Core 1 Self-Assessed Entrance Exam - Answers

1. FR035:
Catherine, your audit manager, has asked you to explain to your client, Michael, the difference between a cash flow statement prepared using the indirect method and a cash flow statement prepared using the direct method. How would you explain this to him?

a. The amount of net cash flow from the operations section is different under both methods.
b. The amount of net cash flow from the operations and investing sections is different under each method.
c. The presentation of the operations, investing, and financing sections are different under both methods but the amount of net cash flow from the operations, investing, and financing sections under both methods are the same.
d. The amount of net cash flow from the operations, investing, and financing sections is the same under both methods. The presentation of the operations section is different under both methods.

Feedback:

a) Answer a) is incorrect. The amount of net cash flow from operations is the same under both methods, not different. Answer d) is correct. The presentation of the operations section is different under both methods but the amount of net cash flow from the operations, investing and financing sections is the same under both methods.
b) Answer b) is incorrect. The amount of net cash flow from operations and investing is the same under both methods, not different. Answer d) is correct. The presentation of the operations section is different under both methods but the amount of net cash flow from the operations, investing and financing sections is the same under both methods.
c) Answer c) is incorrect. The presentation of the investing and financing sections is the same under both methods, not different. Answer d) is correct. The presentation of the operations section is different under both methods but the amount of net cash flow from the operations, investing and financing sections is the same under both methods.

d) Answer d) is correct. The presentation of the operations section is different under both methods but the amount of net cash flow from the operations, investing and financing sections is the same under both methods.
2. FR036:
Judy is preparing the cash flow statement for a client, AAA Moving and Storage. The company has several trucks as well as its own warehouse. The balance for property, plant, and equipment (PP&E) is as follows:

<table>
<thead>
<tr>
<th></th>
<th>20X6</th>
<th>20X5</th>
</tr>
</thead>
<tbody>
<tr>
<td>PP&amp;E, net of accumulated amortization</td>
<td>$825,000</td>
<td>$756,000</td>
</tr>
</tbody>
</table>

Other information available:

- Amortization expense is $79,000.
- A delivery van with a cost of $64,000 and accumulated amortization of $40,000 was sold. The sale took place halfway through the year.

What are the additions for PP&E for the year?

a. $ 69,000
b. $ 93,000
c. $148,000
*d. $172,000

Feedback:

a) Answer a) is incorrect. PP&E, beginning of the year ($756,000) – PP&E, end of the year ($825,000) = $69,000. This calculation does not recognize the net book value of the truck sold and the amortization expense for the year. Answer d) is correct. PP&E, beginning of the year ($756,000) – amortization expense for the year ($79,000) – cost of the delivery van sold ($64,000) + accumulated amortization of the van sold ($40,000) – PP&E, end of the year ($825,000) = $172,000.

b) Answer b) is incorrect. PP&E, beginning of the year ($756,000) – cost of the delivery van sold ($64,000) + accumulated amortization of the van sold ($40,000) – PP&E, end of the year ($825,000) = $93,000. This calculation does not recognize the amortization expense for the year. Answer d) is correct. PP&E, beginning of the year ($756,000) – amortization expense for the year ($79,000) – cost of the delivery van sold ($64,000) + accumulated amortization of the van sold ($40,000) – PP&E, end of the year ($825,000) = $172,000.

c) Answer c) is incorrect. PP&E, beginning of the year ($756,000) – amortization expense for the year ($79,000) – PP&E, end of the year ($825,000) = $148,000. This calculation does not recognize the net book value of the truck sold in the year. Answer d) is correct. PP&E, beginning of the year ($756,000) – amortization expense for the year ($79,000) – cost of the delivery van sold ($64,000) + accumulated amortization of the van sold ($40,000) – PP&E, end of the year ($825,000) = $172,000.

*d) Answer d) is correct. PP&E, beginning of the year ($756,000) – amortization expense for the year ($79,000) – cost of the delivery van sold ($64,000) + accumulated amortization of the van sold ($40,000) – PP&E, end of the year ($825,000) = $172,000.
3. FR197:
The following accounts were taken from Blue Monkey Inc.'s unadjusted trial balance at December 31, 20X6:

<table>
<thead>
<tr>
<th>Account</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>$850,000</td>
</tr>
<tr>
<td>Opening allowance for doubtful accounts (AFDA) January 1, 20X6</td>
<td>($11,000)</td>
</tr>
<tr>
<td>Net credit sales</td>
<td>$2,950,000</td>
</tr>
</tbody>
</table>

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
b. $11,000
*c. $12,750
d. $44,250

Feedback:

a) 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 × 1.5% = $12,750.

b) 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 × 1.5% = $12,750.

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

d) Answer d) is incorrect. This answer calculates the AFDA using total sales rather than the accounts receivable balance ($2,950,000 × 1.5%). Answer c) is correct. The balance of AFDA would be calculated as $850,000 × 1.5% = $12,750.
4. FR196:
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
b. $6,000
c. $7,000
d. $9,600

Feedback:
*a) 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) 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) 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) 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. FR089:
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  
b. The administration building of a large manufacturing company  
c. A truck stop for a national trucking company  
d. The warehouse of a communications company

Feedback:

*a) 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) 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) 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) 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. FR090:
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.
b. There is an authorized plan to sell the asset.
c. The asset is actively marketed and expected to be sold within two years.
*d. Both a) and b) above.

Feedback:

a) 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) 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) 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) 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. FR166:
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.
b. Consolidated retained earnings is impacted by unrealized profit in closing inventory on intercompany inventory sales.
*c. Consolidated retained earnings is impacted by intercompany management fees recognized in the current year.
d. Consolidated retained earnings is impacted by an unrealized loss on an intercompany sale of equipment.

Feedback:

a) 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) 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) 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) 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. FR314:
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.
b. Decrease cost of sales by the unrealized profit in ending inventory and increase inventory by the same amount.
c. Increase cost of sales by the unrealized profit in ending inventory and decrease inventory by the same amount.
d. Decrease sales and cost of sales by the intercompany selling price of the inventory.

Feedback:

*a) 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) 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) 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) 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. FR309:
How should acquisition-related costs, such as due diligence and legal costs, be accounted for?

*a. Expensed as incurred
b. As part of the total consideration
c. As a reduction in equity
d. As a deferred asset

Feedback:

*a) 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) 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) 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) 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. FR310:
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.
b. Recognize a liability in the consolidated balance sheet.
c. Contact the acquiree to confirm its intention.
*d. Reassess each step of your analysis to confirm your preliminary finding.

Feedback:

a) 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) 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) 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) 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. FR199:
Which of the following statements is true?

a. Under IFRS, publicly traded bonds with a maturity less than or equal to three months are considered cash and cash equivalents.
*b. There are no significant differences between IFRS and ASPE in the treatment of cash and cash equivalents.
c. Under ASPE, publicly traded bonds with a maturity less than or equal to three months are considered cash and cash equivalents.
d. Under ASPE, minimum balance requirements in bank accounts are considered cash and cash equivalents.

Feedback:

a) Answer a) is incorrect. Publicly traded bonds are excluded from cash and cash equivalents, as they are subject to a risk of changes in value. Answer b) is correct. There are no significant differences between IFRS and ASPE in the treatment of cash and cash equivalents.

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

c) Answer c) is incorrect. Publicly traded bonds are excluded from cash and cash equivalents, as they are subject to a risk of changes in value. Answer b) is correct. There are no significant differences between IFRS and ASPE in the treatment of cash and cash equivalents.

d) 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. FR256:
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
b. Minimum balance requirements in bank accounts
c. Donations provided for a specific purpose in a not-for-profit organization
*d. Both b) and c)

Feedback:

a) 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) 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) 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) 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. FR080:
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.
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.
*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.
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.

Feedback:

a) 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) 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) 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) 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. FR294:
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.
*b. A public company changes from the cost model to the revaluation model for measuring the value of land.
c. Development costs were capitalized when only five of six criteria for capitalization had been satisfied.
d. The company miscalculated the weighted average number of ordinary shares outstanding because it used the wrong date for a share issuance.

Feedback:

a) 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) 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) 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 in accounting policy under IFRS.

d) 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. FR067:
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.
*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.
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.
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.

Feedback:

a) 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) 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) 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) 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. FR069:
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.
b. Disclose $500,000 and that the occurrence of the future event is unlikely.
c. Accrue only a portion of the $500,000, based on management’s best estimate.
d. Disclose $500,000 and indicate that the result of the lawsuit is not determinable.

Feedback:

a) 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) 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) 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) Answer d) is correct. Because the outcome is not determinable and the amount of the loss is not estimable, disclosure is appropriate.
17. FR108:
Company A is a public company. They have:

- A total of 100,000 common shares outstanding.
- Six months before year end, Company A issued 20,000 debentures that are convertible into a total of 10,000 common shares.
- 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.
b. Only the current common shares outstanding would be included in the denominator of the calculation.
*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.
d. The common shares arising from the convertible debenture issued during the period would only be included once converted.

Feedback:

a) 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) 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) 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) 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. FR290:
Stampede Inc. (SI) is a public company.

On January 1, 20X1, 65,000 common shares were issued and outstanding. During the year:
- 15,000 additional common shares were issued on April 1.
- 20,000 preferred shares were issued on June 1; these shares are non-cumulative and carry an annual dividend entitlement of $2 per share.
- No dividends were declared.
- Net income was $2,000,000.

What is the basic EPS for SI for its fiscal 20X1 year end?

a. $22.75
b. $25.00
c. $25.70
*d. $26.23

Feedback:

a) Answer a) is incorrect. The preferred shares are not part of the WACSO calculation.
Proof: $2,000,000 / [(65,000 × ¼) + (80,000 × ¾) + (20,000 × 7/12)]
Answer d) is correct. Proof of correct answer:
= Income available to common shareholders / WACSO
= $2,000,000 / [(65,000 × ¼) + (80,000 × ¾)]
= $2,000,000 / 76,250
= $26.23

b) Answer b) is incorrect. The denominator must use the weighted average of the shares outstanding during the year.
Answer d) is correct. Proof of correct answer:
= Income available to common shareholders / WACSO
= $2,000,000 / [(65,000 × ¼) + (80,000 × ¾)]
= $2,000,000 / 76,250
= $26.23

c) Answer c) is incorrect. The annual dividend entitlement does not need to be deducted in the numerator because the shares are non-cumulative and no dividend was declared in 20X1.
Answer d) is correct. Proof of correct answer:
= Income available to common shareholders / WACSO
= $2,000,000 / [(65,000 × ¼) + (80,000 × ¾)]
= $2,000,000 / 76,250
= $26.23
*d) Answer d) is correct. Proof of correct answer:

\[ \text{Income available to common shareholders} \div \text{WACSO} \]
\[ = \frac{2,000,000}{(65,000 \times \frac{1}{4}) + (80,000 \times \frac{3}{4})} \]
\[ = \frac{2,000,000}{76,250} \]
\[ = 26.23 \]
19. FR289:
Savon Inc. has a defined contribution plan. During 20X6, its current service cost was $350,000 and Savon paid this amount by the end of 20X6.

In 20X5, Savon had amended its plan for past services. The amendment required $890,000 to be paid into the plan. Savon paid this amount in two equal instalments of $445,000 in 20X5 and $445,000 in 20X6. The plan amendment related to past services provided by employees in 20X2, 20X3, and 20X4.

What is the amount of the pension expense for 20X6?

