

EXAM REVIEW – CHAPTERS 10, 11, 12

STUDY SUGGESTIONS

- Review your class notes, homework exercises and problems.
- Be sure to review any chapter appendices assigned on the General Course Outline.
- Review **Demonstration Problem, Summary and Key Terms** at the end of each chapter.
- Answer the **Multiple Choice Quiz** at the end of each chapter.
- Answer **Multiple Choice Quiz A and B** on the textbook website www.mhhe.com/wild.
- Know accounting terms and concepts by answering the **Discussion Questions** at the end of each chapter.
- Know the account classification (i.e. asset, liability, or owner's equity) and normal balance of all accounts.
- Know what the financial ratios mean and how to calculate them.

Key Terms and Concepts to Know

Chapter 10 – Accounting for Long-Term Liabilities

- Characteristics of a bond and various types of bonds.
- The concept of present value and how to use the present value tables.
- Compute the price that a buyer is willing to pay for a bond using present value.
- Difference between a bond premium and discount:
- Discount:
 - bond interest rate less than market/effective interest rate
 - cash proceeds less than face amount of bonds
 - price of the bond less than 100
 - annual interest expense will be greater than cash interest payments due to the amortization of the discount
 - carrying value will be less than face amount during term of the bonds
 - discount account always has a debit balance
- Premium:
 - bond interest rate greater than market/effective interest rate
 - cash proceeds greater than face amount of bonds
 - price of the bond greater than 100
 - annual interest expense will be less than cash interest payments due to the amortization of the discount
 - carrying value will be greater than face amount during term of the bonds
 - premium account always has a credit balance

- Calculate the amortization of a bond discount or premium and journalize the amortization.
- Journalize the redemption of bonds payable at par and at a premium or discount.
- Record the issuance and payment for long-term notes payable.

Chapter 11 Accounting for Equity

- Characteristics of a corporation.
- Journalize entries for issuing stock at par and at a premium.
- Journalize the entries for purchases and sales of treasury stock.
- Journalize the entries for cash dividends and stock dividends.
 - Cash dividends are paid in cash. Calculate the dollar value of the cash dividend by multiplying the number of shares by the amount of the dividend declared per share.
 - Stock dividends are paid in shares of stock. Stock dividends are categorized as large or small based on the percentage of outstanding shares to be granted.
 - For a large stock dividend, calculate the number of shares by multiplying the number of shares outstanding by the stock dividend percentage. Calculate the dollar value of the stock dividend by multiplying the number of shares by the par value. A large stock dividend is accounted for similar to a stock split.
 - For a small stock dividend, calculate the number of shares by multiplying the number of shares outstanding by the stock dividend percentage. Calculate the dollar value of the stock dividend by multiplying the number of shares by the market price. A small stock dividend is accounted for similar to a cash dividend.
- Effect of stock splits on par value, market price and number of shares.
- Compute dividends per share for common stock and both cumulative and non-cumulative preferred stock.

Chapter 12 – Accounting for Cash Flows

- Purpose for preparing the Statement of Cash Flows.
- Prepare each of the three sections of cash flow activities and identify types of receipts and disbursements are included in each.
 - Operating
 - Investing
 - Financing
- Cash has its own section to report the change in the cash balance and the beginning and ending balances in cash.
- Two methods used to prepare the cash flows from operating activities section.
- Prepare the operating activities section using the indirect method.
- Reporting of investing and financing activities that do not involve cash.
- Be able to classify dividends paid on the cash flow statement.

Practice Problems

Problem 1 - Entries for issuing bonds and amortizing the discount by the straight-line method

On January 1, 1998, the Sparkle Corporation issued \$10,000,000 of five-year, 10% bonds to finance its operations. Interest is payable semiannually. The bond was issued at an effective interest rate of 12% resulting in the company receiving cash of \$9,264,050. Journalize the entries to record the following:

- a) Sale of the bonds
- b) First semiannual interest payment (amortization is to be recorded annually)
- c) Second semiannual interest payment
- d) Amortization of discount at the end of the first year using the straight-line method
- e) Determine the amount of bond interest expense for the first year.

