V – AUDIT OF PROPERTY, PLANT AND EQUIPMENT

PROBLEM NO. 1

Aliaga Corporation was incorporated on January 2, 2006. The following items relate to the Aliaga's property and equipment transactions:

Cost of land, which included an old apartment building appraised at P300,000	P3,000,000
Apartment building mortgage assumed, including related interest due at the time of purchase	80,000
Deliquent property taxes assumed by the Aliaga	30,000
Payments to tenants to vacate the apartment building	20,000
Cost of razing the apartment building	40,000
Proceeds from sale of salvaged materials	10,000
Architects fee for new building	60,000
Building permit for new construction	40,000
Fee for title search	25,000
Survey before construction of new building	20,000
Excavation before construction of new building	100,000
Payment to building contractor	10,000,000
Assessment by city for drainage project	15,000
Cost of grading and leveling	50,000
Temporary quarters for construction crew	80,000
Temporary building to house tools and materials	50,000
Cost of changes during construction to make new building more energy efficient	90,000
Interest cost on specific borrowing incurred during construction	360,000
Payment of medical bills of employees accidentally injured while inspecting building construction	18,000
Cost of paving driveway and parking lot	60,000
Cost of installing lights in parking lot	12,000
Premium for insurance on building during construction	30,000
Cost of open house party to celebrate opening of new building	50,000
Cost of windows broken by vandals distracted by the celebration	12,000

QUESTIONS:

Based on the above and the result of your audit, determine the following:

1. Cost of Land
   a. P2,980,000
   b. P3,270,000
   c. P3,185,000
   d. P3,205,000

2. Cost of Building
   a. P10,810,000
   b. P10,895,000
   c. P10,875,000
   d. P11,110,000

3. Cost of Land Improvements
   a. P12,000
   b. P72,000
   c. P122,000
   d. P 0

4. Amount that should be expensed when incurred
   a. P 80,000
   b. P110,000
   c. P62,000
   d. P50,000

5. Total depreciable property and equipment
   a. P11,182,000
   b. P10,967,000
   c. P10,947,500
   d. P10,882,000

Suggested Solution:

PAS 16 par. 6 defines "Property, plant and equipment" as tangible items that:

i. are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
ii. are expected to be used during more than one period.

Par. 15 and 16 further state that an item of property, plant and equipment that qualifies for recognition of an asset shall be measured at its cost. The cost of an item of PPE comprises:

a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Question No. 1

Cost of land	P3,000,000
Apartment building mortgage assumed, including related interest due at the time of purchase	80,000
Deliquent property taxes assumed by the Aliaga	30,000
Payments to tenants to vacate the apartment building	20,000
Cost of razing the apartment building	40,000

Proceeds from sale of salvaged materials	(10,000)
Fee for title search	25,000
Survey before construction of new building	20,000
Assessment by city for drainage project	15,000
Cost of grading and leveling	50,000
Total cost of Land	P3,270,000

Question No. 2

Architects fee for new building	P60,000
Building permit for new construction	40,000
Excavation before construction of new building	100,000
Payment to building contractor	10,000,000
Temporary quarters for construction crew	80,000
Temporary building to house tools and materials	50,000
Cost of changes during construction to make new building more energy efficient	90,000
Interest cost on specific borrowing incurred during construction	360,000
Premium for insurance on building during construction	30,000
Total cost of Building	P10,810,000

Question No. 3

Cost of paving driveway and parking lot	P60,000
Cost of installing lights in parking lot	12,000
Total cost of Land Improvements	P72,000

Question No. 4

Payment of medical bills of employees	P18,000
Cost of open house party	50,000
Cost of windows broken by vandals	12,000
Total cost amount that should be expensed	P80,000

Question No. 5

Building (see no. 2)	P10,810,000
Land improvements (see no. 3)	72,000
Total depreciable PPE	P10,882,000

Answers: 1) **B**; 2) **A**; 3) **B**; 4) **A**, 5) **D**

PROBLEM NO. 2

The following items relate to the acquisition of a new machine by Bongabon Corporation in 2006:

Invoice price of machinery	P2,000,000
Cash discount not taken	40,000
Freight on new machine	10,000
Cost of removing the old machine	12,000
Loss on disposal of the old machine	150,000
Gratuity paid to operator of the old machine who was laid off	70,000
Installation cost of new machine	60,000
Repair cost of new machine damaged in the process of installation	8,000
Testing costs before machine was put into regular operation	15,000
Salary of engineer for the duration of the trial run	40,000
Operating cost during first month of regular use	250,000
Cash allowance granted because the new machine proved to be of inferior quality	100,000

Question:

How much should be recognized as cost of the new machine?

a. P1,985,000
b. P1,993,000
c. P1,930,000
d. P2,025,000

Suggested Solution:

Invoice price of machinery	P2,000,000
Cash discount not taken	(40,000)
Freight on new machine	10,000
Installation cost of new machine	60,000
Testing costs	15,000
Salary of engineer for the duration of the trial run	40,000
Cash allowance	(100,000)
Cost of the new machine	P1,985,000

Answer: **A**

PROBLEM NO. 3

On January 1, 2005, Cabiao Corporation purchased a tract of land (site number 101) with a building for P1,800,000. Additionally, Cabiao paid a real state broker's commission of P108,000, legal fees of P18,000 and title guarantee insurance of P54,000. The closing statement indicated that the land value was P1,500,000 and the building value was P300,000. Shortly after acquisition, the building was razed at a cost of P225,000.

