

b. Dr. Sales \$3,300; Cr. Accounts receivable \$3,300

@ Answer b) is incorrect. This adjusting entry recognizes \$200 in sales but no sale has taken place. Joe's has only received a deposit to hold the bicycle, but there is no obligation for the customer to buy the bicycle. Control of the bike has not been transferred to the customer. Answer c) is correct. This adjusting entry (Dr. Sales \$3,500; Cr. Accounts receivable \$3,300, Cr. Deferred revenue \$200) properly accounts for the customer deposit as deferred revenue (a liability) and the cash received. The customer has only paid a deposit and has not agreed to buy the bicycle; therefore, no sale has taken place.

*c. Dr. Sales \$3,500; Cr. Accounts receivable \$3,300, Cr. Deferred revenue \$200

@ Answer c) is correct. This adjusting entry properly accounts for the customer deposit as deferred revenue (a liability) and the cash received. The customer has only paid a deposit and has not agreed to buy the bicycle; therefore, no sale has taken place.

d. Dr. Sales \$200; Cr. Deferred revenue \$200

@ Answer d) is incorrect. This adjusting entry does not recognize the initial journal entry. The initial entry recognizes \$3,500 in sales, but no sale has taken place. Joe's has only received a deposit to hold the bicycle, but there is no obligation for the potential customer to buy the bicycle and the adjusting entry does not adjust the remaining \$3,300 revenue amount. Control of the bike has not been transferred to the customer. Answer c) is correct. This adjusting entry (Dr. Sales \$3,500; Cr. Accounts receivable \$3,300, Cr. Deferred revenue \$200) properly accounts for the customer deposit as deferred revenue (a liability) and the cash received. The customer has only paid a deposit and has not agreed to buy the bicycle; therefore, no sale has taken place.

25. Under IFRS, intangible assets that may be capitalized include:

a. Internally generated goodwill

@ Answer a) is incorrect. Under IFRS, internally generated goodwill cannot be recognized as an asset (IAS 38.48). Answer c) is correct because overhead costs directly related to development activities of preparing the asset for use are eligible for capitalization. These costs have a future benefit, they can be distinguished from other costs, and they can be appropriately measured (IAS 38.66).

b. Internally developed brands

@ Answer b) is incorrect. Under IFRS, the costs of internally developed brands cannot be distinguished and measured, and are specifically excluded from capitalization for these reasons (IAS 38.63). Answer c) is correct because overhead costs directly related to development activities of preparing the asset for use are eligible for capitalization. These costs have a future benefit, they can be distinguished from other costs, and they can be appropriately measured (IAS 38.66).

*c. Overhead costs directly related to development activities

@ Answer c) is correct. Overhead costs directly related to development activities of preparing the asset for use are eligible for capitalization. These costs have a future benefit, they can be distinguished from other costs, and they can be appropriately measured (IAS 38.66).

d. Borrowing costs related to research activities

@ Answer d) is incorrect. Under IFRS, borrowing costs related to research cannot be recognized as an asset (IAS 38.54). Answer c) is correct because overhead costs directly related to development activities of preparing the asset for use are eligible for capitalization. These costs have a future benefit, they can be distinguished from other costs, and they can be appropriately measured (IAS 38.66).

26. Carson Inc. spent \$25,000 to develop a new open office concept expected to improve efficiency. Carson Inc. has patented the concept and plans to implement it in its own office before licensing it out to other companies. No new equipment or other expenditures were incurred. Carson Inc.'s CFO, Jim Peltice, reviewed all costs and noted no research amounts. Jim believes that all costs incurred are development costs per IAS 38 *Intangible Assets*.

How should Carson Inc. record the \$25,000 redesign cost?

a. Add the \$25,000 redesign cost to the cost of the office building as a betterment and amortize it over the remaining life of the building.

@ Answer a) is incorrect. The \$25,000 redesign cost does not improve the future benefit of the building, but rather efficiency of the business. Answer b) is correct because the specifically identifiable intangible asset should be amortized over the estimated period of benefit.

*b. Record the \$25,000 redesign cost as a specifically identifiable intangible asset if future benefit is likely and amortize it over the estimated period of benefit.

@ Answer b) is correct. The specifically identifiable intangible asset should be amortized over the estimated period of benefit.

c. Expense the \$25,000 redesign cost as a period cost.

@ Answer c) is incorrect. The \$25,000 redesign cost should be expensed as a period cost only if future benefit is not likely and the period of benefit cannot be estimated. It appears that the improved efficiency is likely, and therefore future benefits would be likely. Answer b) is correct because the specifically identifiable intangible asset should be amortized over the estimated period of benefit.

d. Record the \$25,000 redesign cost as goodwill since it improves the efficiency of the business.

@ Answer d) is incorrect. Internally generated goodwill cannot be recorded; goodwill must be acquired in a business purchase in order to be recognized, per IAS 38.48. Answer b) is correct because the specifically identifiable intangible asset should be amortized over the estimated period of benefit.

27. Whirlwind Inc. (WI) received a grant from the Canadian government in the current fiscal year. The grant of \$200,000 was paid to WI before the December 31, 20X7 year end to offset salary costs to be incurred in fiscal 20X8. WI will be entitled to this grant if it employs a specified number of students during 20X8. WI management is certain that the required student employment threshold will be met. WI applies IFRS.

What is the appropriate journal entry for WI to record in fiscal 20X7 with respect to the government grant?

a.

Dr. Cash	\$200,000	
Cr. Salary expense		\$200,000

@ Answer a) is incorrect. Answer c) is correct. Since the grant is intended for use against 20X8 salary expenses as long as the condition is met, the reduction in expense/increase in income should not be reported until 20X8. It must be shown as a liability in 20X7. The reduction in salary expenses must be recorded as a reduction in expenses in the following fiscal year. Per IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, paragraph 12: "Government grants shall be recognized in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate."

b.

Dr. Cash	\$200,000	
Cr. Grant revenue		\$200,000

@ Answer b) is incorrect. Answer c) is correct. Since the grant is intended for use against 20X8 salary expenses as long as the condition is met, the reduction in expense/increase in income should not be reported until 20X8. It must be shown as a liability in 20X7. Per IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, paragraph 12: "Government grants shall be recognized in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate."

*c.

Dr. Cash	\$200,000	
Cr. Deferred grant revenue		\$200,000

@ Answer c) is correct. Since the grant is intended for use against 20X8 salary expenses, the reduction in expense/increase in income should not be reported until 20X8 as long as the condition as been met. It must be shown as a liability in 20X7. Per IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, paragraph 12: "Government grants shall be recognized in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate."

d. No journal entry is to be recorded until 20X8.

@ Answer d) is incorrect. The cash was received in 20X7, so a journal entry must be recorded. Answer c) is correct. Since the grant is intended for use against 20X8 salary expenses as long as the condition has been met, the reduction in expense/increase in income should not be reported until 20X8. It must be shown as a liability in 20X7. Per IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, paragraph 12: "Government grants shall be recognized in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate."

28. In 20X7, the federal government provided land to Bomb Inc. (BI) to use in its business operations into the foreseeable future. The land had a fair market value of \$55,000 and BI paid \$0 to the federal government for the land use. BI uses IFRS to prepare its financial statements.

Which of the following is the best description of how to account for this grant?

a. The land was received for free by BI so a transaction is not recorded. However, note disclosure is required.

@ Answer a) is incorrect. Answer b) is correct because a transaction is needed to record the grant and the related asset either at the fair market value of the land or at a nominal amount. Per IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, paragraph 23:

A government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In these circumstances, it is usual to assess the fair value of the non-monetary asset and to account for both grant and asset at that fair value. An alternative course that is sometimes followed is to record both asset and grant at a nominal amount.

*b. BI has the option of recording the grant and related asset at fair value or assigning a nominal amount to the grant and related asset.

@ Answer b) is correct. Per IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, paragraph 23:

A government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In these circumstances, it is usual to assess the fair value of the non-monetary asset and to account for both grant and asset at that fair value. An alternative course that is sometimes followed is to record both asset and grant at a nominal amount.

c. BI records a deferred grant at fair value and recognizes the grant over the expected period of usage of the land.

@ Answer c) is incorrect. Answer b) is correct because the grant and the related asset can be recorded either at the fair market value of the land or at a nominal amount. Per IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, paragraph 23:

A government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In these circumstances, it is usual to assess the fair value of the non-monetary asset and to account for both grant and asset at that fair value. An alternative course that is sometimes followed is to record both asset and grant at a nominal amount.

d. BI must obtain an appraisal for the land and record the grant and related asset at fair value.

@ Answer d) is incorrect. Answer b) is correct because the grant and the related asset can be recorded either at the fair market value of the land or at a nominal amount. Per IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, paragraph 23:

A government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In these circumstances, it is usual to assess the fair value of the non-monetary asset and to account for both grant and asset at that fair value. An alternative course that is sometimes followed is to record both asset and grant at a nominal amount.

29. Which of the following is a difference in impairment between IFRS and ASPE?

*a. IFRS requires an assessment of indicators of impairment at least every reporting date, while ASPE requires assessment only when events or a change in circumstances require it.

@ Answer a) is correct. This describes a difference between IFRS and ASPE.

Paragraph 9 of IAS 36 *Impairment of Assets*: “An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.”

Paragraph 9 of ASPE Section 3063 *Impairment of Long-Lived Assets*: “A long-lived asset shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.”

b. Reversals of impairment losses are permitted under ASPE up to the original cost of the asset, while reversals are not permitted under IFRS.

@ Answer b) is incorrect. This is not a valid difference between ASPE and IFRS. IFRS permits reversals while ASPE does not. Answer a) is correct because it describes a difference between IFRS and ASPE. Paragraph 9 of IAS 36 *Impairment of Assets*: “An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.” Paragraph 9 of ASPE Section 3063 *Impairment of Long-Lived Assets*: “A long-lived asset shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.”

c. ASPE uses discounted cash flows in assessing the recoverable amount, while IFRS uses the undiscounted cash flows.

@ Answer c) is incorrect. IFRS uses discounted cash flows when assessing the recoverable amount, whereas ASPE initially uses the undiscounted cash flows to determine if a second level of testing is required to determine fair value. Answer a) is correct because it describes a difference between IFRS and ASPE. Paragraph 9 of IAS 36 *Impairment of Assets*: “An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.” Paragraph 9 of ASPE Section 3063 *Impairment of Long-Lived Assets*: “A long-lived asset shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.”

d. Determining if impairment exists under the ASPE model compares the carrying amount to the higher of the value in use and the fair value less costs of disposal. The IFRS model compares the carrying amount to the undiscounted future net cash flows from use and disposal.

@ Answer d) is incorrect. Recognition of impairment under the IFRS model compares the carrying amount to the higher of the value in use and the fair value less costs of disposal. The ASPE model compares the carrying amount to the undiscounted future net cash flows from use and disposal. Answer a) is correct because it describes a difference between IFRS and ASPE. Paragraph 9 of IAS 36 *Impairment of Assets*: “An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.” Paragraph 9 of ASPE Section 3063 *Impairment of Long-Lived Assets*: “A long-lived asset shall be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.”

30. Nuts and Bolts Inc. (NBI) reports its financial statements in accordance with ASPE. Manufacturing equipment used to manufacture products that have not been selling as well as expected has been identified as potentially impaired. Relevant information to assist management in accounting for the equipment properly is as follows:

Cost of equipment	\$200,000
Accumulated depreciation — equipment	\$40,000
Undiscounted future net cash flows associated with the equipment (estimated)	\$120,000
Fair value of equipment	\$100,000

What is the impairment loss to be reported by NBI with respect to this equipment?

a. \$40,000

@ Answer a) is incorrect. The loss was calculated by taking the difference between the carrying value of the equipment and the undiscounted future cash flows. Proof of incorrect answer: $(\$200,000 - \$40,000) - \$120,000 = \$40,000$. Answer b) is correct because the loss of \$60,000 should be calculated as follows, per ASPE 3063.05-.06: “The carrying amount of a long-lived asset is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition. This assessment is based on the carrying amount of the asset at the date it is tested for recoverability, whether it is in use or under development. An impairment loss shall be measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value.”

*b. \$60,000

@ Answer b) is correct. The loss was calculated by taking the difference between the carrying value of the equipment and the fair value. Proof of correct answer: $(\$200,000 - \$40,000) - \$100,000 = \$60,000$. This is in accordance with ASPE 3063.05-.06: “The carrying amount of a long-lived asset is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition. This assessment is based on the carrying amount of the asset at the date it is tested for recoverability, whether it is in use or under development. An impairment loss shall be measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value.”

c. \$80,000

@ Answer c) is incorrect. The loss was calculated by taking the difference between the cost of the equipment and the undiscounted future cash flows. Proof of incorrect answer: $\$200,000 - \$120,000 = \$80,000$. Answer b) is correct because the loss of \$60,000 should be calculated as follows, per ASPE 3063.05-.06: "The carrying amount of a long-lived asset is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition. This assessment is based on the carrying amount of the asset at the date it is tested for recoverability, whether it is in use or under development. An impairment loss shall be measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value."

d. \$100,000

@ Answer d) is incorrect. The loss was calculated by taking the difference between the cost of the equipment and the fair value. Proof of incorrect answer: $\$200,000 - \$100,000 = \$100,000$. Answer b) is correct because the loss of \$60,000 should be calculated as follows, per ASPE 3063.05-.06: "The carrying amount of a long-lived asset is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition. This assessment is based on the carrying amount of the asset at the date it is tested for recoverability, whether it is in use or under development. An impairment loss shall be measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value."

31. ABC Co. is a privately owned company that reports under ASPE. For the year ending December 31, 20X6, the company reported earnings before tax of \$100,000. The following additional information is available:

Depreciation	\$20,000
Meals and entertainment	\$2,000
Maximum possible capital cost allowance (CCA) claim	\$25,000
Applicable tax rate	20%

What is the journal entry to record the total income tax expense for the year, assuming the company uses the taxes payable method and wishes to minimize taxes?

a. Dr. Income tax expense \$20,000; Cr. Income taxes payable \$20,000

@ Answer a) is incorrect. $\$100,000 \times 20\% = \$20,000$. The increase to income tax expense was based on accounting income before tax, multiplied by the tax rate.

Schedule 1 adjustments were not considered. Answer b) is correct. The \$19,200 debit to income tax expense is calculated as follows:

Net income before tax	\$100,000
Add back depreciation	20,000
Add back non-deductible portion of meals and entertainment	1,000
Less CCA	(25,000)
Net income and taxable income	96,000
Tax rate	20%
Income tax expense	\$ 19,200

*b. Dr. Income tax expense \$19,200; Cr. Income taxes payable \$19,200

@ Answer b) is correct. The \$19,200 debit to income tax expense is calculated as follows:

Net income before tax	\$100,000
Add back depreciation	20,000
Add back non-deductible portion of meals and entertainment	1,000
Less CCA	(25,000)
Net income and taxable income	96,000
Tax rate	20%
Income tax expense	\$ 19,200

c. Dr. Income tax expense \$20,200; Cr. Income taxes payable \$19,200, Cr. Future income tax liability \$1,000

@ Answer c) is incorrect. This option recorded an additional \$1,000 [$(\$25,000 - \$20,000) \times 20\%$] of income tax expense in 20X6, resulting from the difference between the depreciation expense and the maximum CCA deduction. The future income tax method was incorrectly applied, as the question states that the company uses the taxes payable method, not the future income tax method of calculating income tax expense. Answer b) is correct. The \$19,200 debit to income tax expense is calculated as follows:

Net income before tax	\$100,000
Add back depreciation	20,000
Add back non-deductible portion of meals and entertainment	1,000
Less CCA	(25,000)
Net income and taxable income	96,000
Tax rate	20%
Income tax expense	\$ 19,200

d. Dr. Income tax expense \$19,000, Cr. Income taxes payable \$19,000

@ Answer d) is incorrect. The \$19,000 debit to income tax expense is calculated as follows:

Net income before tax	\$100,000
Add back depreciation	20,000
Less CCA	(25,000)
Net income and taxable income	95,000
Tax rate	20%
Income tax expense	\$ 19,000

This calculation is incorrect because it does not factor in the non-deductible portion of meals and entertainment into the calculation of taxes payable. Answer b) is correct. The \$19,200 debit to income tax expense is calculated as follows:

Net income before tax	\$100,000
Add back depreciation	20,000
Add back non-deductible portion of meals and entertainment	1,000
Less CCA	(25,000)
Net income and taxable income	96,000
Tax rate	20%
Income tax expense	\$ 19,200

32. Which of the following statements is true with respect to accounting for income taxes?

a. Under IFRS, companies may choose to use either the deferred method or the taxes payable method.

