**ACC-405**

**Module 4 Practice Problems and Solutions**

**Problem 1.** Selco, a U.S. Company, imports and exports tools, shop equipment, and industrial construction supplies. The company uses a periodic inventory system. During April the company entered into the following transactions. All rate quotations are direct exchange rates.

**April 3** - Purchased power tools from a wholesaler in Japan, on account, at an invoice cost of 1,600,000 yen. On this date the exchange rate for the yen was $.0072.

**April 5** - Sold hand tools on credit that were manufactured in the U.S. to a retail outlet located in West Germany. The invoice price was $2,800. The exchange rate for euros was $0.0322.

**April 9** - Sold electric drills on account to a retailer in New Zealand. The invoice price was 16,800 U.S. dollars and the exchange rate for the New Zealand dollar was $.76.

**April 11** - Purchased drill bits on account from a manufacturer located in Belgium. The billing was for 801,282 euros. The exchange rate for euro was $.0312.

**April 16** - Paid 1,000,000 yen on account to the wholesaler for purchases made on April 3. The exchange rate on this date was $.0067.

**April 18** - Settled the accounts payable with the Belgium manufacturer. The exchange rate was $.0368.

**April 22** - Received full payment from the New Zealand retailer. The exchange rate was $.74.

**April 30** - Completed payment on the April 3 purchase. The exchange rate for yen was $.0078.

**Required:**

**Prepare journal entries** on the books of Selco to record the transactions listed above.

**Answer**

# Apr. 3 Purchases 11,520

 Accounts Payable (1,600,000 x $.0072) 11,520

#  5 Accounts Receivable 2,800

 Sales 2,800

 9 Accounts Receivable 16,800

 Sales 16,800

 11 Purchases 25,000

 Accounts Payable (801,282 x $.0312) 25,000

 16 Accounts Payable (1,000,000 x $.0072) 7,200

 Transaction Gain 500

 Cash (1,000,000 x $.0067) 6,700

 18 Accounts Payable 25,000

 Transaction Loss 4,487

 Cash (801,282 x $.0368) 29,487

 22 Cash 16,800

 Accounts Receivable 16,800

 30 Accounts Payable (600,000 x $.0072) 4,320

 Transaction Loss 360

 Cash (600,000 x $.0078) 4,680

**Problem 2.** Crystal Exporting Co. is a U.S. wholesaler engaged in foreign trade. The following transactions are representative of its business dealings. The company uses a periodic inventory system and is on a calendar-year basis. All exchange rates are direct quotations.

|  |  |  |
| --- | --- | --- |
| Dec. | 1 | Crystal Exporting purchased merchandise from Chang’s Ltd., a Hong Kong manufacturer. The invoice was for 210,000 Hong Kong dollars, payable on April 1. On this same date, Crystal Exporting acquired a forward contract to buy 210,000 Hong Kong dollars on April 1 for $.1314. |
| Dec. | 29 | Crystal Exporting sold merchandise to Zintel Retailers for 120,000 Hong Kong dollars, receivable in 90 days. No hedging was involved. |
| April | 1 | Crystal Exporting received 120,000 Hong Kong dollars from Zintel Retailers. |
| April | 1 | Crystal Exporting submitted full payment of 210,000 Hong Kong dollars to Chang’s, Ltd., after obtaining the 210,000 Hong Kong dollars on its forward contract. |

Spot rates and the forward rates for the Hong Kong dollar were as follows:

|  |  |  |
| --- | --- | --- |
|   | ***Spot Rate*** | ***Forward Rate for*** |
| ***April 1 Delivery*** |
| Dec. 1 | $0.1265  | $0.1314  |
| Dec. 29 | 0.1240 | 0.1305 |
| Dec. 31 | 0.1259 | 0.1308 |
| Apr. 1 | 0.1430 |   |

**Required:**

Prepare journal entries for the transactions including the necessary adjustments on December 31.