Cabiao entered into a P9,000,000 fixed-price contract with Cabanatuan Builders, Inc. on March 1, 2005 for the construction of an office building on the land site 101. The building was completed and occupied on September 30, 2006. Additional construction costs were incurred as follows:

Plans, specifications and blueprints	P 36,000
Architect's fees for design and supervision	285,000

The building is estimated to have a forty-year life from date of completion and will be depreciated using the 150%-declining-balance method.

To finance the construction cost, Cabiao borrowed P9,000,000 on March 1, 2005. The loan is payable in ten annual installments of P900,000 plus interest at the rate of 14%. Cabiao used part of the loan proceeds for working capital requirements. Cabiao's average amounts of accumulated building construction expenditures were as follows:

For the period March 1 to December 31, 2005	P2,700,000
For the period January 1 to September 31, 2006	6,900,000

Cabiao is using the allowed alternative treatment for borrowing cost.

QUESTIONS:

Based on the above and the result of your audit, determine the following:

1. Cost of land site number 101
   a. P1,905,000
   b. P1,800,000
   c. P2,205,000
   d. P2,151,000

2. Cost of office building
   a. P10,581,000
   b. P10,360,500
   c. P10,329,000
   d. P10,960,500

3. Depreciation of office building for 2006
   a. P96,800
   b. P97,130
   c. P102,800
   d. P 99,197

Suggested Solution:

Question No. 1

Acquisition cost	P1,800,000
Real estate broker's commission	108,000
Legal fees	18,000
Title guarantee insurance	54,000
Cost of razing the existing building	225,000
Total cost of land site 101	P2,205,000

Question No. 2

Fixed-price contract cost		P 9,000,000
Plans, specifications and blueprints		36,000
Architect's fees and design supervision		285,000
Capitalizable borrowing cost:		
Mar. 1 to Dec. 31, 2005		
(P2,700,000 x 14% x 10/12)	P315,000	
Jan. 1 to Sept. 30, 2006		
(P6,900,000 x 14% x 9/12)	724,500	1,039,500
Total cost of office building		P10,360,500

Question No. 3

Depreciation expense [P10,360,500 x (1/40x1.5) x 3/12] P97,130

Answers: 1) **C**; 2) **B**; 3) **B**

PROBLEM NO. 4

You noted during your audit of the Carranglan Company that the company carried out a number of transactions involving the acquisition of several assets. All expenditures were recorded in the following single asset account, identified as Property and equipment:

Property and equipment	
Acquisition price of land and building	P 960,000
Options taken out on several pieces of property	16,000
List price of machinery purchased	318,400
Freight on machinery purchased	5,000
Repair to machinery resulting from damage during shipment	1,480
Cost of removing old machinery	4,800
Driveways and sidewalks	102,000
Building remodeling	400,000

Property and equipment	
Utilities paid since acquisition of building	20,800
	P1,828,480

Based on property tax assessments, which are believed to fairly represent the relative values involved, the building is worth twice as much as the land. The machinery was subject to a 2% cash discount, which was taken and credited to Purchases Discounts. Of the two options, P6,000 is related to the building and land purchased and P10,000 related to those not purchased. The old machinery was sold at book value.

QUESTIONS:

Based on the above and the result of your audit, determine the adjusted balance of the following:

1. Land
   a. P644,000 c. P326,000
   b. P322,000 d. P424,000

2. Building
   a. P 644,000 c. P1,044,000
   b. P1,040,000 d. P 722,000

3. Machinery
   a. P317,032 c. P323,400
   b. P318,512 d. P321,832

Suggested Solution:

Questions No. 1 and 2

	Land	Building
Allocation of acquisition price:		
Land (P960,000 x 1/3)	P320,000	
Building (960,000 x 2/3)		P 640,000
Option paid on property acquired:		
Land (6,000 x 1/3)	2,000	
Building (6,000 x 2/3)		4,000
Cost of building remodelling		400,000
Adjusted balances	P322,000	P1,044,000

Question No. 3

Net purchase price of machinery (P318,400 x .98)	P312,032
Freight on machinery purchased	5,000
Adjusted balance	P317,032

Answers: 1) **B**; 2) **C**; 3) **A**

PROBLEM NO. 5

In connection with your audit of Cuyapo Company's financial statements for the year 2006, you noted the following transactions affecting the property and equipment items of the company:

Jan. 1	Purchased real property for P5,026,000, which included a charge of P146,000 representing property tax for 2006 that had been prepaid by the vendor; 20% of the purchase price is deemed applicable to land and the balance to buildings. A mortgage of P3,000,000 was assumed by Cuyapo on the purchase. Cash was paid for the balance.
Jan. 15	Previous owners had failed to take care of normal maintenance and repair requirements on the buildings, necessitating current reconditioning at a cost of P236,800.
Feb. 15	Demolished garages in the rear of the building, P36,000 being recovered on the lumber salvage. The company proceeded to construct a warehouse. The cost of such warehouse was P540,800, which was P90,000 less than the average bids made on the construction by independent contractors. Upon completion of construction, city inspectors ordered extensive modifications to the building as a result of failure on the part of the company to comply with building safety code. Such modifications, which could have been avoided, cost P76,800.
Mar. 1	The company exchanged its own stock with a fair value of P320,000 (par P24,000) for a patent and a new equipment. The equipment has a fair value of P200,000.
Apr. 1	The new machinery for the new building arrived. In addition, a new franchise was acquired from the manufacturer of the machinery. Payment was made by issuing bonds with a face value of P400,000 and by paying cash of P144,000. The value of the franchise is set at P160,000, while the machine's fair value is P360,000.
May 1	The company contracted for parking lots and waiting sheds at a cost P360,000 and P76,800, respectively. The work was completed and paid for on June 1.

Dec. 31 The business was closed to permit taking the year-end inventory. During this time, required redecorating and repairs were completed at a cost of P60,000.

QUESTIONS:

Based on the above and the result of your audit, determine the cost of the following:

1. Land
   a. P 940,000
   b. P1,005,200
   c. P 976,000
   d. P1,052,800

2. Buildings
   a. P4,645,600
   b. P5,005,600
   c. P4,762,400
   d. P4,681,600

3. Machinery and equipment
   a. P360,000
   b. P560,000
   c. P576,615
   d. P659,692

4. Land improvements
   a. P360,000
   b. P 76,800
   c. P436,800
   d. P 0

5. Total property, plant and equipment
   a. P6,764,400
   b. P6,731,200
   c. P6,718,092
   d. P6,618,400

Suggested Solution:

Question No. 1

Total contract price	P5,026,000
Less property taxes for 2006	146,000
Adjusted cost of land and building	4,880,000
Percentage applicable to land	20%
Cost of Land	P 976,000

Question No. 2

Cost allocated to building (P4,880,000 x 80%)	P3,904,000
Reconditioning costs prior to use	236,800
Salvage proceeds from demolition of garages	(36,000)
Construction cost of warehouse	540,800
Cost of Buildings	P4,645,600

Notes:
1) *The savings on construction of P90,000 should be ignored.*
2) *The modification costs of P76,800 and the redecorating and repair costs of P60,000 should be expensed.*

Question No. 3

Fair value of equipment acquired on Mar. 1	P200,000
Fair value of machine acquired on Apr. 1	360,000
Cost of Machinery and equipment	P560,000

Question No. 4

Parking lots	P360,000
Waiting sheds	76,800
Cost of Land improvements	P436,800

Question No. 5

Land	P 976,000
Buildings	4,645,600
Machinery and equipment	560,000
Land improvements	436,800
Total cost of property, plant and equipment	P6,618,400

Answers: 1) **C**; 2) **A**; 3) **B**; 4) **C**, 5) **D**

PROBLEM NO. 6

Gabaldon Company's property, plant and equipment and accumulated depreciation balances at December 31, 2005 are:

	Cost	Accumulated Depreciation
Machinery and equipment	P1,380,000	P 367,500
Automobiles and trucks	210,000	114,326
Leasehold improvements	432,000	108,000

Additional information follows:

Depreciation methods and useful lives:

Machinery and equipment – straight line; 10 years.
Automobiles and trucks – 150% declining balance; 5 years, all acquired after 2001.
Leasehold improvements – straight line

Depreciation is computed to the nearest month.

Salvage values are immaterial except for automobiles and trucks which have estimated salvage values equal to 15% of cost.

Other additional information:

a. Gabaldon entered into a 12-year operating lease starting January 1, 2003. The leasehold improvements were completed on December 31, 2002 and the facility was occupied on January 1, 2003.

b. On July 1, 2006, machinery and equipment were purchased at a total invoice cost of P325,000. Installation cost of P44,000 was incurred.

c. On August 30, 2006, Gabaldon purchased new automobile for P25,000.

d. On September 30, 2006, a truck with a cost of P48,000 and a carrying amount of P30,000 on December 31, 2005 was sold for P23,500.

e. On December 20, 2006, a machine with a cost of P17,000, a carrying amount of P2,975 on date of disposition, was sold for P4,000.