@ Answer a) is incorrect. Under IFRS, companies have no choice and must use the deferred income tax method. Answer d) is correct. Under ASPE, discounting of future income tax assets and liabilities is not allowed (paragraph 52 of ASPE Section 3465 *Income Taxes*).

b. Under ASPE, companies must use the taxes payable method.

@ Answer b) is incorrect. Under ASPE, companies have the choice to use the taxes payable method or the future income tax method. Answer d) is correct. Under ASPE, discounting of future income tax assets and liabilities is not allowed (paragraph 52 of ASPE Section 3465 *Income Taxes*).

c. Under IFRS, the deferred income tax asset and the deferred income tax liability accounts are classified as current or noncurrent, according to the type of asset or liability that created them.

@ Answer c) is incorrect. Under IFRS, companies classify all deferred income tax assets and liabilities as noncurrent. Answer d) is correct. Under ASPE, discounting of future income tax assets and liabilities is not allowed (paragraph 52 of ASPE Section 3465 *Income Taxes*).

*d. Under ASPE, companies choosing to use the future income tax method are not allowed to discount future income tax assets and liabilities.

@ Answer d) is correct. Under ASPE, discounting of future income tax assets and liabilities is not allowed (paragraph 52 of ASPE Section 3465 *Income Taxes*).

33. Which of the following describes a change in an estimate?

a. A company changes the presentation of operating expenses from “by function” to “by nature.”

@ Answer a) is incorrect. The presentation of expenses is an accounting policy choice in IFRS. Answer d) is correct. A change in the useful life of an asset as a result of new information is a change in an estimate.

b. An enterprise switches from the gross method to the net method of presenting government grants.

@ Answer b) is incorrect. The gross method is an accounting policy choice for accounting for government grants. Answer d) is correct. A change in the useful life of an asset as a result of new information is a change in an estimate.

c. A temporary difference was treated as a permanent difference when calculating deferred taxes (IFRS)/future taxes (ASPE).

@ Answer c) is incorrect. This would be considered an error. Answer d) is correct. A change in the useful life of an asset as a result of new information is a change in an estimate.

*d. The useful life of a building was originally estimated to be 20 years but, based on new information available, it was changed to 15 years as at the beginning of the year.

@ Answer d) is correct. A change in the useful life of an asset as a result of new information is a change in an estimate.

34. Which of the following circumstances requires prospective treatment?

a. Your client amortizes computer hardware over four years and computer software over two years. While preparing the current-year financial statements, it is discovered that all computer hardware and software were amortized over two years.

@ Answer a) is incorrect. Because this is an accounting error, this item requires retrospective correction. Answer b) is correct. A change in the useful life of an asset as a result of new information is a change in an estimate, requiring prospective treatment.

*b. Your client purchased some new equipment last year and determined that it should be amortized over five years. In the current year, a new model of the equipment was announced and your client plans on replacing the equipment next year. Your client has revised the amortization period of the existing equipment to the two remaining years.

@ Answer b) is correct. A change in the useful life of an asset as a result of new information is a change in an estimate, requiring prospective treatment.

c. In the current period, your client decided to switch from a straight-line method to a declining-balance method of amortization for a building your client owns because it determined that a competitor uses the declining-balance method of amortization for its buildings.

@ Answer c) is incorrect. Because this is a change in accounting policy, this item requires retrospective treatment. Answer b) is correct. A change in the useful life of an asset as a result of new information is a change in an estimate, requiring prospective treatment.

d. In reviewing the amortization schedule for last year, an adding error was found, which resulted in an overstatement of prior-year amortization expense of \$10,000.

@ Answer d) is incorrect. Because this is an error, this item requires retrospective adjustment. Answer b) is correct. A change in the useful life of an asset as a result of new information is a change in an estimate, requiring prospective treatment.

35. Red Rocket Inc. had a beginning inventory on January 1 of 300 boxes of fuses at a cost of \$9 per box. During the year, the following transactions occurred:

	Transaction	Boxes	Cost
February 10	Purchase	700	\$7
March 20	Sale	500	
October 30	Purchase	100	\$12
November 15	Sale	400	

Determine ending inventory using the FIFO (first in, first out) cost formula.

*a. \$1,900

@ Answer a) is correct. Ending inventory of \$1,900 is determined as follows:

	Purchases			Cost of goods sold			Inventory balance		
	Units	Cost	Total	Units	Cost	Total	Units	Cost	Total
Opening							300	\$9	\$2,700
Feb 10	700	\$7	\$4,900				300 700	\$9 \$7	\$7,600
March 20				300 200	\$9 \$7	\$4,100	500	\$7	\$3,500
Oct 30	100	\$12	\$1,200				500 100	\$7 \$12	\$4,700
Nov 15				400	\$7	\$2,800	100 100	\$7 \$12	\$1,900

b. \$1,800

@ Answer b) is incorrect. Ending inventory was determined using the LIFO (last in, first out) cost formula ($200 \times \$9$). Answer a) is correct because ending inventory of \$1,900 is determined as follows:

	Purchases			Cost of goods sold			Inventory balance		
	Units	Cost	Total	Units	Cost	Total	Units	Cost	Total
Opening							300	\$9	\$2,700
Feb 10	700	\$7	\$4,900				300 700	\$9 \$7	\$7,600
March 20				300 200	\$9 \$7	\$4,100	500	\$7	\$3,500
Oct 30	100	\$12	\$1,200				500 100	\$7 \$12	\$4,700
Nov 15				400	\$7	\$2,800	100 100	\$7 \$12	\$1,900

c. \$1,666

@ Answer c) is incorrect. Ending inventory was determined using the weighted average cost formula on a perpetual basis. Answer a) is correct because ending inventory of \$1,900 is determined as follows:

	Purchases			Cost of goods sold			Inventory balance		
	Units	Cost	Total	Units	Cost	Total	Units	Cost	Total
Opening							300	\$9	\$2,700
Feb 10	700	\$7	\$4,900				300 700	\$9 \$7	\$7,600
March 20				300 200	\$9 \$7	\$4,100	500	\$7	\$3,500
Oct 30	100	\$12	\$1,200				500 100	\$7 \$12	\$4,700
Nov 15				400	\$7	\$2,800	100 100	\$7 \$12	\$1,900

d. \$1,600

@ Answer d) is incorrect. Ending inventory was determined using the weighted average cost formula on a periodic basis. Answer a) is correct because ending inventory of \$1,900 is determined as follows:

	Purchases			Cost of goods sold			Inventory balance		
	Units	Cost	Total	Units	Cost	Total	Units	Cost	Total
Opening							300	\$9	\$2,700
Feb 10	700	\$7	\$4,900				300 700	\$9 \$7	\$7,600
March 20				300 200	\$9 \$7	\$4,100	500	\$7	\$3,500
Oct 30	100	\$12	\$1,200				500 100	\$7 \$12	\$4,700
Nov 15				400	\$7	\$2,800	100 100	\$7 \$12	\$1,900

36. Kaltech manufactures toolboxes for trucks in Sudbury, and maintains a head office in Toronto. The toolboxes are painted in a paint booth that requires Kaltech to adhere to strict safety standards, including always having a safety supervisor on site. Kaltech has a manufacturing facility and a separate sales and administration building.

Which of the following would be included in the value of finished goods inventory?

*a. Safety supervisor's wages

@ Answer a) is correct. The safety supervisor's wages are a direct cost and should be included in the value of inventory.

b. Amortization on the corporate headquarters

@ Answer b) is incorrect. Paragraph 12 of IAS 2 *Inventories* allows for an allocation of fixed costs (which are part of the production of the inventory) to the value of finished goods inventory, not amortization on corporate head offices. Answer a) is correct because the safety supervisor's wages are a direct cost and should be included in the value of inventory.

c. Storage costs, once production is complete

@ Answer c) is incorrect. While paragraph 16(b) of IAS 2 *Inventories* allows for storage costs to be added to the cost of inventory, where the storage costs are necessary in the production process before a further production stage, the same standard excludes post-production storage costs from being added to the cost of finished goods inventory. Answer a) is correct because the safety supervisor's wages are a direct cost and should be included in the value of inventory.

d. CEO's wages

@ Answer d) is incorrect. The CEO's salary is not a part of manufacturing overhead. Answer a) is correct because the safety supervisor's wages are a direct cost and should be included in the value of inventory.

37. Which of the following statements is true when evaluating whether a lease is a finance lease or an operating lease from the lessor's perspective under IFRS?

a. A lease is classified as an operating lease if the lease term is for the major part of the economic life of the asset.

@ Answer a) is incorrect. This statement is false. Where the lease term is for the major part of the economic life of the asset, the lessee will receive substantially all of the economic benefits that are expected to be realized over the life of the leased asset, supporting the classification of the lease as a finance lease. Answer c) is correct because if there is a bargain purchase option (BPO) in the lease, there is reasonable assurance that the lessee will obtain ownership of the leased asset at the end of the lease term, supporting classification of the lease as a finance lease. Conversely, if there is no BPO, then the lease could be an operating lease.

b. A leased asset is classified as an operating lease if the leased asset is specialized.

@ Answer b) is incorrect. This statement is false. Where the leased asset is specialized and is only of use to the lessee, this supports the classification of the lease as a finance lease, rather than an operating lease. Answer c) is correct because if there is a bargain purchase option (BPO) in the lease, there is reasonable assurance that the lessee will obtain ownership of the leased asset at the end of the lease term, supporting classification of the lease as a finance lease. Conversely, if there is no BPO, then the lease could be an operating lease.

*c. A leased asset could be classified as an operating lease if there is no bargain purchase option (BPO) in the lease.

@ Answer c) is correct. If there is a bargain purchase option (BPO) in the lease, there is reasonable assurance that the lessee will obtain ownership of the leased asset at the end of the lease term, supporting classification of the lease as a finance lease. Conversely, if there is no BPO, then the lease could be an operating lease.

d. A leased asset is classified as an operating lease if the present value of the minimum lease payments is substantially all of the fair value of the leased asset.

@ Answer d) is incorrect. This statement is false. Where the present value of the minimum lease payments is substantially all of the fair value of the leased asset, the lessor is able to earn a return on the investment and to recover substantially all of its investment in the leased asset, supporting the lease's classification as a finance lease rather than an operating lease. Answer c) is correct because if there is a bargain purchase option (BPO) in the lease, there is reasonable assurance that the lessee will obtain ownership of the leased asset at the end of the lease term, supporting classification of the lease as a finance lease. Conversely, if there is no BPO, then the lease could be an operating lease.

38. On January 1, 20X6, Beatty Inc. entered into a five-year lease to acquire some machinery. Beatty reports under ASPE and is the lessee. The terms of the lease are as follows:

- o Lease payments of \$25,000 are made annually on the first day of the year.
- o Included in the annual lease payments are maintenance fees of \$2,000 per year.
- o The machinery reverts to the lessor at the end of the lease and the lease contains no renewal options.
- o Beatty uses straight-line depreciation for the machinery that it owns.
- o The machinery has a fair value of \$100,000 on January 1, 20X6, and has an estimated economic life of five years with no residual value.
- o Beatty's incremental borrowing rate is 11% per year.
- o The lease's implicit interest rate is 10%.

What is the present value of the minimum lease payments at the inception date?

*a. \$95,907

@ Answer a) is correct. The present value of the minimum lease payments = \$23,000 (\$25,000 – \$2,000 in maintenance fees) × present value of an annuity due at the beginning of the period for five periods at 10% = \$23,000 × 4.16986 = \$95,907 or $PV(.10, 5, -23000, 0, 1)$. The lessor's implicit rate of 10% was correctly used instead of the lessee's incremental borrowing rate of 11%, as this is the lower of the two rates. ASPE states that the lower of the two rates must be used when calculating the present value of the minimum lease payments.

b. \$94,356

@ Answer b) is incorrect. Proof of calculation: The present value of the minimum lease payments = \$23,000 (\$25,000 – \$2,000 in maintenance fees) × present value of an annuity due at the beginning of the period for five periods at 11% = \$23,000 × 4.10245 = \$94,356 or $PV(.11, 5, -23000, 0, 1)$. The lessee's incremental borrowing rate of 11% was incorrectly used instead of the lessor's implicit rate of 10%. ASPE states that the lower of the lessor's implicit rate and the lessee's incremental borrowing rate must be used when calculating the present value of the minimum lease payments. Answer a) is correct because the present value of the minimum lease payments = \$23,000 (\$25,000 – \$2,000 in maintenance fees) × present value of an annuity due at the beginning of the period for five periods at 10% = \$23,000 × 4.16986 = \$95,907 or $PV(.10, 5, -23000, 0, 1)$.

c. \$104,247

@ Answer c) is incorrect. Proof of calculation: The present value of the minimum lease payments = $\$25,000 \times$ present value of an annuity due at the beginning of the period for five periods at 10% = $\$25,000 \times 4.16986 = \$104,247$ or $PV(.10,5,-25000,0,1)$. The lessor's implicit rate of 10% was correctly used instead of the lessee's incremental borrowing rate of 11%, as this is the lower of the two rates. ASPE states that the lower of the two rates must be used when calculating the present value of the minimum lease payments. This calculation is incorrect because the \$2,000 in maintenance fees was not removed from the annual lease payment. Answer a) is correct because the present value of the minimum lease payments = $\$23,000$ ($\$25,000$ less \$2,000 in maintenance fees) \times present value of an annuity due at the beginning of the period for five periods at 10% = $\$23,000 \times 4.16986 = \$95,907$ or $PV(.10,5,-23000,0,1)$.

d. \$102,561

@ Answer d) is incorrect. Proof of calculation: The present value of the minimum lease payments = $\$25,000 \times$ present value of an annuity due at the beginning of the period for five periods at 11% = $\$25,000 \times 4.10245 = \$102,561$ or $PV(.11,5,-25000,0,1)$. The lessee's incremental borrowing rate of 11% was incorrectly used instead of the lessor's implicit rate of 10%. ASPE states that the lower of the lessor's implicit rate and the lessee's incremental borrowing rate must be used when calculating the present value of the minimum lease payments. Also, the \$2,000 in maintenance fees was not removed from the annual lease payment. Answer a) is correct because the present value of the minimum lease payments = $\$23,000$ ($\$25,000$ less \$2,000 in maintenance fees) \times present value of an annuity due at the beginning of the period for five periods at 10% = $\$23,000 \times 4.16986 = \$95,907$ or $PV(.10,5,-23000,0,1)$.

39. During the year, MNR Ltd. entered into a contract to provide monthly consulting services to XYZ Inc. The contract is expected to last for 12 months. It commenced on March 1, and MNR's year end is October 31. The total value of the contract is \$120,000. XYZ paid the full amount on July 11.

Which of the following statements is correct with respect to MNR's October 31 financial statements?

*a. MNR should record \$40,000 as deferred revenue because the contract is not complete.

@ Answer a) is correct. The performance obligation is satisfied over time as the service is provided. The portion of the contract fee that has yet to be earned at October 31 should be recorded as deferred revenue for the period November 1 to February 28 = $4/12 \times \$120,000$: \$40,000.

b. MNR should record \$80,000 as deferred revenue because that is the amount earned.

@ Answer b) is incorrect. Revenue has been earned for eight months from March 1 to October 31 ($8/12 \times \$120,000 = \$80,000$). Because \$80,000 in revenue has been earned, it should not be recorded as deferred revenue on the October 31 financial statements. Answer a) is correct. The performance obligation is satisfied over time as the service is provided. The portion of the contract fee that has yet to be earned at October 31 should be recorded as deferred revenue for the period November 1 to February 28 = $4/12 \times \$120,000$: \$40,000.

c. MNR should record \$120,000 as deferred revenue because the contract is not yet complete.

@ Answer c) is incorrect. Revenue has been earned for eight months from March 1 to October 31 ($8/12 \times \$120,000 = \$80,000$). Because this revenue has been earned, it can be recorded as revenue on the October 31 financial statements. Answer a) is correct. The performance obligation is satisfied over time as the service is provided. The portion of the contract fee that has yet to be earned at October 31 should be recorded as deferred revenue for the period November 1 to February 28: $4/12 \times \$120,000 = \$40,000$.

d. MNR should record \$120,000 as revenue because that is the amount of cash received.

@ Answer d) is incorrect. This answer assumes that the entire contract fee has been earned as at October 31. This assumption is incorrect because the contract will not be completed until February — there are still four months of consulting services that have yet to be provided. Answer a) is correct. The performance obligation is satisfied over time as the service is provided. The portion of the contract fee that has yet to be earned at October 31 should be recorded as deferred revenue for the period November 1 to February 28: $4/12 \times \$120,000 = \$40,000$.