**Answer:**

Dec 1 Purchases 26,565

 Accounts Payable (210,000 x $.1265) 26,565

 1 FC Receivable from Exchange Dealer 27,594

 Dollars Payable to Exchange Dealer 27,594

 (210,000 x $.1314 = $27,594)

 Dec. 29 Accounts Receivable (120,000 x $.1240) 14,880

 Sales 14,880

 31 Accounts Payable 126

 Transaction Gain [(210,000 x $.1259 = $26,439) - $26,565] 126

 31 Transaction Lost 126

 FC Receivable from Exchange Dealer 126

 [(210,000 x $.1308 = $27,468) - $27,594]

 31 Accounts Receivable 228

 Transaction Gain [(120,000 x $.1259 = $15,108) - $14,880] 228

 Apr. 1 Cash (120,000 x .1430) 17,160

 Accounts Receivable 15,108

 Transaction Gain 2,052

 1 Transaction Loss 3,591

 Accounts Payable [(210,000 x $.1430 = $30,030) - $26,439] 3,591

 1 FC Receivable from Exchange Dealer 2,562

 Transaction Gain [(210,000 x $.1430 = $30,030 - $27,468] 2,562

 1 Investment in FC 30,030

 Dollars Payable to Exchange Dealer 27,594

 Cash 27,594

 FC Receivable from Exchange Dealer 30,030

 1 Accounts Payable 30,030

 Investment in Foreign Currency 30,030

**Problem 3. No sample**

**Problem 4**. Apple Company was incorporated in Delaware in 2012. On November 2, 2019, the controller of the company entered into a forward contract to sell 50,000 British pounds for $1.5920 on March 1, 2020. The following exchange rates were quoted on the indicated dates:

|  |  |  |
| --- | --- | --- |
|  | **Spot Rate** | **Forward Rate March 1 Delivery** |
| **November 2, 2019** |  $ 1.6021  | 1.5920 |
| **December 31, 2019** | 1.5820 | 1.5800 |
| **March 1, 2020** | 1.6543 |   |

Apple Company’s fiscal year-end is December 31.

**Required:**

1. Assume that the forward contract was entered into as a hedge against an exposed foreign currency receivable balance in the amount of £50,000. Prepare the journal entries that would be made by Apple Company on

November 2—to record the sale of the goods on account for £50,000 and to record the forward contract.

December 31—to adjust the accounts related to the exposed asset and forward contract at fiscal year-end.

March 1—to adjust the accounts related to the exposed asset and forward contract and to record the settlement of the receivable and delivery of the pounds to the exchange dealer.

1. Assume that the controller indicated on November 2 that the forward contract was acquired as a hedge of a future foreign currency transaction that is a commitment of Apple to sell inventory for £50,000 on March 1. Apple Company designates this hedge as a fair value hedge of an unrecognized firm commitment. Prepare the journal entries related to the forward contract and commitment to sell inventory that would be made by Apple Company on November 2, December 31, and March 1.
2. Assume that the contract was entered into to speculate in future exchange rate fluctuations. Prepare the journal entries that would be made by Apple Company on November 2, December 31, and March 1.
3. Compute the effect of the transactions in (A), (B), and (C) on the net income for the fiscal years ended December 31, 2019, and December 31, 2020. Indicate how the balance sheet accounts related to the forward contract would be reported in the December 31, 2019, balance sheet.

