

125 Psych.

AIS 300  
University of Wisconsin - Madison  
Fall 2002 - Exam II  
November 11, 2002

Name: [REDACTED]

Instructor: \_\_\_\_\_

- This exam consists of 11 pages, including this page.
- You may omit journal entry explanations.
- Programmable Calculators are not permitted for use on this exam.

	Points	Score
I. Multiple Choice	40	
II. Bank Reconciliation	12	
III. Plant Assets	12	
IV. Bonds Payable	12	
V. Corporation Entries	14	
VI. Statement of Cash Flows	10	
TOTAL POINTS	100	

1. 5%  $\rightarrow$  4,000 84,000

PM m.v.

	<u>Before Action</u>	<u>After Stock Div.</u>	<u>After Stock Split</u>
Stockholders' Equity			
Common Stock (80,000 x 10)	800,000	840,000	800,000
Retained Earnings	1,000,000	16,000 9,440,000	1,000,000
Total SE.	1,800,000	1,800,000	1,800,000
Outstanding Shares	80,000	84,000	160,000
Book value per share	\$22.50	\$21.43	\$11.25

1st guess in pencil

2

**I. MULTIPLE CHOICE - Choose the best answer from those listed. (50 points)**

1. Which one of the following is not an objective of a system of internal controls?
  - a. Safeguard company assets
  - b. Overstate liabilities in order to be conservative
  - c. Enhance the accuracy and reliability of accounting records
  - d. Reduce the risks of errors
  
2. Notification by the bank that a deposited customer check was returned NSF requires that the company make the following adjusting entry:
  - a. Accounts Receivable  
Cash
  - b. Cash  
Accounts Receivable
  - c. Miscellaneous Expense  
Accounts Receivable
  - d. No adjusting entry is necessary.
  
3. An aging of a company's accounts receivable indicates that \$5,000 are estimated to be uncollectible. If Allowance for Doubtful Accounts has a \$700 debit balance, the adjustment to record bad debts for the period will require a
  - a. debit to Bad Debts Expense for \$5,000.
  - b. credit to Allowance for Doubtful Accounts for \$5,700.
  - c. debit to Bad Debts Expense for \$4,300.
  - d. credit to Allowance for Doubtful Accounts for \$700.
  
4. The retailer considers VISA and MasterCard sales as
  - a. cash sales (debit cash).
  - b. promissory sales (debit notes receivable).
  - c. credit sales (debit accounts receivable).
  - d. contingent sales (no entry).
  
5. A company exchanges its old office equipment and \$30,000 for similar new office equipment. The old office equipment has a book value of \$21,000 and a fair market value of \$15,000 on the date of the exchange. The cost of the new office equipment would be recorded at
  - a. \$51,000.
  - b. \$45,000.
  - c. \$39,000.
  - d. \$36,000.

old Office Equip  
Cash

30,000

6. In the balance sheet, the account, Premium on Bonds Payable, is

- a. added to bonds payable.
- b. deducted from bonds payable.
- c. classified as a stockholders' equity account.
- d. classified as a revenue account.

7. Winter Furniture sells \$400,000 of receivables to Kwik Factors, Inc. Kwik Factors assesses a 2% service charge on the amount of receivables sold. What journal entry does Winter Furniture make to record the sale of receivables?

a. Cash .....	392,000	
Loss on Sale of Receivables .....	8,000	
Accounts Receivable .....		400,000
b. Cash .....	392,000	
Accounts Receivable .....		392,000
c. Cash .....	400,000	
Accounts Receivable .....		392,000
Gain on Sale of Receivables .....		8,000
<input checked="" type="radio"/> d. Cash .....	392,000	
Service Charge Expense .....	8,000	
Accounts Receivable .....		400,000

8. Hardy Clinic purchases land for \$90,000 cash. The clinic assumes \$1,500 in property taxes due on the land. The title and attorney fees totaled \$1,000. The clinic has the land graded for \$2,200. What amount does Hardy Clinic record as the cost for the land?

- a. \$92,200.
- b. \$91,000.
- c. \$94,700.
- d. \$93,200.

$$\begin{array}{r} 90,000 \\ 1,500 \\ 1,000 \\ 2,200 \\ \hline 94,700 \end{array}$$

9. A coal company invests \$15 million in a mine estimated to have 20 million tons of coal and no salvage value. It is expected that the mine will be in operation for 5 years. In the first year, 3,000,000 tons of coal are extracted and sold. What is the depletion expense for the first year?

