

Chapter 6– Advanced Accounting, 1st edition by Hamlen, Huefner, and Largay

Solutions to Practice Quiz

1. Topic: Intercompany loans
LO 2

A parent loaned \$1,000,000 to its 90 percent-owned subsidiary in 2011. The subsidiary reported interest expense on this loan of \$4,000 in 2011, and \$3,500 in 2012. At the end of 2012, the loan is still outstanding and the subsidiary owes \$300 in interest to the parent. The eliminating entries I on the 2012 consolidation working paper include all of the following *except*:

- Debit to interest payable of \$300
- Debit to the subsidiary's beginning retained earnings of \$4,000
- Credit to loan receivable of \$1,000,000
- Credit to interest expense of \$3,500

ANS: b

Rationale: The 2012 eliminating entries related to the loan are:

Loan payable	1,000,000	
Loan receivable		1,000,000
Interest payable	300	
Interest receivable		300
Interest revenue	3,500	
Interest expense		3,500

There are no timing issues and therefore no adjustments to retained earnings.

2. Topic: Intercompany services

LO 2

A subsidiary provides consulting services to its parent during 2012, and charges the parent \$5,000,000. The parent records the cost of the services in its general expenses. The services cost the subsidiary \$3,000,000, and are included in the subsidiary's cost of services sold account. The parent still owes the subsidiary \$400,000 for these services at the end of 2012. The eliminating entries I on the 2012 consolidation working paper include all of the following *except*:

- a. Credit to cost of services sold, \$3,000,000
- b. Debit to accounts payable, \$400,000
- c. Debit to service revenues, \$5,000,000
- d. Credit to general expenses, \$5,000,000

ANS: a

Rationale: The 2012 eliminating entries related to intercompany services are:

Accounts payable	400,000	
Accounts receivable		400,000
Service revenues	5,000,000	
General expenses		5,000,000

3. Topic: Intercompany profits on merchandise sales, noncontrolling interest in net income calculation

LO 3, 5

A parent owns an 80 percent interest in its subsidiary. The following information relates to intercompany merchandise transactions for 2012:

The parent's beginning inventory includes \$180,000 purchased from the subsidiary. The parent's ending inventory includes \$300,000 purchased from the subsidiary. The subsidiary sells to the parent at a markup of 20% on cost.

How does this information affect the 2012 noncontrolling interest in net income?

- a. Reduction of \$4,800
- b. Increase of \$4,800
- c. Increase of \$4,000
- d. Reduction of \$4,000

ANS: d

Rationale: The markup on the beginning inventory is $\$180,000 - (\$180,000/1.2) = \$30,000$. The markup on the ending inventory is $\$300,000 - (\$300,000/1.2) = \$50,000$. The effect on noncontrolling interest in net income for 2012 is:

Realized profit on beginning inventory	$(\$30,000 \times 20\%) =$	\$ 6,000
Unrealized profit on ending inventory	$(\$50,000 \times 20\%) =$	<u>(10,000)</u>
Net change in noncontrolling interest in NI		\$ (4,000)

4. Topic: Intercompany profits on depreciable assets, equity in net income calculation

LO 3, 6

A parent owns a 100 percent interest in its subsidiary. The following information relates to intercompany equipment sales:

At the beginning of 2010, the subsidiary sold equipment with a book value of \$10,000 to the parent for \$50,000. The equipment had a remaining life of five years, straight-line. It is now the end of 2012, three years later, and the parent still has the equipment. The parent uses the complete equity method to report its investment on its own books. How is its 2012 equity in net income affected by the intercompany equipment sale?

- a. No effect
- b. Decrease of \$32,000
- c. Decrease of \$16,000
- d. Increase of \$8,000

ANS: d

Rationale: In subsequent years, the intercompany gain of \$40,000 is realized through a reduction in depreciation expense, at a rate of $\$40,000 / 5 = \$8,000$ per year.

5. Topic: Intercompany transfers of land

LO 4

In 2010, a parent sold land with a book value of \$100,000 to its subsidiary for \$600,000. It is now the end of 2012, and the subsidiary still owns the land. On the consolidation working paper, the eliminating entry for this intercompany transaction is:

- a.

Retained earnings, beginning	500,000	
Land		500,000
- b. No entry
- c.

Investment in subsidiary	500,000	
Land		500,000
- d.