**Answer**

**Part A**

Nov. 2 Accounts Receivable 80,105

 Sales (50,000 x $1.6021 = $80,105) 80,105

 Dollars Receivable from Exchange Dealer

(50,000 x $1.5920 = 79,600) 79,600

 FC Payable to Exchange Dealer 79,600

Dec. 31 Transaction Loss 1,005

 Accounts Receivable [(50,000 x $1.5820 = 79,100) - $80,105] 1,005

 FC Payable to Exchange Dealer 600

 Transaction Gain [(50,000 x $1.58 = $79,000) – $79,600] 600

Mar. 1 Accounts Receivable 3,615

 Transaction Gain [(50,000 x $1.6543 = 82,715) - 79,100] 3,615

 Transaction Loss 3,715

 FC Payable to Exchange Dealer

[(50,000 x $1.6543 = $82,715) – $79,000] 3,715

 Investment in FC 82,715

 Accounts Receivable 82,715

 Cash 79,600

 FC Payable to Exchange Dealer 82,715

 Investment in FC 82,715

 Dollars Receivable from Exchange Dealer 79,600

**Part B**

Nov. 2 Dollars Receivable from Exchange Dealer 79,600

 FC Payable to Exchange Dealer 79,600

Dec. 31 FC Payable to Exchange Dealer 600

 Exchange Gain 600

 Exchange Loss 600

 Firm Commitment 600

Mar. 1 Exchange Loss 3,715

 FC Payable to Exchange Dealer 3,715

 Firm Commitment 3,715

 Exchange Gain 3,715

 Investment in FC 82,715

 Sales 79,600

 Firm Commitment ($1.6543 - $1.592) × 50,000 3,115

 Cash 79,600

 FC Payable to Exchange Dealer 82,715

 Investment in FC 82,715

 Dollars Receivable from Exchange Dealer 79,600

**Part C**

Nov. 2 Dollars Receivable from Exchange Dealer 79,600

 FC Payable to Exchange Dealer 79,600

Dec. 31 FC Payable to Exchange Dealer

((50,000 x $1.5800 = $79,000) - $79,600) 600

 Transaction Gain 600

Mar. 1 Transaction Loss ((50,000 x $1.6543 = $82,715) - $79,000) 3,715

 FC Payable to Exchange Dealer 3,715

 Investment in FC 82,715

 Cash 82,715

 Cash 79,600

 FC Payable to Exchange Dealer 82,715

 Dollars Receivable from Exchange Dealer 79,600

 Investment in FC 82,715

**Part D** 2019      A      B\_    C\_\_

 Sales 80,105 0 0

 Transaction gain (loss) 600 600 600

   (1,005) (600) 0

 Increase (decrease) in net income $ 79,700 $ 0 $ 600

 2020

 Sales 0 79,600\* 0

 Transaction gain (loss) 3,615 3,715 0

  (3,715) (3,715) (3,715)

 Increase (decrease) in net income $  (100) $79,600 $(3,715)

 Net increase (decrease) in net income

 2019 + 2020 $79,600 $79,600 $(3,115)\*\*

 \* $82,715 - $3,115 = $79,600

 \*\* Verification of loss

 Cash paid to buy currency 82,715

 Cash paid to complete forward contract 79,600

 Net loss on forward contract $ 3,115

|  |  |  |
| --- | --- | --- |
| On BS |  | 2019 |
| $ Receivable |  | $79,600 |
| FC Payable |  |  79,000 |
|  |  | $ 600 |

**Problem 5.** A U.S. company estimated that, in the first two months of 2016, its export sales to a Swiss company would generate 400,000 francs. On December 1, 2020, in an effort to protect against the weakening franc, the company purchased an option (out of the money) to sell 400,000 Swiss francs at an exchange rate of $0.60 with an expiration date of February 25, 2016. The cost of the option was $6,000. The spot rates on the following dates were:

December 1, 2020 $0.62

December 31, 2020 $0.60

February 25, 2021 $0.57

The option’s value in the options market on December 31, 2020, was $9,000. December 31 is also an interim reporting date. The option was exercised on February 25, 2020.

**Required:**

Prepare all journal entries needed on December 1, December 31, and February 25 to account for the option.

**Answer**

 December 1, 2020

 Option to sell Francs 6,000

 Cash 6,000

 December 31, 2020

 Option to sell Francs 3,000

 Exchange Gain – Other Comprehensive Income (balance sheet equity) 3,000

 To record a gain on the change in option value ($9,000 - $6,000)

 February 25, 2021

 (3) Option to sell Francs 3,000

 Exchange Gain – Other Comprehensive Income 3,000

 To adjust the option value to its current realizable value of $12,000:

 the value of the option [($.60 exercise price less $.57 spot rate) x 400,000 francs]

 of $12,000 less the carrying value of the option ($9,000)

 (4) Cash (400,000 × .60) 240,000

 Option to sell Francs 12,000

 Payable to Option Trader (400,000 × $.57) 228,000

 To exercise the option and settle with the trader.

**Problem 6.** On October 1, 2019, Fairchange Corporation ordered some equipment from a supplier for 300,000 euros. Delivery and payment are to occur on November 15, 2019. The spot rates on October 1 and November 15, 2019, are $1.20 and $1.30, respectively.

**Required:**

1. Assume that Fairchange entered into a forward contract on October 1, 2019, to hedge the firm commitment. The forward rates for euros for November 15 delivery were

October 1 $1.23

November 15 $1.30

Furthermore, assume the equipment was purchased and paid for on November 15. Prepare all journal entries needed to record and settle the hedge and to record the purchase of the equipment.

