NAME:		Date:
Professor:	Section:	Score:

INTERMEDIATE ACCOUNTING 2

SECOND GRADING EXAMINATION

1. PFRSs are adopted from the standards issued by the
a. IASC
b. IASCF
c. IASB
d. FASB

Use the following information for the next three questions:
On January 1, 20x1, KISMET FATE Co., purchased inventory with a list price of ₱4,400,000 and a cash price of ₱4,000,000 by issuing a noninterest-bearing note of ₱4,800,000 due on December 31, 20x3.

2. How much is the carrying amount of the note on initial recognition?
a. 4,400,000 b. 4,000,000 c. 4,800,000 d. 3,786,309

B ***4,000,000*** – the cash price equivalent

3. How much is the interest expense in 20x1?
a. 400,000 b. 279,830 c. 250,780 d. none of these

C
Solution:
Trial and error approach
First trial: (at 10%)
Future cash flows x PV factor at *x%* = PV of note
- 4,800,000 X PV of ₱1 @ 10%, n=3 = 4,000,000
- (4,800,000 x 0.751315) = 3,606,312 is ***not equal to*** 4,000,000

We need a *substantially* ***higher*** amount of present value. Therefore, we need to ***decrease*** *substantially* the interest rate. Let's try 6%.

Second trial: (at 6%)
Future cash flows x PV factor at *x%* = PV of note
- 4,800,000 X PV factor at 6%, n=3 = 4,000,000
- (4,800,000 x 0.839619) = 4,030,171 is ***not equal to*** 4,000,000

We need a *slightly* ***lower*** amount of present value. Therefore, we need to ***increase*** *slightly* the interest rate. Let's try 7%.

Third trial: (at 7%)
Future cash flows x PV factor at *x%* = PV of note
- 4,800,000 X PV factor at 7%, n=3 = 4,000,000
- (4,800,000 x 0.816298) = 3,918,230 is ***not equal to*** 4,000,000

In here, we need to perform ***interpolation***. Looking at the values derived above, we can reasonably expect that the effective interest rate is a rate ***between 6% and 7%.***

To perform the ***interpolation***, we will use the following formula:

$$\frac{x\% - 6\%}{7\% - 6\%}$$

Where: *x%* again is the effective interest rate.

The formula is derived based on our expectation that the effective interest rate is somewhere between 6% and 7%. Notice that the lower rate appears in both the numerator and denominator of the formula while *x %* appears in the numerator.

Let us substitute the amounts of present values computed earlier on the formula.

$$\frac{4{,}000{,}000 - 4{,}030{,}171}{3{,}918{,}230 - 4{,}030{,}171} = \frac{(30{,}171)}{(111{,}941)} = \frac{0.269}{5}$$

The amount computed is added to 6% to derive the effective interest rate. The effective interest rate is ***6.2695%*** (6% + .2695%).

Interest expense in 20x1 = 6.2695% x 4,000,000 = ***250,780***

4. How much is the carrying amount of the note on December 31, 20x1?
a. 4,250,780 b. 4,279,830 c. 4,400,000 d. 4,000,000

A (4,000,000 x 106.2695%) = ***4,250,780***

5. On January 1, 20x1, ABC Co., acquired transportation equipment in exchange for cash of ₱100,000 and ₱1,000,000 noninterest-bearing note payable due in 4 equal annual installments starting December 31, 20x1. The prevailing rate of interest for this type of note is 12%. How much is the current portion of the note on December 31, 20x2?
a. 158,880
b. 177,945
c. 199,298
d. 223,214

Future cash flows – annual installments (₱1M ÷ 4)	250,000
Multiply by: *PV of an* ***ordinary annuity*** *of ₱1 @12%, n=4*	3.037349
Present value of note payable - Jan. 1, 20x1	*759,337*

Date	***Payments***	***Interest expense***	***Amortization***	***Present value***
Jan. 1, 20x1				759,337
Dec. 31, 20x1	250,000	91,120	158,880	600,458
Dec. 31, 20x2	250,000	72,055	**177,945**	422,513
Dec. 31, 20x3	250,000	50,702	199,298	223,214
Dec. 31, 20x4	250,000	26,786	223,214	0

6. Kemp Company must determine the December 31, 2005, year-end accruals for advertising and rent expense. A P50,000 advertising bill was received January 7, 2006, comprising cost of P35,000 for advertisements in December 2006 issues, and P15,000 for advertisements in January 2006 issues of the newspaper.

A store lease, effective December 16, 2004, calls for fixed rent of P120,000 per month, payable one month from the effective date and monthly thereafter. In addition, rent equal to 5% of net sales over P6,000,000 per calendar year is payable on January 31 of the following year. Net sales for 2005 were P9,000,000.

In its December 31, 2005 balance sheet, Kemp should report accrued liabilities of
a. 260,000

b. 185,000
c. 210,000
d. 245,000

D *35+ 60 + 150*

7. ABC Co. is contemplating on issuing a 12%, 3-year, ₱1,000,000 bonds. Principal is due at maturity but interest is due *semi-annually* every July 1 and December 31. ABC determines that the current market rate on January 1, 20x1 is 14%. ABC Co. plans to issue the bonds on September 30, 20x1. How much is the estimated total proceeds from the issuance of the bonds on September 30, 20x1?
a. 666,342
b. 962,563
c. 952,334
d. 992,563

Solution:

Date	Interest payments	Interest expense	Amortization	Present value
Jan. 1, 20x1				952,335
July 1, 20x1	60,000	66,663	6,663	958,998
Sept. 30, 20x1	30,000	33,565	3,565	***962,563***

The estimated issue price pertaining to the bonds ***only*** on Sept. 30, 20x1 is ₱962,563.

The total proceeds is computed as follows:

Issue price pertaining to bonds only	962,563
Sold accrued interest (1M x 12% x 3/12)	30,000
Total issue price or cash proceeds	***992,563***

Only the accrued interest from July to Sept. is added to the issue price of the bonds because the last interest payment date was on July 1.