*a. $350,000  
b. $528,000  
c. $795,000  
d. $1,240,000

Feedback:

*a) Answer a) is correct. The past service cost is expensed in the year the amendment is made, which was 20X5. Only the current service cost for 20X6 is recognized in the pension expense for 20X6.

b) Answer b) is incorrect. A past service cost is expensed in the year of amendment, not spread over the years 20X2 and 20X6. Answer a) is correct because the past service cost is expensed in the year the amendment is made, which was 20X5. Only the current service cost for 20X6 is recognized in the pension expense for 20X6.

c) Answer c) is incorrect. Even though there was a payment made in 20X6 related to the past service cost, the total past service cost was expensed in 20X5. Answer a) is correct because the past service cost is expensed in the year the amendment is made, which was 20X5. Only the current service cost for 20X6 is recognized in the pension expense for 20X6.

d) Answer d) is incorrect. This is the total of the past services cost and the current service cost expensed ($890,000 + $350,000 = $1,240,000). Even though there was a payment made in 20X6 related to the past service cost, the total past service cost was expensed in 20X5. Answer a) is correct because the past service cost is expensed in the year the amendment is made, which was 20X5. Only the current service cost for 20X6 is recognized in the pension expense for 20X6.
20. FR283:
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.
b. The pension expense includes the current service cost, interest costs, and any returns on the plan assets.
c. Annually, the employer pays fixed amounts that have been defined by the plan.
d. The employer guarantees a set amount to be paid on the employee’s retirement.

Feedback:

a) 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. 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.

b) 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) 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) 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. FR132:
Angela’s Artwork Inc. (Angela’s) recently entered into a contract to supply artwork to a U.S. company. The controller of Angela’s is not experienced with translation of foreign currency transactions and has made the following entries to record sales to the U.S. company without factoring in the impact of foreign currency on the transactions:

To record sales in USD dollars:

<table>
<thead>
<tr>
<th>DR Accounts receivable</th>
<th>$156,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>CR Sales</td>
<td>$156,000</td>
</tr>
</tbody>
</table>

To record the collection of a portion of the receivable:

<table>
<thead>
<tr>
<th>DR Cash (USD)</th>
<th>$90,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>CR Accounts receivable</td>
<td>$90,000</td>
</tr>
</tbody>
</table>

To record the conversion of a portion of USD cash to CDN cash:

<table>
<thead>
<tr>
<th>DR Cash (CDN)</th>
<th>$78,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>CR Sales</td>
<td>$18,000</td>
</tr>
<tr>
<td>CR Cash (USD)</td>
<td>$60,000</td>
</tr>
</tbody>
</table>

Sales were made evenly over a period when the exchange rate was US$1.00 = C$1.33, and the exchange rate at the end of the fiscal year was US$1.00 = C$1.25.

The foreign exchange gain or loss to be reported on these transactions is determined as follows:

a. By comparing translated year-end receivables to translated sales

*b. By comparing the sum of Canadian cash, translated year-end receivables, and translated U.S. cash to translated sales

c. By comparing the sum of translated year-end receivables and translated U.S. cash to translated sales.

d. There would be no foreign exchange gain or loss because the difference is an adjustment to sales.

Feedback:

a) Answer a) is incorrect. The translated year-end U.S. cash balance and Canadian cash balances must also be included when determining the foreign exchange gain or loss. Answer b) is correct because all balance sheet accounts related to the sale are compared to the translated sales.

*b) Answer b) is correct. All balance sheet accounts related to the sale are compared to the translated sales.

c) Answer c) is incorrect. Answer b) is correct because all balance sheet accounts related to the sale are compared to the translated sales.
d) Answer d) is incorrect. The difference is not an adjustment to sales. The difference should be classified as a foreign exchange gain or loss. Answer b) is correct because all balance sheet accounts related to the sale are compared to the translated sales.
22. FR258:
An entity’s functional currency is the dollar (or equivalent) in the environment:

a. Where the largest purchases occurred
b. In which its CEO resides
c. Where it has its head office located at the end of the year
*d. In which it operates day to day

Feedback:

a) 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) 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) 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) Answer d) is correct. An entity’s functional currency is the dollar (or equivalent) that it primarily uses in day-to-day operations.
23. FR272:
Which of the following statements regarding functional currency is true?

a. It is the currency that a company reports its financial results in.
b. It is the currency that a company primarily uses in its daily operations.
c. It is the currency that a company’s key management receives remuneration in.
d. It is the currency that a company primarily invests in.

Feedback:

a) Answer a) is incorrect. Presentation currency is the currency that a company reports its financial results in. Answer b) is correct because functional currency is the currency that a company primarily uses in its daily operations.

*b) Answer b) is correct. Functional currency is the currency that a company primarily uses in its daily operations.

c) Answer c) is incorrect. A company’s management compensation may contribute to a primary factor in determining functional currency, but it is not always the currency in which key management is compensated. Answer b) is correct because functional currency is the currency that a company primarily uses in its daily operations.

d) Answer d) is incorrect. Investing or financing activities can be a secondary factor when determining a company’s functional currency. Answer b) is correct because functional currency is the currency that a company primarily uses in its daily operations.
24. FR273:
When discussing an integrated operation for a Canadian company, which of the following statements is true?

a. Its functional currency is the same as in a self-sustaining operation.
b. Its functional currency can vary depending on the presentation currency
   *c. Its functional currency is the Canadian dollar.
d. Its functional currency can vary depending on the company’s reporting framework.

Feedback:

a) Answer a) is incorrect. The functional currency of a self-sustaining operation is not the Canadian dollar. Answer c) is correct because the functional currency of an integrated operation is the Canadian dollar.

b) Answer b) is incorrect. Its functional currency does not vary depending on the presentation currency. Answer c) is correct because the functional currency of an integrated operation is the Canadian dollar.

*c) Answer c) is correct. The functional currency of an integrated operation is the Canadian dollar.

d) Answer d) is incorrect. A company’s functional currency is not different under IFRS and ASPE. Answer c) is correct because the functional currency of an integrated operation is the Canadian dollar.
25. FR098:
Under IFRS, intangible assets that may be capitalized include:

a. Internally generated goodwill
b. Internally developed brands
  *c. Overhead costs directly related to development activities
  d. Borrowing costs related to research activities

Feedback:

a) 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) 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) 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) 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. FR045:
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.
*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.
c. Expense the $25,000 redesign cost as a period cost.
d. Record the $25,000 redesign cost as goodwill since it improves the efficiency of the business.

Feedback:

a) Answer a) is incorrect. The $25,000 redesign cost does not improve the future benefit of the building, but rather the employees and equipment within it. Answer b) is correct because the specifically identifiable intangible asset should be amortized over the estimated period of benefit; however, in reality, it may be difficult to estimate the period of future benefit.

*b) Answer b) is correct. The specifically identifiable intangible asset should be amortized over the estimated period of benefit; however, in reality, it may be difficult to estimate the period of future benefit.

c) 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; however, in reality, it may be difficult to estimate the period of future benefit.

d) 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; however, in reality, it may be difficult to estimate the period of future benefit.
27. FR214:
J1 Inc. (J1) received a government grant of $100,000 in fiscal 20X7. The purpose of the grant was to enable J1 to replace manufacturing equipment with “greener” options. The new equipment cost $800,000 and has an estimated useful life of five years. J1 applies IFRS. Which of the following is true about how to account for the government grant?

*a. It must be recognized in income on a systematic basis over the life of the manufacturing equipment.
b. It must be recognized in income evenly over the life of the manufacturing equipment, which equals $20,000 per year.
c. It must be deducted from the cost of the manufacturing equipment in calculating the carrying amount of the asset, which equals a net carrying amount of $700,000.
d. It must be recognized as deferred income and recognized on a systematic basis over the useful life of the asset.

Feedback:

*a) Answer a) is correct. See IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, paragraphs 26 and 27.

b) Answer b) is incorrect. IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, paragraphs 26 and 27, do not require the grant to be recognized evenly over the life of the manufacturing equipment. It must be recognized on a systematic basis that is consistent with the depreciation policy selected for the asset. For example, if the asset is depreciated on a declining-balance basis, the grant income recognized each year would not be $20,000 per year, but it would be consistent with IAS 20 requirements. Answer a) is correct because it must be recognized in income on a systematic basis over the life of the manufacturing equipment.

c) Answer c) is incorrect. IAS 20 Accounting for Government Grants and Disclosure of Government Assistance allows two options for accounting for a government grant. Deducting from the cost of the asset is one of those options, per paragraph 27. However, paragraph 26 allows for the grant to be recognized as deferred income and recognized on a systematic basis over the useful life of the asset. Answer a) is correct because it must be recognized in income on a systematic basis over the life of the manufacturing equipment.

d) Answer d) is incorrect. IAS 20 Accounting for Government Grants and Disclosure of Government Assistance allows two options for accounting for a government grant. Recognizing the grant as deferred income and recognizing it on a systematic basis over the useful life of the asset is one of those options, per paragraph 26. However, deducting from the cost of the asset is also a valid option, per paragraph 27. Answer a) is correct because it must be recognized in income on a systematic basis over the life of the manufacturing equipment.
28. FR215:
The following case facts pertain to Bok Choy Inc. (BCI) and a grant received from the Ontario government:

- On January 1 of the December 31, 20X7 fiscal year, BCI received a grant for $5,000,000 toward the construction of a new building.
- The total construction cost of the building, which was completed on January 1, 20X7, was $25,000,000.
- The building is to be depreciated on a straight-line basis over its useful life, which is expected to be 25 years.
- The grant does not have to be repaid unless BCI fails to meet certain conditions imposed by the Ontario government.
- Management has assessed that it is likely that BCI will meet all conditions of the grant.

What is the impact on income in 20X7 as a result of the above transactions?

a. Income will increase by $200,000.
*b. Income will decrease by $800,000.
c. Income will decrease by $1,000,000.
d. It is not possible to calculate the impact on income without knowing which method BCI will use to account for the grant.

Feedback:

a) Answer a) is incorrect. This option ignores depreciation expense on the building. Answer b) is correct. Proof: ($25,000,000 – $5,000,000) / 25 years = $800,000.

*b) Answer b) is correct. Proof: ($25,000,000 – $5,000,000) / 25 years = $800,000.

c) Answer c) is incorrect. This option does not take into account that a portion of the grant can be recognized in income. Because there is reasonable assurance that the conditions of the grant will be met, it can be recognized according to the provisions of IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, paragraph 7: “Government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that: (a) the entity will comply with the conditions attaching to them; and (b) the grants will be received.” Answer b) is correct. Proof: ($25,000,000 – $5,000,000) / 25 years = $800,000.

d) Answer d) is incorrect. Regardless of which method is used of the two allowable options noted in IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, the impact on income is the same. Answer b) is correct. Proof: ($25,000,000 – $5,000,000) / 25 years = $800,000.
29. FR238:
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.
b. Reversals of impairment losses are permitted under ASPE up to the original cost of the asset, while reversals are not permitted under IFRS.
c. ASPE uses discounted cash flows in assessing the recoverable amount, while IFRS uses the undiscounted cash flows.
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.

