Complete the multiple choice questions (#1-25) on a green scantron, and the problems in your blue-book.

1. The term used for bonds that are unsecured as to principal is
   a. junk bonds.
   b. debenture bonds.
   c. indebenture bonds.
   d. callable bonds.

2. If bonds are initially sold at a discount and the straight-line method of amortization is used, interest expense in the earlier years will
   a. exceed what it would have been had the effective interest method of amortization been used.
   b. be less than what it would have been had the effective interest method of amortization been used.
   c. be the same as what it would have been had the effective interest method of amortization been used.
   d. be less than the stated (nominal) rate of interest.

-----------------------------
Cox Co. issued $100,000 of ten-year, 10% bonds that pay interest semiannually. The bonds are sold to yield 8%.

3. One step in calculating the issue price of the bonds is to multiply the principal by the table value for
   a. 10 periods and 10% from the present value of 1 table.
   b. 20 periods and 5% from the present value of 1 table.
   c. 10 periods and 8% from the present value of 1 table.
   d. 20 periods and 4% from the present value of 1 table.

-----------------------------
On January 1, 2004, Bleeker Co. issued eight-year bonds with a face value of $2,000,000 and a stated interest rate of 6%, payable semiannually on June 30 and December 31. The bonds were sold to yield 8%. Table values are:

<table>
<thead>
<tr>
<th>Table Value Description</th>
<th>Table Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Present value of 1 for 8 periods at 6%</td>
<td>.627</td>
</tr>
<tr>
<td>Present value of 1 for 8 periods at 8%</td>
<td>.540</td>
</tr>
<tr>
<td>Present value of 1 for 16 periods at 3%</td>
<td>.623</td>
</tr>
<tr>
<td>Present value of 1 for 16 periods at 4%</td>
<td>.534</td>
</tr>
<tr>
<td>Present value of annuity for 8 periods at 6%</td>
<td>6.210</td>
</tr>
<tr>
<td>Present value of annuity for 8 periods at 8%</td>
<td>5.747</td>
</tr>
<tr>
<td>Present value of annuity for 16 periods at 3%</td>
<td>12.561</td>
</tr>
<tr>
<td>Present value of annuity for 16 periods at 4%</td>
<td>11.652</td>
</tr>
</tbody>
</table>
4. The present value of the principal is
   a. $1,068,000.
   b. $1,080,000.
   c. $1,246,000.
   d. $1,254,000.

5. Which of the following items should be presented as a long-term liability on the balance sheet:
   a. A debt which was repaid with proceeds from a stock issuance after the date of the balance sheet, but before the financial statements were issued.
   b. A debt which management intends to refinance after the date of the balance sheet.
   c. A debt which management intends to repay in the following year using cash.
   d. A debt which matures 9 months from the date of the balance sheet.

6. A company pays for goods by issuing a 5 year note payable in the amount of $100,000 and bearing interest at 1%. A bank would lend them the money under the circumstances at a rate of 8%. Which of the following statements is most accurate?
   a. The purchase price of the goods for accounting purposes is more than $100,000.
   b. The purchase price of the goods for accounting purposes is $100,000.
   c. The purchase price of the goods for accounting purposes is less than $100,000.
   d. Accounting should reflect the transaction based on the legal form over the substance of the transaction.

7. When computing the interest expense for a bond which sold at a discount, the interest rate and principal outstanding to be used should be:
   a. The stated rate of interest and the face value of the bonds, adjusted by the original discount recorded.
   b. The stated rate of interest and the face value of the bonds.
   c. The market rate of interest and the face value of the bonds.
   d. The market rate of interest and the net balance of the bonds face value adjusted for any unamortized discount.

8. When the market rate of interest exceeds the stated rate on bonds, those bonds:
   a. Will not be able to be sold because the market would demand a higher rate than the bonds pay.
   b. Would sell at a premium.
   c. Would sell at a discount.
   d. Would sell at face value.
9. When a premium or discount is created in connection with the sale of bonds, that premium or discount should:
   a. Be amortized using the effective interest method. A straight line method may be used only if it produces results materially consistent with the effective interest method.
   b. Be amortized using a straight line method under all circumstances.
   c. Not be amortized until the maturity of the bonds.
   d. Be included as a cost of financing.