Problem 2 - Entries for issuing bonds and amortizing the premium by the straight-line method

On January 1, 1998, the Sparkle Corporation issued \$10,000,000 of five-year, 10% bonds to finance its operations. Interest is payable semiannually. The bond was issued at an effective interest rate of 8% resulting in the company receiving cash of \$10,811,090. Journalize the entries to record the following:

- a) Sale of the bonds
- b) First semiannual interest payment (amortization is to be recorded semi-annually)
- c) Second semiannual interest payment
- d) Amortization of discount at the end of the first year using the straight-line method
- e) Determine the amount of bond interest expense for the first year.

Problem 3 - Entry for calling bonds; loss

Gerber Corporation issued \$10,000,000 of 10 year, 10% bonds callable on January 1, 1999. The bonds were issued for cash at their face amount. Journalize the entry to record the call of the bonds at 101.

Problem 4 - Journalizing Stock Transactions

Journalize each of the following transactions of Chicago Carpet World.

- a) Issued for cash 20,000 shares of \$10 par common stock at \$20 per share.
- b) Reacquired 2,000 shares of its common stock at \$16 per share.
- c) Sold 500 of the reacquired shares for \$12 per share.
- d) Sold the remaining 1,500 shares at \$21 per share.
- e) Declared a \$1 per share cash dividend.
- f) Declared a 5% stock dividend when the market price of the common stock was \$30 per share.
- g) Paid the cash dividend.
- h) Issued the stock certificates from the stock dividend in (f)
- i) Declared a 2 for 1 stock split.

Problem 5 - Dividends per share

Slick, Inc. has stock outstanding as follows: 10,000 shares of \$8 (8%) nonparticipating, noncumulative preferred stock of \$100 par, and 50,000 shares of \$25 par common. During its third year of operation, the corporation paid a dividends of \$167,500.

Required: Calculate the dividends per share for each class of stock.

Problem 6 - Entries for issuing par stock

On June 1, Chicago Carpet World, a carpet retailer, issued for cash 10,000 shares of \$20 par common stock at \$24. On July 1, it issued for cash 5,000 shares of \$10 par preferred stock at \$14.

Required:

- a) Journalize the entries for the issuance of stock
- b) What is the total amount invested (total paid-in capital) by stockholders as of July 1.

Problem 7 - Treasury Stock transaction

On June 1 of the current year, Roma Inc. reacquired 2,000 shares of its common stock at \$32 per share. On July 15, Roma Inc. sold 500 of the reacquired shares at \$41 per share. The remaining 1,500 shares were sold at \$30 per share on November 12.

Required:

- a) Journalize the transactions of June 1, July 15, and November 12.
- b) What is the balance of Paid-in Capital from Sale of Treasury Stock on December 31 of the current year?

Problem 8 - Entries for stock dividend

The board of directors of Home Value Inc., a small chain of home centers, declared a 5% stock dividend when the market price of the common stock was \$ 40 per share. Prior to the stock dividend, the following account balances appear on the balance sheet:

Common Stock, \$25 par, 10,000 shares	\$250,000
Paid-in Capital in excess of par-Common Stock	50,000
Retained Earnings	<u>150,000</u>
Total Stockholders' Equity	\$450,000

Required:

- a) Journalize the entries to record the declaration of the dividend and the issuance of the stock certificates.
- b) What is the total stockholder's equity at year end after the issuance of the stock dividend?

Problem 9 - Entries for cash dividend

On November 15, the board of directors of Parker Corporation declared a cash dividend of 1.00 per share on the 50,000 shares common stock outstanding to stockholders of record on November 30, payable on December 15.

Required: Journalize the necessary entries to record the declaration and payment of the dividend.

Problem 10 - Effect of stock split

Super Clean Corporation, which had 10,000 shares of common stock outstanding, declared a 3 for 1 stock split.

Required:

- a) What will be the number of shares outstanding after the split?
- b) If the common stock had a market value of \$90 per share before the split what would be an approximate market price per share after the split?

Problem 11 - Stockholders' Equity section of a balance sheet

The following accounts and their balances appear in the ledger of The Salty Dog, a company that sells boats and accessories, on December 31, the end of the current fiscal year:

Common Stock \$10 par	\$750,000
Paid-in Capital in Excess of Par-Common Stock	150,000
Paid-in Capital in Excess of Par-Preferred Stock	50,000
Paid-in Capital from Sale of Treasury Stock-Common	14,000
Preferred \$5 Stock, \$100 par	500,000
Retained Earnings	617,000
Treasury Stock-Common	18,000

There are 2,000 shares of common stock held as treasury stock; 250,000 of common stock and 20,000 shares of preferred stock are authorized.