Gain on sale of land	500,000	
Land		500,000

5. *Continued*

ANS: c

Rationale: This is a subsequent year downstream transfer, so the unrealized gain of \$600,000 - \$100,000 = \$500,000 increases the investment and reduces the land, as reported by the subsidiary.

6. Topic: Intercompany transfers of land
LO 4

In 2011, a subsidiary sold land with a book value of \$3,000,000 to its parent for \$2,000,000. During 2013 the parent sold the land to an outside party for \$3,600,000. On the 2013 consolidated income statement, the gain on sale of land is:

- a. \$1,600,000
- b. \$ 600,000
- c. \$1,000,000
- d. \$0

ANS: b

Rationale: Consolidated book value of land sold = \$3,000,000.

Gain on sale = \$3,600,000 - \$3,000,000 = \$600,000.

7. Topic: Intercompany transfers of inventory
LO 5

During 2012, a parent sold inventory costing \$6,000,000 to its subsidiary at a markup of 20% on cost. The subsidiary's ending inventory includes \$600,000 of this inventory (at the subsidiary's cost). The 2012 consolidation working paper eliminations needed to reflect the above information reduces cost of goods sold by a net amount of

- a. \$6,000,000
- b. \$7,200,000
- c. \$5,900,000
- d. \$7,100,000

ANS: d

Rationale: The parent's selling price is \$6,000,000 x 1.2 = \$7,200,000. The unrealized profit in the subsidiary's ending inventory is \$600,000 - (\$600,000/1.2) = \$100,000. The eliminating entries are:

Sales revenue	7,200,000	
Cost of goods sold		7,200,000
Cost of goods sold	100,000	
Inventory		100,000

8. Topic: Intercompany transfers of inventory

LO 5

A subsidiary sells inventory to its parent at a markup of 25% on cost. During 2012, a subsidiary sells inventory to its parent, charging the parent \$5,000,000. The parent's beginning inventory includes \$500,000 of this inventory (at the parent's cost). By the end of 2012, the parent has sold the entire inventory it purchased from the subsidiary. The 2012 consolidation working paper eliminations needed to reflect the above information reduce cost of goods sold by a net amount of:

- a. \$4,900,000
- b. \$5,125,000
- c. \$5,100,000
- d. \$5,000,000

ANS: c

Rationale: The confirmed profit in beginning inventory is:
 $\$500,000 - \$500,000 / 1.25 = \$100,000$. This is an upstream sale.

The eliminating entries are:

Sales revenue	5,000,000	
Cost of goods sold		5,000,000
Retained earnings, beginning	100,000	
Cost of goods sold		100,000

9. Topic: Intercompany transfers of depreciable assets

LO 6

At the beginning of 2012, a parent sold equipment with a book value of \$4,000,000 to its subsidiary for \$7,000,000. At the time of the transfer, the equipment had a remaining life of 5 years, straight-line. The consolidation working paper eliminations at the end of 2012 reduce the net equipment account (cost less accumulated depreciation) by a net amount of:

- a. \$3,000,000
- b. \$2,400,000
- c. \$ 600,000
- d. \$3,600,000

ANS: b

Rationale:

The unrealized gain at the date of acquisition is: $\$7,000,000 - \$4,000,000 = \$3,000,000$.

The realized gain for 2012 is $\$3,000,000/5 = \$600,000$.

The eliminating entries are:

Gain on sale of equipment	3,000,000	
Equipment, net		3,000,000
Equipment, net	600,000	
Depreciation expense		600,000

10. Topic: Intercompany transfers of depreciable assets

LO 6

At the beginning of 2012, a subsidiary sold equipment, on its books for \$8,000,000 cost less \$3,000,000 accumulated depreciation, to its parent for \$6,000,000. At the time of the transfer, the equipment had a remaining life of 5 years, straight-line. The consolidation working paper eliminations at the end of 2014 include a debit to the beginning balance of retained earnings in the amount of:

- a. \$ 600,000
- b. \$1,000,000
- c. \$ 800,000
- d. \$ 400,000

ANS: a

Rationale: The unrealized profit at the date of transfer is:

$\$6,000,000 - (\$8,000,000 - \$3,000,000) = \$1,000,000$. That profit is realized at a rate of $\$1,000,000/5 = \$200,000$ per year. It is now the end of the third year since the transfer. Retained earnings, beginning is adjusted by the unrealized profit as of the beginning of the third year, which is $\$1,000,000 - (2 \times \$200,000) = \$600,000$.