8. On January 1, 20x1, SALIENT PROMINENT Co. issued 1,000, ₱4,000, 12%, 3-year bonds for ₱4,412,336. Principal is due on December 31, 20x3 but interests are due annually every year-end. In addition, SALIENT incurred bond issue cost of ₱213,388.The effective interest rate *before* adjustment for transaction costs is 8%. How much is the carrying amount of the note on December 31, 20x1?
a. 4,019,832 b. 4,198,948 c. 4,288,776 d. 4,138 ,843

D
Solution:
The carrying amount of the bonds on initial recognition is computed as follows:

Issue price *before* transaction costs	4,412,336
Transaction costs (Bond issue costs)	(213,388)
Carrying amount - Jan. 1, 20x1 (net issue price)	*4,198,948*

Trial and error
First trial: (using 10%)
- (4M x PV of ₱1 @ 10%, n=3) + [(4M x 12%) x PV of an ordinary annuity of ₱1 @ 10%, n=3) = 4,198,948
- (4M x 0.751315) + (480,000 x 2.48685) = 4,198,948
- (3,005,260 + 1,193,688) = 4,198,948 ***is equal to*** 4,198,948

Since ***10%*** exactly discounts the future cash flows to the initial carrying amount of the bonds, it shall be regarded as the *effective interest rate*. No further interpolation is needed.

Date	Interest payments	Interest expense	Amortization	Present value
Jan. 1, 20x1				4,198,948
Dec. 31, 20x1	480,000	419,895	60,105	4,138,843

Use the following information for the next two questions:
On January 1, 20x1, SPITEFUL MALICIOUS Co. issued 1,000, ₱4,000, 10%, 3-year bonds for ₱3,807,852. Principal is due on December 31, 20x3 but interests are due annually every year-end. The effective interest rate is 12%. SPITEFUL Co. incorrectly used the straight line method instead of the effective interest method to amortize the discount.

9. What is the effect of the error on the carrying amount of the bonds on December 31, 20x1? *(over) understated*
a. 7,107 b. (7,107) c. 6,341 d. (6,341)

B
Solution:
Erroneous amortization of discount using straight line:
The erroneous ***straight-line amortization*** of the discount on bonds payable is computed as follows:

Face amount of bonds	4,000,000
Cash proceeds	(3,807,852)
Discount on bonds payable - Jan. 1, 20x1	*192,148*
Divide by: Term of bonds (in years)	3
Annual amortization (straight line method)	*64,049*

Interest expense for 20x1 recognized under straight-line method:

Interest paid (4,000,000 x 10%)	400,000
Amortization of discount (see computation above)	64,049
Interest expense under straight-line method	*464,049*

Carrying amount of bonds on Dec. 31, 20x1 under straight-line method:

Carrying amount - Jan. 1, 20x1	3,807,852
Amortization of discount (see computation above)	64,049
Carrying amount - Dec. 31, 20x1	***3,871,901***

Amortization of discount under effective interest method:
Amortization table:

Date	Interest payments	Interest expense	Amortization	Present value
Jan. 1, 20x1				3,807,852
Dec. 31, 20x1	400,000	***456,942***	56,942	***3,864,794***

Effect on carrying amount of bonds as of Dec. 31, 20x1

Carrying amounts on Dec. 31, 20x1:	
Straight-line	3,871,901
Effective interest rate	3,864,794
Difference - overstatement under straight-line	***7,107***

The carrying amount of the bonds on December 31, 20x1 under the straight line method is ***overstated by ₱7,107***.

10. What is the effect of the error on the 20x1 profit? *(over) understated*
a. 7,107 b. (7,107) c. 6,341 d. (6,341)

A
Solution:
Effect on 20x1 profit

Interest expense in 20x1:	
Straight-line (see computations above)	464,049
Effective interest rate (see computations above)	456,942
Difference - overstatement under straight-line	***7,107***

Since interest expense under *straight-line* is *overstated*, the ***profit under straight-line is understated by ₱7,107***.

11. According to PAS 37, contingent liabilities are
a. recognized and disclosed.
b. always disclosed.
c. disclosed, only if their expected occurrence is remote.
d. not disclosed if their expected occurrence is remote.

12. Arrange the following steps in the accounting for defined benefit plans in the correct order.
I. Determine the components of the defined benefit cost to be recognized in P/L and OCI.
II. Determine the net defined benefit liability (asset)
III. Determine the deficit or surplus

a. I, III and II
b. III, II and I
c. II, III and I
d. I, II and III

13. Actuarial gains or losses result from the accounting for which of the following employee benefits?
a. Short-term compensated absences
b. Post-employment defined contribution plans
c. Post-employment defined benefit plans
d. Profit sharing and bonus plans

14. Which of the following factors is least likely to affect the amount of retirement benefits under a defined benefit plan?
a. The age of the retiring employee.
b. The level of the employee's compensation.
c. The employee's length of service.
d. The amount of employer contributions to a fund.

15. Information on the defined benefit plan of Entity A as of December 31, 20x1 is as follows:
- Fair value of plan assets ₱ 800,000

- Present value of the defined benefit obligation ₱1,000,000

How much is (are) presented in Entity A's December 31, 20x1 statement of financial position in relation to its post-employment benefits plan?

a. ₱800,000 in noncurrent assets and ₱1M in noncurrent liabilities
b. ₱200,000 net defined benefit asset in noncurrent assets
c. ₱200,000 net defined benefit liability in noncurrent liabilities
d. ₱1M in noncurrent liabilities

16. The actuarial valuation report of Entity A's post-employment benefit plan shows the following information:

Service cost	300,000
Net interest on the net defined benefit liability (asset)	90,000
Remeasurements of the net defined benefit liability	(20,000)
Total defined benefit cost	*370,000*

How much will be shown in profit or loss and in other comprehensive income?

	Profit or loss	*Other comprehensive income*
a.	370,000	0
b.	300,000	70,000
c.	390,000	(20,000)
d.	0	370,000

17. According to PAS 19, how are other long-term benefits accounted for?

a. similar to defined benefit plans.
b. similar to short-term employee benefits except that the cash flows are discounted.
c. similar to defined benefit plans except that all the components of the defined benefit cost is recognized in other comprehensive income.
d. similar to defined benefit plans except that all the components of the defined benefit cost is recognized in profit or loss.

18. Entity B, a trustee, undertakes to manage the retirement benefit fund of Entity A for the benefit of Entity A's employees. When reporting to Entity A regarding the status and performance of the fund, Entity B would most likely apply which of the following standards?

a. PAS 19
b. PAS 24
c. PAS 26
d. PFRS 6

Use the following information for the next two questions:
An entity is the defendant in a patent infringement lawsuit. The entity's lawyers believe there is a 30% chance that the court will dismiss the case and the entity will incur no outflow of economic benefits. However, if the court rules in favor of the claimant, the lawyers believe that there is a 20% chance that the entity will be required to pay damages of ₱800,000 (the amount sought by the claimant) and an 80% chance that the entity will be required to pay damages of ₱400,000 (the amount that

was recently awarded by the same judge in a similar case). Other outcomes are unlikely.

