Midterm II: Sample Exam

Part I: Multiple Choices (2 points for each question, 32 points in total)

1. Which type of financial assets is purchased with the intent of collecting interest and sell?
   a. Investment accounted for using equity method
   b. FVTOCI financial assets- Debt
   c. FVTPL financial assets- Debt
   d. Amortized Cost financial assets

2. If a FVTOCI financial asset is bought, the investment account is
   a. Debited for the cost of the financial asset NOT including any extra expenditures required in making the purchase
   b. Credited for the cost of the financial asset NOT including any extra expenditures required in making the purchase
   c. Credited for the cost of the financial asset including any extra expenditures required in making the purchase
   d. Debited for the cost of the financial asset including any extra expenditures required in making the purchase

3 The following financial assets are reported at the fair value on the statement of financial position except:
   a. FVTOCI-Debt financial assets.
   b. FVTPL-Equity financial assets.
   c. Investment accounted for using the equity method.
   d. FVTOCI-Equity financial assets.

4. Venco Corporation's December 31, 2020 statement of financial position showed the following:

Share capital—preference 7%, €20 par value, cumulative, 10,000 shares authorized; 7,500 shares issued	€ 150,000
Share capital–ordinary, €10 par value, 1,000,000 shares authorized; 975,000 shares issued, 960,000 shares outstanding	9,750,000
Share premium—preference	30,000
Share premium—ordinary	13,500,000
Retained earnings	3,750,000
Treasury shares (15,000 shares)	315,000

Venco declared and paid a €45,000 cash dividend on December 15, 2020. If the company's dividends in arrears prior to that date were €10,500, Venco's ordinary shareholders received

a. €36,000.
b. €24,000.
c. €27,000.
d. no dividend.

5. Each of the following decreases retained earnings except a

a. Share splits.
b. Net loss.
c. share dividend.
d. cash dividend.

6. Which of the following factors does not affect the initial market price of shares?

a. The company's anticipated future earnings
b. The par value of the shares
c. The current state of the economy
d. The expected dividend rate per share

7. Share Premium–Ordinary

a. is credited when a no-par share does not have a stated value.
b. is reported as part of equity on the statement of financial position.
c. represents the amount of legal capital.
d. normally has a debit balance.

8. Barr, Inc. reports £6,000,000 of share capital, and £6,000,000 of share premium on its statement of financial position. The number of ordinary shares issued and outstanding is 400,000 shares. The book value per share is

a. £25.
b. £15.
c. £30.
d. £.04.

9 Jennifer Company reports the following amounts for 2020:

Net income	$	155,000
Average ordinary shareholders' equity		500,000

Preference dividends	45,000
Ordinary Shares outstanding	80,000
Market price per ordinary shares on 12/31/2020	$24

The 2020 rate of return on ordinary shareholders' equity is

a. 12.0%.
b. 31.0%.
c. 22.0%.
d. 19.4%.

10 The effect of the declaration of a cash dividend by the board of directors is to

	Increase	Decrease
a.	Equity	Assets
b.	Assets	Liabilities
c.	Liabilities	Equity
d.	Liabilities	Assets

11 Shareholders of a corporation directly elect

a. the president of the corporation.
b. the board of directors.
c. the treasurer of the corporation.
d. all of the employees of the corporation.

12 Which one of the following is not an ownership right of a shareholder in a corporation?

a. To vote
b. To declare dividends on the ordinary shares
c. To share in assets upon liquidation
d. To share in corporate earnings

13 When an investor owns between 20% and 50% of the ordinary shares of a corporation, it is generally presumed that the investor

a. has insignificant influence on the investee and that the fair value method should be used to account for the investment.
b. should apply the fair value method in accounting for the investment.
c. will prepare consolidated financial statements.
d. has significant influence on the investee and that the equity method should be used to account for the investment.

14 Daniel Corporation acquired 100% of the ordinary shares of Tysen Company for €1,400,000. On the date of acquisition, Tysen Company's equity consisted of: Share Capital, €700,000; Retained Earnings, €540,000. The intercompany elimination to be made on a worksheet to prepare a consolidated statement of financial position is

a. Share Capital─Tysen 700,000
   Retained Earnings─Tysen 540,000
      Investment in Tysen Shares 1,240,000
b. Investment in Tysen Shares 1,400,000
      Cash 1,400,000
c. Share Capital─Daniel 700,000
   Retained Earnings─Daniel 540,000
      Investment in Tysen Shares 1,240,000
d. Share Capital─Tysen 700,000
   Retained Earnings─Tysen 540,000
   Excess of Cost Over Book Value of Subsidiary 160,000
      Investment in Tysen Shares... 1,400,000

15 Treasury shares may be repurchased

a. to reissue the shares to officers and employees under bonus and stock compensation plans.
b. to increase the share price of the company.
c. to have additional shares available for use in the acquisition of other companies.
d. all of these.