1. If the forward contract was not acquired, record the journal entry to purchase the equipment.

**Answer**

**Note: Settlement date should be stated as 11/15/19.**

**Part A**

Oct. 1 FC Receivable from Exchange Dealer (300,000  $1.23) 369,000

 Dollars Payable to Exchange Dealer 369,000

Nov. 15 FC Receivable from Exchange Dealer 21,000

 Foreign Exchange Gain 21,000

 [300,000 x 1.23 - 1.30)]

 Foreign Exchange Loss 21,000

 Firm Commitment 21,000

 [10,000 x 1.23- 1.30)]

 Investment in FC (300,000 × $1.30) 390,000

 Dollars Payable to Exchange Dealer 369,000

 FC Receivable from Exchange Dealer 390,000

 Cash 369,000

 Firm Commitment 21,000

 Equipment 369,000

 Investment in FC 390,000

**Part B**

 Equipment 390,000

 Cash 390,000

**Problem 7.** On January 1, 2014, Trenten Systems, a U.S.-based company, purchased a controlling interest in Grant Management Consultants located in Zurich, Switzerland. The acquisition was treated as a purchase transaction. The 2014 financial statements stated in Swiss francs are given below.

|  |
| --- |
| **GRANT MANAGEMENT CONSULTANTS** |
| **Comparative Balance Sheets January 1 and December 31, 2014** |
|  | **Jan 1** | **Dec 31** |
| Cash and Receivables | 20,000 | 55,000 |
| Net Property, Plant, and Equipment | 40,000 | 37,000 |
|  Totals | 60,000 | 92,000 |
| Accounts and Notes Payable | 30,000 | 32,000 |
| Common Stock | 20,000 | 20,000 |
| Retained Earnings | 10,000 | 40,000 |
|  Totals | 60,000 | 92,000 |

|  |
| --- |
| **GRANT MANAGEMENT CONSULTANTS** |
| **Consolidated Income and Retained Earnings Statement for the Year Ended December 31, 2014** |
| Revenues |   | 75,000 |
| Operating Expenses including Depreciation of 3,000 francs | 30,000 |
| Net Income |  | 45,000 |
| Dividends Declared and Paid |  | 15,000 |
| Increase in Retained Earnings |   | 30,000 |

Direct exchange rates for Swiss franc are:

|  |  |
| --- | --- |
|   | Dollars per Swiss Franc |
| January 1, 2014 | $1.09  |
| December 31, 2014 |  1.03 |
| Average for 2014 |  1.06 |
| Dividend declaration and payment date |  1.08 |

**Required:**

1. Translate the year-end balance sheet and income statement of the foreign subsidiary using the current rate method of translation.
2. Prepare a schedule to verify the translation adjustment.

**Answer:**

**Part A** Consolidated Income and Retained Earnings Statement

 Swiss Translation

 Francs Rate $ \_\_\_

 Revenues 75,000 $1.06 79.500

 Operating Expenses (30,000) 1.06 (31.800)

 Net Income 45,000 47.700

 Retained Earnings - 1/1 10,000 1.09 10.900

 55,000 58.600

 Dividends (15,000) 1.08 (16.200)

 Retained Earnings - 12/31 40,000 42.400

 Balance Sheet

 Cash and Receivables 55,000 1.03 56,650

 Net Property, Plant, and Equipment 37,000 1.03 38,110

 Total 92,000 94,760

 Accounts and Notes Payable 32,000 1.03 32,960

 Common Stock 20,000 1.09 21,800

 Retained Earnings 40,000 42,400

 92,000 97,160

 Cumulative Translation Adjustment (debit)      - Balancing amt.  (2,400)

 Total 92,000 94,760

 Swiss Translation

 Francs Rate $

**Part B** Exposed net asset position - 1/1 30,000 $1.09 32,700
 Adjustment for changes in the net asset position during the year:

 Net income 45,000 1.06 47,700
 Dividends (15,000) 1.08 (16,200)
 Net asset position translated using rate in effect at date of transactions--- 64,200 Exposed net asset position - 12/31 60,000 1.03 61,800
 Cumulative translation adjustment (debit) (2,400)

**Problem 8**. Refer to **Problem 7 above**. Using the same information, assume that the Brazilian real is identified as the functional currency of the subsidiary.