QUESTIONS:

Based on the above and the result of your audit, answer the following:

1. The gain on sale of truck on September 30 is
   a. P2,680 c. P250
   b. P6,500 d. P 0

2. The gain on sale of machinery on December 20, 2006 is
   a. P1,025 c. P13,000
   b. P2,725 d. P 0

3. The adjusted balance of the property, plant and equipment as of December 31, 2006 is
   a. P1,919,000 c. P2,307,000
   b. P2,388,500 d. P2,351,000

4. The total depreciation expense for the year ended December 31, 2006 is
   a. P185,402 c. P138,000
   b. 245,065 d. P221,402

5. The carrying amount of the property, plant and equipment as of December 31, 2006 is
   a. P1,567,497 c. P1,578,547
   b. P1,290,547 d. P1,617,322

Suggested Solution:

Question No. 1

Sales proceeds			P23,500
Less carrying value of truck			
Cost		P48,000	
Less accumulated dep.:			
Balance, 1/1/06			
(P48,000 - P30,000)	P18,000		
Depreciation for 2006			
(P30,000 x 30% x 9/12)	6,750	24,750	23,250
Gain on sale of truck			P 250

Question No. 2

Sales proceeds	P4,000
Less carrying value of machine sold	2,975
Gain on sale of machine	P1,025

Question No. 3

Machinery and equipment:		
Balance, 1/1	P1,380,000	
Acquired, 7/1 (P325,000 + P44,000)	369,000	
Machine sold, 12/20	(17,000)	P1,732,000
Automobiles and trucks:		
Balance, 1/1	210,000	
Acquired, 8/30	25,000	
Truck sold, 9/30	(48,000)	187,000
Leasehold improvements		432,000
Property, plant & equipment, 12/31/06		P2,351,000

Question No. 4

Machinery and equipment:		
Remaining beginning balance		
[(P1,380,000 - P17,000) x 10%]	P136,300	
Machine sold, 12/20 (P17,000 x 10%)	1,700	
Acquired, 7/1/06		
[(P325,000 + P44,000) x 10% x 6/12]	18,450	P156,450
Automobiles and trucks		
Remaining beginning balance		
[(P210,000-114,326-P30,000) x 30%]	19,702	
Truck sold, 9/30 (P30,000x30%x9/12)	6,750	
Acquired, 8/30 (P25,000 x 30% x 4/12)	2,500	28,952

Leasehold improvements (P432,000/12)		36,000
Total depreciation expense for 2006		P221,402

Question No. 5

Total cost of PPE, 12/31/06 (see no. 3)		P2,351,000
Less accumulated depreciation, 12/31/06:		
Machinery and equipment:		
Balance, 1/1	P367,500	
Depreciation expense for 2006	156,450	
Machine sold, 12/20 (P17,000 - P2,975)	(14,025)	P509,925
Automobiles and trucks:		
Balance, 1/1	114,326	
Depreciation expense for 2006	28,952	
Truck sold, 9/30 (see no. 1)	(24,750)	118,528
Leasehold improvements		
Balance, 1/1	108,000	
Depreciation expense for 2006	36,000	144,000
		772,453
Carrying value, 12/31/06		P1,578,547

Answers: 1) **C**; 2) **A**; 3) **D**; 4) **D**, 5) **C**

PROBLEM NO. 7

Your new audit client, Guimba Company, prepared the trial balance below as of December 31, 2006. The company started its operations on January 1, 2005. Your examination resulted in the necessity of applying the adjusting entries indicated in the additional data below.

Guimba Company
TRIAL BALANCE
December 31, 2006

	Debits	Credits
Cash	P510,000	
Accounts receivable – net	600,000	
Inventories, December 31, 2005	669,000	
Land	660,000	
Buildings	990,000	
Accumulated depreciation, building		P19,800
Machinery	444,000	
Accumulated depreciation, machinery		45,000
Sinking fund assets	75,000	

Guimba Company
TRIAL BALANCE
December 31, 2006

	Debits	Credits
Bond discount	75,000	
Treasury stock, common	105,000	
Accounts payable		567,000
Accrued bond interest		11,250
First mortgage, 6% sinking fund bonds		679,500
Common stock		1,500,000
Premium on common stock		150,000
Stock donation		180,000
Retained earnings, December 31, 2005		222,450
Net sales		2,625,000
Purchases	850,500	
Salaries and wages	507,000	
Factory operating expenses	364,500	
Administrative expenses	105,000	
Bond interest	45,000	
	P6,000,000	P6,000,000

Additional data are as follows:

(1) The 1,500,000 common stock was issued at a 10 percent premium to the owners of the land and buildings on December 31, 2004, the date of organization. Stock with a par value of 180,000 was donated back by the vendors. The following entry was made:

Treasury stock	P180,000	
Stock donation		P180,000

The stock was donated because the proceeds from its subsequent sale were to be considered as an allowance on the purchase price of land and buildings in proportion to their values as first recorded. The treasury stock was sold in 2006 for P75,000, which was credited to Treasury Stock.

(2) On December 31, 2006, a machine costing P15,000 when the business started was removed. The machine had been depreciated at 10 percent during the first year. The only entry made was one crediting the Machinery account with its sales price of P6,000.