40. Waterworks Inc. reported maintenance service costs on a cash basis for 20X6 of \$100,000. In 20X5, Waterworks paid \$20,000 for maintenance services to be performed in 20X6. In 20X6, Waterworks paid \$7,000 in advance for services to be provided in 20X7. Waterworks received maintenance services of \$12,000 in 20X6, which were not paid until 20X7.

What amount should Waterworks report for maintenance services for 20X6, if it reports on an accrual basis?

a. \$85,000

@ Answer a) is incorrect. This amount deducted the services paid in advance in 20X5 and that were received in 20X6 rather than adding them. $\$100,000 - \$20,000 + \$12,000 - \$7,000 = \$85,000$. Answer c) is correct. The correct amount is $\$100,000 + \$20,000 + \$12,000 - \$7,000 = \$125,000$.

b. \$105,000

@ Answer b) is incorrect. This amount excluded the amount paid in advance in 20X5. $\$100,000 + \$12,000 - \$7,000 = \$105,000$. Answer c) is correct. The correct amount is $\$100,000 + \$20,000 + \$12,000 - \$7,000 = \$125,000$.

*c. \$125,000

@ Answer c) is correct. The correct amount is $\$100,000 + \$20,000 + \$12,000 - \$7,000 = \$125,000$.

d. \$139,000

@ Answer d) is incorrect. This amount added the amount that was paid in 20X6 but is for 20X7 services. $\$100,000 + \$20,000 + \$12,000 + \$7,000 = \$139,000$. Answer c) is correct. The correct amount is $\$100,000 + \$20,000 + \$12,000 - \$7,000 = \$125,000$.

41. You, CPA, are preparing a comparison of ASPE versus IFRS for a professional development session. You are looking at how ASPE and IFRS account for non-monetary transactions (NMTs). Which of the statements below is true?

a. IFRS and ASPE standards are completely converged in terms of NMTs; there are no differences.

@ Answer a) is incorrect. Answer b) is correct because the main difference is that under IFRS (IFRS 15 *Revenue from Contracts with Customers*), non-monetary, revenue-generating transactions are recorded at the fair value of the asset received, unless it is unknown, in which case the fair value of the asset given up is used. Under ASPE (Section 3831 *Non-monetary Transactions*), the transaction is measured at the more reliably measurable of the fair value of the asset given up and the fair value of the asset received. When both are reliably measurable, the fair value of the asset given up is used.

*b. IFRS requires non-monetary, revenue-generating transactions to be recorded at the fair value of the asset received when known.

@ Answer b) is correct. The main difference is that under IFRS (IFRS 15 *Revenue from Contracts with Customers*), non-monetary, revenue-generating transactions are recorded at the fair value of the asset received, unless it is unknown, in which case the fair value of the asset given up is used. Under ASPE (Section 3831 *Non-monetary Transactions*), the transaction is measured at the more reliably measurable of the fair value of the asset given up and the fair value of the asset received. When both are reliably measurable, the fair value of the asset given up is used.

c. IFRS does not provide guidance on measurement of NMTs and ASPE does.

@ Answer c) is incorrect. While ASPE has a separate section for NMTs, IFRS does provide guidance within individual sections. Answer b) is correct because the main difference is that under IFRS (IFRS 15 *Revenue from Contracts with Customers*), non-monetary, revenue-generating transactions are recorded at the fair value of the asset received, unless it is unknown, in which case the fair value of the asset given up is used. Under ASPE (Section 3831 *Non-monetary Transactions*), the transaction is measured at the more reliably measurable of the fair value of the asset given up and the fair value of the asset received. When both are reliably measurable, the fair value of the asset given up is used.

d. ASPE does not provide guidance on measurement of NMTs and IFRS does.

@ Answer d) is incorrect. ASPE Section 3831 *Non-monetary Transactions* provides guidance on NMTs. Answer b) is correct because the main difference is that under IFRS (IFRS 15 *Revenue from Contracts with Customers*), non-monetary, revenue-generating transactions are recorded at the fair value of the asset received, unless it is unknown, in which case the fair value of the asset given up is used. Under ASPE (Section 3831), the transaction is measured at the more reliably measurable of the fair value of the asset given up and the fair value of the asset received. When both are reliably measurable, the fair value of the asset given up is used.

42. Which of the following is a correct difference between IFRS and ASPE treatment of decommissioning obligations?

a. IFRS requires the asset portion of the obligation to be depreciated over the life of the asset; ASPE does not require it to be depreciated.

@ Answer a) is incorrect. IFRS requires the asset portion of the obligation to be depreciated over the life of the asset; ASPE also requires it to be depreciated.

*b. IFRS considers the increase in carrying value over time to be a borrowing cost; ASPE considers it to be an operating cost.

@ Answer b) is correct. IFRS considers the increase in carrying value over time to be a borrowing cost; ASPE considers it an operating cost.

c. IFRS uses the pre-tax rate to discount the future estimated costs; ASPE uses the rate after tax as the discount rate.

@ Answer c) is incorrect. Both IFRS and ASPE use pre-tax rates to discount the future expected costs.

d. IFRS recognizes the decommissioning obligation only when there is a legal requirement; ASPE requires the liability to be recorded when it is legally required or there is a constructive obligation.

@ Answer d) is incorrect. ASPE recognizes the decommissioning obligation only when there is a legal requirement; IFRS requires the liability to be recorded when it is legally required or there is a constructive obligation.

43. Which of the following statements about fund accounting under accounting standards for not-for-profit organizations (ASPNO) is true?

*a. A self-balancing set of accounts for each fund

@ Answer a) is correct. Fund accounting works as a self-balancing set of accounts for each fund.

b. Required for each fund

@ Answer b) is incorrect. Fund accounting is optional under ASNPO and only required when an NPO uses the restricted fund method of accounting for contributions. Answer a) is correct because fund accounting works as a self-balancing set of accounts for each fund.

c. Typically shown as a row for each fund in the financial statements

@ Answer c) is incorrect. Fund accounting is typically shown as a column for each fund in the financial statements. Answer a) is correct because fund accounting works as a self-balancing set of accounts for each fund.

d. Made up of net asset funds

@ Answer d) is incorrect. Common funds that are presented in fund accounting include general, restricted, and capital asset funds. Net assets are the net of total assets and liabilities, but are not their own fund. Answer a) is correct because fund accounting works as a self-balancing set of accounts for each fund.

44. Under ASNPO, which of the following statements is true?

a. The deferral method facilitates tracking externally restricted contributions.

@ Answer a) is incorrect. Fund accounting facilitates tracking of externally restricted contributions, not the deferral method. Answer b) is correct because under ASNPO, the NPO may have one bank account that includes the balances of several funds.

*b. The NPO may have one bank account that includes the balances of several funds.

@ Answer b) is correct because under ASNPO, the NPO may have one bank account that includes the balances of several funds.

c. The statement of operations helps users understand which funds are available for use.

@ Answer c) is incorrect. Net assets help users understand which funds are available for use. Answer b) is correct because under ASNPO, the NPO may have one bank account that includes the balances of several funds.

d. The fund method tracks all contributions separately in their own fund.

@ Answer d) is incorrect. The fund method tracks all restricted funds in separate funds as set forth by the restricted contribution. It also has a general fund for all items not subject to restrictions. Answer b) is correct because under ASNPO, the NPO may have one bank account that includes the balances of several funds.

45. You, CPA, are teaching your firm's co-op student about passive investments. You decide to compare how ASPE and IFRS account for passive investments. Which of the following statements is true?

a. IFRS reports all passive investments at fair value, and ASPE reports passive investments at any of cost, fair value, or amortized cost.

@ Answer a) is incorrect. IFRS does not report all passive investments at fair value. Debt investments that meet specified criteria are accounted for at amortized cost.

Answer c) is correct because, for amortized cost investments, IFRS requires the use of the effective interest method and ASPE permits a choice between the straight-line and effective interest methods.

b. Under both ASPE and IFRS, investments adjusted to fair value at each reporting date require the changes in fair value to be reported in net income.

@ Answer b) is incorrect. ASPE reports changes in fair value through net income; however, IFRS reports only some changes in fair value through net income. IFRS reports the change in other comprehensive income for fair value through other comprehensive income (FVTOCI) investments. Answer c) is correct because, for amortized cost investments, IFRS requires the use of the effective interest method and ASPE permits a choice between the straight-line and effective interest methods.

*c. For amortized cost investments, IFRS requires the use of the effective interest method, and ASPE permits a choice between the straight-line and effective interest methods.

@ Answer c) is correct. IFRS does not permit this choice, but ASPE does.

d. Accounting is the same under IFRS and ASPE for passive investments.

@ Answer d) is incorrect. There are significant differences between ASPE and IFRS in how passive investments are accounted for. Answer c) is correct because, for amortized cost investments, IFRS requires the use of the effective interest method and ASPE permits a choice between the straight-line and effective interest methods.

46. Brown Inc. (BI) reports an investment in bonds using the amortized cost method. The bonds have a face value of \$1,000,000 and were purchased on January 1, 20X7. The market interest rate is 8% and the bonds pay interest at a rate of 6%. Interest payments are made every June 30 and December 31. The bonds mature 10 years from the date of purchase, on December 31.

What journal entry records the acquisition of the bonds on January 1, 20X7?

*a.

Dr. Investment in bonds	\$864,100	
Cr. Cash		\$864,100

@ Answer a) is correct:

$$\$1,000,000 \times (P/F \ 4\% \uparrow, \ 20) = \$1,000,000 \times 0.45639 = \$456,390$$

$$\$30,000 \text{ interest} \times (P/A \ 4\% \uparrow, \ 20) = \$30,000 \times 13.59033 = \$407,710$$

$$\text{Issuance price (fair value)} = \$456,390 + \$407,710 = \$864,100$$

$$\uparrow 4\% = 8\% / 2 \text{ to reflect 20 half-year periods or } PV(0.04, 20, -30000, -1000000)$$

b.

Dr. Cash	\$864,100	
Cr. Bonds payable		\$864,100

@ Answer b) is incorrect. The journal entry reflects what the bond issuer would record.

Answer a) is correct:

$$\$1,000,000 \times (P/F \ 4\% \uparrow, \ 20) = \$1,000,000 \times 0.45639 = \$456,390$$

$$\$30,000 \text{ interest} \times (P/A \ 4\% \uparrow, \ 20) = \$30,000 \times 13.59033 = \$407,710$$

$$\text{Issuance price (fair value)} = \$456,390 + \$407,710 = \$864,100$$

$$\uparrow 4\% = 8\% / 2 \text{ to reflect 20 half-year periods or } PV(0.04, 20, -30000, -1000000)$$

c.

Dr. Investment in bonds	\$1,000,000	
Cr. Cash		\$1,000,000

@ Answer c) is incorrect. This answer uses the stated rate to calculate the bond price (reports at face value instead of the fair value). Answer a) is correct:

$$\$1,000,000 \times (P/F \ 4\% \uparrow, \ 20) = \$1,000,000 \times 0.45639 = \$456,390$$

$$\$30,000 \text{ interest} \times (P/A \ 4\% \uparrow, \ 20) = \$30,000 \times 13.59033 = \$407,710$$

$$\text{Issuance price (fair value)} = \$456,390 + \$407,710 = \$864,100$$

$$\uparrow 4\% = 8\% / 2 \text{ to reflect 20 half-year periods or } PV(0.04, 20, -30000, -1000000)$$

d.

Dr. Investment in bonds	\$664,496	
Cr. Cash		\$664,496

@ Answer d) is incorrect. This answer used 10 periods as the amortization period at 8%, but there are actually 20 interest periods — that is, $\$1,000,000 \times (P/F\ 8\%,\ 10)$ and $\$30,000 \times (P/A\ 8\%,\ 10)$ or $PV(0.08, 10, -30000, -1000000)$.

Answer a) is correct:

$$\$1,000,000 \times (P/F\ 4\% \uparrow, 20) = \$1,000,000 \times 0.45639 = \$456,390$$

$$\$30,000 \text{ interest} \times (P/A\ 4\% \uparrow, 20) = \$30,000 \times 13.59033 = \$407,710$$

$$\text{Issuance price (fair value)} = \$456,390 + \$407,710 = \$864,100$$

$$\uparrow 4\% = 8\% / 2 \text{ to reflect 20 half-year periods or } PV(0.04, 20, -30000, -1000000)$$

47. Under IFRS, which of the following can be capitalized to the cost of land?

a. CEO's salary

@ Answer a) is incorrect. The CEO's salary cannot be directly attributed to the cost of the land. Answer d) is correct because costs to perform a title search can be capitalized to the cost of the land.

b. Construction materials

@ Answer b) is incorrect. Construction materials would be capitalized to the cost of the building, not to the cost of the land. Answer d) is correct because costs to perform a title search can be capitalized to the cost of the land.

c. Utilities

@ Answer c) is incorrect. Utilities are not directly attributable to the cost of the land and would be expensed to the income statement (or included as part of manufacturing overhead attributed to inventory). Answer d) is correct because costs to perform a title search can be capitalized to the cost of the land.

*d. Title search

@ Answer d) is correct. Costs to perform a title search can be capitalized to the cost of the land.

48. The units of production method of depreciation:

a. Assumes that the benefit derived from the asset is higher in its initial years
@ Answer a) is incorrect. The declining balance method assumes that the benefit derived from the asset is higher in its initial years and lower as the asset ages.
Answer c) is correct because the units of production method of depreciation is based on allocating the cost in proportion to the fraction of capacity used.

b. Is the cost of the asset, net of the residual value, divided by the estimated useful life
@ Answer b) is incorrect. The straight-line method is the cost of the asset, net of the residual value, divided by the estimated useful life. Answer c) is correct because the units of production method of depreciation is based on allocating the cost in proportion to the fraction of capacity used.

*c. Is based on allocating the cost in proportion to the fraction of capacity used
@ Answer c) is correct. The units of production method of depreciation is based on allocating the cost in proportion to the fraction of capacity used.

d. Is the book value of the asset multiplied by the depreciation rate
@ Answer d) is incorrect. The declining balance method is the book value of the asset multiplied by the depreciation rate. Answer c) is correct because the units of production method of depreciation is based on allocating the cost in proportion to the fraction of capacity used.

49. Solar Inc. (Solar) issued stock options on January 1, 20X2, to its employees. The options vest on December 31, 20X3, and expire on December 31, 20X9. The exercise price is \$4.00 and Solar's share price at the time of the grant was \$3.00.

Which of the following statements is correct with respect to these options?

*a. The share options cannot be exercised during the period January 1, 20X2, to December 31, 20X3.

@ Answer a) is correct. This is the vesting period, and options cannot be exercised during this period.

b. On the date of the grant, the fair market value of each option was \$0, since the share price is lower than the exercise price.

@ Answer b) is incorrect. The fair value of the option is determined by a pricing model and is not simply based on a comparison between the share price and the exercise price. Answer a) is correct. This is the vesting period, and options cannot be exercised during this period.

c. When the options are exercised, the employee will receive \$4.00 per option from the company.

@ Answer c) is incorrect. On exercise, the employee will pay \$4.00 per option to the company in return for a common share. Answer a) is correct. This is the vesting period, and options cannot be exercised during this period.

d. The expense related to granting share options is recognized fully on the date of the grant.

@ Answer d) is incorrect. The expense related to the stock options is recognized over the vesting period of the options. Answer a) is correct. This is the vesting period, and options cannot be exercised during this period.

50. Which of the following is a required disclosure under IFRS, but not ASPE?

a. Nature of transactions

@ Answer a) is incorrect. This is a disclosure required under both ASPE and IFRS. Answer c) is correct because, per IAS 24.17, key management compensation is a required disclosure.

b. Amounts

@ Answer b) is incorrect. This is a disclosure required under both ASPE and IFRS. Answer c) is correct because, per IAS 24.17, key management compensation is a required disclosure.

*c. Key management compensation

@ Answer c) is correct. Per IAS 24.17, key management compensation is a required disclosure.

d. Obligations

@ Answer d) is incorrect. This is a disclosure required under both ASPE and IFRS. Answer c) is correct because, per IAS 24.17, key management compensation is a required disclosure.

51. Which of the following is an example of a non-reciprocal non-monetary transaction?

a. Stuart Co. gives up equipment with a fair market value of \$10,000 in exchange for \$8,000 cash.

@ Answer a) is incorrect. This is not an example of a non-monetary transaction, since only cash (no non-monetary asset) was received for the asset. Answer c) is correct. This is an example of a non-reciprocal exchange, since this is a one-sided exchange where only a non-monetary asset is given up.

b. Stuart Co. gives up a car with a fair market value of \$15,000 in exchange for a similar car of a different colour that has a fair market value of \$15,000.