**Required:**

1. Remeasure the account balances that are expressed in Swiss francs into Brazilian reals, Direct exchange rates for the real are:

|  |  |  |  |
| --- | --- | --- | --- |
|   | Real per Swiss Franc |   | Dollars per Swiss Franc |
| Beginning of current year | 1.3940 | January 1, 2014 | $1.09  |
| End of current year | 1.2899 | December 31, 2014 |  1.03 |
| Average for current year | 1.3445 | Average for 2014 |  1.06 |
| Dividend payment date | 1.2438 | Dividend declaration and payment date |  1.08 |

1. Translate the remeasured accounts that are now stated in Reals into dollars using the current rate method. Direct exchange rates for the real are:

|  |  |
| --- | --- |
|   | Dollars per Real |
| Beginning of current year | $0.4891  |
| End of current year |  .4630 |
| Average for current year |  .4751 |
| Dividend payment date |  .4740 |

**Answer**

 **Part A Part B**



**Problem 9.** Dorsey Corporation purchased 90% of the common stock of Lansing Company on January 1, 2008. The cost of the investment was equal to the book value interest acquired. Lansing Company operates two retail stores and an exporting business in London that specializes in buying and selling British tweeds. The subsidiary provided the following financial statements in pounds to the parent company:

|  |
| --- |
| **LANSING COMPANY** |
| **Consolidated Income and Retained Earnings Statement for the Year Ended December 31, 2014** |
| Sales |   | 2,900,000 |
| Cost of Goods Sold |  | (1,400,000) |
| Depreciation Expense |  | (300,000) |
| Other Expenses |  | (400,000) |
| Net Income |  | 800,000  |
| 1/1 Retained Earnings |  | 900,000  |
|   |  | 1,700,000  |
| Less Dividends Declared and Paid Dec. 31 |  | (325,000) |
| 12/31 Retained Earnings |   | 1,375,000  |

|  |
| --- |
| **LANSING** **COMPANY** |
| **Balance Sheet December 31, 2014** |
|  |  |
| Cash and Receivables | 1,275,000 |
| Merchandise Inventory | 490,000 |
| Property, Plant, and Equipment | 3,450,000 |
|  Totals | 5,215,000 |
| Current Liabilities | 640,000 |
| Long Term Notes Payable | 1,200,000 |
| Capital Stock | 2,000,000 |
| Retained Earnings | 1,375,000 |
|  Totals | 5,215,000 |

Lansing Company was incorporated on January 1, 2006, at which time all the property, plant, and equipment was purchased. The long-term notes were issued to partially finance the purchase of the fixed assets.

Direct exchange rates for the British pound are as follows:

|  |  |
| --- | --- |
| January 1, 2006 | $1.8996  |
| January 1, 2008 | 1.8365 |
| Average for last quarter 2018 | 1.5300 |
| January 1, 2019 | 1.4919 |
| December 31, 2019 | 1.4730 |
| Average for 2019 | 1.4788 |
| Average for Aug - Dec 2019 | 1.4950 |

The January 1, 2019, retained earnings balance of Lansing in dollars was $1,593,408, and the cumulative translation adjustment was a debit balance of $939,898. The beginning inventory of £420,000 was acquired during the last quarter of 2018 and the ending inventory was acquired during the last five months of 2019. Sales were made and purchases and other expenses were incurred evenly during the year.

**Required:**

Translate the December 31, 2019, account balances of Lansing Company into dollars assuming that the pound is the functional currency of Lansing Company.

**Answer**



**Problem 10.** On January 1, 2019, a U.S. company purchased 100% of the outstanding stock of Ventana Grains, a company located in Latz City, New Zealand. Ventana Grains was organized on January 1, 2000. All the property, plant, and equipment held on January 1, 2019, was acquired when the company was organized. The business combination was accounted for as a purchase transaction. The 2019 financial statements for Ventana Grains, prepared in its local currency, the New Zealand dollar, are given here.