Feedback:

a) 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) 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) 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) 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. FR239:
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:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of equipment</td>
<td>$200,000</td>
</tr>
<tr>
<td>Accumulated depreciation — equipment</td>
<td>$40,000</td>
</tr>
<tr>
<td>Undiscounted future net cash flows associated with the equipment (estimated)</td>
<td>$120,000</td>
</tr>
<tr>
<td>Fair value of equipment</td>
<td>$100,000</td>
</tr>
</tbody>
</table>

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

a. $40,000  
b. $60,000  
c. $80,000  
d. $100,000

Feedback:

a) 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) 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) 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) 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. FR056:
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:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation</td>
<td>$20,000</td>
</tr>
<tr>
<td>Meals and entertainment</td>
<td>$2,000</td>
</tr>
<tr>
<td>Maximum possible capital cost allowance (CCA) claim</td>
<td>$25,000</td>
</tr>
<tr>
<td>Applicable tax rate</td>
<td>20%</td>
</tr>
</tbody>
</table>

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

Feedback:

a) Answer a) is incorrect. $100,000 × 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:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income before tax</td>
<td>$100,000</td>
</tr>
<tr>
<td>Add back depreciation</td>
<td>20,000</td>
</tr>
<tr>
<td>Add back non-deductible portion of meals and entertainment</td>
<td>1,000</td>
</tr>
<tr>
<td>Less CCA</td>
<td>(25,000)</td>
</tr>
<tr>
<td>Net income and taxable income</td>
<td>96,000</td>
</tr>
<tr>
<td>Tax rate</td>
<td>20%</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>$19,200</td>
</tr>
</tbody>
</table>
**b) Answer b) is correct. The $19,200 debit to income tax expense is calculated as follows:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income before tax</td>
<td>$100,000</td>
</tr>
<tr>
<td>Add back depreciation</td>
<td>20,000</td>
</tr>
<tr>
<td>Add back non-deductible portion of meals and entertainment</td>
<td>1,000</td>
</tr>
<tr>
<td>Less CCA</td>
<td>(25,000)</td>
</tr>
<tr>
<td>Net income and taxable income</td>
<td>96,000</td>
</tr>
<tr>
<td>Tax rate</td>
<td>20%</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>$19,200</td>
</tr>
</tbody>
</table>

**c) Answer c) is incorrect. This option recorded an additional $1,000 [($25,000 − $20,000) × 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:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income before tax</td>
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<td>Add back depreciation</td>
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</tr>
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<td>Less CCA</td>
<td>(25,000)</td>
</tr>
<tr>
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<td>96,000</td>
</tr>
<tr>
<td>Tax rate</td>
<td>20%</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>$19,200</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income before tax</td>
<td>$100,000</td>
</tr>
<tr>
<td>Add back depreciation</td>
<td>20,000</td>
</tr>
<tr>
<td>Less CCA</td>
<td>(25,000)</td>
</tr>
<tr>
<td>Net income and taxable income</td>
<td>95,000</td>
</tr>
<tr>
<td>Tax rate</td>
<td>20%</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>$19,000</td>
</tr>
</tbody>
</table>
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:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income before tax</td>
<td>$100,000</td>
</tr>
<tr>
<td>Add back depreciation</td>
<td>20,000</td>
</tr>
<tr>
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<td>1,000</td>
</tr>
<tr>
<td>Less CCA</td>
<td>(25,000)</td>
</tr>
<tr>
<td>Net income and taxable income</td>
<td>96,000</td>
</tr>
<tr>
<td>Tax rate</td>
<td>20%</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>$ 19,200</td>
</tr>
</tbody>
</table>
32. FR059:
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.
b. Under ASPE, companies must use the taxes payable method.
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.
*d. Under ASPE, companies choosing to use the future income tax method are not allowed to discount future income tax assets and liabilities.

Feedback:

a) 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) 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) 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) 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. FR295:
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.”
b. An enterprise switches from the gross method to the net method of presenting government grants.
c. A temporary difference was treated as a permanent difference when calculating deferred taxes (IFRS)/future taxes (ASPE).
*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.

Feedback:

a) 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) 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) 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) 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. FR081: 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.  
*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.  
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.  
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.

Feedback:

a) 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) 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) 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) 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. FR042:
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:

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Boxes</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>February 10</td>
<td>Purchase</td>
<td>700</td>
</tr>
<tr>
<td>March 20</td>
<td>Sale</td>
<td>500</td>
</tr>
<tr>
<td>October 30</td>
<td>Purchase</td>
<td>100</td>
</tr>
<tr>
<td>November 15</td>
<td>Sale</td>
<td>400</td>
</tr>
</tbody>
</table>

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

*a. $1,900
b. $1,800
c. $1,666
d. $1,600

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

<table>
<thead>
<tr>
<th>Purchases</th>
<th>Cost of goods sold</th>
<th>Inventory balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Units</td>
<td>Cost</td>
<td>Total</td>
</tr>
<tr>
<td>Opening</td>
<td>300</td>
<td>$9</td>
</tr>
<tr>
<td>Feb 10</td>
<td>700</td>
<td>$7</td>
</tr>
<tr>
<td>March 20</td>
<td>300</td>
<td>$9</td>
</tr>
<tr>
<td>Oct 30</td>
<td>100</td>
<td>$12</td>
</tr>
<tr>
<td>Nov 15</td>
<td>400</td>
<td>$7</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Purchases</th>
<th>Cost of goods sold</th>
<th>Inventory balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Units</td>
<td>Cost</td>
<td>Total</td>
</tr>
<tr>
<td>Opening</td>
<td>300</td>
<td>$9</td>
</tr>
<tr>
<td>Feb 10</td>
<td>700</td>
<td>$7</td>
</tr>
<tr>
<td>March 20</td>
<td>300</td>
<td>$9</td>
</tr>
<tr>
<td>Oct 30</td>
<td>100</td>
<td>$12</td>
</tr>
<tr>
<td>Nov 15</td>
<td>400</td>
<td>$7</td>
</tr>
</tbody>
</table>
c) 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:

<table>
<thead>
<tr>
<th></th>
<th>Purchases</th>
<th>Cost of goods sold</th>
<th>Inventory balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Units</td>
<td>Cost</td>
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</tr>
<tr>
<td>Opening</td>
<td></td>
<td>300</td>
<td>$9</td>
</tr>
<tr>
<td>Feb 10</td>
<td>700</td>
<td>$7</td>
<td>$4,900</td>
</tr>
<tr>
<td>March 20</td>
<td>300</td>
<td>200</td>
<td>$9</td>
</tr>
<tr>
<td>Oct 30</td>
<td>100</td>
<td>$12</td>
<td>$1,200</td>
</tr>
<tr>
<td>Nov 15</td>
<td>400</td>
<td>$7</td>
<td>$2,800</td>
</tr>
</tbody>
</table>


d) 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:

<table>
<thead>
<tr>
<th></th>
<th>Purchases</th>
<th>Cost of goods sold</th>
<th>Inventory balance</th>
</tr>
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<tr>
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<td>300</td>
<td>$9</td>
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<td>$4,900</td>
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<td>March 20</td>
<td>300</td>
<td>200</td>
<td>$9</td>
</tr>
<tr>
<td>Oct 30</td>
<td>100</td>
<td>$12</td>
<td>$1,200</td>
</tr>
<tr>
<td>Nov 15</td>
<td>400</td>
<td>$7</td>
<td>$2,800</td>
</tr>
</tbody>
</table>
36. FR020:
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
b. Amortization on the corporate headquarters
c. Storage costs, once production is complete
d. CEO’s wages

Feedback:

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

b) 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) 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) 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. FR050:
You are discussing the classification of leases with Howie, a fellow associate at Burns and Pickle LLP. Which one of Howie’s statements regarding leases for a company reporting under ASPE is correct?

a. A lease is a capital lease if the present value of the minimum lease payments is 75% or more of the fair market value of the property at the inception of the lease.
b. If a lease has no bargain purchase option, it must be classified as an operating lease.
c. From a lessee’s perspective, when determining the present value of the minimum lease payments, you only include annual lease payments.
*d. When calculating the interest rate implicit in the lease, you include the minimum lease payments plus the unguaranteed residual value of the leased property.

Feedback:

a) Answer a) is incorrect. Where the lessor recovers substantially all of its investment in the leased property and earns a return on that investment (where the present value of the minimum lease payments is equal to 90% or more of the fair value of the leased asset), the lease is classified as a capital lease. Answer d) is correct because the discount rate implicit in the lease is the lessor’s internal rate of return at the beginning of the lease that makes the present value of the minimum lease payments plus any unguaranteed residual values equal to the fair value of the asset being leased.

b) Answer b) is incorrect. Where there is no bargain purchase option, a lease can still be classified as a capital lease where the lessee will benefit from most of the asset benefits due to the length of the lease term and/or the lessor recovers substantially all of its investment and earns a return on that investment. Answer d) is correct because the discount rate implicit in the lease is the lessor’s internal rate of return at the beginning of the lease that makes the present value of the minimum lease payments plus any unguaranteed residual values equal to the fair value of the asset being leased.

c) Answer c) is incorrect. From a lessee’s perspective, the minimum lease payments include the following: the minimum rental payments, any amounts guaranteed by the lessee related to the residual value of the leased asset, and a bargain purchase option (which may or may not be included in the lease conditions). Answer d) is correct because the discount rate implicit in the lease is the lessor’s internal rate of return at the beginning of the lease that makes the present value of the minimum lease payments plus any unguaranteed residual values equal to the fair value of the asset being leased.

*d) Answer d) is correct. The interest rate implicit in the lease is the discount rate at the beginning of the lease that makes the present value of the minimum lease payments plus any unguaranteed residual values equal to the fair value of the asset being leased.
38. FR048:
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:

- Lease payments of $25,000 are made annually on the first day of the year.
- Included in the annual lease payments are maintenance fees of $2,000 per year.
- The machinery reverts to the lessor at the end of the lease and the lease contains no renewal options.
- Beatty uses straight-line depreciation for the machinery that it owns.
- 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.
- Beatty’s incremental borrowing rate is 11% per year.
- 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  
b. $94,356  
c. $104,247  
d. $102,561

Feedback:

*a) 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. 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) 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. 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.
c) Answer c) is incorrect. Proof of calculation: The present value of the minimum lease payments = $25,000 \times \text{present value of an annuity due at the beginning of the period for five periods at 10\%} = $25,000 \times 4.16986 = $104,247. 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 \text{present value of an annuity due at the beginning of the period for five periods at 10\%} = $23,000 \times 4.16986 = $95,907.

d) Answer d) is incorrect. Proof of calculation: The present value of the minimum lease payments = $25,000 \times \text{present value of an annuity due at the beginning of the period for five periods at 11\%} = $25,000 \times 4.10245 = $102,561. 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 \text{present value of an annuity due at the beginning of the period for five periods at 10\%} = $23,000 \times 4.16986 = $95,907.
39. FR083:
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.
b. MNR should record $80,000 as deferred revenue because that is the amount earned.
c. MNR should record $120,000 as deferred revenue because the contract is not yet complete.
d. MNR should record $120,000 as revenue because that is the amount of cash received.

Feedback:
*a) 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 × $120,000: $40,000.

b) Answer b) is incorrect. Revenue has been earned for eight months from March 1 to October 31 (8/12 × $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 × $120,000: $40,000.

c) Answer c) is incorrect. Revenue has been earned for eight months from March 1 to October 31 (8/12 × $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 × $120,000 = $40,000.

d) 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 × $120,000 = $40,000.
40. FR010:
Amaris Corp. manufactures and installs air conditioning systems. It recently signed a contract with Barkley Inc. to provide 10 custom-built air conditioning units, including installation, for total consideration of $250,000. Of this amount, $50,000 is non-refundable and is due in advance; the balance is due after all 10 units have been installed. The units will be manufactured and shipped over a one-month period, and the full installation will occur the following month. Amaris also sells air conditioning units without installation because several of its customers hire independent installers that they have used for other projects.

Which of the following statements is true?

a. Amaris should recognize $250,000 as revenue only when all installations are complete.
b. The non-refundable deposit should be recognized in revenue at the beginning of the contract.
c. The revenue related to the sale of air conditioning units cannot be recognized separately because the Barkley contract specifies that the installation must be completed.
*d. The revenue related to the installation of air conditioning units can be recognized separately because there is evidence of a fair market value for the air conditioners.