The court is expected to rule in late December 20x2. There is no indication that the claimant will settle out of court. A 7% risk adjustment factor to the probability-weighted expected cash flows is considered appropriate to reflect the uncertainties in the cash flow estimates. An appropriate discount rate is 10% per year.

19. How much is the provision for lawsuit at December 31, 20x1?
a. 436,360 b. 446,908 c. 326,836 d. 0

C
Solution:

At twenty per cent chance: (800K x 20%)	160,000
At eighty per cent chance: (400K x 80%)	320,000
Total	480,000
Multiply by: PV of P1 @10%, n=1	0.90909
Total	436,363
Multiply by: Risk adjustment (100% ***+ 7%***)	107%
Total	466,909
Multiply by: Probability of settlement (100% ***- 30%***)	70%
Provision for lawsuit – Dec. 31, 20x1	***326,836***

20. Use the fact pattern above. However, in this question, the entity's lawyers believe there is a 60 per cent chance that the court will dismiss the case and the entity will incur no outflow. How much is the provision for lawsuit at December 31, 20x1?
a. 186,764 b. 446,908 c. 326,836 d. 0

D – the obligation is ***not probable, i.e., only 40% chance***

Fact pattern:
On January 1, 20x1, Entity X (Customer) enters into a 4-year lease of equipment with Entity Y (Supplier). The annual rent is ₱220,000, payable at the end of each year. The equipment has a remaining useful life of 10 years. The interest rate implicit in the lease is 10% while the lessee's incremental borrowing rate is 12%. Entity X uses the straight-line method of depreciation. The relevant present value factors are as follows:
- PV of an ordinary annuity of ₱1 @10%, n=4..... 3.16987
- PV of an ordinary annuity of ₱1 @12%, n=4..... 3.03735

21. How much is the lease liability to be recognized by Entity X on initial recognition?
a. 702,345 c. 668,217
b. 697,371 d. 0

Solution:

Fixed payments	220,000
Multiply by: PV of an ordinary annuity of ₱1 @10%, n=4	3.16987
Lease liability	***697,371***

22. How much is the annual depreciation on the right-of-use asset?
a. 174,343 c. 167,054
b. 175,586 d. 0

Solution:

Cost of right-of-use asset	697,371
Divide by: Lease term (shorter)	4
Annual depreciation	***174,343***

Since the lease contract neither provides for the transfer of ownership to the lessee nor a 'reasonably certain' purchase option, the asset is depreciated over the ***shorter*** of its useful life (10 yrs.) and the lease term (4 yrs.).

23. Assume the lease qualifies for accounting as a lease of "low-value asset." How much is the lease liability to be recognized by Entity X on initial recognition?

a. 702,345 c. 668,217
b. 697,371 d. 0

24. How much is the lease (rent) expense in 20x1?

a. 220,000 c. 167,054
b. 174,343 d. 0

25. Assume the lease is a finance lease. How much is the net investment in the lease to be recognized by Entity Y on initial recognition?

a. 702,345 c. 668,217
b. 697,371 d. 0

Solution:

Fixed payments	220,000
Multiply by: PV of an ordinary annuity of ₱1 @10%, n=4	3.16987
Net investment	***697,371***

26. Assume the lease is an operating lease. How much is the lease (rent) income in 20x1?

a. 220,000 c. 167,054
b. 174,343 d. 0

27. As a result of differences between depreciation for financial reporting purposes and tax purposes, the financial reporting basis of Noor Co.'s sole depreciable asset, acquired in 20x1, exceeded its tax basis by ₱250,000 at December 31, 20x1. This difference will reverse in future years. The enacted tax rate is 30% for 20x1, and 40% for future years. Noor has no other temporary differences. In its December 31, 2001, balance sheet, how should Noor report the deferred tax effect of this difference - Asset (Liability)?

a. ₱75,000 b. ₱100,000 c. (₱75,000) d. (₱100,000)

D

Solution:

Concept: If the ***carrying amount (CA)*** of an ***asset exceeds*** its ***tax base (TB)***, the difference is a ***taxable temporary difference*** which, if multiplied by the tax rate, results to a ***deferred tax liability***.
"For an ***asset***: CA > TB = *difference* is TTD; TTD x Tax rate = DTL"

Excess of CA over TB of asset (Taxable temp. difference)	250,000
Multiply by: Enacted future tax rate	40%
Deferred tax liability	***100,000***

28. Provisions, contingent liabilities and contingent assets are accounted for using
a. PAS 37
b. PFRS 6
c. PAS 29
d. PAS 8

29. These are differences that do not have future tax consequences.
a. Permanent differences
b. Taxable differences
c. Temporary differences
d. Deductible differences

30. This type of difference will give rise to deferred tax asset.
a. Taxable temporary difference
b. Permanent difference
c. Deductible temporary difference
d. No difference

31. The tenant (as opposed to the landlord) in a lease contract is referred to as the
a. Lessor
b. Lessee
c. Leasee
d. Tenor

32. Which of the following is a characteristic of a finance lease?
a. The lease term is substantially less than the estimated economic life of the leased property.
b. The lease contains a bargain-purchase option.
c. The present value of the minimum lease payments at the beginning of the lease term is 75% or more of the fair value of the property at the inception of the lease.
d. The lease obligation does not appear in the balance sheet of the lessee.

33. Leases are accounted for under
a. PAS 16
b. PFRS 14
c. PFRS 15
d. PFRS 16

34. In accounting for a defined benefit plan which is fully funded at the start of the year, any difference between the defined benefit cost recognized and the contributions made to the fund during the year should be reported as
a. An offset to the liability for past service costs.
b. Net defined benefit liability.
c. An operating expense in this period.
d. An accrued actuarial liability.

35. If not yet vested, past service cost (under the revised PAS 19)
a. is recognized immediately in profit or loss
a. is amortized over the vesting period which is at least 10 million years
b. prior period financial statements are restated

c. recognized as expense in the current and future periods until the end of the world or until the moon turns blue, whichever comes earlier.

