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:

	2006	2005
Common stockholders' equity	$1,100,000	$900,000
Dividends paid to common stockholders	62,500	57,600
Dividends paid to preferred stockholders	25,000	20,000
Net income	250,000	240,000
Common shares outstanding	100,000	100,000

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.

Assets	Accumulated Depreciation 1/1/06	Depreciation Expense for 2006	Book Value at 12/31/06
Delivery truck	$ 31,200	$	$
Building	$1,603,800	$	$
Store equipment	$ 108,000	$	$

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 (60,000 × $30)		1,800,000
2/18/06	Retained Earnings	600,000	
	Dividends Payable—Preferred		360,000*
	Dividends Payable—Common ($600,000 - $360,000)		240,000

*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 (46,000 × $10)		460,000
	Paid-in Capital in Excess of Stated Value (46,000 × $30)		1,380,000
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

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

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