|  |
| --- |
| **VENTANA GRAINS** |
| **Comparative Balance Sheets January 1 and December 31, 2019** |
|  | **Jan 1** | **Dec 31** |
| Cash and Receivables | 500,000 | 880,000 |
| Inventories | 600,000 | 500,000 |
| Land | 400,000 | 400,000 |
| Buildings (net) | 650,000 | 605,000 |
| Equipment (net) | 465,000 | 470,000 |
|  Totals | 2,615,000 | 2,855,000 |
| Short-term Accounts and Notes  | 295,000 | 210,000 |
| Long-term Notes (600,000 issued 9/1/06, 80,000 issued 1/1/19 | 600,000 | 680,000 |
| Common Stock | 800,000 | 800,000 |
| Additional Paid-in Capital | 200,000 | 200,000 |
| Retained Earnings | 720,000 | 965,000 |
|  Totals | 2,615,000 | 2,855,000 |

|  |
| --- |
| **VENTANA GRAINS****Consolidated Income and Retained Earnings Statement for the Year Ended December 31, 2019** |
| Revenues |  | 3,225,000 |
| Cost of Good Sold: |  |   |
|  Beginning Inventory |  600,000  |   |
|  Purchases |  2,100,000  |   |
|  Cost of Goods Available for Sale |  2,700,000  |   |
|  Less: Ending Inventory |  500,000  |   |
| Cost of Good Sold: |  | 2,200,000 |
| Gross Profit on Sales |  | 1,025,000 |
| Depreciation Expense |  140,000  |   |
| Other Expenses |  540,000  | 680,000 |
| Net Income |  | 345,000 |
| Jan. 1 Retained Earnings |  | 720,000 |
|  Total |  | 1,065,000 |
| Less Dividends Paid |  | 100,000 |
| Dec. 31 Retained Earnings |   | 965,000 |

The account balances are computed in conformity with U.S. generally accepted accounting standards.

Other information is as follows:

1. Direct exchange rates for the New Zealand dollar on various dates were:

|  |  |
| --- | --- |
| Date | Exchange Rate |
| January 1, 2000 | $0.8011  |
| September 1, 2010 | 0.5813 |
| January 1, 2019 | 0.7924 |
| July 1, 2019 | 0.7412 |
| December 31, 2019 | 0.7298 |
| Average for 2019 | 0.7480 |
| Average for last 4 months on 2019 | 0.7476 |

1. Ventana Grains purchased additional equipment for 100,000 New Zealand dollars on July 1, 2019, by issuing a note for 80,000 New Zealand dollars and paying the balance in cash.
2. Sales were made and purchases and “Other Expenses” were incurred evenly throughout the year.
3. Depreciation for the period in New Zealand dollars was computed as follows:

Building 45,000

Equipment—Purchased before 1/1/2019 85,000

Equipment—Purchased July 1, 2019 10,000

1. The inventory is valued on a FIFO basis. The beginning inventory was acquired when the exchange rate was $.7480. The ending inventory was acquired during the last four months of 2019.
2. Dividends of 50,000 New Zealand dollars were paid on July 1 and December 31.

**Required:**

1. Translate the financial statements into dollars assuming that the local currency of the foreign subsidiary was identified as its functional currency.
2. Prepare a schedule to verify the translation adjustment determined in requirement A. Describe how the translation adjustment would be reported in the financial statements.

**Answer**





**Problem 11.** Refer to the information given in Problem 10 (above).

**Required:**

1. Remeasure the financial statements into dollars assuming that the U.S. dollar was identified as the functional currency of the foreign subsidiary.
2. Prepare a schedule to verify the translation gain or loss determined in requirement A. Describe how the translation gain or loss would be reported in the financial statements.

**Answer**

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**Problem 12. No Sample**

**Problem 13.** Jose, Jill, and Salil decided to engage in a real estate venture as a partnership. Jose invested $100,000 cash and Jill provided office equipment that is carried on her books at $82,000. The partners agree that the equipment has a fair value of $110,000. There is a $30,000 note payable remaining on the equipment to be assumed by the partnership. Although Salil has no physical assets to invest in the partnership, both Jose and Jill believe that his experience as a real estate appraiser is a valuable skill needed by the partnership and is a basis for granting him a capital interest in the partnership.

Required:

Assuming that each partner is to receive an equal capital interest in the partnership,

1. Record the partnership formation under the bonus method.
2. Record the partnership formation under the goodwill method, and assume a total goodwill of $90,000.
3. Discuss the appropriateness of using either the bonus or goodwill methods to record the formation of the partnership.