10. Bonds sold at a discount should be presented on the balance sheet:
    a. As two separate line-items, one for face value and the other for the unamortized discount.
    b. In one line-item which represents: the net value of the bonds (face value net of unamortized discount).
    c. As three separate line items, one for face value, one for the original value of the discount and the last for the amortization of the discount.
    d. Bonds should not be presented on the balance sheet, but instead on a summary of unintended consequences from making the stupid mistake of choosing option d. to this question!

11. Gain or loss from the early extinguishment of long-term debt should always be recorded as an "extraordinary item" in the income statement.
    a. True
    b. False

12. When a Company incurs debt, the costs they pay to an outside party in connection with the raising of the debt should:
    a. Be treated as an expense in the period incurred.
    b. Be treated as a direct charge to equity.
    c. Be capitalized on the balance sheet and amortized over the life of the associated debt.
    d. Be capitalized on the balance sheet and expensed when paid to the party to whom it is payable.

13. The residual interest in a corporation belongs to the
    a. management.
    b. creditors.
    c. common stockholders.
    d. preferred stockholders.

14. The pre-emptive right of a common stockholder is the right to
    a. share proportionately in corporate assets upon liquidation.
    b. share proportionately in any new issues of stock of the same class.
    c. receive cash dividends before they are distributed to preferred stockholders.
    d. exclude preferred stockholders from voting rights.
15. When a corporation issues its capital stock in payment for services, the LEAST appropriate basis for recording the transaction is the
   a. market value of the services received.
   b. par value of the shares issued.
   c. market value of the shares issued.
   d. Any of these provides an appropriate basis for recording the transaction.

16. Preferred stock smells more like debt than does common stock.

   a. True
   b. False
   c. I don't know
   d. Don't choose c or d.

17. A transaction involving exchange of a Company's common stock in exchange for equipment would be recorded at:

   a. The fair value of the equipment, or the stock, whichever is more evident.
   b. The estimated fair value of the stock, always.
   c. The net book value of the equipment received.
   d. The estimated value of AOL stock on the date of the last full moon preceding the transaction.

18. When a Company pays a property dividend, and the property distributed has a fair value greater than the property's net book value:

   a. No gain should be recorded until the date of payment.
   b. No gain should be recognized.
   c. A gain should be recorded on the declaration date.
   d. Only losses should be recorded on the declaration date.

19. Recent clarifications in accounting literature indicate that "mezzanine financing" with debt-like features should be:

   a. Classified as debt on the balance sheet.
   b. Classified as a mezzanine item between debt and equity on the balance sheet.
   c. Classified as a contra-asset on the balance sheet.
   d. This sounds familiar but I forget the answer. Hint: this is not it.
20. A lazy investor does not participate in the election of the board of directors for a company he has invested in. The board of directors approves a transaction that materially reduces the value of the investment the lazy investor holds. Assuming that the board of directors was not acting to defraud anyone or to further their personal interests:

a. The lazy investor has been afforded the control granted by stock ownership, as the board of directors was appointed by him and the other stockholders.

b. It is the responsibility of the board to assure maximized return to each shareholder and consequently the control granted by stock ownership has been denied to the lazy stockholder.

c. The corporate structure has not functioned as designed as each shareholder should be consulted in connection with important transactions of the company.

d. The corporate structure is no longer valid after the issuance of the Sarbanes-Ocley Act of 2002.

Bob should stop whining about the money he lost in the market recently!

21. Which statement below is most accurate regarding the appointment and oversight of "C" level management (i.e CEO, CFO etc.)

a. The stockholders, indirectly by their voting for the appointment of the Board of Directors whose direct responsibilities include the appointment and monitoring of C-level management.

b. The stockholders directly by their required majority vote for each appointment of C-level management personnel and their continued appointment.

c. The stockholders have no involvement whatsoever in the appointment of C-level management.

d. It is up to the SEC to appoint C-level management.

22. Stockholders interest is a "residual interest" representing the assets remaining after all debts have been extinguished.

a. True  
b. False

23. Which of the following statements regarding dividends is most accurate?

a. Dividends are not recorded as a payable until the payment date and are computed based on the shareholders owning stock on the date of record.

b. Dividends should be ignored until the dividend payment date.

c. Dividends should be computed based on the shareholders holding stock on the payment date and recorded as a payable on the date of payment.

d. Dividends are payable as of the date of declaration by the board of directors and are computed based on the shareholders owning stock on the date of record.
24. When a company purchases their own stock:
   a. It should be recorded as an asset on the balance sheet because it has probable future economic benefit.
   b. It should be recorded as a liability on the balance sheet.
   c. It is recorded as treasury stock, a contra-equity account, which reduces the number of shares issued.
   d. It is recorded as treasury stock, a contra-equity account, which does not impact the number of shares issued until such time as it is retired.