(3) Depreciation is to be provided on the straight-line basis, as follows: buildings, 2 percent of cost; machinery, 10 percent of cost. Ignore salvage values.

QUESTIONS:

Based on the above and the result of your audit, you are to provide the answers to the following:

1. The correct balance of Land account as of December 31, 2006 is
   a. P660,000 c. P630,000
   b. P588,000 d. P 0

2. The adjusted carrying value of Building as of December 31. 2006 is
   a. P907,200 c. P905,400
   b. P950,400 d. P945,000

3. The adjusted carrying value of Machinery as of December 31, 2006 is
   a. P399,000 c. P354,000
   b. P345,000 d. P348,000

4. The adjusted depreciation expense for 2006 is
   a. P648,000 c. P63,900
   b. P62,400 d. P63,000

5. How much is the gain or loss on sale of machinery on December 31, 2006?
   a. P6,000 loss c. P6,000 gain
   b. P7,500 loss d. P7,500 gain

Suggested Solution:

Question No. 1

	Land	Building	Total
Unadjusted balances	P660,000	P990,000	P1,650,000
Proceeds from sale of donated stock			
Applied as deduction to:			
Land (P75,000 x 660/1,650)	(30,000)		(30,000)
Bldg. (P75,000 x 990/1,650)		(45,000)	(45,000)
Adjusted balances	P630,000	P945,000	P1,575,000

Note: The proceeds received from sale of donated shares will not be credited to Donated Capital account since this involves "Treasury stock subterfuge". This occurs when excessive shares are issued for a property with the understanding that the stockholders shall subsequently donate a portion of their shares.

Question No. 2

Adjusted cost of building (see no. 1)	P945,000
Less accumulated depreciation, 12/31/06	
(P945,000 x 2% x 2)	37,800
Carrying value of building, 12/31/06	P907,200

Question No. 3

Machinery, 1/1/06 (P444,000 + P6,000)	P450,000
Less machinery sold on 12/31/06	15,000
Machinery, 12/31/06	435,000
Less accumulated depreciation, 12/31/06	
(P435,000 x 10% x 2)	87,000
Carrying value of Machinery, 12/31/06	P348,000

Question No. 4

Depreciation on Building (P945,000 x 2%)	P18,900
Depreciation on Machinery (P450,000 x 10%)	45,000
Total depreciation expense for 2006	P63,900

Question No. 5

Sales proceeds		P 6,000
Less carrying value, 12/31/06:		
Cost	P15,000	
Less accumulated depreciation		
(P15,000 x 10% x 2)	3,000	12,000
Loss on sale of machinery		P 6,000

Answers: 1) **C**; 2) **A**; 3) **D**; 4) **C**, 5) **A**

PROBLEM NO. 5

Jaen Corporation, a manufacturer of steel products, began operation on October 1, 2004. The accounting department of Jaen has started the fixed-asset and depreciation presented below.

JAEN CORPORATION
Fixed Asset and Depreciation Schedule
For Fiscal Years Ended September 30, 2005, and September 30, 2006

Assets	Acq. Date	Cost	Salvage	Dep. Method	Life	Depreciation Expense Year Ended Sept. 30 2005	2006
Land A	10/1/04	?	N/A	N/A	N/A	N/A	N/A
Bldg. A	10/1/04	?	P320,000	Straight-line	?	P139,600	?
Land B	10/1/04	?	N/A	N/A	N/A	N/A	N/A
Bldg. B	Under Const.	?	-	Straight-line	30	-	?
Donated equip.	10/2/04	?	24,000	150% declining balance	10	?	?
Mach. A	10/2/04	?	48,000	Sum-of-the-years'-digits	8	?	?
Mach. B	10/1/05	?	-	Straight-line	20	-	?

N/A – Not applicable

You have been asked to assist in completing this schedule. In addition in ascertaining that the data already on the schedule are correct, you have obtained the following information from the Company's records and personnel:

a. Land A and Building A were acquired from a predecessor corporation. Jaen paid P6,560,000 for the land and building together. At the time of acquisition, the land had an appraised value of P720,000, and the building had an appraised value of P6,480,000.

b. Land B was acquired on October 2, 2004, in exchange for 20,000 newly issued shares of Jaen's common stock. At the date of acquisition, the stock had a par value of P5 per share and a fair value of P30 per share. During October 2004, Jaen paid P128,000 to demolish an existing building on this land so it could construct new building.

c. Construction of building B on the newly acquired land began on October 1, 2005. By September 30, 2006, Jaen has paid P2,560,000 of the estimated total construction costs of P3,600,000. It is estimated that the building will be completed and occupied by July 2007.

d. Certain equipment was donated to the corporation by a local university. An independent appraisal of the equipment when donated placed the fair market value at P240,000 and the salvage value at P24,000.

e. Machinery A's total cost of P1,319,200 includes installation expense of P4,800 and normal repairs and maintenance of P119,200. Salvage value is estimated at P48,000. Machinery A was sold on February 1, 2006.

f. On October 1, 2005, Machinery B was acquired with a down payment of P45,920 and the remaining payments to be made in 11 annual installments of P48,000 each beginning October 1, 2005. The prevailing interest rate was 8%.

