

Name: Answer KEY Vu. A

ACCT 2101 – Prof. J. M. Turner
Exam #4 Fall 2012

INSTRUCTIONS – Please read before you take the exam. Failure to follow instructions will result in the loss of points.

1. This is a closed book and closed notes exam. You must do your own work without assistance from anyone. Giving or receiving assistance from anyone during the exam will result in a grade of zero and reporting to the Office of Student Integrity. To attest to your compliance with this instruction and the Georgia Tech honor system, please sign the honor pledge below before turning in your exam.
2. DO NOT TAKE EXAM APART FOR ANY REASON.
3. To treat all students equally, I do not answer questions during an exam. Answer each question based on the information given. If you think there is a typing error, please let me know.
4. You may use only a calculator supplied by me. You may not use your cell phone or personal computer during the exam. All cell phones must be turned off and placed on the top of your desk in plain view at all times during the exam. Use of your cell phone during the exam is considered cheating and a violation of the Honor System.
5. Each multiple-choice question has only one best answer. If you choose more than one answer, it will be considered an incorrect answer. **Enter your answer to the multiple choice questions on the Scantron sheet provided.** What you enter on the Scantron sheet is your answer for grading purposes. Please totally erase changes on the Scantron or get a clean Scantron form and re-enter your answers. **Insert your Scantron form inside of this exam when you turn it in.**
6. There are 9 pages in this exam. Points available are as follows:

Multiple choice – 12 @ 2.5 points each	30
Terminology matching – 10 @ 2 points each	20
Problems (3)	<u>54</u>
Total available points	<u>104</u>

Grades will be expressed as a percentage of total available points.

Honor Pledge:

On my honor, I pledge that I have neither given nor received any unauthorized help on this exam.

(Signed)

If you do not want your graded exam returned to the grading bins for this class, please sign below. If you do not sign below, your exam will be placed in the bins for this class if you signed a FERPA waiver.

Do not return my graded exam to the bin: _____

Multiple choice (2.5 points each) – Enter your answer on the Scantron form.

- C 1. Company X borrowed \$100,000 from the bank to be repaid with interest at the market rate over the next five years, with payments beginning next month. Which of the following best describes the presentation of this debt in the balance sheet as of today (the date of borrowing)?
- A. \$100,000 in the Long-Term Liability section
 - B. \$100,000 plus the interest to be paid over the five-year period in the Long-Term Liability section
 - C. A portion of the \$100,000 in the Current Liability section and the remainder of the principal in the Long-Term Liability section.
 - D. A portion of the \$100,000 plus interest in the Current Liability section and the remainder of the principal plus interest in the Long-Term Liability section.

Interest does not accrue until time passes.

- C 2. A company is facing a class-action lawsuit in the upcoming year. It is reasonably possible, but not probable, that the company will have to pay a settlement of approximately \$2,000,000. How would this fact be reported in the financial statements to be issued at the end of the current month?
- A. \$2,000,000 in the Current Liability section
 - B. \$2,000,000 in the Long-Term Liability section
 - C. In a descriptive narrative in the footnote section.
 - D. None because disclosure is not required.

Reasonably possible contingent liabilities must be disclosed, but not booked

- B 3. Jacobs Company borrowed 100,000 at 8 percent interest for three months. How much interest does the company owe at the end of three months?
- A. \$8,000
 - B. \$2,000
 - C. \$800
 - D. \$200

$$100,000 \times 8\% \times 3/12 = 2,000$$

- A 4. Amigo Company and Porter Company both bought a new delivery truck on January 1, 2008. Both companies paid exactly the same cost, \$30,000, for their respective vehicles. As of December 31, 2011, the net book value of Amigo's truck was less than Porter Company's net book value for the same vehicle. Which of the following is an acceptable explanation for the difference in net book value?