25. Which of the following items impacts equity:
   a. Restatements of retained earnings
   b. Net income
   c. Other comprehensive income
   d. Dividends
   e. All of the above
26. RATS, Inc. is formed by a public offering on January 1, 2005 with shares authorized of 100,000 at $10 par. They issue 50,000 shares to the public at a price of $100 per share and pay the underwriters $0.02 per share for the issuance.

During the year, the following activity takes place:

**January 31, 2005**
Repurchase 5,000 shares at a price of $70 per share.

**February 28, 2005**
Sell 2,500 shares held in treasury for $75 per share.

**March 31, 2005**
Sell 2,000 shares held in treasury for $50 per share.

**December 25, 2005**
The Board of Directors declares a dividend, payable on January 15, 2006 to shareholders of record as of March 1, 2005. Amount: $2/ share outstanding on record date.

**Income for the year**
Income for the year was $2,000,000

I. Present the journal entry to record the issuance of stock on January 1, 2005

II. Present the journal entry for each date noted above to record the transaction for that date.

III. Prepare the stockholders’ equity section of the balance sheet as of December 31, 2005

IV. Show the journal entry that would have been recorded on April 30, 2005 if the company retired 250 shares in treasury. Do NOT reflect in your answers above.
27. NoFreeLunch, Inc. sold some equipment to WePayLater, Inc. The agreed price was $100,000 payable in $50,000 cash and a $50,000 0% note due in 2 years. Had WePayLater gone out to a bank to borrow the money, the bank would have charged a rate of 12% to lend them the $50,000 for two years with interest compounding annually. The net book value of the equipment on NoFreeLunch's books on the date of the transaction was $45,000. The present value factors below should be useful in answering the questions:

<table>
<thead>
<tr>
<th>Period</th>
<th>Rate</th>
<th>PV factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>12%</td>
<td>0.7972</td>
</tr>
<tr>
<td>24</td>
<td>1%</td>
<td>0.7876</td>
</tr>
<tr>
<td>2</td>
<td>24%</td>
<td>0.6504</td>
</tr>
</tbody>
</table>

(I) Compute the purchase price of the transaction.

(II) Record the journal entry required on the date of the transaction for the seller (NoFreeLunch).

(III) Assuming your journal entries are the only ones booked, record the journal entries required at the end of year one and year two (again for the seller).
<table>
<thead>
<tr>
<th>Chapter</th>
<th>Ref</th>
<th>Ques</th>
<th>Type</th>
<th>Cat</th>
<th>Lvl</th>
<th>Obj</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>14</td>
<td>3</td>
<td>1</td>
<td>b</td>
<td>MChoice</td>
<td>C</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>7</td>
<td>2</td>
<td>a</td>
<td>MChoice</td>
<td>C</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>12</td>
<td>3</td>
<td>d</td>
<td>MChoice</td>
<td>C</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>32</td>
<td>4</td>
<td>a</td>
<td>MChoice</td>
<td>P</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>60</td>
<td>5</td>
<td>a</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>61</td>
<td>6</td>
<td>c</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>62</td>
<td>7</td>
<td>d</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>63</td>
<td>8</td>
<td>c</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>64</td>
<td>9</td>
<td>a</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>65</td>
<td>10</td>
<td>b</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>66</td>
<td>11</td>
<td>b</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>67</td>
<td>12</td>
<td>c</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>1</td>
<td>13</td>
<td>c</td>
<td>MChoice</td>
<td>C</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>2</td>
<td>14</td>
<td>b</td>
<td>MChoice</td>
<td>C</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>8</td>
<td>15</td>
<td>b</td>
<td>MChoice</td>
<td>C</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>76</td>
<td>16</td>
<td>a</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>77</td>
<td>17</td>
<td>a</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>78</td>
<td>18</td>
<td>c</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>79</td>
<td>19</td>
<td>a</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>80</td>
<td>20</td>
<td>a</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>81</td>
<td>21</td>
<td>a</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>82</td>
<td>22</td>
<td>a</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>83</td>
<td>23</td>
<td>d</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>84</td>
<td>24</td>
<td>d</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>85</td>
<td>25</td>
<td>e</td>
<td>MChoice</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
SOLUTION
26.  
I.  