36. PARADIGM EXAMPLE Co. has a 10%, P4,000,000 loan payable as of December 31, 20x1 that is maturing on July 1, 20x2. Interest on the loan is due every July 1 and December 31. On February 1, 20x2, PARADIGM Co. entered into a refinancing agreement with a bank to refinance the loan on a long-term basis. Both parties are financially capable of honoring the agreement's provisions. PARADIGM's financial statements were authorized for issue on March 15, 20x2. How much is presented as current liability in relation to the loan in PARADIGM's 20x1 year-end financial statements?

a. 4,000,000 b. 200,000 c. 4,200,000 d. 0

A – general rule

37. UNKEMPT UNTIDY Co. requires advance payments for custom-built guitar effects, gadgets, and racks. The records of UNKEMPT Co. show the following:

- Unearned revenue, January 1, 20x1 P 4,000,000
- Advances received during 20x1 40,000,000
- Advances applied to orders shipped in 20x1 32,000,000
- Advances pertaining to orders cancelled in 20x1 1,200,000

How much is the current liability if the advance payments received are refundable?

a. 10,800,000 b. 13,200,000 c. 12,000,000 d. 0

(4M + 40M – 32M) = ***12M***

38. On January 1, 20x1, ABC Co. borrowed 10%, ₱1,000,000 loan from XYZ Bank. Principal is due on January 1, 20x4 but interests are due annually starting January 1, 20x2. The bank charged ABC a 3% nonrefundable loan origination fee representing service fee. How much is the carrying amount of the loan on initial recognition?

a. 1,000,000
b. 970,000
c. 930,000
d. 870,000

Principal amount	1,000,000
Origination fee	(30,000)
Initial carrying amount of loan	***970,000***

39. If the current tax expense is greater than the income tax expense during the period, there must be a

a. deferred tax benefit c. income tax payable
b. deferred tax expense d. prepaid income tax

40. An equipment cost P4,000. For tax purposes, depreciation of P2,400 has already been deducted in the current and prior periods and the remaining cost will be deductible in future periods, either as depreciation or through a deduction on disposal. Revenue generated by using the equipment is taxable, any gain on disposal of the equipment will be taxable and any loss on disposal will be deductible for tax purposes. How much is the tax base of the equipment?

a. 4,000 b. 2,400 c. 1,600 d. 0

41. Interest receivable has a carrying amount of P4,000. The related interest revenue will be taxed on a cash basis. How much is the tax base of the asset?
a. 4,000 b. 2,400 c. 1,600 d. 0

42. A loan receivable has a carrying amount of P4,000. The repayment of the loan will have no tax consequences. How much is the tax base of the asset?
a. 4,000 b. 2,400 c. 1,600 d. 0

43. Current liabilities include accrued expenses with a carrying amount of P4,000. The related expense will be deducted for tax purposes on a cash basis. How much is the tax base of the liability?
a. 4,000 b. 2,400 c. 1,600 d. 0

44. Current liabilities include accrued expenses with a carrying amount of P4,000. The related expense has already been deducted for tax purposes. How much is the tax base of the liability?
a. 4,000 b. 2,400 c. 1,600 d. 0

Use the following information for the next six questions:
ABC Co. has pretax income of ₱100,000. The following information was gathered:

Loss on expropriation of property	35,000
Non-deductible premium on life insurance of key employees	6,000
Interest income received on government securities subjected to final tax	5,000
Excess of accelerated depreciation used in taxation over straight line depreciation used in financial reporting	10,000
Warranty expense accrued for financial reporting purposes but is tax deductible only when actually paid	15,000
Rent received in advance	8,000
Quarterly income tax payments *(1st quarter to 3rd quarter)*	20,000
Tax rate	30%
Beginning balance of taxable temporary difference	12,000
Beginning balance of deductible temporary difference	9,000

45. How much is the income tax expense?
a. 40,800
b. 42,600
c. 44,700
d. 46,200

Solution:

Description of items	***Multiply by Tax rate***	***Description of items***
Pretax income	100,000	
Permanent differences:		
Add: Non-deductible expenses:		
Loss on expropriation	35,000	
Premium on life insurance	6,000	
Less: Non-taxable income		

Non-taxable interest income	(5,000)			
Accounting profit subject to tax	136,000	30%	***Income tax expense***	***40,800***
Temporary differences:				
Less: ↑ Taxable temporary difference (TTD) 'FI>TI':			***Less:*** ↑ Deferred tax liability (DTL):	
Excess depreciation	(10,000)	30%		(3,000)
Add: ↑ Deductible temporary difference (DTD) 'FI<TI'			***Add:*** ↑ Deferred tax asset (DTA):	
Warranty expense	15,000	30%		4,500
Rent received in advance	8,000	30%		2,400
Taxable profit	149,000	30%	***Current tax expense***	***44,700***

46. How much is the current tax expense?
a. 40,800
b. 42,600
c. 44,700
d. 46,200

47. How much is the deferred tax expense (benefit)?
a. 4,900
b. (4,900)
c. 3,900
d. (3,900)

Deferred tax expense/benefit	**=**	**Increase in DTL**	**-**	**Increase in DTA**

Increase in DTL*	(3,000)
Increase in DTA (4,500 + 2,400)*	6,900
Deferred tax benefit	***3,900***

*Amounts are taken from the solution above.

48. How much is the current tax payable?
a. 44,700
b. 42,600
c. 24,700
d. 22,600

Income tax payable is computed as follows:

Current tax expense *(see table above)*	44,700
Quarterly income taxes paid	(20,000)
Income tax payable	***24,700***

49. How much is the deferred tax liability to be presented in the statement of financial position?
a. 3,600
b. 6,600
c. 3,000
d. 6,000

Deferred tax liability

	3,600 beg. (₱12,000 TTD, beg. x 30%)

	3,000	Increase (see solution above)
end.	***6,600***	

50. How much is the deferred tax asset to be presented in the statement of financial position?

a. 9,000
b. 9,600
c. 10,200
d. 11,000

Deferred tax asset

beg. (₱9,000 DTD, beg. x 30%)	2,700		
Increase (4,500 + 2,400)	6,900		
		9,600	***end.***

Use the following information for the next four questions:
ABC Co. has the following information from its comparative financial statements.