Feedback:

a) Answer a) is incorrect. The contract is composed of both goods (the air conditioners) and services (the installation), which are distinct. The fact that Amaris sells air conditioners without installation supports the fact that the revenue from the goods can be recognized before the installation occurs. Answer d) is correct. The contract has two distinct components. The sale of the goods would normally be complete when the units are delivered. This amount is measurable and is separate from the amount that is related to installation.

b) Answer b) is incorrect. The deposit is related to the contract, and at the beginning of the contract, no performance obligations have been met. Answer d) is correct. The contract has two distinct components. The sale of the goods would normally be complete when the units are delivered. This amount is measurable and is separate from the amount that is related to installation.

c) Answer c) is incorrect. Since Amaris also sells units without installation, the revenue related to the sale of the air conditioning unit is distinct from the revenue related to installation. Answer d) is correct. The contract has two distinct components. The sale of the goods would normally be complete when the units are delivered. This amount is measurable and is separate from the amount that is related to installation.

*d) Answer d) is correct. The contract has two distinct components. The sale of the goods would normally be complete when the units are delivered. This amount is measurable and is separate from the amount that is related to installation.
41. FR202:
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.
*b. IFRS requires non-monetary, revenue-generating transactions to be recorded at the fair value of the asset received when known.
c. IFRS does not provide guidance on measurement of NMTs and ASPE does.
d. ASPE does not provide guidance on measurement of NMTs and IFRS does.

Feedback:

a) 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) 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) 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) 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. FR177:
John Book, a designated accountant with Books Accounting (Books), offers to prepare the first-year tax return for New Web Design (New Web), a start-up company. In exchange for Book’s services to file New Web’s tax return, New Web will design its first trial cloud-based service application for John’s accounting business. How should this transaction be recorded, as per ASPE?

a. Neither company is required to record this transaction.
b. Only New Web should record this transaction at the fair value of the service given up.
c. Both New Web and Books should record this transaction at the fair value of the asset given up.
*d. Both New Web and Books should record this transaction at an amount equal to the fair value of the tax return filing service.

Feedback:

a) Answer a) is incorrect. This is a non-monetary exchange where services are exchanged for other services with no monetary consideration. Per ASPE 3831, the transaction should be measured and recorded at the fair value of the asset (or service) given up (unless the fair value of the asset (or service) received is a more reliable measure). Both companies are required to record this transaction. Answer d) is correct because New Web should record the transaction at the fair value of the service received while Books should record the transaction at the fair value of the service given up. The fair value of the tax return filing service is more reliably measured than the design of the new trial cloud-based application.

b) Answer b) is incorrect. Per ASPE 3831, the transaction should be measured and recorded at the fair value of the asset (or service) given up, unless the fair value of the asset (or service) received is a more reliable measure. Both companies are required to record this transaction. Answer d) is correct because New Web should record the transaction at the fair value of the service received while Books should record the transaction at the fair value of the service given up. The fair value of the tax return filing service is more reliably measured than the design of the new trial cloud-based application.

c) Answer c) is incorrect. Per ASPE 3831, the transaction should be measured and recorded at the fair value of the asset (or service) given up, unless the fair value of the asset (or service) received is a more reliable measure. Answer d) is correct because the fair value of the tax return filing service is more reliably measured than the design of the new trial cloud-based application.
*d) Answer d) is correct. Per ASPE 3831, the transaction should be measured and recorded at the fair value of the asset (or service) given up, unless the fair value of the asset (or service) received is a more reliable measure. New Web should record the transaction at the fair value of the service received while Books should record the transaction at the fair value of the service given up. The fair value of the tax return filing service is more reliably measured than the design of the new trial cloud-based application.
43. FR261:
Which of the following statements about fund accounting under accounting standards for not-for-profit organizations (ASNPO) is true?

*a. A self-balancing set of accounts for each fund
b. Required for each fund
c. Typically shown as a row for each fund in the financial statements
d. Made up of net asset funds

Feedback:

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

b) 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) 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) 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. FR262:
Under ASNPO, which of the following statements is true?

a. The deferral method facilitates tracking externally restricted contributions.
b. 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.
d. The fund method tracks all contributions separately in their own fund.

Feedback:

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

c) 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) 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. FR206:
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.
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.
*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.
d. Accounting is the same under IFRS and ASPE for passive investments.

Feedback:

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

d) 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. FR207:
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

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

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

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

Feedback:
*a) Answer a) is correct:
$1,000,000 \times (P/F 4\%\dagger, 20) = $1,000,000 \times 0.45639 = $456,390
$30,000 \text{ interest} \times (P/A 4\%\dagger, 20) = $30,000 \times 13.59033 = $407,710
\text{Issuance price (fair value)} = $456,390 + $407,710 = $864,100
\dagger4\% = 8\% / 2 \text{ to reflect 20 half-year periods}

b) 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\%\dagger, 20) = $1,000,000 \times 0.45639 = $456,390
$30,000 \text{ interest} \times (P/A 4\%\dagger, 20) = $30,000 \times 13.59033 = $407,710
\text{Issuance price (fair value)} = $456,390 + $407,710 = $864,100
\dagger4\% = 8\% / 2 \text{ to reflect 20 half-year periods}
c) 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:
$1,000,000 \times (P/F \ 4\%\uparrow, \ 20) = 1,000,000 \times 0.45639 = 456,390$
$30,000 \text{ interest} \times (P/A \ 4\%\uparrow, \ 20) = 30,000 \times 13.59033 = 407,710$
Issuance price (fair value) = $456,390 + 407,710 = 864,100$
\(\uparrow 4\% = 8\% / 2 \text{ to reflect 20 half-year periods}\)

d) 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 $30,000 \times (P/A \ 8\%, \ 10)$.
Answer a) is correct:
$1,000,000 \times (P/F \ 4\%\uparrow, \ 20) = 1,000,000 \times 0.45639 = 456,390$
$30,000 \text{ interest} \times (P/A \ 4\%\uparrow, \ 20) = 30,000 \times 13.59033 = 407,710$
Issuance price (fair value) = $456,390 + 407,710 = 864,100$
\(\uparrow 4\% = 8\% / 2 \text{ to reflect 20 half-year periods}\)
47. FR227:
Under IFRS, which of the following can be capitalized to the cost of land?

a. CEO’s salary  
b. Construction materials  
c. Utilities  
*d. Title search  

Feedback:

a) 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) 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) 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) Answer d) is correct. Costs to perform a title search can be capitalized to the cost of the land.
48. FR230:
The units of production method of depreciation:

a. Assumes that the benefit derived from the asset is higher in its initial years
b. Is the cost of the asset, net of the residual value, divided by the estimated useful life
*c. 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

Feedback:

a) 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) 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) 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) 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. FR178:
Flowers International Ltd. (Flowers), a wholesaler of plants, is a subsidiary of Blooms Inc. Flowers has a 25% ownership interest in Blooms Inc. Blooms Inc. sells floral bouquets nationwide and applies IFRS.

Which one of the following parties would be a related party to Blooms Inc.?

a. The sister to the spouse of Blooms’ CEO
b. National Delivery Service, a company owned 15% by Flowers
c. CostGo, the largest customer of Blooms Inc.
*d. The minority shareholder of Bloom, who accounts for the investment using the equity method

Feedback:

a) Answer a) is incorrect. The spouse of Blooms’ CEO would be a related party to Blooms Inc. Per IAS 24.9(a)(iii), one definition of a related party is a person who is a member of key management personnel of the reporting entity, or a close member of that person’s family. The sister of the CEO’s spouse, a member of key management at Blooms Inc., would not be considered a related party. Answer d) is correct because the minority shareholder is a related party to Blooms Inc. As per IAS 24.9(a)(ii), a person who has significant influence over the reporting entity is a related party. Since the minority shareholder accounts for its investment in Blooms Inc. using the equity method, this implies that the minority shareholder has significant influence and qualifies as a related party to Blooms Inc.

b) Answer b) is incorrect. Neither Bloom nor Flowers have significant influence over National Delivery Service. Bloom is not a related party to National Delivery Service. Answer d) is correct because the minority shareholder is a related party to Blooms Inc. As per IAS 24.9(a)(ii), a person who has significant influence over the reporting entity is a related party. Since the minority shareholder accounts for its investment in Blooms Inc. using the equity method, this implies that the minority shareholder has significant influence and qualifies as a related party to Blooms Inc.

c) Answer c) is incorrect. CostGo is not a related party to Blooms Inc. Customers are not related parties (they have no ability to exercise, directly or indirectly, control, joint control, or significant influence over Blooms Inc.) Answer d) is correct because the minority shareholder is a related party to Blooms Inc. As per IAS 24.9(a)(ii), a person who has significant influence over the reporting entity is a related party. Since the minority shareholder accounts for its investment in Blooms Inc. using the equity method, this implies that the minority shareholder has significant influence and qualifies as a related party to Blooms Inc.
*d) Answer d) is correct. The minority shareholder is a related party to Blooms Inc. As per IAS 24.9(a)(ii), a person who has significant influence over the reporting entity is a related party. Since the minority shareholder accounts for its investment in Blooms Inc. using the equity method, this implies that the minority shareholder has significant influence and qualifies as a related party to Blooms Inc.
50. FR222:
Which of the following is a required disclosure under IFRS, but not ASPE?

a. Nature of transactions  
b. Amounts  
*c. Key management compensation  
d. Obligations  

Feedback:

a) Answer a) is incorrect. This is a disclosure required under both ASPE and IFRS. Answer c) is correct because, per IAS 24.13, key management compensation is a required disclosure.

b) Answer b) is incorrect. This is a disclosure required under both ASPE and IFRS. Answer c) is correct because, per IAS 24.13, key management compensation is a required disclosure.

* c) Answer c) is correct. Per IAS 24.13, key management compensation is a required disclosure.

d) Answer d) is incorrect. This is a disclosure required under both ASPE and IFRS. Answer c) is correct because, per IAS 24.13, key management compensation is a required disclosure.
51. FR298:
Ninja Frog Inc., a publicly traded company, has seven operating segments all producing different products with the following results:

<table>
<thead>
<tr>
<th>Segments</th>
<th>Sales</th>
<th>Profit (Loss)</th>
<th>Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Orange</td>
<td>$100</td>
<td>$50</td>
<td>$500</td>
</tr>
<tr>
<td>Yellow</td>
<td>15</td>
<td>(50)</td>
<td>60</td>
</tr>
<tr>
<td>Purple</td>
<td>200</td>
<td>25</td>
<td>100</td>
</tr>
<tr>
<td>Blue</td>
<td>125</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Red</td>
<td>65</td>
<td>15</td>
<td>5</td>
</tr>
<tr>
<td>Pink</td>
<td>200</td>
<td>50</td>
<td>100</td>
</tr>
<tr>
<td>White</td>
<td>65</td>
<td>20</td>
<td>50</td>
</tr>
</tbody>
</table>

Total: $770, $120, $825

Based on the quantitative thresholds, how many reportable segments are there?

a. 3
b. 4
c. 5
*d. 6

Feedback:
a) Answer a) is incorrect. Answer d) is correct. The orange, yellow, purple, blue, pink, and white segments are all reportable. Proof:

Note: Greater of absolute profit or absolute loss = total profit (170) or total loss (50) = $170.

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<tr>
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<td>6%</td>
<td>1%</td>
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<tr>
<td>Red</td>
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Total: 100% N/A 100%
b) Answer b) is incorrect. Answer d) is correct. The orange, yellow, purple, blue, pink, and white segments are all reportable. Proof:

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c) Answer c) is incorrect. Answer d) is correct. The orange, yellow, purple, blue, pink, and white segments are all reportable. Proof:

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*d) Answer d) is correct. The orange, yellow, purple, blue, pink, and white segments are all reportable. Proof:
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100% N/A 100%
52. FR299:
Each reportable segment must have which of the following disclosed?