@ Answer b) is incorrect. This is a reciprocal non-monetary exchange, since both sides of the transaction represent non-monetary assets. Answer c) is correct. This is an example of a non-reciprocal exchange, since this is a one-sided exchange where only a non-monetary asset is given up.

*c. Stuart Co. gives up a piece of art with a fair market value of \$20,000 in exchange for a donation receipt from a local charity.

@ Answer c) is correct. This is an example of a non-reciprocal exchange, since this is a one-sided exchange where only a non-monetary asset is given up.

d. Stuart Co. gives up equipment with a fair value of \$25,000 in exchange for shares in Roger Co. worth \$20,000 and a note receivable for \$3,000.

@ Answer d) is incorrect. This is a non-monetary reciprocal exchange, since there is a non-monetary asset both given up and received, as well as some monetary consideration. Answer c) is correct. This is an example of a non-reciprocal exchange, since this is a one-sided exchange where only a non-monetary asset is given up.

52. When recording annual depreciation on an asset that includes decommissioning costs, the debit side of the entry would be:

a. A fixed asset

@ Answer a) is incorrect. Answer d) is correct. The journal entry to book depreciation expense on an asset that includes decommissioning costs would be the same as depreciation on any other capital asset:

Dr. Depreciation expense
<input type="checkbox"/> Cr. Accumulated depreciation (contra account to the underlying fixed asset)

b. A decommissioning provision

@ Answer b) is incorrect. Answer d) is correct. The journal entry to book depreciation expense on an asset that includes decommissioning costs would be the same as depreciation on any other capital asset:

Dr. Depreciation expense
<input type="checkbox"/> Cr. Accumulated depreciation (contra account to the underlying fixed asset)

c. An interest expense

@ Answer c) is incorrect. Answer d) is correct. The journal entry to book depreciation expense on an asset that includes decommissioning costs would be the same as depreciation on any other capital asset:

Dr. Depreciation expense
<input type="checkbox"/> Cr. Accumulated depreciation (contra account to the underlying fixed asset)

*d. A depreciation expense

@ Answer d) is correct. The journal entry to book depreciation expense on an asset that includes decommissioning costs would be the same as depreciation on any other capital asset:

Dr. Depreciation expense
<input type="checkbox"/> Cr. Accumulated depreciation (contra account to the underlying fixed asset)

53. Kingsmere Properties (Kingsmere) has just commenced construction on a multi-unit townhome development. Although construction will not be completed for another 12 months, some units have been pre-sold, and the future homeowners have made a down payment for homes in this popular new development. Payments are refundable if the development is not completed. The homes are a standard construction, and the future homeowners are not involved in the decision-making. Kingsmere is anxious to record this revenue as soon as possible in order to secure the necessary financing.

What would be the most appropriate accounting policy recommendation?

*a. Recognize revenue when the home is completed and legal title transfers, because the performance obligation will not be satisfied until this time.

@ Answer a) is correct. The performance obligation is satisfied at a point in time when the unit is transferred to the purchaser. The purchaser is purchasing the asset of the house, not the service of construction, which is evident by the purchasers' lack of involvement in the process and the ability of the down payment to be refunded. Therefore, no revenue should be recognized until title transfers.

b. Recognize revenue when payments are received, because the amount to be recognized is measurable and collectable, and the performance obligation has been satisfied.

@ Answer b) is incorrect. The payments do not reflect the performance obligation being met by Kingsmere. Answer a) is correct. The performance obligation is satisfied at a point in time when the unit is transferred to the purchaser. The purchaser is purchasing the asset of the house, not the service of construction, which is evident by the purchasers' lack of involvement in the process and the ability of the down payment to be refunded. Therefore, no revenue should be recognized until title transfers.

c. Recognize payments into revenue when the related operating expenses are recorded, because this will ensure that revenues match their related expenses.

@ Answer c) is incorrect. The revenue recognition criteria must be met, irrespective of when the related operating expenses are recorded. Answer a) is correct. The performance obligation is satisfied at a point in time when the unit is transferred to the purchaser. The purchaser is purchasing the asset of the house, not the service of construction, which is evident by the purchasers' lack of involvement in the process and the ability of the down payment to be refunded. Therefore, no revenue should be recognized until title transfers.

d. Recognize revenue for the payments in accordance with the owners' wishes, because there appears to be uncertainty and, as such, the policy can match user objectives.

@ Answer d) is incorrect. The revenue recognition standards must be followed, irrespective of the owners' wishes. Answer a) is correct. The performance obligation is satisfied at a point in time when the unit is transferred to the purchaser. The purchaser is purchasing the asset of the house, not the service of construction, which is evident by the purchasers' lack of involvement in the process and the ability of the down payment to be refunded. Therefore, no revenue should be recognized until title transfers.

54. A company sells clothes wholesale from its factories overseas to department stores in Canada. The shipping terms are FOB Shipping. Under ASPE, at what point are revenues generally recognized in the financial statements?

a. When the return period has expired

@ Answer a) is incorrect. The right of return is usually an insignificant risk that should not delay revenue recognition, provided the seller can reliably estimate future returns and recognizes a liability for returns. Answer b) is correct. Performance is achieved when control has transferred to the buyer, and when reasonable assurance exists regarding the measurement of the consideration that will be derived from the sale of goods and the extent to which goods may be returned. Per ASPE, revenue is recognized when performance is complete, consideration is measurable, and collection is reasonably assured.

*b. When the clothes are shipped to the customer

@ Answer b) is correct. Performance is achieved when control has transferred to the buyer, and when reasonable assurance exists regarding the measurement of the consideration that will be derived from the sale of goods and the extent to which goods may be returned. Per ASPE, revenue is recognized when performance is complete, consideration is measurable, and collection is reasonably assured.

c. When future benefits of an asset expire

@ Answer c) is incorrect. The asset is clothing inventory, and it does not normally expire. When assets expire (for example, prepaid insurance), the future benefits become an expense, not revenue. Answer b) is correct. Performance is achieved when control has transferred to the buyer, and when reasonable assurance exists regarding the measurement of the consideration that will be derived from the sale of goods and the extent to which goods may be returned. Per ASPE, revenue is recognized when performance is complete, consideration is measurable, and collection is reasonably assured.

d. When contracts/invoices are prepared

@ Answer d) is incorrect. The completion of performance is normally considered the delivery of the goods, not the completion of the paperwork that documents the transaction. Answer b) is correct. Performance is achieved when control has transferred to the buyer, and when reasonable assurance exists regarding the measurement of the consideration that will be derived from the sale of goods and the extent to which goods may be returned. Per ASPE, revenue is recognized when performance is complete, consideration is measurable, and collection is reasonably assured.

55. ASPE identifies two types of subsequent events:

- i) those that provide further evidence of conditions that existed at the financial statement date; and
- ii) those that are indicative of conditions that arose subsequent to the financial statement date.

How should event ii) be treated?

a. Adjust the financial statements.

@ Answer a) is incorrect. Material conditions that arise subsequent to year end do not require adjustment in the financial statements. Answer b) is correct. The event occurred subsequent to the financial statement date but before the financial statements were completed and is material, therefore disclosure is required.

*b. Disclose within the notes to financial statements.

@ Answer b) is correct. The event occurred subsequent to the financial statement date but before the financial statements were completed and is material, therefore disclosure is required.

c. No action is required, as long as the company is a going concern.

@ Answer c) is incorrect. The fact the company is a going concern does not impact whether or not the disclosure must be made. Answer b) is correct. The event occurred subsequent to the financial statement date but before the financial statements were completed and is material, therefore disclosure is required.

d. Both options a) and b) above

@ Answer d) is incorrect. There is no need to both adjust and disclose the event. Answer b) is correct. The event occurred subsequent to the financial statement date but before the financial statements were completed and is material, therefore disclosure is required.

56. Which of the following subsequent events would require an adjustment to the company's financial statements?

a. Purchase of a business by the company subsequent to the financial statement date
@ Answer a) is incorrect. Financial statements are not adjusted for events occurring between the date of the financial statements and the date of their completion that do not relate to conditions that existed at the date of the financial statements. Answer c) is correct because when an event occurs between the date of the financial statements and the date of their completion, and that event provides additional evidence relating to conditions that existed at the date of the financial statements, financial statement adjustments are required.

b. Change in foreign currency exchange rates subsequent to the financial statement date
@ Answer b) is incorrect. Financial statements are not adjusted for events occurring between the date of the financial statements and the date of their completion that do not relate to conditions that existed at the date of the financial statements. Answer c) is correct because when an event occurs between the date of the financial statements and the date of their completion, and that event provides additional evidence relating to conditions that existed at the date of the financial statements, financial statement adjustments are required.

*c. Initiation of bankruptcy proceedings subsequent to the financial statement date against a customer with a large accounts receivable balance at year end
@ Answer c) is correct. When an event occurs between the date of the financial statements and the date of their completion, and that event provides additional evidence relating to conditions that existed at the date of the financial statements, financial statement adjustments are required.

d. Commencement of litigation where the customer slipped on ice and fell after year end
@ Answer d) is incorrect. Financial statements are not adjusted for events occurring between the date of the financial statements and the date of their completion that do not relate to conditions that existed at the date of the financial statements. Answer c) is correct because when an event occurs between the date of the financial statements and the date of their completion, and that event provides additional evidence relating to conditions that existed at the date of the financial statements, financial statement adjustments are required.

57. Bedford Inc. (BI) acquired 25% of the shares of Red Inc. (RI) in the current fiscal year for \$150,000 with no fair value differentials. It was determined that BI's investment in RI should be accounted for using the equity method. During the year:

- o RI paid \$100,000 in dividends.
- o RI reported net income of \$500,000, which included \$20,000 (in profits) that resulted from sales of inventory to BI.

BI has yet to process the inventory it purchased from RI. This inventory will be processed next year and the resulting product will be sold to one of BI's customers.

What should be reported as "investment in RI" on BI's current-year statement of financial position? Ignore any potential tax consequences.

a. \$150,000

@ Answer a) is incorrect. This option accounts for the investment at cost rather than using the equity method of accounting. Answer c) is correct because the \$150,000 investment cost less 25% of \$100,000 in dividends paid, plus 25% of \$500,000 of current-year profits, less 25% of unrealized profit of \$20,000 = $\$150,000 - \$25,000 + \$125,000 - \$5,000 = \$245,000$.

b. \$170,000

@ Answer b) is incorrect. This option deducts the entire dividend rather than just the applicable percentage. Answer c) is correct because the \$150,000 investment cost less 25% of \$100,000 in dividends paid, plus 25% of \$500,000 of current-year profits, less 25% of unrealized profit of \$20,000 = $\$150,000 - \$25,000 + \$125,000 - \$5,000 = \$245,000$.

*c. \$245,000

@ Answer c) is correct. The \$150,000 investment cost less 25% of \$100,000 in dividends paid, plus 25% of \$500,000 of current-year profits, less 25% of unrealized profit of \$20,000 = $\$150,000 - \$25,000 + \$125,000 - \$5,000 = \$245,000$.

d. \$250,000

@ Answer d) is incorrect. This option ignores the unrealized profit on the intercompany transaction. Answer c) is correct because the \$150,000 investment cost less 25% of \$100,000 in dividends paid, plus 25% of \$500,000 of current-year profits, less 25% of unrealized profit of \$20,000 = $\$150,000 - \$25,000 + \$125,000 - \$5,000 = \$245,000$.

58. Company A has significant influence over Company B. Under IFRS, which one of the following factors could cause Company A's investment account to decrease?

a. Purchase price

@ Answer a) is incorrect. Purchase price increases the investment account. Answer d) is correct. Until the inventory has been sold to a third party, profit in inventory is considered unrealized and needs to be reduced from equity income.

b. Goodwill

@ Answer b) is incorrect. Goodwill does not impact equity income; rather, it is an account created from the acquisition differential after any fair value differentials. Answer d) is correct. Until the inventory has been sold to a third party, profit in inventory is considered unrealized and needs to be reduced from equity income.

c. Net income

@ Answer c) is incorrect. Net income would increase the investment account. Answer d) is correct. Until the inventory has been sold to a third party, profit in inventory is considered unrealized and needs to be reduced from equity income.

*d. Unrealized profit in inventory

@ Answer d) is correct. Until the inventory has been sold to a third party, profit in inventory is considered unrealized and needs to be reduced from equity income.

59. Quencor Inc. started a new defined contribution plan this year. During the year, the company paid \$250,000 into this pension plan. At the end of the year, the current service cost was determined to be \$210,000, lower than expected. Any excess payment can be used to reduce next year's payment. What is the journal entry required to recognize the current service cost and the payment made during the year?

*a. Dr. Pension expense \$210,000; Dr. Prepaid asset \$40,000; Cr. Cash \$250,000
@ Answer a) is correct. Since the payment made was greater than the amount required, and any excess can be applied to next year's payment, a prepaid is set up for the overpayment. The pension expense is equal to the current service cost for the year.

b. Dr. Pension expense \$250,000; Cr. Cash \$250,000
@ Answer b) is incorrect. The pension expense is equal to the current service cost of \$210,000, and any excess paid over this amount is recognized as a prepaid asset. Answer a) is correct. Since the payment made was greater than the amount required, and any excess can be applied to next year's payment, a prepaid is set up for the overpayment. The pension expense is equal to the current service cost for the year.

c. Dr. Pension expense \$210,000; Dr. Net defined pension liability \$40,000; Cr. Cash \$250,000
@ Answer c) is incorrect. With a defined contribution plan, there is no net pension liability. The \$40,000 overpayment is recognized as a prepaid asset. Answer a) is correct. Since the payment made was greater than the amount required, and any excess can be applied to next year's payment, a prepaid is set up for the overpayment. The pension expense is equal to the current service cost for the year.

d. Dr. Pension plan assets \$250,000; Dr. Pension expense \$210,000; Cr. Pension benefit obligation \$210,000; Cr. Cash \$250,000
@ Answer d) is incorrect. With a defined contribution plan, there are no company plan assets or obligations. The \$40,000 overpayment is recognized as a prepaid asset. Answer a) is correct. Since the payment made was greater than the amount required, and any excess can be applied to next year's payment, a prepaid is set up for the overpayment. The pension expense is equal to the current service cost for the year.

60. On February 1, 20X6, Nickel Mining Co. (NMC) decided to use a forward contract to hedge the price of nickel on 150,000 pounds of nickel, which represents 30% of its annual sales. Currently, the spot price is \$6 per pound. NMC will settle the contract on July 31, 20X6. The company has entered into a forward contract to deliver 150,000 pounds of nickel on July 31, 20X6, at a forward price of \$7 per pound.

Which of the following statements BEST describes what this contract means for NMC?

a. NMC will purchase 150,000 pounds of nickel on July 31, 20X6, and will have to pay \$1,050,000.

@ Answer a) is incorrect. The contract is to sell (deliver) nickel, not purchase it, and NMC will receive cash on delivery, not pay it ($150,000 \times \$7 = \$1,050,000$). Answer d) is correct. A forward contract requires each party to perform, so delivery must be made and NMC will receive cash on delivery of \$1,050,000 ($= 150,000 \times \7).

b. NMC will deliver 150,000 pounds of nickel on July 31, 20X6, and receive cash of \$900,000 on delivery.

@ Answer b) is incorrect. NMC will receive the forward price of \$7 per pound on delivery, which totals \$1,050,000, not the spot price of \$6 per pound ($\$6 \times 150,000 = \$900,000$). Answer d) is correct. A forward contract requires each party to perform, so delivery must be made and NMC will receive cash on delivery of \$1,050,000 ($= 150,000 \times \7).

c. NMC will deliver 150,000 pounds of nickel on July 31, 20X6, and receive the higher of the \$7 per pound or the spot price on that date per pound.

@ Answer c) is incorrect. With a forward contract, NMC will receive the agreed-upon forward price of \$7 per pound, regardless of the spot price. Answer d) is correct. A forward contract requires each party to perform, so delivery must be made and NMC will receive cash on delivery of \$1,050,000 ($= 150,000 \times \7).

*d. NMC will deliver 150,000 pounds of nickel on July 31, 20X6, and receive \$1,050,000 on delivery.

@ Answer d) is correct. A forward contract requires each party to perform, so delivery must be made and NMC will receive cash on delivery of \$1,050,000 ($= 150,000 \times \7).

61. For 20X5, Queen Company reported sales of \$60,000 on a cash basis. This amount includes \$8,000 that was collected during 20X5 but relates to sales made in 20X4. Also included in the cash collections is \$4,000 for customer deposits made on future sales that will occur in 20X6. In addition, the company collected \$10,000 in 20X6 for sales that occurred in 20X5.