	20x2	***20x1***
Trade account receivable from service revenues	1,500,000	1,200,000
Prepaid insurance	120,000	100,000
Building - net of accumulated depreciation	9,000,000	9,500,000
Estimated liability for warranty obligation	300,000	280,000

Additional information:

- ABC recognizes revenues from service fees as services are rendered but are taxed only when cash is collected. Total collections in 20x2 amounted to ₱800,000.
- The prepaid insurance account pertains to the unexpired portion of life insurance premiums taken on the life of key personnel. ABC is the irrevocable beneficiary of the insurance policy. Total premiums paid in 20x2 were ₱50,000.
- The building was acquired on January 1, 20x1 and is depreciated over an estimated useful life of 20 years with no residual value. The straight line method of depreciation is used for financial reporting while the double declining balance method is used for taxation.
- Warranty expense is recognized at the time goods are sold but are tax deductible only when actually paid. Tax deductible warranty expense for 20x2 amounted to ₱40,000.
- Pretax income in 20x2 is ₱1,000,000. Income tax rate is 30%.

51. How much is the deferred tax asset as of December 31, 20x1?

a. 84,000
b. 96,000
c. 102,000
d. 114,000

Solutions:

***Requirement (a)* – DTL and DTA in statement of financial position in 20x1 and 20x2**

 For an ***asset***:

CA > TB = TTD or 'FI>TI' : TTD *multiplied by tax rate* results to DTL

20x1

Trade account receivable – December 31, 20x1:

Carrying amount – December 31, 20x1	1,200,000
Tax base*	-
Taxable temporary difference	*1,200,000*
Multiply by tax rate	30%
Deferred tax liability – December 31, 20x1	*360,000*

* The tax base is ***zero*** because the receivable is taxable only when collected. *(See previous discussion on tax bases)*

Prepaid insurance – December 31, 20x1:

No temporary difference arises from the prepaid insurance because the premiums paid ***have no tax consequence***, i.e., not tax deductible.

Building – December 31, 20x1:

Carrying amount – December 31, 20x1	9,500,000
Tax base*	(9,000,000)
Taxable temporary difference	*500,000*
Multiply by tax rate	30%
Deferred tax liability – December 31, 20x1	*150,000*

*The tax base of the building on Dec. 31, 20x1 is computed as follows:

Carrying amount – December 31, 20x1	9,500,000
Divide by: Unexpired life (straight line) [a]	19/20
Historical cost	10,000,000
Accumulated depreciation – Dec. 31, 20x1 (10M x 10%) [b]	(1,000,000)
Tax base – December 31, 20x1	*9,000,000*

[a] The building is 1-year old as of December 31, 20x1 because the acquisition date is January 1, 20x1.

[b] Double declining rate is 10% (2 ÷ 20 years).

Estimated liability for warranty obligation – December 31, 20x1:

Carrying amount – December 31, 20x1	280,000
Tax base*	-
Deductible temporary difference	*280,000*
Multiply by tax rate	30%
Deferred tax asset – December 31, 20x1	*84,000*

* The tax base is ***zero*** because the warranty is tax deductible only when paid. *(See previous discussion on tax bases)*

Deferred tax asset – December 31, 20x1	***84,000***
Deferred tax liability – December 31, 20x1 (360K + 150K)	***510,000***

52. How much is the deferred tax liability as of December 31, 20x1?

a. 360,000
b. 410,000

c. 510,000
d. 620,000

53. How much is the deferred tax asset as of December 31, 20x2?
a. 72,000
b. 86,000
c. 90,000
d. 110,000

Trade account receivable – December 31, 20x2:	
Carrying amount – December 31, 20x2	1,500,000
Tax base	-
Taxable temporary difference	*1,500,000*
Multiply by tax rate	30%
Deferred tax liability – December 31, 20x2	*450,000*

Building – December 31, 20x2:	
Carrying amount – December 31, 20x2	9,000,000
Tax base*	(8,100,000)
Taxable temporary difference	*900,000*
Multiply by tax rate	30%
Deferred tax liability – December 31, 20x2	*270,000*

*The tax base of the building on Dec. 31, 20x2 is computed as follows:

Historical cost *(see previous computation)*	10,000,000
Accumulated depreciation – Dec. 31, 20x2 [1M + (9M x 10%)]	(1,900,000)
Tax base – December 31, 20x2	8,100,000

Estimated liability for warranty obligation – December 31, 20x1:	
Carrying amount – December 31, 20x2	300,000
Tax base	-
Deductible temporary difference	*300,000*
Multiply by tax rate	30%
Deferred tax asset – December 31, 20x2	*90,000*

Deferred tax asset – December 31, 20x2	***90,000***
Deferred tax liability – December 31, 20x2 (450K + 270K)	***720,000***

54. How much is the deferred tax liability as of December 31, 20x2?
a. 510,000
b. 680,000
c. 720,000
d. 810,000

55. How much is the income tax expense in 20x2?
a. 1,050,000
b. 350,000
c. 309,000
d. 105,000

Description of items		*Multiply by Tax rate*	*Description of items*	
Pretax income	**1,000,000**			
Permanent difference: [a]	**30,000**			
Acctg. profit subj. to tax	**1,030,000**	**30%**	***ITE***	***309,000***
Less: ↑ TTD	(700,000)	30%	↑ DTL [b]	**(210,000)**
Add: ↑ DTD	20,000	30%	↑ DTA	**6,000**
Taxable profit - 20x2	350,000	30%	***CTE***	***105,000***

[a] The permanent difference pertains to the insurance expense recognized in financial reporting but is *non-tax deductible*. This is computed in the T-account below:

Prepaid insurance

Jan. 1, 20x2	100,000		
Premiums paid	50,000	***30,000***	Insurance expense ***(squeeze)***
		120,000	Dec. 31, 20x2

[b] The amounts placed in the formula above are the ***changes*** in TTD, DTD, DTL and DTA, respectively. The *changes* in DTL and DTA are computed as follows:

DTL - 20x2	720,000	DTA - 20x2	90,000
DTL - 20x1	(510,000)	DTA - 20x1	(84,000)
Increase in DTL	*210,000*	*Increase in DTA*	*6,000*

56. How much is the current tax expense in 20x2?
a. 1,050,000
b. 350,000
c. 309,000
d. 105,000

Use the following information for the next two questions:
ABC Co. started its operations on January 1, 20x1. Information on temporary differences during the first two years of operations is shown below:

	Dec. 31, 20x2			***Dec. 31, 20x1***		
	Carrying amount	***Tax base***	***Difference***	***Carrying amount***	***Tax base***	***Difference***
Assets	100,000	90,000	10,000	120,000	100,000	20,000
Liabilities	50,000	43,000	7,000	60,000	45,000	15,000

Pretax incomes were ₱400,000 and ₱500,000 in 20x2 and 20x1, respectively. Income tax rate is 30%.