- a. \$2,250,000.
- b. \$900,000.
- c. \$3,000,000.
- d. \$4,000,000.

$$\left( \frac{15}{20} \right) \cdot 3$$

10. If the market interest rate is greater than the contractual interest rate, bonds will sell

- a. at a premium.
- b. at face value.
- c. at a discount.
- d. only after the stated interest rate is increased.

11. Goodwill can be recorded

- a. when customers keep returning because they are satisfied with the company's products.
- b. when the company acquires a good location for its business.
- c. when the company has exceptional management.
- d. only when there is an exchange transaction involving the purchase of an entire business.

12. Lowe Company sells 4,000 units of its product for \$500 each. The selling price includes a one-year warranty on parts. It is expected that 3% of the units will be defective and that repair costs will average \$50 per unit. In the year of sale, warranty contracts are honored on 80 units for a total cost of \$4,000. What amount will be reported on Lowe Company's balance sheet as Estimated Warranty Liability on December 31, 2002?

- a. \$4,000.
- b. \$6,000.
- c. \$2,000.
- d. cannot be determined.

13. Which of the following show the proper effect of a stock split and a stock dividend?

Item	Stock Split	Stock Dividend
a. Total paid-in capital	Increase	Increase
b. Total retained earnings	Decrease	Decrease
c. Book value per share	Decrease	Increase
<input checked="" type="radio"/> d. Outstanding shares	Increase	Increase

14. Romano Corporation reports net income of \$450,000 and a weighted average of 200,000 shares of common stock outstanding for the year. Romano has cumulative preferred stock dividends for the current year of \$40,000 that were not declared and paid. The earnings per share for the year is

- a. \$2.05
- b. \$2.25
- c. \$2.45
- d. \$2.81

15. If convertible preferred stock is converted into common shares,

- a. a gain on conversion must be recorded if the par value of the preferred stock is greater than the par value of the common stock.
- b. a loss on conversion must be recorded if the par value of the preferred stock is less than the par value of the common stock.
- c. a gain or loss on conversion is not recorded.
- d. the market value of the preferred shares on the date of conversion is credited to the common stock account.

16. When an account is written off using the allowance method, accounts receivable
- a. is unchanged and the allowance account increases.
  - b. increases and the allowance account increases.
  - c.** decreases and the allowance account decreases.
  - d. increases and the allowance account decreases.

17. An example of a cash flow from financing activity is:
- a. receipt of dividends on investment in stock.
  - b. purchase of land.
  - c. depreciation.
  - d.** issuance of capital stock.

18. Carey Company is a publicly held corporation whose \$1 par value stock is actively traded at \$20 per share. The company issued 3,000 shares of stock to acquire land recently advertised at \$45,000. When recording this transaction, Carey Company will
- a.** debit Land for \$60,000.
  - b. credit Common Stock for \$60,000.
  - c.** debit Land for \$45,000.
  - d. credit Paid-In Capital in Excess of Par Value for \$63,000.
- This is what you paid for it (3,000 x 20)*

19. Lopez, Inc. has 2,000 shares of 6%, \$50 par value, cumulative preferred stock and 50,000 shares of \$1 par value common stock outstanding at December 31, 2001, and December 31, 2002. The board of directors declared and paid a \$4,000 dividend in 2001. In 2002, \$20,000-of dividends are declared and paid. What are the dividends received by the preferred and common shareholders in 2002?

	<u>Preferred</u>	<u>Common</u>
a.	\$12,000	\$8,000
b.	\$10,000	\$10,000
<b>c.</b>	\$8,000	\$12,000
d.	\$6,000	\$14,000

20. Harwell Company lends Newton Company \$60,000 on April 1, accepting a four-month, 9% interest note. Harwell Company prepares financial statements on April 30. What adjusting entry should be made before the financial statements can be prepared?

a.	Note Receivable .....	60,000	
	Cash .....		60,000
<b>b.</b>	Interest Receivable .....	450	
	Interest Revenue .....		450
c.	Cash .....	450	
	Interest Revenue .....		450
<b>d.</b>	Interest Receivable .....	1,800	
	Interest Revenue .....	1,800	
		4	1,800