16 Which of the following statements is **false**?

a. Ownership of ordinary shares gives the owner a voting right.
b. Par value and market price of a company's shares are always the same.
c. The equity section begins with a share capital section.
d. The authorization of share capital does not result in a formal accounting entry.

Part II: Problems (72 points in total)

1.

AE Co., which began operations on January 4, 2020, had the following subsequent transactions and events in its long-term investments.

2020

Jan. 5	AE purchased 30,000 ordinary shares (20% of total) of Brave for $1,560,000.
Oct. 23	Brave declared and paid a cash dividend of $3.20 per share.
Dec. 31	Brave's net income for 2020 is $1,164,000, and the fair value of its shares at December 31 is $55.5 per share.
2021	
Oct. 15	Brave declared and paid a cash dividend of $2.60 per share.
Dec. 31	Brave's net income for 2021 is $1,476,000, and the fair value of its shares at December 31 is $60.9 per share.
2022	
Jan. 2	AE sold all of its investment in Brave for $1,894,000 cash.

Required:

Part 1: Assume that AE has a significant influence over Brave with its 20% share of ordinary shares.

1. Prepare journal entries to record these transactions and events for AE. (12 points)
2. Compute the carrying amount (book value) per share of AE's investment in Brave's ordinary shares as reflected in the investment account on January 1, 2022. (2 points)
3. Compute the net increase or decrease in AE's equity from January 5, 2020, through January 2, 2022, resulting from its investment in Brave. (3 points)

Part 2: Assume that although AE owns 20% of Brave's outstanding shares, circumstances indicate that it does not have a significant influence over the investee and that it is classified as a FVTOCI-Equity investment.

1. Prepare journal entries to record the preceding transactions and events for AE. (Hint: Please include the closing entry and reclassification entry) (22 points)
2. Compute the cost per share of AE's investment in Brave ordinary shares as reflected in the investment account on January 1, 2022. (2 points)
3. Compute the net increase or decrease in AE's equity from January 5, 2020, through January 2, 2022, resulting from its investment in Brave. (3 points)

2.

The following selected items and amounts were taken from the statement of financial position of Quale Company as of December 31, 2020:

Cash	$93,000
Property, plant, and equipment	850,000
Accumulated depreciation	150,000
Liabilities	50,000
Share Capital-Preference (7%, $100 par, noncumulative, 10,000 shares authorized, 5,000 shares issued and outstanding)	500,000
Share Capital-Ordinary ($10 par, 100,000 shares authorized, 80,000 shares issued and outstanding)	800,000
Share Premium-Preference	1,000
Share Premium-Ordinary	125,000
Share premium-Treasury	1,000
Retained Earnings	310,000

Required:

For each of parts (1) to (6), (a) prepare the necessary journal entry (or entries) to record each transaction, and (b) calculate the amount that would appear on the December 31, 2021, balance sheet as a consequence of this transaction only for the account given. (**Note: In your answer to each part of this problem, consider this to be the only transaction that took place during 2021.**) (28 points)

(1) Quale Company issued 200 shares of ordinary share in exchange for cash of $4,000.

(a) Entry

(b) Share Premium-Ordinary

(2) Quale Company issued 200 shares of preference share at a price of $102 per share.

(a) Entry

(b) Share Premium-Preference

(3) Quale Company issued 500 shares of ordinary share in exchange for a building. The ordinary share is not actively traded, but the building was recently appraised at $11,000.

(a) Entry

(b) Property, plant, and equipment

(4) Quale Company reacquired 1,000 shares of ordinary from a shareholder for $23,000

and subsequently reissued the shares to a different investor for 21,500. (Note: Make two entries)

(a) Entries

(b) Share premium-Treasury

(5) The board of directors declared dividends of $75,000. This amount includes the current-year dividend preference of preference shares, with the remainder to be paid to ordinary shareholders.

(a) Entry

(b) Retained Earnings

(6) The board of directors declared a 5% share dividends on July 1, 2021. On July 31, 2021, Bernard issues the dividend shares. On the day of declaration, suppose that its ordinary shares has a market value of NT $33 per share.

(a) Entries on the declaration and issuance days.

(b) Retained Earnings

Answer key:

I. Multiple choice questions:

1	2	3	4	5
B	**D**	**C**	**B**	**A**
6	7	8	9	10
B	**B**	**C**	**C**	**C**
11	12	13	14	15
B	**B**	**D**	**D**	**D**
16				
B				

II. Problems:

(P1)

Part 1

1. Journal entries (assuming significant influence)

2020

Jan. 5	Equity Investment	1,560,000	
	Cash		1,560,000
	Purchased Brave shares.		
Oct. 23	Cash	96,000	
	Equity Investment		96,000
	Received cash dividend (30,000 x $3.20).		
Dec. 31	Equity Investment	232,800	
	Revenue from Equity Investments		232,800
	Record equity in investee earnings ($1,164,000 x 20%).		

2021

Oct. 15	Cash	78,000	
	Equity Investment		78,000
	Record cash dividend (30,000 x $2.60).		
Dec. 31	Equity Investment	295,200	
	Revenue from Equity Investments		295,200
	Record equity in investee earnings ($1,476,000 x 20%).		