57. How much is the income tax expense in 20x2?
a. 150,000
b. 148,500
c. 120,000
d. 120,600

Solutions:

20x1

The 20x1 income tax expense and current tax expense are computed as:

Description of items		*Multiply by Tax rate*	*Description of items*	
Pretax income	500,000			
Permanent difference:	-			
Acctg. profit subj. to tax	500,000	30%	***ITE***	***150,000***
Less: ↑ TTD	(20,000)	30%	***Less:*** ↑ DTL	(6,000)
Add: ↑ DTD	15,000	30%	***Add:*** ↑ DTA	4,500
Taxable profit - 20x1	495,000	30%	***CTE***	***148,500***

20x2

The 20x2 income tax expense and current tax expense are computed as:

Description of items		*Multiply by Tax rate*	*Description of items*	
Pretax income	400,000			
Permanent difference:	-			
Acctg. profit subj. to tax	400,000	30%	***ITE***	***120,000***
ADD: ↓ TTD	(10,000)	30%	***ADD:*** ↓ DTL	3,000
LESS: ↓ DTD	8,000	30%	***LESS:*** ↓ DTA	(2,400)
Taxable profit - 20x1	402,000	30%	***CTE***	***120,600***

58. How much is the current tax expense in 20x2?

a. 150,000
b. 148,500
c. 120,000
d. 120,600

Use the following information for the next four questions:
On January 1, 20x1, ABC purchased machinery for ₱1,000,000. The equipment is depreciated using the straight line method over an estimated useful life of 10 years with no residual value. On January 1, 20x3, the equipment was revalued at a fair value of ₱1,200,000 with no change in useful life. The pretax income ***before*** deduction for depreciation expense in 20x3 is ₱1,000,000. Income tax rate is 30%.

59. How much is the deferred tax liability as of January 1, 20x3?

a. 400,000
b. 280,000
c. 120,000
d. 90,000

Solution:

Fair value	1,200,000
Carrying amount - January 1, 20x3 (1M x 8/10)	(800,000)
Revaluation surplus *before* tax – Jan. 1, 20x3	400,000

The revaluation surplus before tax is allocated as follows:

Revaluation surplus ***after tax*** – Jan. 1, 20x3 (400K x 70%)	***280,000***
Deferred tax liability – Jan. 1, 20x3 (400K x 30%)	***120,000***

60. How much is the deferred tax liability as of December 31, 20x3?
a. 280,000
b. 245,000
c. 120,000
d. 105,000

Revaluation surplus – Dec. 31, 20x3 (280,000 x 7/8*)	***245,000***
Deferred tax liability – Dec. 31, 20x3 (120,000 x 7/8*)	***105,000***

*7 years remaining from the total 8-year life on previous revaluation date.

61. How much is the income tax expense in 20x3?
a. 850,000
b. 900,000
c. 270,000
d. 255,000

Description of items	***Multiply by Tax rate***		***Description of items***	
Pretax income *before* depn.	**1,000,000**			
Depreciation expense	**(150,000)**			
Pretax income after depn.	**850,000**			
Permanent differences:	**-**			
Acctg. profit subj. to tax	**850,000**	**30%**	**ITE**	***255,000***
Add: Excess of depreciation recognized for financial reporting over taxation purposes (FI<TI)	50,000	30%	***Add: Decrease*** in DTL (120K – 105K)	**15,000**
Taxable profit - 20x3	900,000	30%	***CTE***	***270,000***

62. How much is the current tax expense in 20x3?
a. 850,000
b. 320,000
c. 270,000
d. 255,000

63. Entity A received a subscription for 2,000 shares at ₱18 per share on March 31, 20x1. Entity A's shares have a par value ₱5 per share. Entity A collected the subscription receivable on May 15, 20x1. Which of the following statements is correct?
a. Entity A should credit share premium for ₱13,000 on March 31, 20x1.
b. Entity A should credit share premium for ₱26,000 on March 31, 20x1.
c. Entity A should credit share premium for ₱13,000 on May 15, 20x1.
d. Entity A should credit share premium for ₱26,000 on May 15, 20x1.

2,000 sh. x (18 – 5) = 26,000 share premium recorded at the subscription date, not collection date

64. Entity A has the following share capital transactions during the year:

- Issued 10,000 shares with par value of ₱10 per share for a total consideration of ₱160,000.
- Received share subscriptions for 20,000 shares at a subscription price of ₱22 per share. Only half of the subscriptions were collected by the end of the year.

How much is the total share premium arising from the share transactions above?

a. 60,000
c. 300,000
b. 320,000
d. 180,000

[160,000 – (10,000 x 10)] + [20,000 x (22 – 10)] = ***300,000***

65. Entity A was incorporated on January 1, 20x1 with an authorized capitalization is ₱1,000,000 divided into 100,000 shares with par value of ₱10 per share. The following were the share-related transactions of Entity A during the year:

- Cash subscriptions of 30,000 shares at ₱12 per share.
- Subscriptions of 40,000 shares at ₱18 per share. Seventy-five percent of the subscription price was collected during the year.

How much is the Entity A's total shareholders' equity after recording the transactions above?

a. 900,000
c. 540,000
b. 680,000
d. 360,000

Solution:

Share capital (30K x 10)	300,000
Subscribed shares (40K x 10)	400,000
Subscriptions receivable (40K x 18 x 25%)	(180,000)
Share premium (30K x 2) + (40K x 8)	380,000
Total SHE	***900,000***

Short-cut: (30,000 x 12) + (40,000 x 18 x 75%) = *900,000*

66. Entity A's total shareholders' equity was ₱900,000 before recording the following share transactions:

- Received cash subscriptions for 10,000 shares with par value of ₱1 at ₱14 per share. Share issuance costs amounted to ₱2,000.
- Received subscriptions for 20,000 shares at ₱20 per share. Twenty-five percent down payment was collected on subscription date.
- Collected the remaining unpaid subscription price of 15,000 subscribed shares and issued the related share certificates. Share issuance costs amounted to ₱3,000.