What is the sales amount that should be reported in 20X5 on an accrual basis?

a. \$48,000

@ Answer a) is incorrect. The amount for the payments received in 20X6 for sales in 20X5 was not included. $\$60,000 - \$8,000 - \$4,000 = \$48,000$. Answer b) is correct. The sales amount on an accrual basis is $\$60,000 - \$8,000$ (cash collection for 20X4 sales) $- \$4,000$ (deposits for 20X6 sales) $+ \$10,000$ (cash collected in 20X6 for 20X5 sales) = $\$58,000$.

*b. \$58,000

@ Answer b) is correct. The sales amount on an accrual basis is $\$60,000 - \$8,000$ (cash collection for 20X4 sales) $- \$4,000$ (deposits for 20X6 sales) $+ \$10,000$ (cash collected in 20X6 for 20X5 sales) = $\$58,000$.

c. \$62,000

@ Answer c) is incorrect. The deposits received for 20X6 sales were not deducted. $\$60,000 - \$8,000 + \$10,000 = \$62,000$. Answer b) is correct. The sales amount on an accrual basis is $\$60,000 - \$8,000$ (cash collection for 20X4 sales) $- \$4,000$ (deposits for 20X6 sales) $+ \$10,000$ (cash collected in 20X6 for 20X5 sales) = $\$58,000$.

d. \$66,000

@ Answer d) is incorrect. The deposits received in 20X5 for 20X6 sales were added rather than deducted. $\$60,000 - \$8,000 + \$4,000 + \$10,000 = \$66,000$. Answer b) is correct. The sales amount on an accrual basis is $\$60,000 - \$8,000$ (cash collection for 20X4 sales) $- \$4,000$ (deposits for 20X6 sales) $+ \$10,000$ (cash collected in 20X6 for 20X5 sales) = $\$58,000$.

62. Which of the following items should be included in a company's management discussion and analysis (MD&A)?

a. A description of the company's accounting policies

@ Answer a) is incorrect. This is not an item that should be included in a company's MD&A. A description of the company's accounting policies must be included in the notes to the financial statements. Answer c) is correct. Industry and economic factors that affect an entity's business should be included in the MD&A because this information helps users to understand the overall performance of the company.

b. Explanations of uncertainties and contingencies in accordance with the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

@ Answer b) is incorrect. This is not an item that should be included in a company's MD&A. Explanations of uncertainties and contingencies must be included in the notes to the financial statements. Answer c) is correct. Industry and economic factors that affect an entity's business should be included in the MD&A because this information helps users to understand the overall performance of the company.

*c. Industry and economic factors affecting the business

@ Answer c) is correct. This is an item that should be included in a company's MD&A. Industry and economic factors that affect an entity's business should be included in the MD&A because this information helps users to understand the overall performance of the company.

d. The auditor's view on future performance

@ Answer d) is incorrect. This is not an item that should be included in a company's MD&A. It is not the auditor's responsibility to express a view on future performance. Answer c) is correct. Industry and economic factors that affect an entity's business should be included in the MD&A because this information helps users to understand the overall performance of the company.

63. Projack Services Ltd. (Projack) manufactures portable power-generating plants to specifications for several industrial customers. Its policy is to recognize revenue on a percentage of completion basis under ASPE. The following projects were underway over the current year end:

Project	Costs incurred to year end	Estimated costs to complete at year end	% complete at year end	Total contract fee
Belford plant	\$40,000	\$65,000	38%	\$135,000
Gotham plant	15,000	28,000	35%	49,000
Markham plant	17,000	96,000	15%	145,000
Vickon plant	21,000	5,000	81%	33,000

On a percentage of completion basis, how much gross contract fee revenue should Projack recognize at the current year end?

a. \$52,950

@ Answer a) is incorrect. Gross contract fee revenue to be recognized at the current year end was calculated as Belford ($\$65,000 \times 38\% = \$24,700$) plus Gotham ($\$28,000 \times 35\% = \$9,800$) plus Markham ($\$96,000 \times 15\% = \$14,400$) plus Vickon ($\$5,000 \times 81\% = \$4,050$). This calculation incorrectly multiplies the estimated costs to complete at year end by the percentage complete at year end to determine gross contract fee revenue to be recognized. Answer d) is correct. Gross contract fee revenue to be recognized at the current year end is \$116,930: Belford ($\$135,000 \times 38\% = \$51,300$) plus Gotham ($\$49,000 \times 35\% = \$17,150$) plus Markham ($\$145,000 \times 15\% = \$21,750$) plus Vickon ($\$33,000 \times 81\% = \$26,730$).

b. \$73,050

@ Answer b) is incorrect. Gross contract fee revenue to be recognized at the current year end was calculated as Belford ($\$135,000 \times 38\% = \$51,300$) plus Markham ($\$145,000 \times 15\% = \$21,750$). The gross contract fee revenue on the Gotham and Vickon plants was not included. Answer d) is correct. Gross contract fee revenue to be recognized at the current year end is \$116,930: Belford ($\$135,000 \times 38\% = \$51,300$) plus Gotham ($\$49,000 \times 35\% = \$17,150$) plus Markham ($\$145,000 \times 15\% = \$21,750$) plus Vickon ($\$33,000 \times 81\% = \$26,730$).

c. \$90,200

@ Answer c) is incorrect. Gross contract fee revenue to be recognized at the current year end was calculated as Belford ($\$135,000 \times 38\% = \$51,300$) plus Gotham ($\$49,000 \times 35\% = \$17,150$) plus Markham ($\$145,000 \times 15\% = \$21,750$). The gross contract fee revenue on the Vickon plant was not included. Answer d) is correct. Gross contract fee revenue to be recognized at the current year end is \$116,930: Belford ($\$135,000 \times 38\% = \$51,300$) plus Gotham ($\$49,000 \times 35\% = \$17,150$) plus Markham ($\$145,000 \times 15\% = \$21,750$) plus Vickon ($\$33,000 \times 81\% = \$26,730$).

*d. \$116,930

@ Answer d) is correct. Gross contract fee revenue to be recognized at the current year end is \$116,930: Belford ($\$135,000 \times 38\% = \$51,300$) plus Gotham ($\$49,000 \times 35\% = \$17,150$) plus Markham ($\$145,000 \times 15\% = \$21,750$) plus Vickon ($\$33,000 \times 81\% = \$26,730$).

64. What is one of the objectives of government financial reporting?

a. To show how much profit has been earned by the government in the reporting period
@ Answer a) is incorrect. The government's objective is not to make a profit but to show the results of its operations and how it provided the services required. Answer b) is correct. One of the objectives of government financial reporting is to describe the government's financial position, showing how the government will finance activities, meet liabilities, and provide future services.

*b. To describe the government's financial position with respect to financing activities and its ability to meet its liabilities

@ Answer b) is correct. One of the objectives of government financial reporting is to describe the government's financial position, showing how the government will finance activities, meet liabilities, and provide future services.

c. To provide a comparison of the budget to the actual results for the reporting period
@ Answer c) is incorrect. The financial statements do not provide information on a comparison of budget to actual results. Answer b) is correct. One of the objectives of government financial reporting is to describe the government's financial position, showing how the government will finance activities, meet liabilities, and provide future services.

d. To provide disclosure on compensation paid to key employees of the government
@ Answer d) is incorrect. This is not part of the financial statement reporting objectives. Answer b) is correct. One of the objectives of government financial reporting is to describe the government's financial position, showing how the government will finance activities, meet liabilities, and provide future services.

65. On January 1, 20X6, Lessor Corp. entered into a contract to lease equipment to Lessee Co. with the following terms:

- o The lease term is five years, with payments due on the first day of the year.
- o The first payment is due on January 1, 20X6.
- o The equipment has a fair market value of \$300,000 on January 1, 20X6.
- o Lessee Co. has an incremental borrowing rate of 9% and Lessee Co. is aware of Lessor Corp.'s rate of 10%.
- o The equipment has an estimated useful life of six years.
- o Both the lessor and the lessee use straight-line amortization.
- o The annual lease payment equals \$70,733, which includes a \$4,000 reimbursement to Lessor Corp. for insurance costs paid by the lessor to the insurance company.
- o Both Lessor Corp. and Lessee Co. report under ASPE.

What is the present value of the minimum lease payments for this lease?

a. \$299,900

@ Answer a) is incorrect. Proof of calculation: $\$70,733 + \$70,733(\text{PVIFA}, 4 \text{ years}, 9\%) = \$299,900$ or $\text{PV}(0.09, 5, -70733, 0, 1)$. The \$4,000 in insurance costs should have been subtracted from the annual lease payment before calculating the present value of the minimum lease payments. Answer b) is correct. Lease payments = \$66,733 (\$70,733 less \$4,000 in insurance costs). $\text{PV} = \$66,733 + \$66,733(\text{PVIFA}, 4 \text{ years}, 9\%) = \$282,900$ or $\text{PV}(0.09, 5, -66733, 0, 1)$

*b. \$282,900

@ Answer b) is correct. Lease payments = \$66,733 (\$70,733 less \$4,000 in insurance costs). $\text{PV} = \$66,733 + \$66,733(\text{PVIFA}, 4 \text{ years}, 9\%) = \$282,900$ or $\text{PV}(0.09, 5, -66733, 0, 1)$

c. \$294,900

@ Answer c) is incorrect. Proof of calculation: $\$70,733 + \$70,733(\text{PVIFA}, 4 \text{ years}, 10\%) = \$294,900$ or $\text{PV}(0.10, 5, -70733, 0, 1)$. The \$4,000 in insurance costs should have been subtracted from the annual lease payment before calculating the present value of the minimum lease payments. Also, the lessee's incremental borrowing rate of 9% should have been used to calculate the present value of the minimum lease payments. ASPE specifies that the lower of the two rates (the rate implicit in the lease and the incremental borrowing rate) be used. Answer b) is correct. Lease payments = \$66,733 (\$70,733 less \$4,000 in insurance costs). $\text{PV} = \$66,733 + \$66,733(\text{PVIFA}, 4 \text{ years}, 9\%) = \$282,900$ or $\text{PV}(0.09, 5, -66733, 0, 1)$

d. \$278,300

@ Answer d) is incorrect. Proof of calculation: Lease payments = \$66,733 (\$70,733, less \$4,000 in insurance costs). $PV = \$66,733 + \$66,733(PVIFA, 4 \text{ years}, 10\%) = \$278,300$ or $PV(0.1, 5, -66733, 0, 1)$. The lessee's incremental borrowing rate of 9% should have been used to calculate the present value of the minimum lease payments. ASPE specifies that the lower of the two rates (the rate implicit in the lease and the incremental borrowing rate) be used. Answer b) is correct. Lease payments = \$66,733 (\$70,733 less \$4,000 in insurance costs). $PV = \$66,733 + \$66,733(PVIFA, 4 \text{ years}, 9\%) = \$282,900$ or $PV(0.09, 5, -66733, 0, 1)$

66. Recently, Zeko Inc. placed an order for new machinery from a German supplier. The machine will cost €1,000,000 and will be shipped and received eight months from now. At that time, the full payment is due.

Which of the following represents an eligible hedging instrument for this firm commitment?

a. Sales that were priced in euros that have already been recognized and fully collected
@ Answer a) is incorrect. There is no outstanding risk exposure on the sales or related receivables, and therefore these prior sales cannot be used to hedge a future transaction. Answer c) is correct. A forward contract, which is a derivative, can be used to reduce or eliminate the euro exposure and therefore can be categorized as an eligible hedging instrument for this order of equipment.

b. A loan payable in euros that will be outstanding for the next eight months
@ Answer b) is incorrect. This loan payable has the same risk exposure as the equipment purchase and is not offsetting the machine order's risk exposure. Answer c) is correct. A forward contract, which is a derivative, can be used to reduce or eliminate the euro exposure and therefore can be categorized as an eligible hedging instrument for this order of equipment.

*c. A forward contract to buy euros
@ Answer c) is correct. A forward contract, which is a derivative, can be used to reduce or eliminate the euro exposure and therefore can be categorized as an eligible hedging instrument for this order of equipment.

d. Expenses that have been paid for in euros during the year
@ Answer d) is incorrect. The expenses have already been paid and therefore do not qualify as a hedging instrument. Answer c) is correct. A forward contract, which is a derivative, can be used to reduce or eliminate the euro exposure and therefore can be categorized as an eligible hedging instrument for this order of equipment.

67. Which of the following statements regarding an audit of financial statements is true?

*a. They increase agency costs

@ Answer a) is correct. Agency costs are the costs used to reduce agency risk. A financial statement audit would reduce the agency risk, and therefore the cost is considered an agency cost.

b. They increase agency risk

@ Answer b) is incorrect. A financial statement audit would decrease agency risk. Answer a) is correct. Agency costs are the costs used to reduce agency risk. A financial statement audit would reduce the agency risk, and therefore the cost is considered an agency cost.

c. They increase information risk

@ Answer c) is incorrect. A financial statement audit would decrease information risk. Answer a) is correct. Agency costs are the costs used to reduce agency risk. A financial statement audit would reduce the agency risk, and therefore the cost is considered an agency cost.

d. They decrease information costs

@ Answer d) is incorrect. A financial statement audit increases information costs. Answer a) is correct. Agency costs are the costs used to reduce agency risk. A financial statement audit would reduce the agency risk, and therefore the cost is considered an agency cost.

68. Why are substantive procedures required in both a purely substantive audit approach and a combined audit approach?

*a. Control testing alone does not sufficiently address the risk of material misstatement.
@ Answer a) is correct. Control testing reduces control risk but as internal controls cannot operate effectively 100% of the time, substantive procedures are still required to achieve sufficient appropriate audit evidence to sufficiently reduce the risk of material misstatement in a financial statement audit.

b. Tests of controls alone are too costly.
@ Answer b) is incorrect. Because the testing of account balances and transactions is so extensive under the substantive approach, it is generally a more time-consuming and expensive audit approach. Answer a) is correct. Control testing reduces control risk but as internal controls cannot operate effectively 100% of the time, substantive procedures are still required to achieve sufficient appropriate audit evidence to sufficiently reduce the risk of material misstatement in a financial statement audit.

c. It is more effective to audit a large number of transactions using substantive procedures.
@ Answer c) is incorrect. The testing of a large number of transactions using substantive procedures is time consuming and is not more effective than testing controls under a combined approach. Answer a) is correct. Control testing reduces control risk but as internal controls cannot operate effectively 100% of the time, substantive procedures are still required to achieve sufficient appropriate audit evidence to sufficiently reduce the risk of material misstatement in a financial statement audit.

d. Substantive procedures can be performed after year end.
@ Answer d) is incorrect. While substantive procedures can be performed after year end has closed, this is not why substantive procedures are required in both the combined and substantive audit approaches. Answer a) is correct. Control testing reduces control risk but as internal controls cannot operate effectively 100% of the time, substantive procedures are still required to achieve sufficient appropriate audit evidence to sufficiently reduce the risk of material misstatement in a financial statement audit.

69. In which of the following situations would a practitioner use a purely substantive approach instead of a combined approach when planning the audit?

a. The company's chief financial officer is a CPA.

@ Answer a) is incorrect. A company that employs a CPA as its chief financial officer would likely have a stronger control environment, which would not support a purely substantive approach. Answer d) is correct. For a company with few transactions, the practitioner may decide to use a purely substantive approach because it would be faster to test the accounts than to spend time performing tests of controls.

b. The company has many transactions.

@ Answer b) is incorrect. Many transactions would mean that more substantive work would need to be performed, so it would take longer to use a purely substantive approach over a combined approach. Answer d) is correct. For a company with few transactions, the practitioner may decide to use a purely substantive approach because it would be faster to test the accounts than to spend time performing tests of controls.

c. The company has controls that can be relied on.

@ Answer c) is incorrect. Having controls that can be relied on qualifies for the use of a combined approach. Answer d) is correct. For a company with few transactions, the practitioner may decide to use a purely substantive approach because it would be faster to test the accounts than to spend time performing tests of controls.

*d. The company has few transactions.

@ Answer d) is correct. For a company with few transactions, the practitioner may decide to use a purely substantive approach because it would be faster to test the accounts than to spend time performing tests of controls.

70. Audit evidence is primarily gathered during which stage of the audit process?

a. Stage 1 — Acceptance/continuance

@ Answer a) is incorrect. Answer c) is correct because audit evidence is primarily gathered during the execution stage (Stage 3) of the audit process.

b. Stage 2 — Planning

@ Answer b) is incorrect. Answer c) is correct because audit evidence is primarily gathered during the execution stage (Stage 3) of the audit process.