QUESTIONS:

Based on the above and the result of your audit, answer the following:

1. The cost of Building A is
   a. P5,904,000 c. P656,000
   b. P6,560,000 d. P 0

2. The cost of Land B is
   a. P600,000 c. P228,000
   b. P728,000 d. P 0

3. The cost of Machine B is
   a. P370,080 c. P388,592
   b. P416,000 d. P389,776

4. The total depreciation expense for the year ended September 30, 2006 is
   a. P264,296 c. P265,667
   b. P415,000 d. P262,608

Suggested Solution:

Question No. 1

Cost of building A (P6,560,000 x 6,480/7,200)	P5,904,000

Question No. 2

Fair value of common stock (20,000 x P30)	P600,000
Demolition costs	128,000
Cost of Land B	P728,000

Question No. 3

Down payment	P 45,920
Add present value of installment payments (P48,000 x 7.710)	370,080
Cost of Machine B	P416,000

Question No. 4

Building A *(same in 2005 since it is straight-line depreciation)*	P139,600
Building B *(under construction)*	-
Donated equipment (P240,000 x 85% x 15%)	30,600
Machine A [(P1,319,200-P119,200-P48,000) x 7/36 x 4/12]	74,667
Machine B (P416,000/20)	20,800
Total depreciation expense	P265,667

Answers: 1) **A**; 2) **B**; 3) **B**; 4) **C**

PROBLEM NO. 9

The following data relate on the Plant Assets account of Licab, Inc. at December 31, 2005:

	Plant Assets			
	L	A	R	E
Original cost	P87,500	P127,500	P200,000	P200,000
Year Purchased	2000	2001	2002	2004
Useful life	10 years	37,500 hours	15 years	10 years
Salvage value	P7,750	P7,500	P12,500	P12,500
Depreciation method	SYD	Activity	Straight-line	Double-declining balance

Note: In the year an asset is purchased, Licab, Inc. does not record any depreciation expense on the asset.

In the year an asset is retired or traded in, Licab, Inc. takes a full year depreciation on the asset.

The following transaction occurred during 2006:

(a) On May 5, Asset L was sold for P32,500 cash.

(b) On December 31, it was determined that asset A had been used 5,250 hours during 2006.

(c) On December 31, before computing depreciation expense on Asset R, the management of Licab, Inc. decided the useful life remaining from 1/1/06 was 10 years.

(d) On December 31, it was discovered that a plant asset purchased in 2005 had been expensed completely in that year. This asset costs P55,000 and has useful life of 10 years and no salvage value. Management has decided to use the double-declining balance for this asset, which can be referred to as "Asset S."

QUESTIONS:

Based on the above and the result of your audit, answer the following: (Disregard tax implications)

1. How much is the gain or loss on sale of Asset L?
   a. P10,250 loss c. P16,050 gain
   b. P10,250 gain d. P16,050 loss

2. How much is the depreciation of Asset R for 2006?
   a. P15,000 c. P16,250
   b. P21,429 d. P23,214

3. The adjusting entry to correct the error of failure to capitalize Asset S would include a debit/credit to Retained Earnings of
   a. P55,000 debit c. P44,000 credit
   b. P55,000 credit d. P 0

4. How much is the adjusted balance of Plant Assets as of December 31, 2006?
   a. P670,000 c. P615,000
   b. P527,500 d. P582,500

5. How much is the total depreciation expense for 2006?
   a. P83,300 c. P82,050
   b. P88,479 d. P80,600

Suggested Solution:

Question No. 1

Sales proceeds		P32,500
Less carrying value:		
Cost	P87,500	
Less accumulated depreciation [(P87,500-P7,750) x 45/55]	65,250	22,250
Gain on sale of Asset L		P10,250

Question No. 2

Cost	P200,000
Less accumulated depreciation, 1/1/05	
[(P200,000 - P12,500) x 3/15]	37,500
Carrying value, 1/1/06	162,500
Less residual value	12,500
Remaining depreciable amount	150,000
Divide by remaining life	10
Depreciation of Asset R for 2006	P 15,000

Question No. 3

Adjusting entry:

Asset S	P55,000	
Retained earnings		P55,000

Question No. 4

Asset L (Sold)	P -
Asset A	127,500
Asset R	200,000
Asset E	200,000
Asset S	55,000
Plant Assets, 12/31/06	P582,500

Question No. 5

Asset L [(P87,500 - P7,750) x 5/55]	P 7,250
Asset A [(P127,500 - P7,500)/37,500 x 5,250]	16,800
Asset R (see no. 2)	15,000
Asset E [(P200,000 x 80%) x 20%]	32,000
Asset S (P55,000 x 20%)	11,000
Total depreciation expense for 2006	P82,050

Answers: 1) **B**; 2) **A**; 3) **B**; 4) **D**, 5) **C**

PROBLEM NO. 10

Your audit of Llanera Corporation for the year 2006 disclosed the following property dispositions:

	Cost	Acc. Dep.	Proceeds	Fair value
Land	P4,800,000	-	3,720,000	3,720,000
Building	1,800,000	-	288,000	-

	Cost	Acc. Dep.	Proceeds	Fair value
Warehouse	8,400,000	1,320,000	8,880,000	8,880,000
Machine	960,000	384,000	108,000	864,000
Delivery truck	1,200,000	570,000	564,000	564,000

Land

On January 15, a condemnation award was received as consideration for the forced sale of the company's land and building, which stood in the path of a new highway.