*a. Net earnings
b. Gross revenues
c. Related parties
d. Earnings per share

Feedback:

*a) Answer a) is correct. Profit or loss is required to be disclosed for each reportable segment.

b) Answer b) is incorrect. Gross revenues are not required to be disclosed for each reportable segment. Answer a) is correct. Profit or loss is required to be disclosed by each reportable segment.

c) Answer c) is incorrect. Related parties are not required to be disclosed for each reportable segment. Answer a) is correct. Profit or loss is required to be disclosed by each reportable segment.

d) Answer d) is incorrect. Earnings per share are not required to be disclosed for each reportable segment. Answer a) is correct. Profit or loss is required to be disclosed by each reportable segment.
53. FR002:
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.
b. Recognize revenue when payments are received, because the amount to be recognized is measurable and collectable, and the performance obligation has been satisfied.
c. Recognize payments into revenue when the related operating expenses are recorded, because this will ensure that revenues match their related expenses.
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.

Feedback:

*a) 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) 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) 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) 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. FR120:
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
*b. When the clothes are shipped to the customer

c. When future benefits of an asset expire
d. When contracts/invoices are prepared

Feedback:

a) 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) 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) 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) 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. FR180:
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.
*b. Disclose within the notes to financial statements.
c. No action is required, as long as the company is a going concern.
d. Both options a) and b) above

Feedback:

a) 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) 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.

c) 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) 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. FR145:
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
b. Change in foreign currency exchange rates subsequent to the financial statement date
*c. Initiation of bankruptcy proceedings subsequent to the financial statement date against a customer with a large accounts receivable balance at year end
d. Commencement of litigation where the customer slipped on ice and fell after year end

Feedback:

a) 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) 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) 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) 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. FR211:
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:
- RI paid $100,000 in dividends.
- 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
b. $170,000
*c. $245,000
d. $250,000

Feedback:

a) 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) 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) 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) 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. FR212:
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
b. Goodwill
c. Net income
*d. Unrealized profit in inventory

Feedback:

a) Answer a) is incorrect. Purchase price increases the investment account. Answer d) is correct because, 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) 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 because, 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) Answer c) is incorrect. Net income would increase the investment account. Answer d) is correct because, 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) 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. FR025:
Recently, Claries Clothing Inc. (CCI), a Canadian company, received an order to sell to a new customer in the United States. The invoice is for US$300,000.

On August 15, 20X6, the goods were shipped and invoiced. On this date the exchange rate is US$1 = C$1.20. The customer has agreed to pay on October 15, 20X6, two months from the date of sale and shipment. The company has taken no action to offset its foreign exchange risk at this point.

Which of the following statements BEST describes possible outcomes related to this sale?

a. If the customer pays the invoice immediately, at the date of sale, there is foreign exchange risk associated with the amount of the sale and an exchange gain of $60,000 is recorded [$300,000 × (1.00 – 1.20)].

b. If CCI enters into a forward contract on the date of sale and shipment, based on a two-month forward rate of US$1 = C$1.23, CCI will record an exchange loss of $9,000 on the date the customer pays.

c. If the customer pays in two months, and if the exchange rate is US$1 = C$1.25 at that time, CCI will realize an exchange loss of $15,000.

*d. If the customer pays in two months, and if the exchange rate is US$1 = C$1.25 at that time, CCI will realize an exchange gain of $15,000.

Feedback:

a) Answer a) is incorrect. The sale has been completed and is reported at the spot rate in effect at the date of sale. If the invoice is paid immediately, there is no foreign exchange risk as the amount of cash is received immediately. Answer d) is correct because the company will realize an exchange gain of $15,000 [$300,000 × (1.25 – 1.20)].

b) Answer b) is incorrect. The company will actually record an exchange gain of $9,000 [$300,000 × (1.23 – 1.20)] on the date the customer pays and settles the bill. Answer d) is correct because the company will realize an exchange gain of $15,000 [$300,000 × (1.25 – 1.20)].

c) Answer c) is incorrect. This exchange rate is more favourable for CCI and will result in an exchange gain of $15,000 [$300,000 × (1.25 – 1.20)], not a loss. Answer d) is correct because the company will realize an exchange gain of $15,000 [$300,000 × (1.25 – 1.20)].

*d) Answer d) is correct. The company will realize an exchange gain of $15,000 [$300,000 × (1.25 – 1.20)].
60. FR024:
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.
b. NMC will deliver 150,000 pounds of nickel on July 31, 20X6, and receive cash of $900,000 on delivery.
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.
d. NMC will deliver 150,000 pounds of nickel on July 31, 20X6, and receive $1,050,000 on delivery.

Feedback:
a) 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 × $7 = $1,050,000). Answer d) is correct because 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 × $7).
b) 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 × 150,000 = $900,000). Answer d) is correct because 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 × $7).
c) 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 because 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 × $7).
d) 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 × $7).
61. FR003:
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:

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Cash</td>
<td>$200</td>
</tr>
<tr>
<td>Dr. Accounts receivable</td>
<td>$3,300</td>
</tr>
<tr>
<td>Cr. Sales</td>
<td>$3,500</td>
</tr>
</tbody>
</table>

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

Feedback:

a) 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) 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) 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) Answer d) is incorrect. This adjusting entry recognizes $3,300 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. 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.
62. A195:
You, CPA, are conducting an audit of your client, Georgetown Plastic Corp. (GPC). Early in the fiscal year, GPC suffered a gas explosion, which had a significant impact on its results and will continue to have a significant effect on its financial position. The gas explosion has been properly recognized and disclosed in the financial statements. You were able to obtain sufficient appropriate audit evidence to ensure that the financial statements at year end are free of material misstatements.

As part of your auditor's report, which of the following must be included?

*a. An emphasis of matter paragraph  
b. A scope limitation  
c. A qualified opinion  
d. An adverse opinion

Feedback:
*a) Answer a) is correct. An emphasis of matter paragraph is used by a practitioner when it is necessary to draw the users’ attention to a matter presented or disclosed in the financial statements that is, according to the practitioner’s judgment, fundamental to the users’ understanding of the financial statements.

b) Answer b) is incorrect. There is no scope limitation in this example, since sufficient appropriate audit evidence has been gathered. Answer a) is correct because an emphasis of matter paragraph is used by a practitioner when it is necessary to draw the users’ attention to a matter presented or disclosed in the financial statements that is, according to the practitioner’s judgment, fundamental to the users’ understanding of the financial statements.

c) Answer c) is incorrect. A qualified opinion is required when misstatements are determined to be material but not pervasive. There are no misstatements in this case. Answer a) is correct because an emphasis of matter paragraph is used by a practitioner when it is necessary to draw the users’ attention to a matter presented or disclosed in the financial statements that is, according to the practitioner’s judgment, fundamental to the users’ understanding of the financial statements.

d) Answer d) is incorrect. An adverse opinion is required where the misstatements are determined to be material and pervasive. There are no misstatements in this case. Answer a) is correct because an emphasis of matter paragraph is used by a practitioner when it is necessary to draw the users’ attention to a matter presented or disclosed in the financial statements that is, according to the practitioner’s judgment, fundamental to the users’ understanding of the financial statements.
63. A005:
Which of the following statements regarding an audit of financial statements is true?

*a. They increase agency costs  
b. They increase agency risk  
c. They increase information risk  
d. They decrease information costs

Feedback:

*a) 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) 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) 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) 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.
64. A068:
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.  
b. Tests of controls alone are too costly.  
c. It is more effective to audit a large number of transactions using substantive procedures.  
d. Substantive procedures can be performed after year end.

Feedback:

*a) Answer a) is correct. Control testing reduces control risk but does not address either detection risk or inherent risk; therefore, substantive procedures are still required to sufficiently reduce the risk of material misstatement in a financial statement audit.

b) 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 does not address either detection risk or inherent risk; therefore, substantive procedures are still required to sufficiently reduce the risk of material misstatement in a financial statement audit.

c) 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 does not address either detection risk or inherent risk; therefore, substantive procedures are still required to sufficiently reduce the risk of material misstatement in a financial statement audit.

d) 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 does not address either detection risk or inherent risk; therefore, substantive procedures are still required to sufficiently reduce the risk of material misstatement in a financial statement audit.
65. A069:
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.
b. The company has many transactions.
c. The company has controls that can be relied on.
  *d. The company has few transactions.

Feedback:

a) 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) 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) 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) 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.
66. A127:
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
*b. Issue an unqualified opinion

c. Use a combined audit approach

d. Rely on management’s statements as fact

Feedback:

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

b) 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 unqualified audit opinion.

c) 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 unqualified audit opinion.

d) 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 unqualified audit opinion.
67. A128:
Which of the following statements regarding audit evidence is true?

a. Sufficiency is the measure of the quality of audit evidence.
b. The higher the relevance and reliability of evidence, the lower the quality of results
*c. The higher the quality of evidence, the less evidence may be required.
d. Reliability refers to the connection between audit procedures and assertions.

Feedback:

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

d) 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.
68. A161:
When a sample is stratified, which items would the practitioner judgmentally select from the population for testing?

a. High-value items only
b. High-risk items only
c. Various representative items
*d. High-risk items and high-value items

Feedback:

a) Answer a) is incorrect. Answer d) is correct because both high-value items and high-risk items are considered to be “specific” items when stratifying a population.

b) Answer b) is incorrect. Answer d) is correct because both high-value items and high-risk items are considered to be “specific” items when stratifying a population.

c) Answer c) is incorrect. Answer d) is correct because both high-value items and high-risk items are considered to be “specific” items when stratifying a population.

*d) Answer d) is correct. Both high-value items and high-risk items are considered to be “specific” items when stratifying a population.
69. A154:
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
*b. Confirmation and recalculation
c. Analytical reviews and reperformance
d. Inquiry and reperformance

Feedback:

a) 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) 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) 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) 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.
70. A194:
Steven, CPA, has completed his audit of Abbots Machining Inc. (AMI). The confirmation of accounts receivable did not go well, and the majority of AMI’s customers were unresponsive to the confirmations and follow up requests. Steven is now preparing the auditor’s report.

This failure to be able to obtain external confirmation of customers’ outstanding balances was determined to potentially have a material but not pervasive impact on the financial statements.

As a result, the auditor’s report will have:

*a. A qualified opinion
b. A disclaimer of opinion
c. An emphasis of matter paragraph
d. An adverse opinion

Feedback:

*a) Answer a) is correct. A qualified opinion is required when a scope limitation could limit the ability to identify errors that may be material but not pervasive.

b) Answer b) is incorrect. A disclaimer of opinion is provided when the effect of the scope limitation is determined to limit the ability to identify errors that may be material and pervasive. Answer a) is correct. A qualified opinion is required when a scope limitation could limit the ability to identify errors that may be material but not pervasive.

c) Answer c) is incorrect. An emphasis of matter paragraph is provided when there is no material misstatement or scope limitation, but there is an important point that the practitioner wants to draw attention to. Answer a) is correct. A qualified opinion is required when a scope limitation could limit the ability to identify errors that may be material but not pervasive.

d) Answer d) is incorrect. An adverse opinion is required when sufficient appropriate audit evidence is obtained to determine that the misstatements are material and pervasive. Answer a) is correct. A qualified opinion is required when a scope limitation could limit the ability to identify errors that may be material but not pervasive.
71. A173:
You, CPA, are conducting an audit of your client, Window Installers Inc. You have just completed your audit of the inventory and found that the opening inventory had incorrectly included the inventory at an off-site storage facility twice, causing the opening inventory to be overstated by $135,000.

What type of misstatement does this represent?

a. Fraud
*b. Factual
 c. Projected
 d. Judgmental

Feedback:

a) Answer a) is incorrect. There is no indication that this represents fraud. Answer b) is correct because this is a factual misstatement, since there is no doubt as to the amount by which the opening inventory is overstated. In this case, the misstatement arises due to including certain inventory items twice.

