Practice Midterm 202
Covers Chapters 10 - 12

Problem - I — Multiple Choice (20 points)
Circle the one best answer.

1. The amortization of premium on bonds payable
   a. will increase bond interest expense.
   b. should take place over a period not to exceed 40 years.
   c. will decrease bond interest expense.
   d. will increase bond interest revenue.

2. A corporation issued $600,000 of 6%, 5-year bonds on January 1, at 102. Interest is paid
   semiannually on January 1 and July 1. If the corporation uses the straight-line method of
   amortization, the amount of bond interest expense to be recognized on July 1 is
   a. $36,000.
   b. $18,000.
   c. $19,200.
   d. $16,800.

3. A $200,000, 5%, 20-year bond was issued at 99. The proceeds received from the bond
   issuance are
   a. $200,000.
   b. $198,000.
   c. $204,000.
   d. $196,000.

4. A prior period adjustment
   a. appears on the income statement as an extraordinary item.
   b. is a correction of an error, made directly to retained earnings.
   c. is made when preferred dividends in arrears are finally paid.
   d. is made to reverse an adjusting entry.

5. The Ewing Company purchases 1,000 shares of its common stock for $20,000. The
   $20,000 amount should be debited to
   a. an asset account.
   b. Treasury Stock.
   c. Common Stock.
   d. Retained Earnings.

Problem - II — Ratios (8 points)

The following information is available for Balken Corporation:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common stockholders’ equity</td>
<td>$1,100,000</td>
<td>$900,000</td>
</tr>
<tr>
<td>Dividends paid to common stockholders</td>
<td>62,500</td>
<td>57,600</td>
</tr>
<tr>
<td>Dividends paid to preferred stockholders</td>
<td>25,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Net income</td>
<td>250,000</td>
<td>240,000</td>
</tr>
<tr>
<td>Common shares outstanding</td>
<td>100,000</td>
<td>100,000</td>
</tr>
</tbody>
</table>

_Everett Community College Tutoring Center_
Instructions
Calculate each of the following for 2006:

(a) Payout ratio

(b) Return on common stockholders’ equity

Problem - III — Corporation Entries (24 points)

Sunset Corporation stockholders’ equity consisted of the following on January 1, 2006:

Stockholders’ Equity
Paid-in capital
Capital stock
   6% Preferred stock, $100 par value, cumulative, 50,000 shares authorized, 30,000 shares issued and outstanding $ 3,000,000
   Common stock, no par, $10 stated value, 1,000,000 shares authorized, 400,000 shares issued and outstanding 10,000,000
   Total capital stock 13,000,000
Additional paid-in capital
   In excess of par value—preferred $300,000
   In excess of stated value—common 600,000 900,000
   Total paid-in capital 13,900,000
Retained earnings (Note A) 4,100,000
Total stockholders’ equity $18,000,000

Note A: Preferred dividends are in arrears for 2005.

Instructions
Prepare the appropriate journal entries, if any, for the following transactions in 2006. You may omit journal entry explanations but you should show computations.

1/25/06 Issued 60,000 shares of common stock for $40 per share.

2/18/06 The Board of Directors declared a cash dividend on preferred and common stock totaling $600,000, payable on March 15, to stockholders of record on February 28. (Record dividends payable on preferred and common stock in separate accounts.)

2/28/06 Date of record for cash dividends on preferred and common stock.
3/15/06  Paid the cash dividend to preferred and common stockholders.

5/20/06  Declared a 10% stock dividend on the common stock, payable on June 15, to stockholders of record on May 31. The market value of Sunset Corporation’s common stock was $40 per share.

6/15/06  Distributed stock dividend to common stockholders.

7/10/06  Purchased 50,000 shares of common stock for the treasury at $38 per share.

Problem - IV — Bonds Payable (20 points)

Tipten Company issues $200,000 of 8%, 10-year bonds on January 1, 2006, at 103. Interest is payable semiannually on July 1 and January 1. The company uses the straight-line method of amortization.

Instructions
(a) Journalize the entries for the bonds on (1) January 1, 2006, (2) July 1, 2006, and (3) December 31, 2006.
(b) Show the balance sheet presentation of the bonds at December 31, 2006.
(c) Assume on July 1 2006, after paying interest, Tipten calls bonds having a face value of $100,000. The call price is 101. Record the redemption of the bonds.
**Problem- V — Plant Asset Depreciation and Disposal Entries (16 points)**

Prepare the necessary journal entries to record the following transactions in 2006 for Jano Company.

March 1  Discarded old store equipment that originally cost $24,000 and had a book value of $6,000 on the date of disposal. Assume depreciation on the equipment has already been recorded for the current year.

July 31  Sold a delivery truck for $5,000. The delivery truck originally cost $28,000 and had accumulated depreciation of $20,000 on the date of sale. Assume the depreciation on the truck has already been recorded for the current year.

Dec 31  Recorded straight-line depreciation on asset with cost of $34,000, salvage value of $2,000 and useful life of 4 years.

**Problem- VI — Depreciation Methods (12 points)**

The following information is available for Queen Company, which has an accounting year end on December 31, 2006.