*Duh*

*Divide by four*

## II. BANK RECONCILIATION ( 12 points)

Noland Boat Company's bank statement for the month of September showed a balance per bank of \$7,000. The company's Cash account in the general ledger had a balance of \$4,667 at September 30. Other information is as follows:

- (1) Deposits in transit were \$4,200. *Add Bank*
- (2) The bank statement shows a debit memorandum for \$40 for check printing charges. *Less Books*
- (3) Outstanding checks at September 30 amounted to \$5,800. *Less Bank*
- (4) Noland Boat Company issued check No. 138 for \$429 to Grainger, on account. The check, which cleared the bank, was incorrectly journalized and posted by Noland Boat Company for \$492. *Add 63 Books*
- (5) The bank returned an NSF check from a customer for \$550. *Less Books*
- (6) The bank included a credit memorandum for \$1,260 which represents collection of a customer's note by the bank for the company; principal amount of the note was \$1,200 and interest was \$60. *Less Books, Add Add Books*

**Instructions:** Prepare a bank reconciliation for Noland Boat Company at September 30.

NOLAND BOAT COMPANY  
Bank Reconciliation  
September 30

	<u>Amount</u>		<u>Amount</u>
Balance per bank statement	\$ 7,000	Balance per books	\$ 4,667
Add: <i>Deposits in transit</i>	<i>4,200</i>	Add: <i>Collection of a note</i>	<i>1,260</i>
		<i>Error</i>	<i>63</i>
Less: <i>Outstanding checks</i>	<i>(5,800)</i>	Less: <i>Check printing charge (40)</i>	
		<i>NSF check</i>	<i>(550)</i>
Adjusted bank balance	<i>5,400</i>	Adjusted book balance	<i>5,400</i>

### III. PLANT ASSETS ( 12 points)

Blue Chip Company purchased a machine on October 1, 2002, at a total cost of \$800,000. The machine has an estimated useful life of 10 years and a salvage value of \$75,000. The machine is depreciated using the straight-line method. Blue Chip Company uses a calendar year in preparing annual financial statements.

1. Calculate depreciation expense of the machine for 2002 and the book value of the machine at Dec. 31, 2002.

$$\left( \frac{800,000 - 75,000}{10} \right) \cdot \left( \frac{3}{12} \right) = 18,125$$

$$\text{Book Value} = 800,000 - 18,125 = 781,875$$

Depreciation expense for 2002: \$ 18,125 Book value at Dec. 31, 2002: \$ 781,875

2. Now assume that Blue Chip Company uses the declining balance method to depreciate the machine. Blue Chip Company uses a double-declining balance. Calculate the depreciation expense for 2002 using this method.

$$40,000 = 800,000 \times \left( 2 \times \frac{100\%}{10} \right) \times \left( \frac{3}{12} \right)$$

3. Assume that there is \$150,000 in the Accumulated Depreciation account for the above machine on January 1, 2004. On the same day, Blue Chip Company gets new information that changes the remaining useful life of the machine to 4 years with a revised salvage value of \$25,000. Given this information, calculate the revised depreciation on the machine for 2004.

$$\frac{(800,000 - 150,000) - 25,000}{4} = 156,250$$

4. Assume, instead, that there is \$500,000 in the Accumulated Depreciation account for the above machine on January 1, 2006. On that same day, Blue Chip Company sells the machine for \$275,000. Prepare the journal entry (or entries) to record the sale of the machine on January 1, 2006.

Cash	275,000	
Acc. Dep.	500,000	
Loss on disposal	25,000	
Machine		800,000

#### IV. BONDS PAYABLE ( 12 points)

Elwood Company issues \$2,000,000 of 9%, 10-year bonds on January 1, 2002, at 102. Interest is payable semiannually on January 1 and July 1. The company uses the straight-line method of amortization.