*b) Answer b) is correct. This is a factual misstatement, since there is no doubt as to the amount by which the opening inventory is overstated. In this case, the misstatement arises due to including certain inventory items twice.

c) Answer c) is incorrect. Projected misstatements are calculated by projecting misstatements identified in audit samples to the entire representative population from which the sample was drawn. Answer b) is correct because this is a factual misstatement, since there is no doubt as to the amount by which the opening inventory is overstated. In this case, the misstatement arises due to including certain inventory items twice.

d) Answer d) is incorrect. A judgmental misstatement arises when management has applied estimates that the auditor believes are not appropriate. Answer b) is correct because this is a factual misstatement, since there is no doubt as to the amount by which the opening inventory is overstated. In this case, the misstatement arises due to including certain inventory items twice.
72. A070:
Which of the following options supports a practitioner using a combined approach instead of a purely substantive approach when planning the audit?

*a. The company has an employee code of conduct manual.  
b. The company has few transactions.  
c. The company does not have an internal audit department.  
d. The company has many foreign-currency transactions. 

Feedback:

*a) Answer a) is correct. The employee code of conduct manual supports a formal set of policies and procedures that would decrease control risk.

b) Answer b) is incorrect. Few transactions mean that, even if controls could be relied on, it might be more efficient to audit using a purely substantive approach. Answer a) is correct because the employee code of conduct manual supports a formal set of policies and procedures that would decrease control risk.

c) Answer c) is incorrect. An internal audit department can decrease control environment risk. Answer a) is correct because the employee code of conduct manual supports a formal set of policies and procedures that would decrease control risk.

d) Answer d) is incorrect. This is an inherent risk and would not impact the practitioner's decision to implement either a combined or a purely substantive approach. Answer a) is correct because the employee code of conduct manual supports a formal set of policies and procedures that would decrease control risk.
73. A085:
Which of the following would improve the quick ratio?

*a. Sell fixed assets to reduce accounts payable.
b. Increase bank indebtedness to purchase equipment.
c. Issue common stock to purchase inventory.
d. Aggressively collect accounts receivable.

Feedback:

*a) 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) 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) 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) 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.
74. A084:
During the year, LMN Inc. had:

- sales of $2,500,000
- gross profit of $1,000,000
- 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
b. 5.22 times
c. 5.45 times
d. 8.70 times

Feedback:

a) Answer a) is incorrect. The inventory turnover of five times is incorrectly calculated as ($2,500,000 sales – $1,000,000 gross profit) / $300,000 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 sales – $1,000,000 gross profit) / [($300,000 ending inventory balance + $275,000 beginning inventory balance) / 2]. Inventory turnover is calculated as cost of goods sold (sales less gross profit) divided by the average inventory balance.

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

c) Answer c) is incorrect. The inventory turnover of 5.45 times is incorrectly calculated as ($2,500,000 sales – $1,000,000 gross profit) / $275,000 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 sales – $1,000,000 gross profit) / [($300,000 ending inventory balance + $275,000 beginning inventory balance) / 2]. Inventory turnover is calculated as cost of goods sold (sales less gross profit) divided by the average inventory balance.

d) Answer d) is incorrect. The inventory turnover ratio of 8.70 times is incorrectly calculated as $2,500,000 sales / [($300,000 ending inventory balance + $275,000 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 sales – $1,000,000 gross profit) / [($300,000 ending inventory balance + $275,000 beginning inventory balance) / 2]. Inventory turnover is calculated as cost of goods sold (sales less gross profit) divided by the average inventory balance.
75. A071:
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.
b. The number of substantive tests is low.
c. Controls cannot be relied on.
d. Fraud risk is assessed as high.

Feedback:

a) 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 because, 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) 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) 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.

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Answer b) is correct because, 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.

Answer d) is correct. 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 because, 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.
76. A081:
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  
b. Inventory turnover ratio  
*c. Quick ratio  
d. Times interest earned

Feedback:

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

d) 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.
77. A080:
Why is conducting an analysis of a company’s financial ratios beneficial?

a. It is a central component of value-chain analysis.
b. It identifies external opportunities for the company to pursue.
c. It uncovers critical industry trends.
*d. It provides insights into a company’s financial state.

Feedback:

a) 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) 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) 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) 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.
78. A082:
Which of the following statements for financial statement analysis is true?

*a. A high debt-to-equity ratio is a negative qualitative factor.
b. A high gross-margin-percentage ratio is a negative qualitative factor.
c. A high dividend-payout ratio is positive qualitative factor.
d. A high days-payable-outstanding ratio is a positive qualitative factor.

Feedback:

*a) 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) 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) 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) 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.
79. A152:
Which one of the following statements describes analytical procedures?

a. Analytical procedures are only used in the planning stage of an engagement.
*b. Analytical procedures help to identify unusual or unexpected balances that require further assurance work.
c. Analytical procedures are not used in the planning stage of an engagement.
d. Analytical procedures are used exclusively on the income statement to analyze the reasonability of accounts as compared to plan and prior year.

Feedback:

a) 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) 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) 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) 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.
80. A153:
Substantive procedures are designed to:

*a. Detect material misstatements at the account level
b. Detect material misstatements at the overall financial statement level
c. Detect all misstatements.
d. Detect changes from the prior year’s financial statements.

Feedback:

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

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

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

d) Answer d) is incorrect. Answer a) is correct because substantive procedures are designed to detect material misstatements at the account level.
81. A172:
You, CPA, are conducting an audit of your client, Bread Baker Corp. You have just completed your audit of the accounts receivable and found that the company has recorded an allowance for doubtful accounts of $560,000. Based on your audit, you have determined the allowance for doubtful accounts should be $970,000. The difference arises due to disagreement on what assumptions have been used to recognize the allowance. Thus, there is a misstatement of $410,000 in Bread Baker’s year-end statements.

What type of misstatement does this represent?

a. Factual
b. Projected
*c. Judgmental
d. Fraud

Feedback:

a) Answer a) is incorrect. Factual misstatements are misstatements regarding which there is no doubt. In this case, the misstatement arises due to differences in assumptions used. Answer c) is correct because the allowance for doubtful accounts is based on assumptions and estimates, and therefore represents a judgmental misstatement because you, as the auditor, consider management’s estimate to be unreasonable or inappropriate.

b) Answer b) is incorrect. Projected misstatements are calculated by projecting misstatements identified in audit samples to the entire representative population from which the sample was drawn. Answer c) is correct because the allowance for doubtful accounts is based on assumptions and estimates, and therefore represents a judgmental misstatement because you, as the auditor, consider management’s estimate to be unreasonable or inappropriate.

*c) Answer c) is correct. The allowance for doubtful accounts is based on assumptions and estimates, and therefore represents a judgmental misstatement because you, as the auditor, consider management’s estimate to be unreasonable or inappropriate.

d) Answer d) is incorrect. There is no indication that this represents fraud. Answer c) is correct because the allowance for doubtful accounts is based on assumptions and estimates, and therefore represents a judgmental misstatement because you, as the auditor, consider management’s estimate to be unreasonable or inappropriate.
82. A175:
Sarah, CPA, is conducting an audit for her client, Jimmy’s Trattoria Restaurants (JTR). After gathering sufficient and appropriate audit evidence, Sarah is faced with the following misstatements that JTR refuses to adjust:

- Marketing expenses of $150,000 that relate to next year and should not have been accrued at year end
- A provision for warranty costs in the amount of $280,000 that was not recognized
- A purchase of land for $125,000 that was incorrectly recorded as an intangible asset

The total impact of JTR’s uncorrected misstatements is that pre-tax income is:

a. Understated by $430,000
b. Understated by $5,000
c. Overstated by $130,000
d. Overstated by $555,000

Feedback:

a) Answer a) is incorrect. The warranty costs were not recognized and, therefore, pre-tax income will be decreased if the warranty costs are corrected. Answer c) is correct because the impact of these unadjusted differences is calculated as follows: $150,000 (marketing expenses) minus $280,000 (warranty costs). The adjustment for the land is to reduce intangible assets and increase property, plant, and equipment, so there is no impact on pre-tax income.

b) Answer b) is incorrect. The land purchase was not originally expensed and, therefore, the correcting adjustment has no impact on pre-tax income. Answer c) is correct because the impact of these unadjusted differences is calculated as follows: $150,000 (marketing expenses) minus $280,000 (warranty costs). The adjustment for the land is to reduce intangible assets and increase property, plant, and equipment, so there is no impact on pre-tax income.

*c) Answer c) is correct. The impact of these unadjusted differences is calculated as follows: $150,000 (marketing expenses) minus $280,000 (warranty costs). The adjustment for the land is to reduce intangible assets and increase property, plant, and equipment, so there is no impact on pre-tax income.

*d) Answer d) is incorrect. The marketing expense correction will increase pre-tax income, not reduce it, and the adjustment of the land purchase has no impact on pre-tax income. Answer c) is correct because the impact of these unadjusted differences is calculated as follows: $150,000 (marketing expenses) minus $280,000 (warranty costs). The adjustment for the land is to reduce intangible assets and increase property, plant, and equipment, so there is no impact on pre-tax income.
83. T029:
Assume the following for Mark’s Warehouse Ltd. (Mark’s):

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income for tax purposes</td>
<td>$530,200</td>
</tr>
<tr>
<td>Less</td>
<td></td>
</tr>
<tr>
<td>Net capital losses of other years</td>
<td>(5,000)</td>
</tr>
<tr>
<td>Charitable donations</td>
<td>(50,000)</td>
</tr>
<tr>
<td>Taxable income</td>
<td>$475,200</td>
</tr>
</tbody>
</table>

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
b. $510,200
c. $515,200
d. $475,200

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income for tax purposes</td>
<td>$530,200</td>
</tr>
<tr>
<td>Taxable capital gain included in net income</td>
<td>(20,000)</td>
</tr>
<tr>
<td>Charitable donations</td>
<td></td>
</tr>
<tr>
<td>ABI</td>
<td>$460,200</td>
</tr>
</tbody>
</table>

Charitable donations are not deducted in determining ABI.

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income for tax purposes</td>
<td>$530,200</td>
</tr>
<tr>
<td>Taxable capital gain included in net income</td>
<td>(20,000)</td>
</tr>
<tr>
<td>ABI</td>
<td>$510,200</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income for tax purposes</td>
<td>$530,200</td>
</tr>
<tr>
<td>Taxable capital gain included in net income</td>
<td>(20,000)</td>
</tr>
<tr>
<td>ABI</td>
<td>$510,200</td>
</tr>
</tbody>
</table>
c) Answer c) is incorrect. It was determined as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income for tax purposes</td>
<td>$530,200</td>
</tr>
<tr>
<td>Net taxable capital gain included in net income:</td>
<td>(15,000)</td>
</tr>
<tr>
<td>((($100,000 – $60,000) × ½) – 5,000)</td>
<td></td>
</tr>
<tr>
<td>ABI</td>
<td>$515,200</td>
</tr>
</tbody>
</table>

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:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income for tax purposes</td>
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</tr>
<tr>
<td>($100,000 – $60,000) × ½</td>
<td></td>
</tr>
<tr>
<td>ABI</td>
<td>$510,200</td>
</tr>
</tbody>
</table>

d) 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:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income for tax purposes</td>
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<td>Taxable capital gain included in net income:</td>
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</tr>
<tr>
<td>($100,000 – $60,000) × ½</td>
<td></td>
</tr>
<tr>
<td>ABI</td>
<td>$510,200</td>
</tr>
</tbody>
</table>
84. T094:
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
b. August 27, Year 9
*c. October 25, Year 9
d. November 30, Year 9

Feedback:

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

b) Answer b) is incorrect. This is 30 days from the date of the notice of reassessment. Answer c) is correct because the notice of objection must be filed within 90 days after the notice of reassessment and one year after the filing due date.