**Answer**

|  |  |  |  |
| --- | --- | --- | --- |
| Agreed Fair Values  | Invested by Jose | Invested by Jill  | Invested by Salil  |
| Cash |  $100,000 | - - - | - - - |
| Equipment |                |  110,000 |  - - - |
| Total assets |  100,000 |  110,000 |  0 |
| Note payable assumed by partnership |    - - -    |   30,000 |  - - - |
| Net assets invested |  $100,000 |   $80,000 |  $0 |

|  |  |
| --- | --- |
| **Part A** Bonus Method | **Part B** Goodwill Method |
|  |  |  | Cash | 100,000 |  |
| Cash | 100,000 |  | Equipment | 110,000 |  |
| Equipment | 110,000 |  | Goodwill | 90,000 |  |
| Note Payable |  | 30,000 | Note Payable |  | 30,000 |
| Jose, Capital |  | 60,000 | Jose, Capital |  | 90,000 |
| Jill, Capital |  | 60,000 | Jill, Capital |  | 90,000 |
| Salil, Capital |  | 60,000 | Salil, Capital |  | 90,000 |

**Problem 14. No Sample**

**Problem 15.** Jones, Silva, and Thompson form a partnership and agree to allocate income equally after recognition of 10% interest on beginning capital balances and monthly salary allowances of $2,000 to Jones and $1,500 to Thompson. Capital balances on January 1 were as follows:

Jones $40,000

Silva 25,000

Thompson 30,000

**Required:**

Calculate the net income (loss) allocation to each partner under each of the following independent situations.

1. Net income for the year is $99,500.
2. Net income for the year is $38,300.
3. Net loss for the year is $15,100.

**Answer**

**Exercise 15-3**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  |  Jones |  Silva |  Thompson |  Total |
|  1 | Interest on capital | $4,000 | $2,500 | $3,000 | $9,500 |
|  | Salary (12 months) |   24,000 |     0 |   18,000 |    42,000 |
|  | Total |  28,000 |  2,500 | 21,000 | 51,500 |
|  | Remainder divided equally |   16,000 |  16,000 |   16,000 |    48,000 |
|  | Income allocation |  $44,000 |  $18,500 |  $37,000 |  $99,500 |
|  2 | Interest on capital and salary |  $28,000 |  $2,500 |  $21,000 |  $51,500 |
|  | Excess allocation ($38,300 - $51,500) |  (4,400) |  (4,400) |   (4,400) |  (13,200) |
|  | Income allocation |  $23,600 |  $(1,900) |  $16,600 |  $38,300 |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  3 | Interest on capital and salary |  $28,000 |  $2,500 |  $21,000 |  $51,500 |
|  | Excess allocation (-$15,100 -$51,500) |   (22,200) |    (22,200) |   (22,200) |   (66,600) |
|  | Net loss allocation |  $5,800 |  $(19,700) |  $(1,200) |  $(15,100) |

**Problem 16**. Gino Smith and Quandre Diggs are partners in an electrical repair business. Their respective capital balances are $90,000 and $50,000, and they share profits and losses equally. Because the partners are confronted with personal financial problems, they decided to admit a new partner to the partnership. After an extensive interviewing process they elect to admit Uchenna Nwosa into the partnership.

**Required:**

Prepare the journal entry to record the admission of Uchenna Nwosa into the partnership under each of the following conditions:

1. Uchenna acquires one‐fourth of Gino’s capital interest by paying $30,000 directly to him.
2. Uchenna acquires one‐fifth of each of Gino’s and Quandre’s capital interests. Gino receives $25,000 and Quandre receives $15,000 directly from Uchenna.
3. Uchenna acquires a one‐fifth capital interest for a $60,000 cash investment in the partnership. Total capital after the admission is to be $200,000.
4. Uchenna invests $40,000 for a one‐fifth interest in partnership capital. Implicit goodwill is to be recorded, consistent with the non‐GAAP use of the goodwill method for internal purposes.

**Answer**

1. Smith, Capital 22,500

 Nwosa, Capital (1/4) ×90,000 22,500

2. Smith, Capital (1/5) ×90,000 18,000

 Diggs, Capital (1/5) ×5,000 10,000

 Nwosa, Capital 28,000

3. Cash 60,000

 Smith, Capital ($60,000 - $40,000) × .50 10,000

 Diggs, Capital 10,000

 Nwosa, Capital 40,000

 ($90,000 + $50,000) + $60,000 = $200,000; Therefore, no goodwill is to be recognized.