1. Prepare the journal entry to record the bond issuance.

Cash	2,040,000	-
Premium on B.P.		40,000
B.P.		2,000,000

2. Prepare the journal entry to record bond interest expense on July 1, 2002, assuming no previous accrual of interest.

Bond Int. Expense	88,000	
Premium Amortization	2,000	
<del>Cash Interest Payable</del>		90,000
Cash		

3. What is the carrying value (book value) of the bonds after the first interest date?

$$2,038,000 = 2,000,000 + (40,000 - 2,000)$$

4. Assume that Elwood Company retires the above bonds on June 30, 2007, at 104. Also assume that the carrying value of the bonds at the redemption date was \$2,020,000. Prepare the journal entry to record the retirement of the bonds

Bonds Payable	2,000,000	
Premium	20,000	
Loss on redemption	60,000	
Cash		2,080,000

## V. CORPORATION ENTRIES (14 points)

Carson Corporation was organized on Jan. 1, 2002. Carson had the following transactions during the year. Prepare the appropriate journal entries. You may omit journal entry explanations.

- 1/02/02 Issued 2,000 shares of \$1 par value common stock to attorneys in payment of a bill for \$8,000 for services rendered in helping the company to incorporate.

Organizational Expense	8,000	
Common Stock		2,000
Paid-in capital in excess of <del>par</del> par value		6,000

APIC - C.S.

- 1/31/02 Issued 50,000 shares of \$1 par value common stock for cash at \$4 per share.

Cash	200,000	
Common Stock		50,000
APIC - C.S.		150,000

Normal credit balance

- 4/10/02 Purchased 2,000 shares of treasury stock for \$5 per share.

Treasury Stock	10,000	
Cash		10,000

- 8/23/02 Sold 1,000 shares of treasury stock for \$6 per share.

Cash	6,000	
TS		<del>5,000</del> 5,000
APIC - T.S.		1,000

- 12/01/02 Declared a cash dividend on outstanding shares of \$1 per share to stockholders of record on December 15.

Retained Earnings	<del>5,000</del> 5,000	
Dividends Payable		5,000

## VI. STATEMENT OF CASH FLOWS ( 10 points)

The comparative balance sheet for McHenry Company appears below:

### McHENRY COMPANY Comparative Balance Sheet

	<u>Dec 31, 2002</u>	<u>Dec 31, 2001</u>
<u>Assets</u>		
Cash and cash equivalents .....	\$37,685	\$13,815
Accounts receivable .....	5,880	8,380
Merchandise Inventory .....	12,280	6,980
Equipment .....	27,350	20,550
Accumulated depreciation—equipment .....	(2,720)	(2,020)
Patent .....	<u>2,000</u>	<u>2,000</u>
Total assets .....	<u>\$82,475</u>	<u>\$49,705</u>
<u>Liabilities and Stockholders' Equity</u>		
Accounts payable .....	\$3,125	\$ 2,015
Interest payable.....	50	0
Income taxes payable.....	975	1,215
Bonds payable.....	18,000	14,000
Common stock .....	20,040	20,040
Retained earnings .....	<u>40,285</u>	<u>12,435</u>
Total liabilities and stockholders' equity .....	<u>\$82,475</u>	<u>\$49,705</u>

#### Additional information for 2002

- 1) Net income for 2002 was \$34,850.
- 2) Depreciation expense for 2002 was \$2,900.
- 3) Cash dividends of \$7,000 were declared and paid during the year.
- 4) Two separate transactions affected Amazon Company's equipment account:
  - a) They sold equipment for \$2,050 that originally cost \$7,500 and had a book value of \$5,300, and
  - b) They purchased new equipment for \$14,300 cash.

Instructions are on the next page. For easier reference, you may detach this sheet from the exam. If you do so, please:

- 1) Provide both your name and your TA's name below and place this sheet in the middle of the exam when you hand it in.
- 2) This page must be included with the exam to receive credit for the problem.

Name: \_\_\_\_\_

TA: \_\_\_\_\_

**Instructions:** Prepare the operating activities and investing activities sections of the statement of cash flows, using the indirect method. You do not have to prepare the financing activities section.

McHenry Company  
Statement of Cash Flows  
For the year ended December 31, 2002

Cash flows from operating activities

Net Income		34,850
- Adj. to reconcile net income to net cash		
Depreciation	2,900	
Loss on sale of equip.	3,250	
Decrease in A/R.	2,500	
Increase in Inventory	(5,300)	
Increase in A.P.	1,100	
Increase in Int. Payable	50	
Decrease in Inc. Taxes Payable	<u>(240)</u>	<u>4,270</u>
Net cash provided by O.A.		39,120

Cash flow from investing activities

Sale of Equipment	2,050	
Purchase of Equipment	<u>(14,300)</u>	
		(12,250)

You do not have to prepare the financing activities section.