- A. Amigo Company estimated a lower residual value, but both estimated the same useful life and both elected straight-line depreciation. *possible*
- B. Both companies elected straight-line depreciation, but Amigo Company used a longer estimated life. *less depr*
- C. Because GAAP specifies rigid guidelines regarding the calculation of depreciation, this situation is not possible. *untrue*
- D. Amigo Company is using the straight-line method of depreciation, and Porter Company is using the double-declining-balance method of depreciation. *less depr.*

*Amigo NBV < Porter NBV
Thus Amigo has higher depr. xp*

- B 5. Ryan, Inc., uses straight-line depreciation for all of its depreciable assets. Ryan sold a used piece of machinery on December 31, 2012, that it purchased on January 1, 2011, for \$10,000. The asset had a five-year life, zero residual value, and \$2,000 accumulated depreciation as of December 31, 2011. If the sales price of the used machine was \$6,500, the resulting gain or loss upon the sale was which of the following amounts?

- A. Loss of \$500
- B Gain of \$500
- C. Loss of \$1,500
- D. Gain of \$1,500
- E. No gain or loss upon the sale.

held 2 years - Accum depr = 2000 x 2 = 4000

SP	\$ 6,500
less:	
Cost	10,000
Accum dep	<u>4,000</u>
	<u>6,000</u>
Gain	<u>500</u>

- D 6. A company wishes to report the highest earnings possible for financial reporting purposes. Therefore, when calculating depreciation, *which minimizes depr?*

- A. It will select the double-declining-balance-method of depreciation. *?*
- B. It will select the shortest lives possible for its assets. *?*
- C. It will select the lowest residual values for its assets. *?*
- D It will estimate higher residual values for its assets. *✓ - this reduces total depr. over asset life*

- B 7. Sandy Co. filed suit against Zenith, Inc., seeking damages for patent infringement. Zenith's legal counsel believes it is probable that Zenith will settle the lawsuit for an estimated amount in the range of \$100,000 to \$250,000, and that \$150,000 is the amount that most likely will be accepted by Sandy Co. How should Western report the suit filed by Sandy Co.?

- A. As a liability for \$100,000 with disclosure of the range.
- B As a liability for \$150,000 with disclosure of the range.
- C. As a liability for \$250,000 with disclosure of the range.
- D. As a disclosure only. No liability is reported since the loss is contingent.

- D 8. Which of the following factors causes a lease to be treated as a capital lease rather than an operating lease?

- A. The lease term is 50% or more of the asset's expected economic life.
- B. The lease is for real property.
- C. The lease permits the lessee to purchase the asset at its fair market value at any time during the lease term.
- D The present value of the lease payments is 90% or more of the fair market value of the asset when the lease is signed.
- E. Any of these factors will result in capital lease accounting.

- B 9. On March 1, Wright Company purchased new equipment with a total cost of \$50,000. The seller agreed to finance the equipment at 10% for three months. Wright paid cash of \$10,000 upon delivery and must pay the balance (\$40,000) in three months. Other costs associated with the equipment were: transportation costs, \$1,000; sales tax paid \$3,000; and installation cost, \$2,500. Wright paid the balance due plus interest of \$1,000 three months later. At what amount will the equipment be recorded at on a balance sheet?
- A. \$57,500
 B. \$56,500
 C. \$54,000
 D. \$51,000
 E. \$50,000

$$50,000 + 1,000 + 3,000 + 2,500 = 56,500$$

- A 10. Which of the following is correct for Smith Company when Smith issues 10,000 shares of \$10 par value common stock and pays \$20,000 cash in exchange for a building? The market price of the Smith stock on the exchange date was \$35 per share. The building's book value on the books of the seller was \$200,000.

- A. Total assets increase \$350,000.
 B. Stockholders' equity increases \$200,000.
 C. Stockholders' equity increases \$330,000.
 D. Total assets increase \$370,000.

DK Asset 370,000
 CR Cash 20,000
 CR Stock 350,000

$$\text{Asset} - \text{cash} = 350,000 \Delta \text{ in total assets.}$$

- C 11. Which of the following describes the effect of recording depreciation expense at year-end?
- A. Net income decreases and total assets aren't affected.
 B. Total assets decrease and stockholders' equity is not affected.
 C. Net income decreases and total assets decrease.
 D. Stockholders' equity is not affected and net income decreases.