*c. Stage 3 — Execution

@ Answer c) is correct. Audit evidence is primarily gathered during the execution stage (Stage 3) of the audit process.

d. Stage 4 — Reporting and concluding

@ Answer d) is incorrect. Answer c) is correct because audit evidence is primarily gathered during the execution stage (Stage 3) of the audit process.

71. Audit, inherent, and control risk are all assessed as low; detection risk is assessed as high. Therefore, which of the following statements is true?

a. Risk of material misstatement is assessed as high.

@ Answer a) is incorrect. Risk of material misstatement (RMM) is the combination of inherent and control risk. As these are both low, RMM is also assessed at low. Answer b) is correct. When detection risk is high, it means there are fewer substantive procedures. This is a result of risk of material misstatement being low enough that detection risk can be high and still keep the audit risk at low.

*b. The number of substantive tests is low.

@ Answer b) is correct. When detection risk is high, it means there are fewer substantive procedures. This is a result of risk of material misstatement being low enough that detection risk can be high and still keep the audit risk at low.

c. Controls cannot be relied on.

@ Answer c) is incorrect. Control risk is low; therefore, controls can be relied on. Answer b) is correct. When detection risk is high, it means there are fewer substantive procedures. This is a result of risk of material misstatement being low enough that detection risk can be high and still keep the audit risk at low.

d. Fraud risk is assessed as high.

@ Answer d) is incorrect. Fraud risk is linked to either inherent or control risk. As both were assessed as low, fraud risk could not be assessed as high. Answer b) is correct. When detection risk is high, it means there are fewer substantive procedures. This is a result of risk of material misstatement being low enough that detection risk can be high and still keep the audit risk at low.

72. Which of the following would improve the quick ratio?

*a. Sell fixed assets to reduce accounts payable.

@ Answer a) is correct. The quick ratio is defined as current assets less inventory, divided by current liabilities. A decrease in fixed assets would not affect the quick ratio, but a decrease in accounts payable would increase the quick ratio.

b. Increase bank indebtedness to purchase equipment.

@ Answer b) is incorrect. The quick ratio is defined as current assets less inventory, divided by current liabilities. An increase in bank indebtedness and an increase to fixed assets would increase current liabilities and long-term assets, which would decrease the quick ratio. Answer a) is correct because the quick ratio is defined as current assets less inventory, divided by current liabilities. A decrease in fixed assets would not affect the quick ratio, but a decrease in accounts payable would increase the quick ratio.

c. Issue common stock to purchase inventory.

@ Answer c) is incorrect. The quick ratio is defined as current assets less inventory, divided by current liabilities. An increase in common stock would not affect the quick ratio. The quick ratio excludes inventory so an increase in inventory would not impact the quick ratio. Answer a) is correct because the quick ratio is defined as current assets less inventory, divided by current liabilities. A decrease in fixed assets would not affect the quick ratio, but a decrease in accounts payable would increase the quick ratio.

d. Aggressively collect accounts receivable.

@ Answer d) is incorrect. The quick ratio is defined as current assets less inventory, divided by current liabilities. An increase in cash and a reduction in accounts receivable would have a nil effect on the quick ratio. Answer a) is correct because the quick ratio is defined as current assets less inventory, divided by current liabilities. A decrease in fixed assets would not affect the quick ratio, but a decrease in accounts payable would increase the quick ratio.

73. During the year, LMN Inc. had:

- o sales of \$2,500,000
- o gross profit of \$1,000,000
- o net income of \$125,000

Inventory was \$275,000 at the beginning of the year and \$300,000 at the end of the year. Assume the company used average balances when measuring its performance. What is the inventory turnover for the year?

a. 5 times

@ Answer a) is incorrect. The inventory turnover of five times is incorrectly calculated as $(\$2,500,000 \text{ sales} - \$1,000,000 \text{ gross profit}) / \$300,000 \text{ ending inventory balance}$. This calculation incorrectly uses the ending inventory balance in the denominator.

Answer b) is correct because the inventory turnover of 5.22 times is correctly calculated as $(\$2,500,000 \text{ sales} - \$1,000,000 \text{ gross profit}) / [(\$300,000 \text{ ending inventory balance} + \$275,000 \text{ beginning inventory balance}) / 2]$. Inventory turnover is calculated as cost of goods sold (sales less gross profit) divided by the average inventory balance.

*b. 5.22 times

@ Answer b) is correct. The inventory turnover of 5.22 times is correctly calculated as $(\$2,500,000 \text{ sales} - \$1,000,000 \text{ gross profit}) / [(\$300,000 \text{ ending inventory balance} + \$275,000 \text{ beginning inventory balance}) / 2]$. Inventory turnover is calculated as cost of goods sold (sales less gross profit) divided by the average inventory balance.

c. 5.45 times

@ Answer c) is incorrect. The inventory turnover of 5.45 times is incorrectly calculated as $(\$2,500,000 \text{ sales} - \$1,000,000 \text{ gross profit}) / \$275,000 \text{ beginning inventory balance}$. This calculation incorrectly uses the beginning inventory balance in the denominator. Answer b) is correct because the inventory turnover of 5.22 times is correctly calculated as $(\$2,500,000 \text{ sales} - \$1,000,000 \text{ gross profit}) / [(\$300,000 \text{ ending inventory balance} + \$275,000 \text{ beginning inventory balance}) / 2]$. Inventory turnover is calculated as cost of goods sold (sales less gross profit) divided by the average inventory balance.

d. 8.70 times

@ Answer d) is incorrect. The inventory turnover ratio of 8.70 times is incorrectly calculated as $\$2,500,000 \text{ sales} / [(\$300,000 \text{ ending inventory balance} + \$275,000 \text{ beginning inventory balance}) / 2]$. This calculation incorrectly uses sales in the numerator. Answer b) is correct because the inventory turnover of 5.22 times is correctly calculated as $(\$2,500,000 \text{ sales} - \$1,000,000 \text{ gross profit}) / [(\$300,000 \text{ ending inventory balance} + \$275,000 \text{ beginning inventory balance}) / 2]$. Inventory turnover is calculated as cost of goods sold (sales less gross profit) divided by the average inventory balance.

74. You, CPA, are concerned about one of your firm's clients, Farm Acre Foods Inc. (Farm). Although very profitable, you suspect that Farm may be experiencing problems paying off short-term debt. Which one of the following analytical review calculations will highlight this concern?

a. Gross profit percentage

@ Answer a) is incorrect. The gross profit percentage does not provide information about Farm's ability to pay liabilities as they become due. Answer c) is correct because the quick ratio provides information about Farm's ability to meet its liabilities in the short term.

b. Inventory turnover ratio

@ Answer b) is incorrect. The inventory turnover ratio provides information about the number of times in the year that Farm's inventory turns over. This ratio does not provide information about Farm's ability to pay liabilities as they become due. Answer c) is correct because the quick ratio provides information about Farm's ability to meet its liabilities in the short term.

*c. Quick ratio

@ Answer c) is correct. The quick ratio provides information about Farm's ability to meet its liabilities in the short term.

d. Times interest earned

@ Answer d) is incorrect. The times-interest-earned ratio provides information about Farm's ability to make interest payments on debt. While this ratio provides some information about liquidity, the information provided is not to the extent of the quick ratio. Answer c) is correct because the quick ratio provides information about Farm's ability to meet its liabilities in the short term.

75. Why is conducting an analysis of a company's financial ratios beneficial?

a. It is a central component of value-chain analysis.

@ Answer a) is incorrect. The value-chain analysis views the organization as a sequential process of value-creating activities. Answer d) is correct because financial ratio analysis identifies how an organization is performing according to its balance sheet and income statement from a historical perspective to detect trends. This trend and comparative analysis serves as an indicator of the organization's strengths and weaknesses.

b. It identifies external opportunities for the company to pursue.

@ Answer b) is incorrect. Ratio and comparative analysis is useful for determining strengths and weaknesses, not opportunities and threats. Answer d) is correct because financial ratio analysis identifies how an organization is performing according to its balance sheet and income statement from a historical perspective to detect trends. This trend and comparative analysis serves as an indicator of the organization's strengths and weaknesses.

c. It uncovers critical industry trends.

@ Answer c) is incorrect. Ratio and comparative analysis examines internal trends, not external industry trends. Answer d) is correct because financial ratio analysis identifies how an organization is performing according to its balance sheet and income statement from a historical perspective to detect trends. This trend and comparative analysis serves as an indicator of the organization's strengths and weaknesses.

*d. It provides insights into a company's financial state.

@ Answer d) is correct. Financial ratio analysis identifies how an organization is performing according to its balance sheet and income statement from a historical perspective to detect trends. This trend and comparative analysis serves as an indicator of the organization's strengths and weaknesses.

76. Which of the following statements for financial statement analysis is true?

*a. A high debt-to-equity ratio is a negative qualitative factor.

@ Answer a) is correct. Debt service ratios provide an indication of a company's long-term solvency. A higher ratio means that the organization has a more leveraged capital structure, which is considered higher risk.

b. A high gross-margin-percentage ratio is a negative qualitative factor.

@ Answer b) is incorrect. A high gross-margin-percentage is a positive qualitative factor as it indicates a company is more profitable. Answer a) is correct. Debt service ratios provide an indication of a company's long-term solvency. A higher ratio means that the organization has a more leveraged capital structure, which is considered higher risk.

c. A high dividend-payout ratio is positive qualitative factor.

@ Answer c) is incorrect. This would be case dependent. An excessively high dividend payout could be considered a return of capital to investors, not funds generated from the business's operations. Answer a) is correct. Debt service ratios provide an indication of a company's long-term solvency. A higher ratio means that the organization has a more leveraged capital structure, which is considered higher risk.

d. A high days-payable-outstanding ratio is a positive qualitative factor.

@ Answer d) is incorrect. A high days-payable-outstanding ratio could indicate a company's difficulty in paying its current obligations. Answer a) is correct. Debt service ratios provide an indication of a company's long-term solvency. A higher ratio means that the organization has a more leveraged capital structure, which is considered higher risk.

77. If the practitioner is unable to obtain sufficient appropriate audit evidence related to all accounts, classes of transactions, and disclosures in the financial statements, then the practitioner is unable to:

a. Continue with the engagement

@ Answer a) is incorrect. Answer b) is correct because if sufficient and appropriate audit evidence is not obtained, then the practitioner is unable to issue an unmodified audit opinion.

*b. Issue an unmodified opinion

@ Answer b) is correct. If sufficient and appropriate audit evidence is not obtained, then the practitioner is unable to issue an unmodified audit opinion.

c. Use a combined audit approach

@ Answer c) is incorrect. Answer b) is correct because if sufficient and appropriate audit evidence is not obtained, then the practitioner is unable to issue an unmodified audit opinion.

d. Rely on management's statements as fact

@ Answer d) is incorrect. Answer b) is correct because if sufficient and appropriate audit evidence is not obtained, then the practitioner is unable to issue an unmodified audit opinion.

78. Which of the following statements regarding audit evidence is true?

a. Sufficiency is the measure of the quality of audit evidence.

@ Answer a) is incorrect. Sufficiency is the measure of the quantity of audit evidence. Answer c) is correct because the higher the quality of evidence, the less evidence may be required.

b. The higher the relevance and reliability of evidence, the lower the quality of results

@ Answer b) is incorrect. The higher the relevance and reliability, the higher the quality of results. Answer c) is correct because the higher the quality of evidence, the less evidence may be required.

*c. The higher the quality of evidence, the less evidence may be required.

@ Answer c) is correct. The higher the quality of evidence, the less evidence may be required.

d. Reliability refers to the connection between audit procedures and assertions.

@ Answer d) is incorrect. Relevance refers to the connection between audit procedures and assertions. Answer c) is correct because the higher the quality of evidence, the less evidence may be required.

79. Obtaining written communication from a third party and footing a subledger are examples of which two types of substantive procedures, respectively?

a. Inspection and observation

@ Answer a) is incorrect. Answer b) is correct because a written communication from a third party is a confirmation type of substantive procedure and footing a subledger is a recalculation type of substantive procedure.

*b. Confirmation and recalculation

@ Answer b) is correct. Written communication from a third party is a confirmation type of substantive procedure; footing a subledger is a recalculation type of substantive procedure.

c. Analytical reviews and reperformance

@ Answer c) is incorrect. Answer b) is correct because a written communication from a third party is a confirmation type of substantive procedure and footing a subledger is a recalculation type of substantive procedure.

d. Inquiry and reperformance

@ Answer d) is incorrect. Answer b) is correct because a written communication from a third party is a confirmation type of substantive procedure and footing a subledger is a recalculation type of substantive procedure.

80. Which one of the following statements describes analytical procedures?

a. Analytical procedures are only used in the planning stage of an engagement.

@ Answer a) is incorrect. Analytical procedures are used in the planning stage of an engagement to design the nature, extent, and timing of other audit procedures.

Analytical procedures are also used as assessment procedures during the final evidence-gathering phase of an audit. Answer b) is correct because analytical procedures are generally used to identify items that indicate risk of misstatement, exceptions to predicted patterns, and items that should be addressed or followed up on.

*b. Analytical procedures help to identify unusual or unexpected balances that require further assurance work.

@ Answer b) is correct. Analytical procedures are generally used to identify items that indicate risk of misstatement, exceptions to predicted patterns, and items that should be addressed or followed up on.

c. Analytical procedures are not used in the planning stage of an engagement.

@ Answer c) is incorrect. Analytical procedures are used during the planning phase of an audit to design the nature, extent, and timing of other audit procedures. Answer b) is correct because analytical procedures are generally used to identify items that indicate risk of misstatement, exceptions to predicted patterns, and items that should be addressed or followed up on.

d. Analytical procedures are used exclusively on the income statement to analyze the reasonability of accounts as compared to budget and prior year.

@ Answer d) is incorrect. While analytical procedures are often focused on the income statement, they may be performed on the balance sheet to analyze the reasonability of various accounts. Answer b) is correct because analytical procedures are generally used to identify items that indicate risk of misstatement, exceptions to predicted patterns, and items that should be addressed or followed up on.

81. Substantive procedures are designed to:

*a. Detect material misstatements at the assertion level.

@ Answer a) is correct. Substantive procedures are designed to detect material misstatements at the assertion level.

b. Detect material misstatements at the overall financial statement level.

@ Answer b) is incorrect. Answer a) is correct because substantive procedures are designed to detect material misstatements at the assertion level.

c. Detect all misstatements.

@ Answer c) is incorrect. Answer a) is correct because substantive procedures are designed to detect material misstatements at the assertion level.

d. Detect changes from the prior year's financial statements.

@ Answer d) is incorrect. Answer a) is correct because substantive procedures are designed to detect material misstatements at the assertion level.

82. During the year, Peter and Barbie were divorced. The divorce agreement states Peter is to pay Barbie \$2,000 per month in spousal support and \$2,500 per month in child support beginning April 1 of the current year. Which of the following statements is true?

a. Peter's current-year deduction from net income as a result of the payment of spousal and child support is \$nil.

@ Answer a) is incorrect. This statement is false. In determining his net income for tax purposes, Peter may deduct the amount he paid for spousal support. Answer b) is correct. This statement is true. In determining his net income for tax purposes, Peter may deduct the amount he paid for spousal support of $\$2,000 \times 9 = \$18,000$.

*b. Peter's current-year deduction from net income as a result of the payment of spousal and child support is \$18,000.

@ Answer b) is correct. This statement is true. In determining his net income for tax purposes, Peter may deduct the amount he paid for spousal support of $\$2,000 \times 9 = \$18,000$.

c. Barbie will include \$22,500 in her net income as a result of receiving spousal and child support.

@ Answer c) is incorrect. This statement is false. \$22,500 is the amount Barbie received for child support ($\$2,500 \times 9 = \$22,500$). Child support is not taxable. Answer b) is correct. This statement is true. In determining his net income for tax purposes, Peter may deduct the amount he paid for spousal support of $\$2,000 \times 9 = \$18,000$.

d. Barbie will include \$40,500 in her net income as a result of receiving spousal and child support.

@ Answer d) is incorrect. This statement is false. \$40,500 is the total Barbie received for both spousal and child support [$(\$2,500 \times 9 = \$22,500) + (\$2,000 \times 9 = \$18,000)$]. Child support is not taxable. Answer b) is correct. This statement is true. In determining his net income for tax purposes, Peter may deduct the amount he paid for spousal support of $\$2,000 \times 9 = \$18,000$.

83. Assume the following for Mark's Warehouse Ltd. (Mark's):

Net income for tax purposes	\$530,200
Less	
Net capital losses of other years	(5,000)
Charitable donations	(50,000)
Taxable income	<u>\$475,200</u>

During the year, Mark's sold some shares in a public company for \$100,000. The shares cost \$60,000. This was the only sale of assets in the year. Mark's did not earn any interest or dividend income during the year.