Required: Prepare the Stockholders' Equity section of the balance sheet as of December 31 using the format shown below.

Stockholders' Equity

Capital Stock:

Preferred \$____ stock, \$____ par (_____ shares authorized, _____ shares issued)	_____
Common stock, \$____ par (_____ shares authorized, _____ shares issued)	_____
Total Capital Stock	_____

Additional Paid-In Capital:

Excess of issue price over par – preferred stock	_____
Excess of issue price over par – common stock	_____
Total Paid-In Capital	_____

Retained earnings

Less: treasury common stock (_____ shares at cost)	_____
Total stockholder' equity	_____

Problem 12 - Identify the type of cash flow activity

Identify the type of cash flow activity (operating, investing, or financing) for each of the following transactions:

- a) payment of cash dividends
- b) sale of land
- c) issuance of bonds
- d) redemption of bonds
- e) purchase of bonds as an investment
- f) sale of treasury stock
- g) issuance of preferred stock
- h) purchase of equipment

Problem 13 - State the effect on cash flow

State the effect on cash flow (increase or decrease and the amount) of each of the following transactions, considered individually:

- a) Issued 10,000 shares of \$10 par common stock for \$15 per share, receiving cash.
- b) Sold investment, which cost \$72,000 for \$62,000.
- c) Issued \$ 1,000,000 of 10 year 8 % bonds at 98.
- d) Purchased 2,000 shares of \$10 par common stock as treasury stock at \$25 per share.
- e) Redeemed bonds with a face value of \$250,000 and a carrying value of \$248,000 for \$252,500.
- f) Sold land which cost \$75,000 for \$ 90,000
- g) Sold 1,000 shares of treasury stock, which cost \$25 per share for \$30 per share.

Problem 14 - State the effect on cash flow

Fully depreciated equipment costing \$10,000 was discarded. What was the effect of the transaction on cash flow if:

- a) There was no salvage value and no cash was received
- b) \$500 in cash is received?

Problem 15 - Cash dividends paid

The board of directors declared cash dividends totaling \$85,000 during the current year. The comparative balance sheet indicates dividends payable of \$15,000 at the beginning of the year and \$25,000 at the end of the year.

Required: What was the amount of cash dividends paid to stockholders during the year?

Problem 16 - State the effect on cash flow from operating activities

The balances of the current asset and current liability accounts at the beginning and end of the year are listed below. Determine if the balance increased or decreased and indicate whether each of the following would be added to or deducted from net income in determining the net cash flow from operating activities using the indirect method.

	<u>End of</u> <u>Year</u>	<u>Beginning</u> <u>of Year</u>	<u>Increase</u> <u>(Decrease)</u>	<u>Add or</u> <u>Deduct</u>
a) Accounts receivable	74,000	84,100		
b) Prepaid expenses	5,100	6,600		
c) Accounts payable	39,400	33,200		
d) Salaries payable	5,000	7,000		

Problem 17 - State the effect on cash flow from operating activities

Net income for the current year was \$92,150. Depreciation expense was \$26,500. The balances of the current asset and current liability accounts at the beginning and end of the year are listed below. Prepare the cash flows from operating activities section of the statement of cash flows using the indirect method.

	<u>End of</u> <u>Year</u>	<u>Beginning</u> <u>of Year</u>	<u>Increase</u> <u>(Decrease)</u>	<u>Add or</u> <u>Deduct</u>
a) Cash	61,500	56,250		
b) Accounts receivable	81,250	74,100		
c) Inventories	103,000	81,000		
d) Prepaid expenses	6,100	7,600		
e) Accounts payable	49,400	51,200		
f) Salaries payable	6,500	5,200		