Building

On March 12, land and building were purchased at a total cost of P6,000,000, of which 30% was allocated to the building on the corporate books. The real estate was acquired with the intention of demolishing the building, and this was accomplished during the month of August. Cash proceeds received in September represent the net proceeds from demolition of building.

Warehouse

On July 4, the warehouse was destroyed by fire. The warehouse was purchased on January 2, 2000. On December 12, the insurance proceeds and other funds were used to purchase a replacement warehouse at a cost of P7,200,000.

Machine

On December 15, the machine was exchanged for a machine having a fair value of P756,000 and cash of P108,000 was received.

Delivery Truck

On November 13, the delivery truck was sold to a used car dealer.

QUESTIONS:

Based on the above and the result of your audit, compute the gain or loss to be recognized for each of the following dispositions:

1. Land
   a. P3,720,000 gain
   b. P1,080,000 loss
   c. P4,800,000 loss
   d. P 0

2. Building
   a. P 432,000 gain
   b. P2,232,000 loss
   c. P1,368,000 loss
   d. P 0

3. Warehouse
   a. P1,800,000 gain
   b. P 480,000 gain
   c. P5,400,000 loss
   d. P 0

4. Machine
   a. P36,000 gain
   b. P27,000 gain
   c. P288,000 gain
   d. P 0

5. Delivery truck
   a. P636,000 loss
   b. P636,000 gain
   c. P66,000 loss
   d. P66,000 gain

Suggested Solution:

Question No. 1

Cash received	P3,720,000
Cost of land	4,800,000
Loss on condemnation of land	P1,080,000

Question No. 2

None. The proceeds from demolition of building will be deducted from the cost of the land.

Question No. 3

Insurance proceeds	P8,880,000
Carrying value (P8,400,000 - P1,320,000)	7,080,000
Gain on insurance policy settlement	P1,800,000

Question No. 4

Fair value of old machine	P864,000
Carrying value (P960,000 - P384,000)	576,000
Gain on exchange	P288,000

Question No. 5

Sales proceeds	P564,000
Carrying value (P1,200,000 - P570,000)	630,000
Loss on sale	P 66,000

Answers: 1) **B**; 2) **D**; 3) **A**; 4) **C**, 5) **C**

PROBLEM NO. 11

In connection with your audit of the Talavera Mining Corporation for the year ended December 31, 2006, you noted that the company purchased for P10,400,000 mining property estimated to contain 8,000,000 tons of ore. The residual value of the property is P800,000.

Building used in mine operations costs P800,000 and have estimated life of fifteen years with no residual value. Mine machinery costs P1,600,000 with an estimated residual value P320,000 after its physical life of 4 years.

Following is the summary of the company's operations for first year of operations.

Tons mined	800,000 tons
Tons sold	640,000 tons
Unit selling price per ton	P4.40
Direct labor	640,000
Miscellaneous mining overhead	128,000
Operating expenses (excluding depreciation)	576,000

Inventories are valued on a first-in, first-out basis. Depreciation on the building is to be allocated as follows: 20% to operating expenses, 80% to production. Depreciation on machinery is chargeable to production.

QUESTIONS:

Based on the above and the result of your audit, answer the following: (Disregard tax implications)

1. How much is the depletion for 2006?
   a. P768,000
   b. P192,000
   c. P 960,000
   d. P1,040,000

2. Total inventoriable depreciation for 2006?
   a. P400,000
   b. P384,000
   c. P362,667
   d. P 0

3. How much is the Inventory as of December 31, 2006?
   a. P438,400
   b. P425,600
   c. P422,400
   d. P418,133

4. How much is the cost of sales for the year ended December 31, 2005?
   a. P1,689,600
   b. P1,702,400
   c. P1,753,600
   d. P1,672,533

5. How much is the maximum amount that may be declared as dividends at the end of the company's first year of operations?
   a. P1,494,400 c. P1,289,600
   b. P1,302,400 d. P1,319,467

Suggested Solution:

Question No. 1

Acquisition cost	P10,400,000
Less residual value	800,000
Depletable cost	9,600,000
Divide by total estimated reserves	8,000,000
Depletion rate	1.20
Multiply by tons mined in 2006	800,000
Depletion for 2006	P 960,000