What is the correct amount of active business income (ABI) to be used for determining one of the lesser of amounts for the small business deduction for Mark's for the year?

a. \$460,200

@ Answer a) is incorrect. It was determined as follows:

Net income for tax purposes	\$530,200
Taxable capital gain included in net income: $(\$100,000 - \$60,000) \times \frac{1}{2}$	(20,000)
Charitable donations	(50,000)
ABI	\$460,200

Charitable donations are not deducted in determining ABI.

Answer b) is correct. It was determined as follows:

Net income for tax purposes	\$530,200
Taxable capital gain included in net income: $(\$100,000 - \$60,000) \times \frac{1}{2}$	(20,000)
ABI	\$510,200

*b. \$510,200

@ Answer b) is correct. It was determined as follows:

Net income for tax purposes	\$530,200
Taxable capital gain included in net income: $(\$100,000 - \$60,000) \times \frac{1}{2}$	(20,000)
ABI	\$510,200

c. \$515,200

@ Answer c) is incorrect. It was determined as follows:

Net income for tax purposes	\$530,200
Net taxable capital gain included in net income: $[(\$100,000 - \$60,000) \times \frac{1}{2}] - 5,000$	(15,000)
ABI	\$515,200

Net income for tax purposes should have been adjusted for the taxable capital gain included in net income; not the taxable capital gain included in net income less the net capital loss claimed as a Division C deduction.

Answer b) is correct. It was determined as follows:

Net income for tax purposes	\$530,200
Taxable capital gain included in net income: $(\$100,000 - \$60,000) \times \frac{1}{2}$	(20,000)
ABI	\$510,200

d. \$475,200

@ Answer d) is incorrect. This is taxable income. It will be used to determine the small business deduction because the small business deduction is 19% of the lesser of the annual business limit, ABI and taxable income. In this question, taxable income is less than ABI.

Answer b) is correct. It was determined as follows:

Net income for tax purposes	\$530,200
Taxable capital gain included in net income: $(\$100,000 - \$60,000) \times \frac{1}{2}$	(20,000)
ABI	\$510,200

84. Harry and Vera are married. Harry's net income for the year was \$65,000 and Vera's net income was \$10,500. Both Harry and Vera had a significant amount of dental work completed in the year, with receipts totalling \$2,300 for Harry and \$1,100 for Vera. Based on the information provided, on whose tax return would you include the medical expenses in order to optimize the tax benefit for Harry and Vera?

*a. Both Harry's and Vera's medical expenses should be claimed on Harry's tax return.

@ Answer a) is correct. All of the medical expenses should be included in Harry's tax return. Vera cannot use the medical expense tax credit because her income is only \$10,500, and after claiming the basic personal tax credit, she will have no tax payable to deduct a medical expense tax credit against.

b. Both Harry's and Vera's medical expenses should be claimed on Vera's tax return.

@ Answer b) is incorrect. Vera cannot use the medical expense tax credit because her income is only \$10,500, and after claiming the basic personal tax credit, she will have no tax payable.

Answer a) is correct. All of the medical expenses should be included in Harry's tax return. Vera cannot use the medical expense tax credit because her income is only \$10,500 and after claiming the basic personal tax credit, she will have no tax payable to deduct a medical expense tax credit against.

c. Harry's medical expenses should be claimed on Harry's return and Vera's medical expenses should be claimed on her return.

@ Answer c) is incorrect. The taxpayer may claim a medical expense tax credit for the medical expenses of the taxpayer, the taxpayer's spouse, or a dependent individual. Although the medical expenses can be split between the two returns, it is usually more beneficial for the lower-income spouse to claim all of the expenses, as the 3% threshold will be lower.

Answer a) is correct. All of the medical expenses should be included in Harry's tax return. Vera cannot use the medical expense tax credit because her income is only \$10,500, and after claiming the basic personal tax credit, she will have no tax payable to deduct a medical expense tax credit against.

d. Harry and Vera will be indifferent between including the total of the medical expenses on either taxpayer's return.

@ Answer d) is incorrect. The taxpayer may claim a medical expense tax credit for the medical expenses of the taxpayer, the taxpayer's spouse, or a dependent individual. Although the medical expenses can be split between the two returns, it is usually more beneficial for the lower-income spouse to claim all of the expenses, as the 3% threshold will be lower.

Answer a) is correct. All of the medical expenses should be included in Harry's tax return. Vera cannot use the medical expense tax credit because her income is only \$10,500 and after claiming the basic personal tax credit, she will have no tax payable to deduct a medical expense tax credit against.

85. Cleanco Supply Ltd. sells cleaning supplies. The company is considering implementing new employee benefits. Which of the following statements about the taxation of the proposed benefits to the employees is true?

a. If Cleanco Supply paid premiums under a private health services plan for the employee, a taxable benefit would result.

@ Answer a) is incorrect. Premiums paid under a private health services plan are not a taxable benefit to the employee. Answer b) is correct because Cleanco Supply can provide a non-cash term of service award if the term of service is greater than five years. The value of the gift must not exceed \$500. The vacuum system meets these criteria since it is less than \$500, it is not cash or a gift certificate, and the gift is given in recognition of five years of service. Term of service awards can only be given every five years.

*b. Cleanco Supply could supply a built-in vacuum system worth \$400 to an employee in recognition of a five-year term of service every five years without this being considered a taxable benefit.

@ Answer b) is correct. Cleanco Supply can provide a non-cash term of service award if the term of service is greater than five years. The value of the gift must not exceed \$500. The vacuum system meets these criteria since it is less than \$500, it is not cash or a gift certificate, and the gift is given in recognition of five years of service. Term of service awards can only be given every five years.

c. Cleanco Supply could supply a fitness club membership worth \$600 to all employees without this being considered a taxable benefit.

@ Answer c) is incorrect. A fitness club membership primarily benefits the employee and is therefore considered a taxable benefit. Physical fitness of employees is not a direct benefit to the employer selling cleaning supplies. Answer b) is correct because Cleanco Supply can provide a non-cash term of service award if the term of service is greater than five years. The value of the gift must not exceed \$500. The vacuum system meets these criteria since it is less than \$500, it is not cash or a gift certificate, and the gift is given in recognition of five years of service. Term of service awards can only be given every five years.

d. If Cleanco Supply offers loans at rates below the CRA's prescribed rates, the loans are not considered a taxable benefit to the employee.

@ Answer d) is incorrect. If an employer offers loans to employees at rates lower than the CRA's prescribed rates, then a taxable benefit is calculated based on prescribed rates less the actual interest paid. Answer b) is correct because Cleanco Supply can provide a non-cash term of service award if the term of service is greater than five years. The value of the gift must not exceed \$500. The vacuum system meets these criteria since it is less than \$500, it is not cash or a gift certificate, and the gift is given in recognition of five years of service. Term of service awards can only be given every five years.

86. Which of the following is a taxable benefit to an employee?

a. Payments made for a private health services plan

@ Answer a) is incorrect. Where an employer makes contributions to a private health services plan (such as a medical or dental plan) on behalf of an employee, there is no taxable benefit to the employee. Answer d) is correct because, if a spouse or common-law partner accompanies an employee on a business trip, the amount paid by the employer for the employee's spouse or common-law partner's travelling expenses is a taxable benefit to the employee.

b. Payment for a \$400 gold watch to commemorate six years of service

@ Answer b) is incorrect. An employer can give an employee a non-cash, long-service or anniversary award valued at \$500 or less, tax-free. The award must be for a minimum of five years of service. Any amount over \$500 is a taxable benefit to an employee. Answer d) is correct because, if a spouse or common-law partner accompanies an employee on a business trip, the amount paid by the employer for the employee's spouse or common-law partner's travelling expenses is a taxable benefit to the employee.

c. Payment for tuition for a course on "building good relationships with clients"

@ Answer c) is incorrect. Tuition paid on behalf of the employee for courses taken to maintain or upgrade employment-related skills where the employer is the beneficiary of the training is not a taxable benefit to an employee. Answer d) is correct because, if a spouse or common-law partner accompanies an employee on a business trip, the amount paid by the employer for the employee's spouse or common-law partner's travelling expenses is a taxable benefit to the employee.

*d. Payment of an employee's spouse's travelling expenses incurred while accompanying the employee on a business trip

@ Answer d) is correct. If a spouse or common-law partner accompanies an employee on a business trip, the amount paid by the employer for the employee's spouse or common-law partner's travelling expenses is a taxable benefit to the employee.

87. Matilda owns two rental properties, both of which were acquired three years ago. You have been provided with the following information for the two properties for the current year:

	Property I	Property II
Undepreciated capital cost	\$160,000	\$190,000
Revenue	\$ 33,000	\$ 26,200
Expenses (1)	<u>24,600</u>	<u>29,100</u>
Net rental income	<u>\$ 8,400</u>	<u>\$ (2,900)</u>

Note 1: Expenses include property taxes, insurance, interest, and maintenance and repairs. The tenants pay the utilities.

What amount of net rental income or loss will be included in Matilda's personal tax return for the current year?

a. \$(900)

@ Answer a) is incorrect. This was determined as follows: Property I: Rental income before capital cost allowance (CCA) of \$8,400 less CCA of $\$160,000 \times 4\% = \$6,400$, resulting in rental income net of CCA on Property I of \$2,000. Net rental income of \$2,000 on Property I less rental loss before CCA on Property II of \$2,900 equals \$(900). A rental loss may not be created or increased through the deduction of CCA. Answer b) is correct. Net rental income on both properties before CCA: $\$8,400 - \$2,900 = \$5,500$. Maximum CCA claim permitted: \$14,000 (Property I: $\$160,000 \times 4\% = \$6,400$; Property II: $\$190,000 \times 4\% = \$7,600$). The CCA claim is the lesser of \$5,500 and \$14,000, so the maximum is \$5,500 and net rental income after CCA is reduced to nil.

*b. \$0

@ Answer b) is correct. Net rental income on both properties before capital cost allowance (CCA): $\$8,400 - \$2,900 = \$5,500$. Maximum CCA claim permitted: \$14,000 (Property I: $\$160,000 \times 4\% = \$6,400$; Property II: $\$190,000 \times 4\% = \$7,600$). The CCA claim is the lesser of \$5,500 and \$14,000, so the maximum is \$5,500 and net rental income after CCA is reduced to nil. A rental loss may not be created or increased through the deduction of CCA.

c. \$(8,500)

@ Answer c) is incorrect. This was determined as $\$8,400 - \$2,900 = \$5,500$ (net rental income before capital cost allowance [CCA] on both properties) less CCA of \$14,000 (Property I: $\$160,000 \times 4\% = \$6,400$; Property II: $\$190,000 \times 4\% = \$7,600$). A rental loss may not be created or increased through the deduction of CCA. Answer b) is correct. Net rental income on both properties before CCA: $\$8,400 - \$2,900 = \$5,500$. Maximum CCA claim permitted: \$14,000 (Property I: $\$160,000 \times 4\% = \$6,400$; Property II: $\$190,000 \times 4\% = \$7,600$). The CCA claim is the lesser of \$5,500 and \$14,000, so the maximum is \$5,500 and net rental income after CCA is reduced to nil.

d. \$2,000

@ Answer d) is incorrect. This was determined as follows: Property I: Rental income before capital cost allowance (CCA) of \$8,400 less CCA of $\$160,000 \times 4\% = \$6,400$, resulting in rental income net of CCA on Property I of \$2,000. The rental loss before CCA for Property II should have been deducted as well. Answer b) is correct. Net rental income on both properties before CCA: $\$8,400 - \$2,900 = \$5,500$. Maximum CCA claim permitted: \$14,000 (Property I: $\$160,000 \times 4\% = \$6,400$; Property II: $\$190,000 \times 4\% = \$7,600$). The CCA claim is the lesser of \$5,500 and \$14,000, so the maximum is \$5,500 and net rental income after CCA is reduced to nil. A rental loss may not be created or increased through the deduction of CCA.

88. An employee will be required to include a taxable benefit in his return if:

a. The employee uses a company car for business purposes.

@ Answer a) is incorrect. Where an employee uses a company car for business purposes, there is not a taxable benefit for the employee. Where an employee uses a company car for personal purposes, the personal use of the vehicle is considered a taxable benefit for the employee. Answer c) is correct because any benefit that an employee receives as a result of an interest-free or low-interest loan because of employment must be included in the employee's taxable income.

b. The employee is a senior accountant with a public accounting firm, and the firm pays for the employee's CPA membership dues.

@ Answer b) is incorrect. Where an employer pays the professional membership dues for an employee and the employer is the primary beneficiary of the payment, there is no taxable benefit to the employee. Answer c) is correct because any benefit that an employee receives as a result of an interest-free or low-interest loan because of employment must be included in the employee's taxable income.

*c. The employee has a loan from his employer at a rate that is below the prescribed rate but pays the interest within 30 days of the end of the calendar year.

@ Answer c) is correct. Any benefit that an employee receives as a result of an interest-free or low-interest loan because of employment must be included in the employee's taxable income.

d. The employee uses his own automobile for company business, and the company reimburses him at a reasonable rate acceptable to the Canada Revenue Agency (CRA).

@ Answer d) is incorrect. A reimbursement for automobile expenses is not a taxable benefit for the employee receiving it unless the reimbursement represents payment of the employee's personal automobile expenses. Answer c) is correct because any benefit that an employee receives as a result of an interest-free or low-interest loan because of employment must be included in the employee's taxable income.

89. A personal income tax client of your firm has decided to set up a small business selling semi-precious gemstones, beads, and jewelry-making supplies. The estimated sales for the first year of operations are \$25,000. Therefore, the business does not have to collect and remit GST to the Canada Revenue Agency (CRA). What is the advantage to the client of registering for a GST account before the store's annual sales reach \$30,000?

a. The business income will be taxed at a lower rate.

@ Answer a) is incorrect. The business income of a GST registrant is not taxed at a lower rate. Answer c) is correct. A GST registrant may recover the GST paid or owed on purchases and expenses related to the registrant's commercial activities by claiming input tax credits. Commercial activity is defined as any business carried on with a reasonable expectation of profit by an individual, a personal trust, or a partnership where all the members are individuals.

b. The business can charge GST and not have to remit the GST collected to the CRA.

@ Answer b) is incorrect. Where a business charges GST, it will have to remit the GST collected less any input tax credits claimed on qualifying purchases. Answer c) is correct. A GST registrant may recover the GST paid or owed on purchases and expenses related to the registrant's commercial activities by claiming input tax credits. Commercial activity is defined as any business carried on with a reasonable expectation of profit by an individual, a personal trust, or a partnership where all the members are individuals.

*c. The business can recover GST paid on qualifying purchases, including startup costs.

@ Answer c) is correct. A GST registrant may recover the GST paid or owed on purchases and expenses related to the registrant's commercial activities by claiming input tax credits. Commercial activity is defined as any business carried on with a reasonable expectation of profit by an individual, a personal trust, or a partnership where all the members are individuals.

d. The business will receive priority treatment in dealing with the CRA.

@ Answer d) is incorrect. The CRA does not provide GST registrants with priority treatment. Answer c) is correct. A GST registrant may recover the GST paid or owed on purchases and expenses related to the registrant's commercial activities by claiming input tax credits. Commercial activity is defined as any business carried on with a reasonable expectation of profit by an individual, a personal trust, or a partnership where all the members are individuals.

90. Telco Inc., a public corporation, received a notice of reassessment for its Year 5 taxation year. The notice was dated July 27, Year 9. Telco has a November 30 year end. The original assessment for Year 5 was dated March 31, Year 6.

Telco does not agree with the reassessment. By what date does Telco need to file the notice of objection?

a. May 31, Year 9

@ Answer a) is incorrect. This is the corporate filing due date of the last taxation year. Answer c) is correct. The notice of objection must be filed within 90 days after the notice of reassessment.

b. August 27, Year 9

@ Answer b) is incorrect. This is 30 days from the date of the notice of reassessment. Answer c) is correct. The notice of objection must be filed within 90 days after the notice of reassessment.

*c. October 25, Year 9

@ Answer c) is correct. The notice of objection must be filed within 90 days after the notice of reassessment.

d. November 30, Year 9

@ Answer d) is incorrect. This is the year end of the company. Answer c) is correct. The notice of objection must be filed within 90 days after the notice of reassessment.

91. Maurizio is a full-time student enrolled in doctoral studies at an accredited university in Canada studying chemistry. During the year, he received a scholarship of \$8,000 and a research grant of \$7,000. Which of the following is true with respect to Maurizio's income inclusion for the scholarship and research grant?

a. Maurizio is not required to include either the scholarship or the research grant in his net income for the year.