*c) Answer c) is correct. The notice of objection must be filed the later of within 90 days after the notice of reassessment and one year after the filing due date.

d) Answer d) is incorrect. This is the year end of the company. Answer c) is correct because the notice of objection must be filed within 90 days after the notice of reassessment and one year after the filing due date.
85. T100:
Which of the following additional case facts would indicate an assessment that the individual is a contractor?

a. The individual registers for a goods and services tax (GST) account.
b. The individual is not permitted to work for other catering business.
c. The individual receives a set monthly schedule.
*d. The individual receives remuneration as a percentage of total clients served.

Feedback:

a) Answer a) is incorrect. Registration of a GST account does not necessarily indicate an individual is a contractor. Answer d) is correct because the individual now has a chance of profit/risk of loss, as the individual is paid based on the number of clients served. If fewer clients attend and, therefore, there are fewer clients to serve, the individual’s compensation would decrease.

b) Answer b) is incorrect. This factor indicates the individual is an employee, not a contractor. Answer d) is correct because the individual now has a chance of profit/risk of loss, as the individual is paid based on the number of clients served. If fewer clients attend and, therefore, there are fewer clients to serve, the individual’s compensation would decrease.

c) Answer c) is incorrect. A set monthly schedule adds control to the employer, not the individual, and is a supporting factor of employment. Answer d) is correct because the individual now has a chance of profit/risk of loss, as the individual is paid based on the number of clients served. If fewer clients attend and, therefore, there are fewer clients to serve, the individual’s compensation would decrease.

* d) Answer d) is correct. The individual now has a chance of profit/risk of loss, as the individual is paid based on the number of clients served. If fewer clients attend and, therefore, there are fewer clients to serve, the individual's compensation would decrease.
86. T066:
Which of the following is a taxable benefit to an employee?

a. Payments made for a private health services plan  
b. Payment for a $400 gold watch to commemorate six years of service  
c. Payment for tuition for a course on “building good relationships with clients”  
*d. Payment of an employee’s spouse’s travelling expenses incurred while accompanying the employee on a business trip

Feedback:

a) 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) 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) 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) 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. T120:
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:

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

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)
*b. $0

Feedback:

a) 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 × 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 × 4% = $6,400; Property II: $190,000 × 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) 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 × 4% = $6,400; Property II: $190,000 × 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) 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 × 4% = $6,400; Property II: $190,000 × 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 × 4% = $6,400; Property II: $190,000 × 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) 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 × 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 × 4% = $6,400; Property II: $190,000 × 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. T123:
In Year 1, John purchased a house in the city. In Year 6, he purchased a cottage at the lake. In Year 13, he sold both the house and the cottage and realized capital gains of $195,000 and $168,000 on the house and cottage, respectively. John wishes to minimize the taxable capital gain to be included in his income as a result of the disposal of these two properties by claiming the principal residence exemption.

How many years should John designate each property as his principal residence to maximize the principal residence exemption and minimize his taxable capital gain?

a. House in city, 12 years; cottage, 1 year
b. House in city, 5 years; cottage, 8 years
*c. House in city, 6 years; cottage, 7 years
d. House in city, 12 years; cottage, 0 years (not considered a principal residence)

Feedback:

a) Answer a) is incorrect. The capital gain on disposal of the house is higher than the capital gain on disposal of the cottage. However, the gain per year on the house is $195,000/13 = $15,000, and the gain per year on the cottage is $168,000/8 = $21,000. John can minimize his overall capital gain by designating the property with the highest gain per year (the cottage) as his principal residence for the number of years owned less one and designating the other property as his principal residence for the remaining years. Answer c) is correct. The formula for determining the exempt gain is [(1 + number of years designated) / number of years owned] × capital gain on disposal of principal residence. Because of the “1 +” in the formula, a taxpayer may fully exempt a gain on a personal residence by designating the residence as his or her principal residence for the number of years owned less one. The gain per year on the cottage is $168,000/8 = $21,000, and the gain per year on the house is $195,000/13 = $15,000. The cottage was owned for eight years, so John may designate the cottage as his principal residence for seven years. That leaves six years (13 years less seven years) for the house.

b) Answer b) is incorrect. The gain per year on the cottage is $168,000/8 = $21,000, and the gain per year on the house is $195,000/13 = $15,000. John can fully exempt the gain on the cottage by designating the cottage as his principal residence for seven years (number of years owned less one year). That leaves six years for the house, resulting in an increase in the principal residence exemption on the house. Answer c) is correct. The formula for determining the exempt gain is [(1 + number of years designated) / number of years owned] × capital gain on disposal of principal residence. Because of the “1 +” in the formula, a taxpayer may fully exempt a gain on a personal residence by designating the residence as his or her principal residence for the number of years owned less one. The gain per year on the cottage is $168,000/8 = $21,000, and the gain per year on the house is $195,000/13 = $15,000. The cottage was owned for eight years, so John may designate the cottage as his principal residence for seven years. That leaves six years (13 years less seven years) for the house.
*c) Answer c) is correct. The formula for determining the exempt gain is \[\frac{(1 + \text{number of years designated})}{\text{number of years owned}} \times \text{capital gain on disposal of principal residence}\]. Because of the “1 +” in the formula, a taxpayer may fully exempt a gain on a personal residence by designating the residence as his or her principal residence for the number of years owned less one. The gain per year on the cottage is \(\frac{168,000}{8} = 21,000\), and the gain per year on the house is \(\frac{195,000}{13} = 15,000\). The cottage was owned for eight years, so John may designate the cottage as his principal residence for seven years. That leaves six years (13 years less seven years) for the house.

d) Answer d) is incorrect. A principal residence includes any housing unit including a house, condo, cottage, mobile home, and so forth. Answer c) is correct. The formula for determining the exempt gain is \[\frac{(1 + \text{number of years designated})}{\text{number of years owned}} \times \text{capital gain on disposal of principal residence}\]. Because of the “1 +” in the formula, a taxpayer may fully exempt a gain on a personal residence by designating the residence as his or her principal residence for the number of years owned less one. The gain per year on the cottage is \(\frac{168,000}{8} = 21,000\), and the gain per year on the house is \(\frac{195,000}{13} = 15,000\). The cottage was owned for eight years, so John may designate the cottage as his principal residence for seven years. That leaves six years (13 years less seven years) for the house.
89. T262: 
During the year, Ken and Barbie were divorced. The divorce agreement states Ken 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. Ken’s current-year deduction from net income as a result of the payment of spousal and child support is $nil.
* b. Ken’s current-year deduction from net income as a result of the payment of spousal and child support is $18,000.
  
c. Barbie will include $22,500 in her net income as a result of receiving spousal and child support.
  
d. Barbie will include $40,500 in her net income as a result of receiving spousal and child support.

Feedback:

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

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

  c) 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, Ken may deduct the amount he paid for spousal support of $2,000 \times 9 = $18,000.

  d) 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, Ken may deduct the amount he paid for spousal support of $2,000 \times 9 = $18,000.
90. T447:
Early in the current year, Ed found a new job that required him to relocate from Saskatoon to Edmonton. He incurred the following costs with respect to the move:

<table>
<thead>
<tr>
<th>Cost description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of flight and cab fare for house-hunting trip to Edmonton (1)</td>
<td>$ 545</td>
</tr>
<tr>
<td>Lease cancellation costs on Saskatoon home</td>
<td>590</td>
</tr>
<tr>
<td>Cost of moving household effects</td>
<td>2,180</td>
</tr>
<tr>
<td>Legal fees and title transfer fees on Edmonton home</td>
<td>1,860</td>
</tr>
</tbody>
</table>

(1) Ed made a one-day trip to Edmonton to find a new home. He had done significant research prior to the trip, so with the help of a realtor, it took only one day to finalize the purchase of a home.

Assuming Ed earned sufficient employment income after the move, what is the maximum claim Ed may make for moving expenses?

a. $3,315  
b. $4,040  
c. $5,175  
*d. $2,770

Feedback:

a) Answer a) is incorrect. $3,315 includes the cost of the house-hunting trip of $545, the lease cancellation costs on the Saskatoon home of $590, and the cost of moving household effects of $2,180. This answer is not correct because the cost of the house-hunting trip prior to the move is not a deductible moving expense. Answer d) is correct. The maximum deduction is $2,770, which includes the lease cancellation costs on the Saskatoon home of $590 and the cost of moving household effects of $2,180.

b) Answer b) is incorrect. $4,040 includes the legal fees and title transfer tax on the Edmonton home of $1,860 and the cost of moving household effects of $2,180. The lease cancellation costs on the Saskatoon home have not been included, although they are deductible, and the legal and title transfer fees on the purchase of the Edmonton home are not deductible because the Saskatoon home was rented, not owned. Answer d) is correct. The maximum deduction is $2,770, which includes the lease cancellation costs on the Saskatoon home of $590 and the cost of moving household effects of $2,180. The cost of the house-hunting trip is not deductible, and the legal fees and title transfer fees on the Edmonton home are not deductible because the Saskatoon home was not owned (it was rented).
c) Answer c) is incorrect. $5,175 includes the cost of the house-hunting trip of $545, the lease cancellation costs on the Saskatoon home of $590, the legal fees and title transfer fees on the Edmonton home of $1,860, and the cost of moving household effects of $2,180. This answer is not correct because the cost of the house-hunting trip prior to the move is not a deductible moving expense and the legal and title transfer fees on the purchase of the Edmonton home are not deductible because the Saskatoon home was rented, not owned. Answer d) is correct. The maximum deduction is $2,770, which includes the lease cancellation costs on the Saskatoon home of $590 and the cost of moving household effects of $2,180. The cost of the house-hunting trip is not deductible, and the legal fees and title transfer fees on the Edmonton home are not deductible because the Saskatoon home was not owned (it was rented).

*d) Answer d) is correct. The maximum deduction is $2,770, which includes the lease cancellation costs on the Saskatoon home of $590 and the cost of moving household effects of $2,180. The cost of the house-hunting trip is not deductible, and the legal fees and title transfer fees on the Edmonton home are not deductible because the Saskatoon home was not owned (it was rented).
91. T265:
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.
b. Maurizio is required to include the $8,000 scholarship in his net income.
c. Maurizio is required to include $15,000 in his net income, the total of the scholarship and the research grant.
d. Maurizio is required to include the $7,000 research grant in his net income.

Feedback:

a) 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 student qualifying for the education tax credit. 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) 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 student qualifying for the education tax credit. 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 student qualifying for the education tax credit. 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) 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 student qualifying for the education tax credit. 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 student qualifying for the education tax credit. 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) 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 student qualifying for the education tax credit. 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. T067:
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.
*b. The lower-income spouse, Ellis, must claim the charitable donations.
c. Either Juliet or Ellis can claim the charitable donations.
d. Any unclaimed charitable donations can be carried forward for a period of up to five years.

Feedback:

d) 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.
93. T443:
Which of the following statements regarding the death of a taxpayer is true?

a. Charitable donations, including amounts carried forward from the preceding five years, of up to 100% of taxable income are eligible for credit in the year a taxpayer dies.
b. In the year of death, medical expenses incurred by the taxpayer within any 36-month period which includes the date of death may be claimed as a basis for the medical expense tax credit.
*c. In the year of death, net capital loss carryovers of the deceased individual may be claimed against any source of income included in the taxpayer’s terminal tax return.
d. In the year a taxpayer dies, if he owns an investment on which dividends have been declared but not paid at the date of his death, he is required to include the dividends in his terminal return.