Practice True / False Questions

1. Any significant gain or loss from the early retirement of bonds should be shown as a gain or loss on the income statement.
True False
2. Investors will pay an amount greater than the face amount of a bond if the face interest rate on bonds is greater than the market interest rate.
True False
3. When bonds are issued at a premium, the annual interest expense reported will be greater than the annual cash interest payments.
True False
4. When bonds are issued at a price below face value, the Discount on Bonds Payable account is credited for the difference between the issue price and the face value.
True False
5. Interest on bonds must be paid in full even when the corporation operates at a loss.
True False
6. The issuing corporation has the right to require the owner of a convertible bond to surrender the bond for payment before the maturity date of the bond.
True False
7. If the market rate of interest on the day that bonds are issued is lower than the face rate of interest, the bonds will sell at a discount.
True False
8. Amortizing bond premiums over the period from the issue date to the maturity date reduces bond interest expense shown on the income statement.
True False
9. The stockholders of a corporation are agents of the corporation empowered to act for the firm.
True False
10. Before dividends can be paid, they must be declared and voted upon by the shareholders.
True False

11. When common stock is issued, the par value, or stated value, of the shares issued is recorded in the Common Stock account.
True False
12. Preferred Stock is shown in the Stockholders' Equity section of the balance sheet.
True False
13. A separate Common Stock account is kept in the general ledger for each common stockholder of a corporation.
True False
14. Before treasury stock can be sold, the sale must be voted upon by the shareholders.
True False
15. When common stock is issued, the par value, or stated value, of the shares issued is recorded in the Common Stock account.
True False
16. The amount received in excess of the par value of preferred stock issued is recorded in an account called Paid-in Capital in Excess of Par Value—Preferred Stock.
True False
17. Usually, there is a difference between the net income reported on the income statement and the net cash from operating activities shown on the statement of cash flows.
True False
18. An increase or decrease in accounts payable during a fiscal period has no effect on the net cash provided by operating activities.
True False
19. A sale of used equipment for cash produces a cash inflow from investing activities.
True False
20. The payment of cash dividends to stockholders would be classified as a cash outflow resulting from a financing activity.
True False

21. The starting point for analyzing cash flows from operating activities is the beginning balance of cash.
True False
22. If the income statement reflects a net loss for the year, the loss is not reported under cash flows from operating activities in the statement of cash flows.
True False
23. Interest expense is treated as an outflow of cash from a financing activity.
True False
24. The Financial Accounting Standards Board prefers the indirect method of preparing the statement of cash flows.
True False
25. A complete set of published financial statements for a corporation must include a statement of cash flow.
True False
26. When the net income is reconciled with the net cash provided by operating activities, depreciation expense is added to the net income.
True False
27. A 3-for-2 stock split will triple the reported dollar amount of stockholders' equity.
True False
28. Both cash dividends and stock dividends decrease the total stockholders' equity.
True False
29. When a corporation purchases its own stock and intends to reissue that stock at a later date, the cost of the shares is shown in the Assets section of the balance sheet until the stock is reissued.
True False
30. When treasury stock is purchased, the Treasury Stock account is debited for the entire amount paid for the stock.
True False

Practice Multiple Choice Questions

1. When bonds mature, a corporation will pay the bondholders
 - a) the current market value of the bonds.
 - b) the face amount plus the original premium or minus the original discount.
 - c) the face amount plus the interest accrued since the date the bonds were issued.
 - d) the face amount of the bonds.

2. On December 31, 2013, a corporation issued \$200,000 face value, 12 percent bonds that mature 10 years from the date of issue. The issue price was 97. If the firm uses the straight-line method of amortization, interest expense for 2014 will be reported at
 - a) \$24,600
 - b) \$24,000
 - c) \$23,400
 - d) \$19,400

3. Bonds with a face value of \$200,000 were issued at 103. The entry to record the issuance will include a credit to the Bonds Payable account for
 - a) \$206,000
 - b) \$200,000
 - c) \$103,000
 - d) \$230,000.

4. The entry to record the adjustment for accrued bond interest includes
 - a) a debit to Bond Interest Expense and a credit to Cash.
 - b) a debit to Bond Interest Expense and a credit to Bond Interest Payable.
 - c) a debit to Bond Interest Payable and a credit to the Bond Interest Expense.
 - d) a debit to Bond Interest Expense and a credit to Bonds Payable.

5. The entry to record the issuance of bonds at face value includes
 - a) a credit to Bond Interest Payable.
 - b) a credit to Bond Payable.
 - c) a debit to Bond Interest Expense.
 - d) a debit to Bond Interest Payable.

