Chapter 6– Advanced Accounting, 3rd Edition by Hamlen, Huefner and Largay

Solutions to Practice Quiz

1. Topic: Intercompany loans
LO 1
Answer: b

Rationale: The 2016 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 1
Answer: a

Rationale: The 2016 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 2, 4
Answer: 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 2016 is:

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

4. **Topic: Intercompany profits on depreciable assets, equity in net income calculation**
   LO 2, 5
   Answer: 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 3
   Answer: 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 3
   Answer: 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 4
   Answer: 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 4
Answer: 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 5
Answer: b

Rationale: The unrealized gain at the date of acquisition is: $7,000,000 – $4,000,000 = $3,000,000. The realized gain for 2016 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 5
Answer: 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 x $200,000) = $600,000.