How much is the balance of Entity A's total shareholders' equity after recording the transactions above? *(Hint: Preparing journal entries makes this problem easier to solve.)*

a. 1,490,000
c. 1,360,000
b. 1,510,000
d. 1,610,000

Solution:

• *Date*	Cash (10,000 x ₱14)	140,000	
	Share capital (10,000 x ₱1)		10,000
	Share premium		130,000
Date	Share premium	2,000	
	Cash		2,000
• *Date*	Cash (20,000 x ₱20 x 25%)	100,000	
	Subscriptions receivable (20K x ₱20 x 75%)	300,000	
	Subscribed share capital (20,000 x ₱1)		20,000
	Share premium		380,000
• *Date*	Cash (15,000 x ₱20 x 75%)	225,000	
	Subscriptions receivable		225,000
1. *Date*	Subscribed share capital (15,000 x ₱1)	15,000	
	Share capital		15,000
2. *Date*	Share premium	3,000	
	Cash		3,000

Total SHE before share transactions	900,000
Share capital (10,000 + 15,000)	25,000
Subscribed share capital (20,000 - 15,000)	5,000
Subscription receivable (300,000 – 225,000)	(75,000)
Share premium (130,000 – 2,000 + 380,000 – 3,000)	505,000
Total SHE after share transactions	***1,360,000***

Short-cut: 900,000 + (10,000 x 14 – 2,000) + (20,000 x 20 x 25%) + (15,000 x 20 x 75% - 3,000) = ***1,360,000***

67. On February 26, 20x1, Entity A acquires 10,000 of its own shares for ₱3 per share. The shares have a par value of ₱1 and were selling in the stock market at ₱4 per share on this date. To record the reacquisition, Entity A should

a. debit Treasury shares account for ₱30,000.
b. credit Treasury shares account for ₱30,000.
c. debit Share premium account for ₱10,000.
d. credit Treasury shares account for ₱40,000.

10,000 x ₱3 ***cost*** = 30,000

68. Two years ago, Entity A reacquired 2,000 of its own shares with par value of ₱100 per share for ₱240,000. Today, Entity A reissues half of the treasury shares at ₱160 per share. The journal entry to record the reissuance includes which of the following?

a. Credit to *Retained earnings – unrestricted* account for ₱240,000
b. Debit to *Treasury shares* account for ₱120,000
c. Credit to *Share premium – treasury shares* for ₱80,000
d. Credit to *Share premium – treasury shares* for ₱40,000

Solution:

Date	Cash (1,000 x ₱160)	160,000	
	Treasury shares (240,000 x 1/2)		120,000
	Share premium – treasury shares		***40,000***
Date	Retained earnings – appropriated	120,000	
	Retained earnings – unrestricted		120,000

69. Entity A reacquires 10,000 of its own shares for ₱50. The shares have par value of ₱10 and were originally issued at ₱15 per share. Subsequently, Entity A reissues the 10,000 shares at ₱48 per share. The journal entry to record the reissuance involves which of the following?

a. Debit to *Retained earnings* for ₱20,000
b. Credit to *Cash* for ₱480,000
c. Debit to *Share premium* for ₱50,000
d. Debit to *Treasury shares* for ₱500,000

Solution:

Date			
	Cash (10,00 x ₱48)	480,000	
	(a) *Share premium – treasury shares*	-	
	(b) *Retained earnings*	20,000	
	Treasury shares (10,000 x ₱50)		500,000

70. Entity A reacquires 10,000 of its own shares for ₱50. The shares have par value of ₱10 and were originally issued at ₱15 per share. Subsequently, Entity A reissues half of the reacquired shares at ₱58 per share and retires the other half. The journal entry to record the retirement of the shares includes which of the following? *(Hint: Provide the entries for both the reissuance and the retirement.)*

a. Debit to *Retained earnings* for ₱175,000
b. Credit to *Share premium - retirement* for ₱40,000
c. Debit to *Share premium* for ₱50,000
d. Debit to *Retained earnings* for ₱135,000

Solutions:

Date			
	Cash (10,000 x ½ x ₱58)	290,000	
	Treasury shares (10,000 x ½ x ₱50)		250,000
	Share premium – treasury shares		***40,000***

Date			
	Share capital (5,000 x ₱10)	50,000	
	Share premium – original issuance (5K x ₱5)	25,000	
	(a) *Share premium – treasury shares* *(see above)*	***40,000***	
	(b) *Retained earnings* *(balancing figure)*	***135,000***	
	Treasury shares (5,000 x 50)		250,000

71. Entity A reacquires 1,000 of its own shares for ₱25 and immediately retires them. The shares have par value of ₱10 and were originally issued at ₱30 per share. The journal entry to record the retirement of the shares includes which of the following?

a. Debit to *Retained earnings* for ₱5,000
b. Credit to *Treasury shares* for ₱30,000
c. Credit to *Share capital* for ₱10,000
d. Credit to *Share premium - retirement* for ₱5,000

Solution:

Date			
	Share capital (1,000 x ₱10)	10,000	
	Share premium – original issuance (1K x ₱20)	20,000	
	Cash (1,000 x 25)		25,000

	Share premium – retirement		5,000

72. Entity A receives 20,000 shares with par value of ₱100 and fair value of ₱210 on November 2, 20x1. The shares have fair value of ₱220 per share on December 31, 20x1. How much additional capital is recognized in Entity A's December 31, 20x1 balance sheet as having resulted from the receipt of the donated shares?

a. 2,000,000
b. 4,200,000
c. 4,400,000
d. 0

73. You and I are the accountants of A Corporation. Our company's authorized capitalization is ₱100M divided into 100M shares with par value per share of ₱1. Which of the following statements is correct?

a. If our company issues 10,000 shares for ₱5 each, we will recognize a share premium of ₱50,000.
b. Our company can issue shares at a subscription price that is below ₱1.
c. Our company can issue more than 100M shares without amending its articles of incorporation.
d. If our company receives share subscription for 20,000 shares at ₱15 per share, we will most likely recognize the related share premium on subscription date rather than on the collection date.

Use the following information for the next two questions:
Information on ABC Co.'s operations during the year is shown below.