6. In the interest formula $I = P \times R \times T$, the P stands for
 - a) Payment
 - b) Principal
 - c) Premium
 - d) Prime number

7. The amortization of the bond discount _____ the carrying value of the bond, while the amortization of the bond premium _____ the carrying value of the bond.
 - a) decreases, increases
 - b) increases, decreases
 - c) increases, increases
 - d) decreases, decreases

8. If market interest rates are higher than the rate offered on the bonds being sold, they will be sold at
 - a) a premium
 - b) a discount
 - c) face value
 - d) a loss

9. Bonds issued at a premium are
 - a) traded for stock
 - b) sold at face value
 - c) sold at less than face value
 - d) sold for more than face value

10. A corporation has 4,000 shares of 5 percent, \$100 par-value preferred stock and 50,000 shares of \$2 par-value common stock outstanding. If the board of the directors decides to distribute dividends totaling \$100,000, the common stockholders will receive a dividend of
 - a) \$1.00 a share
 - b) \$1.60 a share
 - c) \$2.00 a share
 - d) \$2.40 a share

11. A corporation has 10,000 shares of 6 percent, \$50 par-value cumulative preferred stock and 50,000 shares of \$4 par-value common stock outstanding. Last year, no dividends were paid. This year, the company decided to pay a dividend of \$80,000. The common stockholders will receive a dividend of
 - a) \$0.40 a share
 - b) \$1.00 a share
 - c) \$1.60 a share
 - d) \$2.00 a share

12. The entry to record the issuance of 2,000 shares of \$10 par-value common stock for \$14 a share consists of a debit to Cash for \$28,000 and a credit to Common Stock for
 - a) \$28,000
 - b) \$20,000 and a credit to Gain on Sale of Common Stock for \$8,000
 - c) \$20,000 and a credit to Treasury Stock for \$8,000
 - d) \$20,000 and a credit to Paid-in Capital in Excess of Par Value—Common Stock for \$8,000

13. The entry to record the issuance of 500 shares of \$10 par-value common stock for \$14 a share consists of a debit to Cash for \$7,000 and a credit to Common Stock for
 - a) \$5,000 and a credit to Treasury Stock for \$2,000.
 - b) \$5,000 and a credit to Paid-in Capital in Excess of Par Value—Common Stock for \$2,000.
 - c) \$5,000 and a credit to Gain on Sale of Common Stock for \$2,000.
 - d) \$7,000.

14. The Paid-in Capital in Excess of Par Value—Preferred Stock account would be shown in the
 - a) Assets section of the balance sheet.
 - b) Stockholders' Equity section of the balance sheet.
 - c) Revenue section of the income statement.
 - d) Expense section of the income statement.

15. A liability for the payment of cash dividends is recorded
 - a) on the date the board of directors publicly declares its intention to pay the dividends.
 - b) only when cumulative preferred dividends are passed over (not paid) and are in arrears.
 - c) at the end of any year during which common stock dividends were not paid.
 - d) at the end of every year that the corporation makes a profit.

16. A corporation reported a net income of \$120,000 for its fiscal year and declared and paid cash dividends of \$60,000. A stock dividend recorded at \$40,000 was also distributed during the year. If the ending balance of the Retained Earnings account was \$200,000, the beginning balance is
 - a) \$160,000.
 - b) \$180,000.
 - c) \$200,000.
 - d) \$220,000.

17. The Treasury Stock account is shown on the balance sheet as
 - a) an asset.
 - b) an addition to the Common Stock and Preferred Stock accounts in the Stockholders' Equity section.
 - c) a deduction from the Retained Earnings in the Stockholders' Equity section.
 - d) a deduction from the sum of all other items in the Stockholders' Equity section.

18. When a corporation reacquires its own shares of stock, the Treasury Stock account is usually debited for
 - a) par value of the shares reacquired.
 - b) the price paid to reacquire the shares.
 - c) the original issue price of the shares.
 - d) the current market value of the shares.

19. Treasury stock is
 - a) stock previously paid for in full by a stockholder, then repurchased by the issuing corporation.
 - b) donated by stockholders.
 - c) always preferred stock.
 - d) categorized under Paid-in Capital on the balance sheet and added to preferred and common stock.