Question No. 2

Depreciation - Building [(P800,000/8,000,000 tons) x 800,000 tons x 80%]	P 64,000
Depreciation - Machinery [(P1,600,000-P320,000/4]	320,000
Total depreciation chargeable to production	P384,000

Question No. 3

Depletion (see no. 1)	P 960,000
Direct labor	640,000
Depreciation (see no. 2)	384,000
Miscellaneous mining overhead	128,000
Total production cost	2,112,000
Divide by tons mined	800,000
Cost per ton	2.64
Unsold tons (800,000 - 640,000)	160,000
Inventory, 12/31/06	P 422,400

Question No. 4

Cost of sales (640,000 tons x P2.64)	P1,689,600

Question No. 5

Sales (640,000 x P4.4)	P2,816,000
Less cost of sales (see no. 4)	1,689,600
Gross profit	1,126,400
Operating expenses	(576,000)
Depreciation - Building [(P800,000/8,000,000 tons) x 800,000 tons x 20%]	(16,000)
Net income	534,400
Realized depletion (640,000 tons x P1.2)	768,000
Maximum amount that may be declared as dividends	P1,302,400

Answers: 1) **C**; 2) **B**; 3) **C**; 4) **A**, 5) **B**

PROBLEM NO. 12

Select the best answer for each of the following:

1. Which of the following questions would an auditor least likely include on an internal control questionnaire concerning the initiation and execution of equipment transactions?
   a. Are procedures in place to monitor and properly restrict access to equipment?
   b. Are requests for major repairs approved at a higher level than the department initiating the request?
   c. Are prenumbered purchase orders used for equipment and periodically accounted for?
   d. Are requests for purchases of equipment reviewed for consideration of soliciting competitive bids?

2. Property acquisitions that are misclassified as maintenance expense would most likely be detected by internal control procedures that provide for
   a. Review and approval of the monthly depreciation entry by the plant supervisor.
   b. Investigation of variances within a formal budgeting system.
   c. Examination by the internal auditor of vendor invoices and canceled checks for property acquisitions.
   d. Segregation of duties of employees in the accounts payable department.

3. A weakness in internal accounting control over recording retirements of equipment may cause the auditor to
   a. Trace additions to the "other assets" account to search for equipment that is still on hand but no longer being used.
   b. Inspect certain items of equipment in the plant and trace those items to the accounting records.
   c. Select certain items of equipment from the accounting records and locate them in the plant.
   d. Review the subsidiary ledger to ascertain whether depreciation was taken on each item of equipment during the year.

4. The most significant audit step in substantiating additions to the office furniture account balance is
   a. Comparison to prior year's acquisitions.
   b. Examination of vendors' invoices and receiving reports for current year's acquisitions.
   c. Review of transactions near the balance sheet date for proper period cutoff.
   d. Calculation of ratio of depreciation expense to gross office equipment cost.

5. An auditor is verifying the existence of newly acquired fixed assets recorded in the accounting records. Which of the following is the best evidence to help achieve this objective?
   a. Oral evidence obtained by discussions with operating management.
   b. Documentary support obtained by vouching entries to subsidiary records and invoices.
   c. Documentary support obtained by reviewing titles and tax returns.
   d. Physical examination of a sample of newly recorded fixed assets.

6. In auditing plant assets and accumulated depreciation for proper valuation, the auditor should do all except the following:
   a. Physically inspect major plant assets additions.
   b. Recalculate depreciation expense on a test basis.
   c. Vouch repairs and maintenance expense on a test basis.
   d. Vouch major additions by reference to underlying documentation.

7. To verify the proper value of costs charged to real property records for improvements to the property, the best source of evidence would be:
   a. A letter signed by the real property manager asserting the propriety of costs incurred.
   b. Original invoices supporting entries into the accounting records.
   c. A comparison of billed amounts to contract estimates.
   d. Inspection by the auditor of real property improvements.

8. To test the accuracy of the current year's depreciation charges, an auditor should rely most heavily on
   a. Comparison of depreciation schedule detail with schedules supporting the income tax return.
   b. Re-computation of depreciation for a sample of plant assets.
   c. Tracing of totals from the depreciation schedule to properly approved journal entries and ledger postings.
   d. Vouching of the current year's fixed asset acquisitions.

9. The audit procedure of analyzing the repairs and maintenance accounts is primarily designed to provide evidence in support of the audit proposition that all
   a. Capital expenditures have been properly authorized.
   b. Expenditures for fixed assets have been recorded in the proper period.
   c. Expenditures for fixed assets have been capitalized.
   d. Non-capitalizable expenditures have been properly expensed.

10. Assets may suffer an impairment in value for a variety of reasons, but not likely as a result of:
   a. A corporate restructuring.
   b. Slumping demand for uncompetitive products.
   c. Significant increases in market share.
   d. Obsolescence.

Answers: 1) **A**; 2) **B**; 3) **C**; 4) **B**, 5) **D**; 6) **A**; 7) **B**; 8) **B**; 9) **C**; 10) **C**