- Revenues are recognized for financial reporting at point of sale while revenues are taxed on cash basis. Gross profit recognized for financial reporting amounted to ₱1,000,000 while taxable gross profit is ₱800,000.
- Retirement benefit costs are deducted for financial reporting as services are rendered by employees but are tax deductible only when actually paid to retiring employees. Current service cost recognized during the year is ₱100,000 while benefits paid to retiring employees amounted to ₱150,000.
- Research costs amounting to ₱90,000 are expensed immediately during the year for financial reporting. For taxation purposes, research costs are amortized over a three-year period. Amortization of research cost deducted for taxation purposes is ₱30,000.
- Unrealized losses of ₱10,000 were recognized during the year in profit or loss on an investment in held for trading equity securities. No equivalent adjustment was made for taxation purposes. Any gain or loss on actual disposal of such securities is taxable (tax deductible).
- Payments during the year for fines, surcharges, and penalties arising from violation of law amounted to ₱40,000.
- ABC reported pretax income of ₱100,000. Income tax rate is 30%.
- Any operating loss can be carried over to the next period. ABC expects to realize the economic benefit of any operating loss carry forward.

74. How much is the deferred tax liability?

a. 75,000
b. 69,000
c. 82,000
d. 33,000

Solution:
Excess of gross profit recognized for financial reporting over taxable gross profit (1M – 800,000) – 'FI>TI' 200,000
Excess of retirement benefits expense recognized for

taxation over retirement benefits expense recognized for financial reporting (150,000 – 100,000) – 'FI>TI'	50,000
Taxable temporary differences	250,000
Multiply by tax rate	30%
Deferred tax liability	***75,000***

75. How much is the deferred tax asset?

a. 75,000
b. 69,000
c. 82,000
d. 33,000

Excess of research cost expensed for financial reporting over tax deductible research expense (90K – 30K) – 'FI<TI'	60,000
Excess of loss recognized for financial reporting over tax deductible loss – 'FI<TI'	10,000
Deductible temporary differences *before* operating loss carry forward	70,000
Operating loss carry forward*	***40,000***
Deductible temporary differences – *adjusted*	110,000
Multiply by tax rate	30%
Deferred tax asset	***33,000***

*Operating loss carry forward is computed as follows:

Description of items	
Pretax income	100,000
Add: Non-deductible losses on fines and surcharges	40,000
Accounting profit subject to tax	140,000
Less: Taxable temporary difference (TTD) 'FI>TI':	(250,000)
Add: Deductible temporary difference *before NOLCO* (DTD) 'FI<TI'	70,000
Operating loss carry forward	***(40,000)***

76. On December 31, 20x1, an entity has an asset of ₱4,000 for interest receivable that will be taxed when the cash is received in 20x2. Tax is payable at 20% on the first ₱500,000 of taxable profit earned and 30% on any remainder (i.e., excess above ₱500,000). In 20x1 the entity earned taxable profit of ₱450,000. In 20x2 the entity expects to earn taxable profit of ₱550,000. How much is the deferred tax liability on Dec. 31, 20x1?

a. 864.15
b. 748.19
c. 891.23
d. 836.40

Solution:

Tax on first ₱500,000 of taxable profit (500,000 x ***20%***)	100,000
Tax on excess taxable profit [(550,000 - 500,000) x ***30%***]	15,000
Total current tax expense in 20x2	115,000
Divide by: Expected taxable profit in 20x2	550,000
Average rate expected to apply on reversal date	*20.91%*

Taxable temporary difference 'CA > TB' (4,000 - 0)	4,000
Multiply by: ***Average rate***	20.91%

Deferred tax liability – Dec. 31, 20x1	***836.40***

77. Wall Co. leased office premises to Fox, Inc. for a five-year term beginning January 2, 20x9. Under the terms of the operating lease, rent for the first year is ₱8,000 and rent for years 2 through 5 is ₱12,500 per annum. However, as an inducement to enter the lease, Wall granted Fox the first six months of the lease rent-free. In its December 31, 20x9, income statement, what amount should Wall report as rental income?

a. 12,000 b. 11,600 c. 10,800 d. 8,000

C

Solution:

Rent for the first year (8,000 x 6/12)	4,000
Rent for the subsequent years (12,500 x 4)	50,000
Total collection on rentals	*54,000*
Divide by:	5
Annual rent income	***10,800***

78. As an inducement to enter a lease, Arts, Inc., a lessor, grants Hompson Corp., a lessee, nine months of free rent under a five-year operating lease. The lease is effective on July 1, 20x5, and provides for monthly rental of ₱1,000 to begin April 1, 20x6. In Art's income statement for the year ended June 30, 20x6, rent income should be reported as

a. 10,200 b. 9,000 c. 3,000 d. 2,550

A

Solution:

Lease term in years	5
Multiply by: No. of months in a year	12
Lease term in months	*60*
Nine months free rent	(9)
Total	51
Multiply by: Monthly rental	1,000
Total rental payments on the lease	51,000
Divide by: Lease term in years	5
Annual rent income (July 1 to June 30)	***10,200***

79. ABC Co. has the following information relating to its income tax on December 31, 20x1:

- Provision for probable loss on litigation of ₱300,000 is recognized for financial reporting. This amount is tax deductible only when actually paid. ABC expects to pay for the accrued loss in 20x2.
- Revenue for financial reporting is recognized based on percentage of completion while revenue for taxation purposes is recognized based on collections on progress billings. Total revenue recognized for financial reporting is ₱1,000,000 while revenue recognized for taxation purposes is ₱800,000.
- Pretax income for the year is ₱1,000,000. Income tax rate for 20x1 is 30%. However, an enacted tax law that will take effect starting January 1, 20x2 requires a tax rate of 32%.
- There are no temporary differences on January 1, 20x1.

How much is the income tax expense?

a. 320,000
b. 300,000
c. 298,000
d. 289,000

Solution:

Description of items		***Tax rates***				
Pretax income	**START**	1M				
Permanent differences	↓	-				
Acctg. profit subj. to tax		1M	**N/A**	***ITE***	***298K***	**SQUEEZE**
Less: Revenue (FI>TI)		(200K)	**32%**	DTL	(64K)	↑
Add: Provision (FI<TI)		300K	**32%**	DTA	96K	
Taxable profit		1.1M	**30%**	CTE	330K	

80. Who was the first Filipino Certified Public Accountant?

a. Lapu-lapu
b. Andres Bonifacio
c. Spongebob Squarepants
d. Don Vincente Fabella

"We want each of you to show this same diligence to the very end, so that what you hope for may be fully realized." (Hebrews 6:11)

- END -