1. A delivery truck was purchased on June 1, 2004, for $80,000. It was estimated to have an $8,000 salvage value after being driven 120,000 miles. During 2006, the truck was driven 20,000 miles. The units-of-activity method of depreciation used.

2. A building was purchased on January 1, 1979, for $2,400,000. It is estimated to have a $24,000 salvage value at the end of its 40-year useful life. The straight-line method of depreciation is being used.

3. Store equipment was purchased on January 1, 2005, for $270,000. It was estimated that the store equipment would have a $27,000 salvage value at the end of its 5 year useful life. The double-declining balance method of depreciation is being used.
Instructions
Complete the table shown below by filling in the appropriate amounts.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Accumulated Depreciation 1/1/06</th>
<th>Depreciation Expense for 2006</th>
<th>Book Value at 12/31/06</th>
</tr>
</thead>
<tbody>
<tr>
<td>Delivery truck</td>
<td>$31,200</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Building</td>
<td>$1,603,800</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Store equipment</td>
<td>$108,000</td>
<td>$</td>
<td>$</td>
</tr>
</tbody>
</table>

Solutions — Practice Midterm 201

Problem - I — Solution
1. c
2. d
3. b
4. b
5. b

Problem - II — Solution
(a) Payout ratio: ($62,500 ÷ $250,000) = 25%
(b) Return on common stockholders' equity: \[
\frac{250,000 - 25,000}{(900,000 + 1,100,000)/2} = 22.5%
\]

Problem C - III — Solution
1/25/06 Cash  .......................................................................................................2,400,000
Common Stock (60,000 × $10) .................................................................600,000
Paid-in Capital in Excess of Stated Value ........................................1,800,000
(60,000 × $30)
2/18/06 Retained Earnings ......................................................................600,000
Dividends Payable—Preferred .................................................................360,000*
Dividends Payable—Common .................................................................240,000
($600,000 - $360,000)

*Dividends in arrears, $6 × 30,000 = $180,000
Dividends for 2006, $6 × 30,000 = 180,000
Total dividends $360,000

2/28/06 No entry required.
3/15/06 Dividends Payable—Preferred .............................................................360,000
Dividends Payable—Common .................................................................240,000
Cash ........................................................................................................600,000
5/20/06 Retained Earnings (46,000 × $40) .....................................................1,840,000
Common Stock Dividends Distributable ..............................................460,000
(46,000 × $10)
Paid-in Capital in Excess of Stated Value .........................................1,380,000
(46,000 × $30)
6/15/06 Common Stock Dividends Distributable ........................................460,000
Common Stock ......................................................................................460,000
7/10/06 Treasury Stock (50,000 × $38) .....................................................1,900,000
Cash ........................................................................................................1,900,000

* Everett Community College Tutoring Center

5
Problem - IV — Solution

(a) (1) Cash ($200,000 × 1.03) ................................................................. 206,000
    Bonds Payable .......................................................... 200,000
    Premium on Bonds Payable .................................. 6,000
(2) Bond Interest Expense ..................................................... 7,700
    Premium on Bonds Payable ($6,000 ÷ 20) .............. 300
    Cash ($200,000 × 8% × 1/2) ....................................... 8,000
(3) Bond Interest Expense ..................................................... 7,700
    Premium on Bonds Payable ................................... 300
    Bond Interest Payable ........................................... 8,000
(b) Long-term liabilities
    Bonds payable  $200,000
    Plus: Premium on bonds payable ($6,000 - $300 - $300) $5,400
      $205,400
(c) Bonds Payable ............................................................ 100,000
    Premium on Bonds Payable [(6,000 - $300) × .50*] 2,850
    Cash ($100,000 × 1.01) ............................................... 101,000
    Gain on Bond Redemption ....................................... 1,850
*$$100,000 ÷ 200,000$

Problem - V — Solution

March 1  Loss on Disposal .......................................................... 6,000
    Accumulated Depreciation—Store Equipment ............. 18,000
    Store Equipment ....................................................... 24,000
July 31  Cash ................................................................. 5,000
    Accumulated Depreciation—Delivery Truck ............ 20,000
    Loss on Disposal ($8,000 - $5,000) ......................... 3,000
    Delivery Truck ......................................................... 28,000
Dec. 31  Depreciation Expense ($32,000/4) ................. 8,000
    Accumulated Depreciation ................................... 8,000

Problem - VI — Solution

<table>
<thead>
<tr>
<th>Assets</th>
<th>Accumulated Depreciation 1/1/06</th>
<th>Depreciation Expense for 2006</th>
<th>Book Value at 12/31/06</th>
</tr>
</thead>
<tbody>
<tr>
<td>Delivery truck</td>
<td>$ 31,200</td>
<td>$12,000</td>
<td>$ 36,800</td>
</tr>
<tr>
<td>Building</td>
<td>$1,603,800</td>
<td>$59,400</td>
<td>$736,800</td>
</tr>
<tr>
<td>Store equipment</td>
<td>$ 108,000</td>
<td>$64,800</td>
<td>$ 97,200</td>
</tr>
</tbody>
</table>