20. The net cash provided by operating activities is affected by
 - a) a change in merchandise inventory.
 - b) a purchase of land for cash.
 - c) the issue of bonds payable for cash.
 - d) proceeds of cash investments by stockholders.

21. Investing activities include
 - a) purchases of merchandise for cash.
 - b) purchases of plant and equipment for cash.
 - c) purchases of prepaid expense items such as supplies and insurance for cash.
 - d) increase in accounts receivable.

22. An example of a financing activity is
 - a) the sale of merchandise for cash.
 - b) the issue of stock for cash.
 - c) the sale of used equipment for cash.
 - d) the purchase of a building.

23. A corporation received \$50,000 in cash when it sold a building and paid \$90,000 in cash when it purchased some new machinery. As a result, the statement of cash flows would report
- a) \$40,000 as the net cash used in financing activities.
 - b) \$40,000 as the net cash provided by investing activities.
 - c) \$40,000 as the net cash used in investing activities.
 - d) \$40,000 as the net cash provided by financing activities.
24. On a statement of cash flows, depreciation expense is
- a) subtracted from net income in the computation of the net cash provided by operating activities
 - b) added to net income in the computation of the net cash provided by operating activities
 - c) treated as a cash outflow in the computation of the net cash used in investing activities
 - d) treated as a cash inflow in the computation of the net cash used in investing activities
25. Generally, if a short-term investment is to be classified as a cash equivalent, it must fall due within
- a) 12 months from the date it was acquired
 - b) 6 months from the date it was acquired
 - c) 3 months from the date it was acquired
 - d) 1 month from the date it was acquired
26. Polyglot Services, Inc. sold equipment that cost \$45,600 for \$12,450. Depreciation on the equipment from purchase to date of sale amounted to \$35,000. What amount is reported in the Cash Flows from Investing Activities section of the Statement of Cash Flows?
- a) \$12,450
 - b) \$0
 - c) \$1,850
 - d) \$10,600
27. Elmo's Organization acquired land valued at \$56,000 for 4,200 shares of its stock. Where on the Statement of Cash flows does this transaction activity appear?
- a) Operating Activities
 - b) Investing Activities
 - c) Financing Activities
 - d) Disclosures

28. The purchase or resale of treasury stock is reported in which of the following categories?
- a) Operating Activities
 - b) Investing Activities
 - c) Financing Activities
 - d) Disclosures
29. The Natural Company's cash balance at December 31, 2015, was \$150,000. The following information was reported on the company statement of cash flows for 2013:

Net income	\$360,000
Depreciation and amortization	110,000
Increase in accounts receivable	58,000
Increase in inventory	120,000
Decrease in accounts payable	40,000
Dividends paid to shareholders	25,000
Proceeds from sale of common stock	500,000
Repayment of bonds payable	200,000
Proceeds from sale of equipment, book value = \$84,000	50,000
Purchase of land and building	300,000

The Natural Company's balance sheet would report the balance of Cash on December 31, 2013

- a) \$311,000.
- b) \$410,000
- c) \$426,000
- d) \$461,000.

Solutions to Practice Problems

Problem 1 - Entries for issuing bonds and amortizing the discount by the straight-line method

a)	Cash	9,264,050	
	Discount on bonds payable	735,950	
	Bonds payable		10,000,000
b)	Interest expense	500,000	
	Cash		500,000
c)	Interest expense	500,000	
	Cash		500,000
d)	Interest expense	147,190	
	Discount on bonds payable		147,190
	<i>(735,950/5 years = 147,190)</i>		
e)	Bond Interest Expense: 500,000 + 500,000 + 147,190 = 1,147,190		

Problem 2 - Entries for issuing bonds and amortizing the premium by the straight-line method

a)	Cash	10,811,090	
	Premium on bonds payable		811,090
	Bonds payable		10,000,000
b)	Interest expense	500,000	
	Cash		500,000
c)	Premium on bonds payable	81,109	
	Interest expense		81,109
	<i>(811,090/10 periods = 81,109)</i>		
d)	Interest expense	500,000	
	Cash		500,000
e)	Premium on bonds payable	81,109	
	Interest expense		81,109
f)	Bond Interest Expense: 500,000 + 500,000 – 81,109 - 81,109 = 837,782		