- C 12. Lemon Delivery purchased a fleet of trucks on Feb. 1, 2011 requiring the following payment schedule:

\$90,000 on Feb. 1, 2011	X 1	90,000	} 174,294
\$20,000 on Feb. 1, 2012	X ,9091	18,182	
\$80,000 on Feb. 1, 2013	X ,8264	66,112	

The seller normally charges an interest rate of 10 percent. What is the present value of the payments needed to record the purchase of the trucks?

- A. \$158,451
 B. \$157,016
C. \$174,294
 D. \$175,684

Present value interest factor of \$1 at i% for n periods, PVIF(i,n).

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091
2	0.9803	0.9612	0.9426	0.9246	0.9070	0.8900	0.8734	0.8573	0.8417	0.8264
3	0.9706	0.9423	0.9151	0.8890	0.8638	0.8396	0.8163	0.7938	0.7722	0.7513
4	0.9610	0.9238	0.8885	0.8548	0.8227	0.7921	0.7629	0.7350	0.7084	0.6830
5	0.9515	0.9057	0.8626	0.8219	0.7835	0.7473	0.7130	0.6806	0.6499	0.6209
6	0.9420	0.8880	0.8375	0.7903	0.7462	0.7050	0.6663	0.6302	0.5963	0.5645
7	0.9327	0.8706	0.8131	0.7599	0.7107	0.6651	0.6227	0.5835	0.5470	0.5132
8	0.9235	0.8535	0.7894	0.7307	0.6768	0.6274	0.5820	0.5403	0.5019	0.4665
9	0.9143	0.8368	0.7664	0.7026	0.6446	0.5919	0.5439	0.5002	0.4604	0.4241
10	0.9053	0.8203	0.7441	0.6756	0.6139	0.5584	0.5083	0.4632	0.4224	0.3855

Present value of an (ordinary) annuity of \$1 per period at i% for n periods, PVIFA(i,n).

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355
3	2.9410	2.8839	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.5313	2.4869
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	5.9952	5.7590
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.4177	6.1446

Matching (2 points each) – Match the term with the definition or phrase that best describes it.
Each term may be used only once.

A	Accrued liabilities
B	Acquisition cost
C	Amortization
D	Annuity
E	Capital lease
F	Contingent liability
G	Current liabilities
H	Depreciation
I	Future value
J	Intangible assets

K	Liabilities
L	Liquidity
M	Net book value
N	Operating lease
O	Present value
P	Residual value
Q	Solvency
R	Tangible assets
S	Time value of money

- E 1 A lease that is in substance a purchase and results in the recording of an asset and liability
- D 2 A series of equal, periodic payments or cash receipts
- J 3 Assets that have special rights, but not physical substance.
- A 4 Expenses that have been incurred but have not been paid at the end of the accounting period
- K 5 Probable debts or obligations that result from past transactions, which will be paid with assets or services
- L 6 The ability to pay current obligations
- P 7 The amount to be recovered by the company at the end of an asset's estimated useful life
- O 8 The current value of an amount to be received in the future
- B 9 The net cash equivalent amount paid or to be paid for an asset
- C 10 The systematic and rational allocation of the acquisition cost of an intangible asset over its useful life

Problem 1 (16 points) – You must show your work to receive full credit.

Covey Company purchased a machine and placed it into service on January 1, 2010, by paying cash of \$250,000. The machine has an estimated useful life of five years, is expected to produce 500,000 units, and has an estimated residual value of \$25,000.

Required: Enter your answers in the table below.

- Calculate annual depreciation expense (to the nearest dollar) for the first three years of the machine's useful life under (1) straight-line depreciation; and (2) the 200% declining balance method.
- What is the book value of the machine after three years using the 200% declining- balance method?
- What is the book value of the machinery after three years using the straight-line method of depreciation?
- If the machine was used to produce and sell 120,000 units in 2010, what would the depreciation expense be in 2010 using the units of production method?