2022

Jan. 2	Cash	1,894,000	
	Loss from sale of Investments in associates	20,000	
	Equity Investment *		1,914,000
	Sold Brave shares.		

*Investment carrying value, January 2, 2022

Original cost	$ 1,560,000
Less 2020 dividends	(96,000)
Plus 2020 earnings	232,800
Less 2021 dividends	(78,000)
Plus 2021 earnings	295,200
Carrying amount at date of sale	$ 1,914,000

2. Carrying amount (book value) per share, January 1, 2022 (see computations in part 1) = $1,914,000 ÷ 30,000 shares = $ 63.80

3. Change in Pillar's equity due to shares investment

Earnings from Brave (2020)	$ 232,800
Earnings from Brave (2021)	295,200
Loss on sale of investments	(20,000)
Net increase	$ 508,000

Part 2

1. Journal entries (assuming NO significant influence)

2020

Jan. 5	Financial Assets at FVTOCI-Equity	1,560,000	
	Cash		1,560,000
	Purchased Brave shares.		
Oct. 23	Cash	96,000	
	Dividend Revenue		96,000
	Received cash dividend (30,000 x $3.20).		
Dec. 31	Fair Value Adjustment- FVTOCI-Equity *	105,000	
	Unrealized gains or losses on Financial Assets at FVTOCI-Equity		105,000
	Record fair value adjustment.		
	**30,000 x $55.5 = $1,665,000*		
	$1,665,000 - $1,560,000 = $105,000		
Dec. 31(Closing)	Unrealized gains or losses on Financial Assets at FVTOCI-Equity	105,000	
	Accumulated Other Comprehensive income		105,000

2021			
Oct. 15	Cash	78,000	
	Dividend Revenue		78,000
	Received cash dividends (30,000 x $2.60)		
Dec. 31	Fair Value Adjustment- FVTOCI-Equity *	162,000	
	Unrealized gains or losses on Financial Assets at FVTOCI-Equity		162,000
	Record fair value adjustment.		
	**30,000 x $60.9 = $1,827,000*		
	$1,827,000 - $1,560,000 = $267,000		
	$267,000 - $105,000 = $162,000		
Dec. 31(Closing)	Unrealized gains or losses on Financial Assets at FVTOCI-Equity	162,000	
	Accumulated Other Comprehensive income		162,000
2022			
Jan. 2	Fair Value Adjustment- FVTOCI-Equity	67,000	
	Unrealized gains or losses on Financial Assets at FVTOCI-Equity		67,000
Jan. 2	Cash	1,894,000	
	Financial Assets at FVTOCI-Equity		1,560,000
	Fair Value Adjustment- FVTOCI-Equity		334,000
	Sold Brave shares.		
Dec. 31 (Closing)	Unrealized gains or losses on Financial Assets at FVTOCI-Equity	67,000	
	Accumulated Other Comprehensive income		67,000
Dec. 31	Accumulated Other Comprehensive income	334,000	
	Retained Earnings		334,000

2. Investment cost per share, January 1, 2018 (see computations in part 1)
   $1,560,000 ÷ 30,000 shares = <u>$52</u>

3. Change in Pillar's equity due to investment

Dividend Revenue (2020)	$ 96,000
Dividend Revenue (2021)	78,000

Retained Earnings	334,000
Net increase	$ 508,000

(P2)

1.	**a.**	**Cash**	**4,000**	
		Share Capital-Ordinary		**2,000**
		Share Premium -Ordinary		**2,000**
	b.	**$125,000 + $2,000 = $127,000**		
2.	**a.**	**Cash**	**20,400**	
		Share Capital-Preference		**20,000**
		Share Premium -Preference		**400**
	b.	**$1,000 + $400 = $1,400**		
3.	**a.**	**Building**	**11,000**	
		Share Capital-Ordinary		**5,000**
		Share Premium -Ordinary		**6,000**
	b.	**$850,000 + $11,000 = $861,000**		
4.	**a.**	**Treasury Shares**	**23,000**	
		Cash		**23,000**
		Cash	**21,500**	
		Share premium-Treasury	**1,000**	
		Retained Earnings	**500**	
		Treasury Shares		**23,000**
	b.	**$1,000 – $1,000 = $0**		
5.	**a.**	**Dividends, Preference Shares**	**35,000**	
		Dividends, Ordinary Shares	**40,000**	
		Dividends Payable		**75,000**

Or

Dividends	**75,000**	
Dividends Payable		**75,000**

b. $310,000 – $75,000 = $235,000

6.

a.

Declaration:

Share Dividends (80,000*5%*$33)	**132,000**	
Ordinary Share Dividends Distributable		**40,000**
Share Premium -Ordinary..		**92,000**

Issuance

Ordinary Share Dividends Distributable...............	**40,000**	
Share Capital-Ordinary		**40,000**

b. $310,000 – $132,000 = $178,000