Problem 3 - Entry for calling bonds; loss

Bonds Payable	10,000,000	
Loss on Redemption		100,000
Cash		10,100,000

Problem 4 - Journalizing Stock Transactions

a) Cash	400,000	
Common stock		200,000
PIC in excess of par		200,000
b) Treasury stock	32,000	
Cash		32,000
c) Cash	6,000	
PIC-treasury stock	2,000	
Treasury stock		8,000
d) Cash	31,500	
PIC-treasury stock		7,500
Treasury stock		24,000
e) Cash dividends	20,000	
Cash dividends payable		20,000
f) Stock dividends	30,000	
Stock dividends distributable		10,000
PIC in excess of par-common		20,000
g) Cash dividends payable	20,000	
Cash		20,000
h) Stock dividends distributable	10,000	
Common stock		10,000
i) No entries are required for a stock split. Shares increase to 40,000 and par decreases to \$5 per share.		

Problem 5 - Dividends per share

Preferred Stock Dividend: \$8 per share X 10,000 shares =\$80,000

Total dividends paid \$167,500 - \$80,000 to preferred shareholders
= \$87,500 for common shareholders

Common Stock Dividend: \$87,500 / 50,000 shares = \$1.75 per share

Problem 6 - Entries for issuing par stock

a) June 1:			
Cash		240,000	
Common stock			200,000
PIC in excess of par-common			40,000
July 1:			
Cash		70,000	
Preferred stock			50,000
PIC in excess of par-preferred			20,000
b) Total amount invested by all stockholders as of July 1:			
\$310,000 = \$240,000 + \$70,000			

Problem 7 - Treasury Stock transactions

a) June 1:			
Treasury stock		64,000	
Cash			64,000
July 15:			
Cash		20,500	
Treasury stock			16,000
PIC-treasury stock			4,500
Nov 12:			
Cash		45,000	
Treasury stock			48,000
PIC-treasury stock		3,000	
b) Credit balance of \$1,500			

Problem 8 - Entries for stock dividend

- a)
- | | | |
|---|--------|--------|
| Stock dividends | 20,000 | |
| Stock dividends distributable | | 12,500 |
| Paid-in capital in excess of par-common stock | | 7,500 |
| | | |
| Stock dividends distributable | 12,500 | |
| Common stock | | 12,500 |
- b) Total Stockholders' Equity after the stock dividend is \$450,000 (the same as it was before the stock split)

Problem 9 - Entries for cash dividend

- Nov 15:
- | | | |
|-------------------|--------|--------|
| Cash dividends | 50,000 | |
| Dividends payable | | 50,000 |
- Nov 30:
No entry required
- Dec 15:
- | | | |
|-------------------|--------|--------|
| Dividends payable | 50,000 | |
| Cash | | 50,000 |

Problem 10 - Effect of stock split

- a) 30,000 shares
b) \$30 per share

Problem 11 - Stockholders' Equity section of balance sheet

Paid-in capital:		
Preferred \$5 stock, \$100 par (20,000 shares authorized, 5,000 shares issued)	\$500,000	
Excess of issue price over par	<u>50,000</u>	\$ 550,000
Common stock, \$10 par (250,000 shares authorized, 75,000 shares issued)	750,000	
Excess of issue price over par	<u>150,000</u>	900,000
From sales of treasury stock		<u>14,000</u>
Total paid-in capital		\$1,464,000
Retained earnings		<u>617,000</u>
Total		\$2,081,000
Deduct treasury common stock (2,000 shares at cost)	<u>18,000</u>	
Total stockholder' equity		\$2,063,000

Problem 12 - Identify the type of cash flow activity

- a. payment of cash dividends - **financing**
- b. sale of land - **investing**
- c. issuance of bonds - **financing**
- d. redemption of bonds - **financing**
- e. purchase of bonds as an investment - **investing**
- f. sale of treasury stock - **financing**
- g. issuance of preferred stock - **financing**
- h. purchase of equipment – **investing**