Feedback:

a) Answer a) is incorrect. The limitation is based on net income, not taxable income [ITA 118.1]. Answer c) is correct. Under ITA 111(2), net capital losses may be deducted against any source of income in the year of death.

b) Answer b) is incorrect. Under ITA 118.2, the normal 12-month period for the claim of medical expenses is extended to 24 months in the case of a deceased taxpayer. Answer c) is correct. Under ITA 111(2), net capital losses may be deducted against any source of income in the year of death.

*c) Answer c) is correct. Under ITA 111(2), net capital losses may be deducted against any source of income in the year of death.

d) Answer d) is incorrect. While the dividends may be included in the terminal return of the taxpayer, they do not have to be. Instead, the dividends may be included in a separate rights or things return. This is normally preferable as it will result in a decrease in overall taxes payable. Answer c) is correct. Under ITA 111(2), net capital losses may be deducted against any source of income in the year of death.
94. T448:
Evergreen Co. has computed its net income for tax purposes for Year 7 as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from business</td>
<td>$200,000</td>
</tr>
<tr>
<td>Dividends from taxable Canadian corporations</td>
<td>30,000</td>
</tr>
<tr>
<td>Dividends from foreign corporations</td>
<td>15,000</td>
</tr>
<tr>
<td>Taxable capital gains</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Net income for tax purposes</strong></td>
<td><strong>$255,000</strong></td>
</tr>
</tbody>
</table>

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:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net capital loss (Year 3)</td>
<td>$12,000</td>
</tr>
<tr>
<td>Non-capital loss (Year 4)</td>
<td>13,000</td>
</tr>
<tr>
<td>Charitable donations (Year 6)</td>
<td>2,000</td>
</tr>
</tbody>
</table>

What is Evergreen’s taxable income?

- a. $180,000
- b. $178,000
- c. $195,000
- d. $197,000

Feedback:

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income for tax purposes</td>
<td>$255,000</td>
</tr>
<tr>
<td>Current-year charitable donations</td>
<td>(5,000)</td>
</tr>
<tr>
<td>Charitable donation carryover</td>
<td>(2,000)</td>
</tr>
<tr>
<td>Dividends from taxable Canadian corporations</td>
<td>(30,000)</td>
</tr>
<tr>
<td>Dividends from foreign corporations</td>
<td>(15,000)</td>
</tr>
<tr>
<td>Net capital loss carryover</td>
<td>(10,000)</td>
</tr>
<tr>
<td>Non-capital loss carryover</td>
<td>(13,000)</td>
</tr>
<tr>
<td><strong>Taxable income</strong></td>
<td><strong>$180,000</strong></td>
</tr>
</tbody>
</table>

This is incorrect because the $15,000 of dividends from 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:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income for tax purposes</td>
<td>$255,000</td>
</tr>
<tr>
<td>Dividends from taxable Canadian corporations</td>
<td>(30,000)</td>
</tr>
<tr>
<td>Net capital loss carryover</td>
<td>(10,000)</td>
</tr>
<tr>
<td>Current-year charitable donations</td>
<td>(5,000)</td>
</tr>
<tr>
<td>Charitable donations carryover</td>
<td>(2,000)</td>
</tr>
<tr>
<td>Non-capital loss carryover</td>
<td>(13,000)</td>
</tr>
<tr>
<td><strong>Taxable income</strong></td>
<td><strong>$195,000</strong></td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income for tax purposes</td>
<td>$255,000</td>
</tr>
<tr>
<td>Current-year charitable donations</td>
<td>(5,000)</td>
</tr>
<tr>
<td>Charitable donation carryover</td>
<td>(2,000)</td>
</tr>
<tr>
<td>Dividends from taxable Canadian corporations</td>
<td>(30,000)</td>
</tr>
<tr>
<td>Dividends from foreign corporations</td>
<td>(15,000)</td>
</tr>
<tr>
<td>Net capital loss carryover</td>
<td>(12,000)</td>
</tr>
<tr>
<td>Non-capital loss carryover</td>
<td>(13,000)</td>
</tr>
<tr>
<td><strong>Taxable income</strong></td>
<td><strong>$178,000</strong></td>
</tr>
</tbody>
</table>

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:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income for tax purposes</td>
<td>$255,000</td>
</tr>
<tr>
<td>Dividends from taxable Canadian corporations</td>
<td>(30,000)</td>
</tr>
<tr>
<td>Net capital loss carryover</td>
<td>(10,000)</td>
</tr>
<tr>
<td>Current-year charitable donations</td>
<td>(5,000)</td>
</tr>
<tr>
<td>Charitable donations carryover</td>
<td>(2,000)</td>
</tr>
<tr>
<td>Non-capital loss carryover</td>
<td>(13,000)</td>
</tr>
<tr>
<td><strong>Taxable income</strong></td>
<td><strong>$195,000</strong></td>
</tr>
</tbody>
</table>
c) 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 $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 (13,000)
Taxable income $195,000

d) 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 $197,000

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).
95. T059:
An employee will be required to include a taxable benefit in his return if:

a. The employee uses a company car for business purposes.
b. The employee is a senior accountant with a public accounting firm, and the firm pays for the employee’s CPA membership dues.
*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.
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).

Feedback:

a) 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) 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) 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) 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.
96. T061: 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.
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.
c. Cleanco Supply could supply a fitness club membership worth $600 to all employees without this being considered a taxable benefit.
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.

Feedback:

a) 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) 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) 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) 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.
97. T068:
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.
b. Both Harry’s and Vera’s medical expenses should be claimed on Vera’s tax return.
c. Harry’s medical expenses should be claimed on Harry’s return and Vera’s medical expenses should be claimed on her return.
d. Harry and Vera will be indifferent between including the total of the medical expenses on either taxpayer’s return.

Feedback:
*a) 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) 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) 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) 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.
98. F412:
SunnyBrook Inc. is currently reviewing its cash balance and making plans for how much cash will be required to cover the next six months for transactions.

Which of the following planned transactions should **NOT** be taken into consideration in determining the amount of the cash required?

a. The delivery of a large piece of equipment, which will be paid for on delivery.
b. Annual dividends declared at the end of last month to be paid within 30 days of declaration.
*c. The granting of stock options to the CEO of the organization.
d. Payment for the government-regulated inspection completed every five years for the elevators.

Feedback:

a) Answer a) is incorrect. This capital disbursement will reduce the cash on hand. Answer c) is correct. Granting stock options to the CEO has no immediate impact on the firm’s cash levels; therefore, it will not impact the cash on hand over the next six months.

b) Answer b) is incorrect. The dividends have been declared and will be paid within the six-month period being examined, thus reducing the cash on hand. Answer c) is correct. Granting stock options to the CEO has no immediate impact on the firm’s cash levels; therefore, it will not impact the cash on hand over the next six months.

*c) Answer c) is correct. Granting stock options to the CEO has no immediate impact on the firm’s cash levels; therefore, it will not impact the cash on hand over the next six months.

d) Answer d) is incorrect. The payment of this government-regulated inspection will reduce cash on hand. Answer c) is correct. Granting stock options to the CEO has no immediate impact on the firm’s cash levels; therefore, it will not impact the cash on hand over the next six months.
99. F2025:
You, a CPA, and the chief financial officer of Invest Inc. have been meeting regularly to analyze last year’s financial results. Today you are reviewing the company’s cash flow. Pertinent information is as follows:

<table>
<thead>
<tr>
<th>#</th>
<th>Item</th>
<th>Action</th>
<th>Book value or maturity value</th>
<th>Transaction value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Investment in FVTPL that are held for trading (HFT)</td>
<td>Sold</td>
<td>$13,000</td>
<td>$16,000</td>
</tr>
<tr>
<td>2</td>
<td>Shares in an associate</td>
<td>Bought</td>
<td>$21,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>3</td>
<td>Equipment (owned)</td>
<td>Sold</td>
<td>$25,000</td>
<td>$21,000</td>
</tr>
<tr>
<td>4</td>
<td>Equipment (leased)</td>
<td></td>
<td>$50,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>5</td>
<td>Investment in bonds</td>
<td>Purchased</td>
<td>$300,000</td>
<td>$285,000</td>
</tr>
</tbody>
</table>

Assuming that Invest Inc. prepares its financial statements in accordance with IFRS, what is the amount that the company should report as cash flows arising from investing activities?

a. $268,000 cash outflow  
b. $284,000 cash outflow  
c. $299,000 cash outflow  
d. $334,000 cash outflow

Feedback:

a) Answer a) is incorrect. You incorrectly included the cash inflow from the sale of the HFT security in the cash flow from investing section. It is an operating activity. Include #2 ($20,000 cash outflow), #3 ($21,000 cash inflow) and #5 ($285,000 cash outflow). Net outflow from investing activities is $284,000. Exclude #1 (operating activity) and #4 (non-cash activity). Answer b) is correct. Include #2 ($20,000 cash outflow), #3 ($21,000 cash inflow) and #5 ($285,000 cash outflow). Net outflow from investing activities is $284,000. Exclude #1 (operating activity) and #4 (non-cash activity).

*b) Answer b) is correct. Include #2 ($20,000 cash outflow), #3 ($21,000 cash inflow) and #5 ($285,000 cash outflow). Net outflow from investing activities is $284,000. Exclude #1 (operating activity) and #4 (non-cash activity).

c) Answer c) is incorrect. You incorrectly recorded the cash outflow for the bond purchase at the maturity value, rather than the price paid. Include #2 ($20,000 cash outflow), #3 ($21,000 cash inflow) and #5 ($285,000 cash outflow). Net outflow from investing activities is $284,000. Exclude #1 (operating activity) and #4 (non-cash activity). Answer b) is correct. Include #2 ($20,000 cash outflow), #3 ($21,000 cash inflow) and #5 ($285,000 cash outflow). Net outflow from investing activities is $284,000. Exclude #1 (operating activity) and #4 (non-cash activity).
d) Answer d) is incorrect. You incorrectly included the value of the leased equipment as a cash outflow; however, this is a non-cash transaction that is not reported directly on the statement of cash flows. Include #2 ($20,000 cash outflow), #3 ($21,000 cash inflow) and #5 ($285,000 cash outflow). Net outflow from investing activities is $284,000. Exclude #1 (operating activity) and #4 (non-cash activity). Answer b) is correct. Include #2 ($20,000 cash outflow), #3 ($21,000 cash inflow) and #5 ($285,000 cash outflow). Net outflow from investing activities is $284,000. Exclude #1 (operating activity) and #4 (non-cash activity).
100. F1038:
Which of the following is a disadvantage of informal negotiations with creditors?

a. The process of informal negotiations is lengthy and expensive for the entity.
b. Individual creditors have little say or control over what terms and conditions can be renegotiated, since the entire class of creditors has to agree.
*c. Individual creditors may refuse to negotiate, jeopardizing the entire restructuring plan for the company.
d. The entity is required to provide cash flow forecasts to the creditors.

Feedback:

a) Answer a) is incorrect. Informal negotiations are usually completed more quickly and for less cost than more formal legal court proceedings. Answer c) is correct. Some creditors may “hold out” and refuse to negotiate, requiring the company to seek formal legal court proceedings instead.

b) Answer b) is incorrect. Informal negotiations are done individually with each creditor, so this will give each creditor more control over the final revised terms and conditions. Answer c) is correct. Some creditors may “hold out” and refuse to negotiate, requiring the company to seek formal legal court proceedings instead.

*c) Answer c) is correct. Some creditors may “hold out” and refuse to negotiate, requiring the company to seek formal legal court proceedings instead.

d) Answer d) is incorrect. There is no legal requirement to provide creditors with information. In fact, this lack of information may be detrimental, since a creditor may not be able to make a decision without some knowledge of how the company will improve its cash flows in the future. Answer c) is correct. Some creditors may “hold out” and refuse to negotiate, requiring the company to seek formal legal court proceedings instead.