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>5,000,000</td>
</tr>
<tr>
<td>Common stock</td>
<td>500,000</td>
</tr>
<tr>
<td>Cash</td>
<td>1,000</td>
</tr>
<tr>
<td>APIC</td>
<td>4,499,000</td>
</tr>
</tbody>
</table>

II.  January 31, 2005

- Treasury stock: 350,000
- Cash: 350,000

February 28, 2005

- Cash: 187,500
- Treasury stock: 175,000
- APIC Treasury stock: 12,500

March 31, 2005

- Cash: 100,000
- Treasury stock: 140,000
- APIC treasury stock: 12,500
- Retained earnings: 27,500

December 25, 2005

- Retained earnings: 95,000
- Dividends payable: 95,000

III.  

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common stock</td>
<td>500,000</td>
</tr>
<tr>
<td>APIC</td>
<td>4,499,000</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>1,877,500</td>
</tr>
<tr>
<td>Less treasury stock, 500 shares</td>
<td>(35,000)</td>
</tr>
<tr>
<td>Stockholders’ equity</td>
<td>6,841,500</td>
</tr>
</tbody>
</table>

IV.  

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treasury stock</td>
<td>17,500</td>
</tr>
<tr>
<td>Common stock</td>
<td>2,500</td>
</tr>
<tr>
<td>APIC</td>
<td>22,495</td>
</tr>
<tr>
<td>APIC retirement</td>
<td>7,495</td>
</tr>
</tbody>
</table>

EXPLANATION, NOT POINTS

(5,000 shares * $70/share)

(2,500 shares * $75 share sales price)
(2,500 shares * $70 share cost of treas stk sold)

(2,000 shares * $50 share sales price)
(2,000 shares * $70 share cost of treas stk sold)
Uses all available APIC treas stock from 2/28 sale
Rest of debit comes out of retained earnings

(50,000 shares less 2,500 in T Stck on record date * $2/ share)
27. NoFreeLunch, Inc. sold some equipment to WePayLater, Inc. The agreed price was $100,000 payable in $50,000 cash and a $50,000 0% note due in 2 years. Had WePayLater gone out to a bank to borrow the money, the bank would have charged a rate of 12% to lend them the $50,000 for two years with interest compounding annually. The net book value of the equipment on NoFreeLunch's books on the date of the transaction was $45,000. The present value factors below should be useful in answering the questions:

**Present value of a lump sum of $1:**

<table>
<thead>
<tr>
<th>Period</th>
<th>Rate</th>
<th>PV factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>12%</td>
<td>0.7972</td>
</tr>
<tr>
<td>24</td>
<td>1%</td>
<td>0.7876</td>
</tr>
<tr>
<td>2</td>
<td>24%</td>
<td>0.6504</td>
</tr>
</tbody>
</table>

(I) Compute the purchase price of the transaction.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>PV of cash</td>
<td>$50,000</td>
</tr>
<tr>
<td>PV of note</td>
<td>$39,860</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>89,860</strong></td>
</tr>
</tbody>
</table>

(II) Record the journal entry required on the date of the transaction for the seller (NoFreeLunch).

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$50,000</td>
</tr>
<tr>
<td><strong>Note receivable</strong></td>
<td>$50,000</td>
</tr>
<tr>
<td>Deferred financing</td>
<td>$10,140</td>
</tr>
<tr>
<td><strong>Equipment</strong></td>
<td>$45,000</td>
</tr>
<tr>
<td>Gain on sale</td>
<td>$44,860</td>
</tr>
</tbody>
</table>

(III) Assuming your journal entries are the only ones booked, record the journal entries required at the end of year one and year two (again for the seller).

**YEAR ONE**

\[
\text{Deferred financing} = 39,860 \times 12\% = 4,783 \\
\text{Interest income} = 4,783
\]

**REVISED**

\[
\text{PV of note} = 44,643
\]

**YEAR TWO**

\[
\text{Deferred financing} = 44,643 \times 12\% = 5,357 \\
\text{Interest income} = 5,357
\]

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$50,000</td>
</tr>
<tr>
<td><strong>Note receivable</strong></td>
<td>$50,000</td>
</tr>
</tbody>
</table>

* If showed note receivable net (39,860) in part ii then this debit should be to "note receivable", will accept accrued interest.