 Nwosa, capital = $200,000 × 0.20 = $40,000

4. Goodwill 20,000

 Smith, Capital 10,000

 Diggs, Capital 10,000

 $40,000/0.20 = $200,000

 Goodwill = $200,000 - ($90,000 + $50,000 + $40,000) = $20,000

 Cash 40,000

 Nwosa, Capital 40,000

**Problem 17.** Disha, Brianna, and Phoebe are partners in a retail appliance store. The partnership was formed January 1, 2019, with each partner investing $45,000. They agreed that profits and losses are to be shared as follows:

1. Divided in the ratio of 40:30:30 if net income is not sufficient to cover salaries, bonus, and interest.
2. A net loss is to be allocated equally.
3. Net income is to be allocated as follows if net income is in excess of salaries, bonus, and interest.
4. Monthly salary allowances are:

 Disha $3,500

 Brianna 2,500

 Phoebe 1,500

1. Brianna is to receive a bonus of 8% of net income before subtracting salaries and interest, but after subtracting the bonus.
2. Interest of 10% is allocated based on the beginning‐of‐year capital balances.
3. Any remainder is to be allocated equally.

Operating performance and other capital transactions were as follows.

|  |
| --- |
| **Capital Transactions** |
|  |  | **Disha** | **Brianna** | **Phoebe** |
| Year-End | Net Income (Loss)  | Investment | Withdrawals | Investment | Withdrawals | Investment | Withdrawals |
| 12/31/2019 |  $(5,400) | $15,000  | $17,000  | $15,000  | $7,000  | $6,000  | $3,200  |
| 12/31/2020 |  27,000  | 0 |  17,000  | 0 |  7,000  |  6,000  |  3,200  |
| 12/31/2021 |  120,000  | 0 |  19,000  | 0 |  9,000  |  6,000  |  3,200  |

**Required:**

A. Prepare a schedule of changes in partners' capital accounts for each of the three years.

B. Prepare the journal entry to close the income summary account to the partners' capital accounts at the end of each year.

**Answer**

**Part A**

A. DISHA, BRIANNA, AND PHOEBE PARTNERSHIP

 Statement of Changes in Partners' Capital Accounts

 For the Years Ended December 31, 2019, 2020, and 2021

December 31, 2019 Disha Brianna Phoebe Total

Beginning Capital Balances - 1/1 $45,000 $45,000 $45,000 $135,000

Add: Investments 15,000 15,000 6,000 36,000

 60,000 60,000 51,000 171,000

Less: Withdrawals (17,000) (7,000) (3,200) (27,200)

 Net loss allocation (1,800) (1,800) (1,800) (5,400)

Capital Balances - 12/31 $41,200 $51,200 $46,000 $138,400

December 31, 2020

Beginning Capital Balances - 1/1 $41,200 $51,200 $46,000 $138,400

Add: Investments 0 0 6,000 6,000

 Net income allocation (40:30:30) 10,800 8,100 8,100 27,000

 52,000 59,300 60,100 171,400

Less: Withdrawals (17,000) (7,000) (3,200) (27,200)

Capital Balances - 12/31 $35,000 $52,300 $56,900 $144,200

December 31, 2021

Beginning Capital Balances - 1/1 $35,000 $52,300 $56,900 $144,200

Add: Investments 0 0 6,000 6,000

Net income allocation:

Salaries 42,000 30,000 18,000 90,000

Bonus \* 8,889 8,889

Interest 3,500 5,230 5,690 14,420

Residual – Equally divided 2,230 2,231 2,230 6,691

 47,730 46,350 25,920 120,000

 82,730 98,650 88,820 270,200

Less: Withdrawals (19,000) (9,000) (3,200) (31,200)

Capital Balances - 12/31 $63,730 $89,650 $85,620 $239,000

\*Bonus = 0.08 × (NI - B)

 B = 0.08 × ($120,000 - B) = $9,600 - .08B

 1.08B = $9,600

 B = $8,889

**Part B** Closing Journal Entries:

 December 31, 2019

 Disha, Capital 1,800

 Brianna, Capital 1,800

 Phoebe, Capital 1,800

 Income Summary 5,400

 December 31, 2020

 Income Summary 27,000

 Disha, Capital 10,800

 Brianna, Capital 8,100

 Phoebe, Capital 8,100

 December 31, 2021

 Income Summary 120,000

 Disha, Capital 47,730

 Brianna, Capital 46,350

 Phoebe, Capital 25,920