Problem 13 - State the effect on cash flow

- a. Issued 10,000 shares of \$10 par common stock for \$15 per share, receiving cash.
Increase in cash of \$150,000
- b. Sold investment which cost \$72,000 for \$62,000.
Increase in cash of \$62,000
- c. Issued \$ 1,000,000 of 10 year 8 % bonds at 98.
Increase in cash of \$980,000
- d. Purchased 2,000 shares of \$ 10 par common stock as treasury stock at \$25 per share.
Decrease in cash of \$50,000
- e. Redeemed bonds with a face value of \$250,000 and a carrying value of \$248,000 for \$252,500.
Decrease in cash of \$252,500
- f. Sold land which cost \$75,000 for \$ 90,000
Increase in cash of \$90,000
- g. Sold 1,000 shares of treasury stock which cost \$25 per share for \$30 per share.
Increase in cash of \$30,000

Problem 14 - State the effect on cash flow

- a. No effect on cash flow
- b. Increase in cash of \$500

Problem 15 - Cash dividends paid

Cash dividends declared	\$85,000
Plus dividends payable at beginning of year	15,000
Less Dividends payable at end of year	<u>(25,000)</u>
Cash dividends paid during year	\$75,000

Problem 16 - State the effect on cash flow from operating activities

	<u>End of</u> <u>Year</u>	<u>Beginning</u> <u>of Year</u>	<u>(Decrease)</u>	<u>Deduct</u>
a) Accounts receivable	74,000	84,100	Decrease	Add
b) Prepaid expenses	5,100	6,600	Decrease	Add
c) Accounts payable	39,400	33,200	Increase	Add
d) Salaries payable	5,000	7,000	Decrease	Deduct

Problem 17 - State the effect on cash flow from operating activities

	<u>End of</u>	<u>Beginning</u>		
	<u>Year</u>	<u>of Year</u>	<u>(Decrease)</u>	<u>Deduct</u>
a) Cash	61,500	56,250	5,250	
b) Accounts receivable	81,250	74,100	7,150	Deduct
c) Inventories	103,000	81,000	22,000	Deduct
d) Prepaid expenses	6,100	7,600	(1,500)	Add
e) Accounts payable	49,400	51,200	(1,800)	Deduct
f) Salaries payable	6,500	5,200	1,300	Add

Cash flows from operating activities section of the Statement of Cash Flows:

Net income per income statement		\$92,150
Add:		
Depreciation	26,500	
Decrease in Prepaid expenses	1,500	
Increase in Salaries payable	<u>1,300</u>	<u>29,300</u>
		121,450
Deduct:		
Increase in Accounts receivable	7,150	
Increase in Inventories	22,000	
Decrease in Accounts payable	<u>1,800</u>	<u>30,950</u>
Net cash flow from operating activities		<u>\$90,500</u>

Solutions to True / False Questions

1. True
2. True
3. False – Interest expense will be less than cash interest payments as the amortization of the premium is a credit to interest expense.
4. False – Discount on bonds payable is a contra-liability account and is debited when bonds are sold at a discount.
5. True
6. False – Convertible bonds can be exchanged for stock; callable bonds can be retired before the maturity date.
7. False – If the bond interest rate exceeds the market interest rate, the bonds sell at a premium.
8. True
9. False – Stockholders are owners, not agents of the corporations.
10. False – Dividends are declared and voted on by the board of directors.
11. True
12. True
13. False – The general ledger contains only one common stock account.
14. False – Treasury stock may be sold at management's discretion.
15. True
16. True
17. True
18. False – Changes in the balance of accounts payable affect the net cash flows from operating activities.
19. True
20. True
21. False – Under the indirect method, the starting point for analyzing cash flows from operating activities is net income.
22. False – Net losses are reported in the cash flows from operating activities section.
23. False – Interest expense is part of the operating activities section since it appears on the income statement as an expense.
24. False – The FASB prefers the direct method.
25. True
26. True
27. False – Stock splits do not affect total stockholders' equity.
28. False – Only cash dividends decrease total stockholders' equity.
29. False – Treasury stock is shown as a contra-equity account in the equity section of the balance sheet.
30. True

Solutions to Multiple Questions

1. D
2. A
3. B
4. B
5. B
6. B
7. B
8. B
9. D
10. B
11. A
12. D
13. B
14. B
15. A
16. B
17. D
18. B
19. A
20. A
21. B
22. B
23. C
24. B
25. C
26. A
27. D
28. C
29. D