@ Answer a) is incorrect. This statement is false. Maurizio is required to include the research grant net of unreimbursed expenses related to doing the research in his net income. Answer d) is correct. This statement is true. Scholarships are included in income under Paragraph 56(1)(n) but are fully offset by the exemption under Section 56(3) for a full-time qualifying student. Maurizio was a full-time student in the current year, so he qualifies for the exemption. Research grants are included in income under Paragraph 56(1)(o) less any unreimbursed expenses.

b. Maurizio is required to include the \$8,000 scholarship in his net income.

@ Answer b) is incorrect. This statement is false. Scholarships are included in income under Paragraph 56(1)(n) but are fully offset by the exemption under Section 56(3) for a full-time qualifying student. Maurizio was a full-time student in the current year, so he qualifies for the exemption and the scholarship has no net impact on his net income. Answer d) is correct. This statement is true. Scholarships are included in income under Paragraph 56(1)(n) but are fully offset by the exemption under Section 56(3) for a full-time qualifying student. Maurizio was a full-time student in the current year, so he qualifies for the exemption. Research grants are included in income under Paragraph 56(1)(o) less any unreimbursed expenses.

c. Maurizio is required to include \$15,000 in his net income, the total of the scholarship and the research grant.

@ Answer c) is incorrect. This statement is false. Scholarships are included in income under Paragraph 56(1)(n) but are fully offset by the exemption under Section 56(3) for a full-time qualifying student. Maurizio was a full-time student in the current year, so he qualifies for the exemption and the scholarship has no net impact on his net income. Answer d) is correct. This statement is true. Scholarships are included in income under Paragraph 56(1)(n) but are fully offset by the exemption under Section 56(3) for a full-time qualifying student. Maurizio was a full-time student in the current year, so he qualifies for the exemption. Research grants are included in income under Paragraph 56(1)(o) less any unreimbursed expenses.

*d. Maurizio is required to include the \$7,000 research grant in his net income.

@ Answer d) is correct. This statement is true. Scholarships are included in income under Paragraph 56(1)(n) but are fully offset by the exemption under Section 56(3) for a full-time qualifying student. Maurizio was a full-time student in the current year, so he qualifies for the exemption. Research grants are included in income under Paragraph 56(1)(o) less any unreimbursed expenses.

92. A personal tax client, Juliet, has asked you to explain the tax rules related to charitable donations made by her and her spouse, Ellis. Which one of the following statements is *false*?

a. Juliet and Ellis can include the total of their charitable donations on either of their tax returns.

@ Answer a) is incorrect. This statement is true. Juliet and Ellis can include the total of their charitable donations in either of their tax returns. Answer b) is correct. Either Juliet or Ellis can claim the charitable donations on their tax return.

*b. The lower-income spouse, Ellis, must claim the charitable donations.

@ Answer b) is correct. This statement is false. Either Juliet or Ellis can claim the charitable donations on their tax return.

c. Either Juliet or Ellis can claim the charitable donations.

@ Answer c) is incorrect. This statement is true. Either Juliet or Ellis can claim the charitable donations on their tax return. Answer b) is correct. Either Juliet or Ellis can claim the charitable donations on their tax return.

d. Any unclaimed charitable donations can be carried forward for a period of up to five years.

@ Answer d) is incorrect. This statement is true. Unclaimed charitable donations can be carried forward for a period of up to five years. Answer b) is correct. Either Juliet or Ellis can claim the charitable donations on their tax return.

93. Which of the following is a criterion that the CRA considers in assessing if an individual is an employee or a contractor?

a. Who determines the method of payment?

@ Answer a) is incorrect. The question of who determines the method of payment is not a factor used to determine the relationship because both employees and contractors can be paid in cash, in services, in kind, or so on. Answer d) is correct because an employer will usually bear all chance of profit/risk of loss, as an employee will be paid irrespective of whether the employer is paid for work. As a result, this is a criterion that the CRA considers in assessing whether an individual is an employee or a contractor.

b. Does the individual have any close family ties to senior management?

@ Answer b) is incorrect. Close family relationships are not a factor when determining the employee or contractor relationship. Answer d) is correct because an employer will usually bear all chance of profit/risk of loss, as an employee will be paid irrespective of whether the employer is paid for work. As a result, this is a criterion that the CRA considers in assessing whether an individual is an employee or a contractor.

c. Has the individual incorporated?

@ Answer c) is incorrect. Incorporation does not automatically make the individual shareholder of the incorporated entity a contractor. Answer d) is correct because an employer will usually bear all chance of profit/risk of loss, as an employee will be paid irrespective of whether the employer is paid for work. As a result, this is a criterion that the CRA considers in assessing whether an individual is an employee or a contractor.

*d. With whom does the chance of profit/risk of loss rest?

@ Answer d) is correct. An employer will usually bear all chance of profit/risk of loss, as an employee will be paid irrespective of whether the employer is paid for work. As a result, this is a criterion that the CRA considers in assessing whether an individual is an employee or a contractor.

94. Evergreen Co. has computed its net income for tax purposes for Year 7 as follows:

Income from business	\$200,000
Dividends from taxable Canadian corporations	30,000
Dividends from non-affiliated foreign corporations	15,000
Taxable capital gains	<u>10,000</u>
Net income for tax purposes	<u>\$255,000</u>

Evergreen made charitable donations of \$5,000 to registered charities in the year. In addition, the company has the following carryover balances at the beginning of the year:

Net capital loss (Year 3)	\$12,000
Non-capital loss (Year 4)	13,000
Charitable donations (Year 6)	2,000

What is Evergreen's taxable income?

a. \$180,000

@ Answer a) is incorrect. This was determined as follows:

Net income for tax purposes	\$255,000
Current-year charitable donations	(5,000)
Charitable donation carryover	(2,000)
Dividends from taxable Canadian corporations	(30,000)
Dividends from non-affiliated foreign corporations	(15,000)
Net capital loss carryover	(10,000)
Non-capital loss carryover	<u>(13,000)</u>
Taxable income	<u>\$180,000</u>

This is incorrect because the \$15,000 of dividends from non-affiliated foreign corporations was deducted. Generally, only dividends from taxable Canadian corporations are deductible in determining taxable income of a corporation.

Answer c) is correct. It was determined as follows:

Net income for tax purposes	\$255,000
Dividends from taxable Canadian corporations	(30,000)
Net capital loss carryover	(10,000)
Current-year charitable donations	(5,000)
Charitable donations carryover	(2,000)
Non-capital loss carryover	<u>(13,000)</u>
Taxable income	<u>\$195,000</u>

b. \$178,000

@ Answer b) is incorrect. This was determined as follows:

Net income for tax purposes	\$255,000
Current-year charitable donations	(5,000)
Charitable donation carryover	(2,000)
Dividends from taxable Canadian corporations	(30,000)
Dividends from non-affiliated foreign corporations	(15,000)
Net capital loss carryover	(12,000)
Non-capital loss carryover	<u>(13,000)</u>
Taxable income	<u>\$178,000</u>

A net capital loss carryover of \$12,000 was deducted. The amount of a net capital loss deductible in the year is the lesser of the net capital loss carryover and taxable capital gains included in net income. Taxable capital gains included in net income were \$10,000; therefore, the net capital loss carryover available to be used in the current year is \$10,000.

Answer c) is correct. It was determined as follows:

Net income for tax purposes	\$255,000
Dividends from taxable Canadian corporations	(30,000)
Net capital loss carryover	(10,000)
Current-year charitable donations	(5,000)
Charitable donations carryover	(2,000)
Non-capital loss carryover	<u>(13,000)</u>
Taxable income	<u>\$195,000</u>

*c. \$195,000

@ Answer c) is correct. It was determined as follows:

Net income for tax purposes	\$255,000
Dividends from taxable Canadian corporations	(30,000)
Net capital loss carryover	(10,000)
Current-year charitable donations	(5,000)
Charitable donations carryover	(2,000)
Non-capital loss carryover	<u>(13,000)</u>
Taxable income	<u>\$195,000</u>

d. \$197,000

@ Answer d) is incorrect. This was determined as follows:

Net income for tax purposes	\$255,000
Current-year charitable donations	(5,000)
Dividends from taxable Canadian corporations	(30,000)
Net capital loss carryover	(10,000)
Non-capital loss carryover	(13,000)
Taxable income	<u>\$197,000</u>

Charitable donations carried forward were not deducted. The available deduction for charitable donations is the lesser of 75% of net income (\$191,250) and the sum of current-period charitable donations of \$5,000 and the charitable donation carryforward of \$2,000 (\$7,000).

Answer c) is correct. It was determined as follows:

Net income for tax purposes	\$255,000
Dividends from taxable Canadian corporations	(30,000)
Net capital loss carryover	(10,000)
Current-year charitable donations	(5,000)
Charitable donations carryover	(2,000)
Non-capital loss carryover	(13,000)
Taxable income	<u>\$195,000</u>

95. You are calculating the value of a brand-name piece of equipment using the market-based approach.

Which of the following is the **most** appropriate factor to consider when evaluating the comparability of recent sales transactions?

a. Net operating income earned from using the asset

@ Answer a) is incorrect. Net operating income is specific to the asset and is used when applying an income-based approach. Answer b) is correct. Location, age, and operating condition are considered when assessing how similar or different comparable transactions are.

*b. Location, age, and operating condition

@ Answer b) is correct. Location, age, and operating condition are considered when assessing how similar or different comparable transactions are.

c. The appropriate discount rate

@ Answer c) is incorrect. The discount rate is required when using an income-based approach. Answer b) is correct. Location, age, and operating condition are considered when assessing how similar or different comparable transactions are.

d. Obsolescence

@ Answer d) is incorrect. Obsolescence is assessed when using the replacement cost approach. Answer b) is correct. Location, age, and operating condition are considered when assessing how similar or different comparable transactions are.

96. You are valuing a company using a capitalized cash flow approach. You have determined that the company has the following:

- o maintainable earnings before interest, tax, depreciation, and amortization (EBITDA) of \$200,000
- o sustaining capital reinvestment net of taxes of \$50,000
- o a tax rate of 30%
- o a capitalization rate of 10%
- o a present value (PV) of the undepreciated capital cost (UCC) tax shield on existing assets of \$20,000
- o interest-bearing debt of \$130,000

What is the equity value of the company?

a. \$1,290,000

@ Answer a) is incorrect. The sustaining capital reinvestment net of the tax shield was not deducted before capitalizing the cash flow. Answer c) is correct. The equity value of the company = EBITDA after tax [$\$200,000 \times (1 - 30\%)$] – sustaining capital reinvestment (\$50,000) = \$90,000 / capitalization rate (10%) = \$900,000 + PV of UCC tax shield (\$20,000) – interest-bearing debt (\$130,000) = \$790,000.

b. \$920,000

@ Answer b) is incorrect. The value of the interest-bearing debt was not deducted from the enterprise value to determine the equity value of the company. Answer c) is correct. The equity value of the company = EBITDA after tax [$\$200,000 \times (1 - 30\%)$] – sustaining capital reinvestment (\$50,000) = \$90,000 / capitalization rate (10%) = \$900,000 + PV of UCC tax shield (\$20,000) – interest-bearing debt (\$130,000) = \$790,000.

*c. \$790,000

@ Answer c) is correct. The equity value of the company = EBITDA after tax [$\$200,000 \times (1 - 30\%)$] – sustaining capital reinvestment (\$50,000) = \$90,000 / capitalization rate (10%) = \$900,000 + PV of UCC tax shield (\$20,000) – interest-bearing debt (\$130,000) = \$790,000.

d. \$770,000

@ Answer d) is incorrect. The PV of the UCC tax shield on existing assets was not added to the capitalized cash flows.

Answer c) is correct. The equity value of the company = EBITDA after tax [$\$200,000 \times (1 - 30\%)$] – sustaining capital reinvestment (\$50,000) = \$90,000 / capitalization rate (10%) = \$900,000 + PV of UCC tax shield (\$20,000) – interest-bearing debt (\$130,000) = \$790,000.

97. You have been asked to value a business by an owner who intends to shut the business down due to lack of productivity. The owner still has control over the assets and is not being forced to sell them immediately.

Which valuation approach should you use?

a. Capitalized cash flow

@ Answer a) is incorrect. The company is not a going concern. Answer c) is correct. The company is not a going concern, but the owner is not being forced to sell the assets.

b. Adjusted net asset

@ Answer b) is incorrect. The company is not a going concern. Answer c) is correct. The company is not a going concern, but the owner is not being forced to sell the assets.

*c. Orderly liquidation

@ Answer c) is correct. The company is not a going concern, but the owner is not being forced to sell the assets.

d. Forced liquidation

@ Answer d) is incorrect. The owner isn't being forced to sell the assets of the company. Answer c) is correct. The company is not a going concern, but the owner is not being forced to sell the assets.

98. Lazer Force Company (Lazer) is a manufacturer of cold medication with a strategic objective of improving operational efficiency. The company is reviewing possible ways to reduce costs related to distribution. Any arrangement will be temporary and will initially last for three years. Which of the following is the most likely type of arrangement to meet Lazer's objectives?

a. Acquire control of a company that distributes similar products in similar markets to Lazer.

@ Answer a) is incorrect. The acquisition of another company is permanent and will impact many other areas in addition to distribution. Answer b) is correct. Outsourcing to a company that specializes in distribution logistics will help to reduce costs. This can be a temporary arrangement that can be easily terminated in three years.

*b. Outsource the logistics of product distribution.

@ Answer b) is correct. Outsourcing to a company that specializes in distribution logistics will help to reduce costs. This can be a temporary arrangement that can be easily terminated in three years.

c. Undertake a joint venture with a competitor to share distribution resources.

@ Answer c) is incorrect. Although a joint venture may reduce overall distribution costs, this is a more permanent solution for a longer period of time. The unwinding of the joint venture in three years may be difficult, time consuming, and costly. Answer b) is correct. Outsourcing to a company that specializes in distribution logistics will help to reduce costs. This can be a temporary arrangement that can be easily terminated in three years.

d. Purchase bonds in a publicly listed pharmaceutical distribution company.

@ Answer d) is incorrect. Purchasing bonds in a company does not help with reducing operational costs. This is a passive investment from which Lazer will simply receive interest income and capital gains or losses on sale. Answer b) is correct. Outsourcing to a company that specializes in distribution logistics will help to reduce costs. This can be a temporary arrangement that can be easily terminated in three years.

99. Currently, Zisor Co. (Zisor) has two business units: one producing hair products and another producing facial creams. The company just completed a strategic review and decided to completely divest its facial cream manufacturing operations. The company wants to sell off the entire facial cream manufacturing operation and receive cash to use for other business purposes.

Which of the following transactions would be the most suitable course of action?

a. Perform an equity carve-out of the facial cream business retaining at least 85%.

@ Answer a) is incorrect. An equity carve-out would not result in divesting the entire operation. The carve-out would still leave Zisor owning at least 85% of the business. Answer c) is correct. Selling the net assets will satisfy both goals: Zisor will completely divest itself of the division and obtain cash that can be used for other purposes.

b. Spin off the facial cream division as a separate entity.

@ Answer b) is incorrect. The spin-off will not result in any cash flow to the company. Answer c) is correct. Selling the net assets will satisfy both goals: Zisor will completely divest itself of the division and obtain cash that can be used for other purposes.

*c. Sell the net assets of the facial cream division for cash.

@ Answer c) is correct. Selling the net assets will satisfy both goals: Zisor will completely divest itself of the division and obtain cash that can be used for other purposes.

d. Sell shares of Zisor to a strategic buyer.

@ Answer d) is incorrect. Selling the shares of the company will result in Zisor still having both divisions, and only the ownership of Zisor has changed to include additional equity holders. Answer c) is correct. Selling the net assets will satisfy both goals: Zisor will completely divest itself of the division and obtain cash that can be used for other purposes.

100. The definition of fair market value for valuation purposes includes which of the following terms:

*a. Acting at arm's length

@ Answer a) is correct. Acting at arm's length is part of the definition of fair market value.

b. Closed and restricted market

@ Answer b) is incorrect. A valuator determines the value of a company considering an open and unrestricted market. Answer a) is correct. Acting at arm's length is part of the definition of fair market value.

c. Lowest price available

@ Answer c) is incorrect. It is the highest price available that is part of the definition of fair market value. Answer a) is correct. Acting at arm's length is part of the definition of fair market value.

d. Under a compulsion to act

@ Answer d) is incorrect. The definition of fair market value requires that the parties be under no compulsion to act. Answer a) is correct. Acting at arm's length is part of the definition of fair market value.