	5	8	3
	Straight-line	Double declining balance	Units of production
Depreciation expense:			
2010	1 45,000	3 100,000	3 54,000
2011	1 45,000	2 60,000	N/A
2012	1 45,000	1 36,000	N/A
Net book value:			
12-31-2012	2 115,000	2 54,000	N/A

Cost	250,000	250,000	250,000
- Residual value	<u>25,000</u>	<u>N/A</u>	<u>- 25,000</u>
Depn. cost	225,000	250,000	\$ 225,000
Annual rate	$\frac{1}{5}$ <u>20%</u>	<u>X 40%</u>	<u>÷ 500,000</u>
Annual S/L	<u>45,000</u>	<u>100,000</u>	<u>\$.45 / unit</u>
		250,000	<u>X 120,000</u>
		<u>- 100,000</u>	<u>54,000</u>
	NBV	150,000	
		<u>X 40%</u>	
	YR 2 dep	<u>60,000</u>	
		150,000	
		<u>- 60,000</u>	
		90,000	
		<u>X 40%</u>	
		<u>36,000</u>	

Problem 2 (18 points) – You must show your work to receive full credit.

On January 1, 2012, El Hombre, Inc. purchased a new asset from a supplier who was willing to provide financing. The asset cost \$180,000. El Hombre negotiated the following payment schedule.

January 1, 2012	\$36,000
January 1, 2013	72,000
January 1, 2014	72,000

The asset has a five-year useful life and no (zero) residual value. El Hombre's average cost of capital is 5%, which should be used to discount the total purchase obligation. Present value tables are on page 5 of this exam.

$$PV \text{ Annuity } 2 \text{ yrs. } 5\% = 1.8594 \times 72,000 = \underline{\underline{133,876.80}}$$

Required:

1. Prepare in journal form the entry needed to record the acquisition of the asset on January 1, 2012.

9

Asset	169,877	
Cash		36,000
Note payable		133,877

9

2. Prepare in journal form the entry needed to record the payment of \$72,000 on January 1, 2013.

Note Payable	65,306	
Int expense	6,694	
Cash		72,000

$$\begin{array}{rcl} \text{Beg CV} & = & 133,877 \\ \text{Int rate} & = & \underline{5\%} \\ & & \underline{\underline{6,693.85}} \end{array}$$

$$\begin{array}{rcl} 72,000 & \text{pmt} & \\ - 6,694 & \text{int} & \\ \hline 65,306 & \text{prin.} & \end{array}$$

Problem 3 (2 points each)

For each of the following items, enter the correct letter, either C, R, or N, to the left to show the type of expenditure. "Capital expenditures" are recorded as assets. "Revenue expenditures" are recorded as expenses.

- | | | | |
|---|---------------------|----------|--|
| C | Capital expenditure | <u>C</u> | 1. Purchased a patent, \$4,300 |
| R | Revenue expenditure | <u>R</u> | 2. Paid \$10,000 for monthly salaries to employees |
| N | Neither | <u>N</u> | 3. Paid cash dividends, \$20,000 |
| | | <u>C</u> | 4. Purchased a machine, \$7,000 |
| | | <u>C</u> | 5. Paid three-year insurance premium, \$900 |
| | | <u>R</u> | 6. Paid for routine maintenance, \$200 |
| | | <u>R</u> | 7. Paid \$400 for ordinary repairs |
| | | <u>C</u> | 8. Paid \$6,000 for extraordinary repairs |
| | | <u>C</u> | 9. Paid \$20,000 cash for addition to old building |
| | | <u>C</u> | 10. Paid \$5,700 for installation and testing of newly purchased machinery |

N or

Bonus Question – 2 Points

What was the name of the hurricane that hit the New Jersey shore last week causing multiple fatalities and billions of dollars in damage?

SANDY