

ACCTB 215 Fall 09

19

Sec. EB

Quiz 5 Kyle's Kickoff

Kyle has decided to open a store in Seattle selling all things football. Naturally, the only Cougar fans allowed in the store bleed blue (for those of you who missed it, that means they cheer for BYU). Anyone wearing red is promptly asked to leave the store. He has asked you to help him answer the following questions.

market 5%
coupon 7%

1. Kyle wants to issue 10-year bonds to raise cash. Kyle's bonds will pay interest annually. He talked to a bond trader who said something about two different interest rates: a coupon rate and a market rate. The two rates are 5% and 7% but Kyle doesn't remember which rate is which. The bonds have a total face value of \$1,000,000. Kyle also remembers the bond trader telling him that his bonds would sell at a premium to face value based on the two interest rates above. **Make the journal entry to record Kyle's bond issuance.** (You can assume that the bond trader is right about the rates and the fact that Kyle's bonds will sell at a premium). (3 points)

$$\begin{aligned} 1,000,000 \times 0.61391 &= 613,910 \\ 70,000 \times 7.72173 &= 540,521.1 \\ \hline &1,154,431.1 \end{aligned}$$

Cash	1,154,431
Premium on B/P	154,431
B/P	1,000,000

2. Ignore question 1. Kyle sells 5-year, 8% coupon, \$1,000,000 face value bonds that make semi-annual interest payments. The yield on these bonds is 6%. Total proceeds from this bond issue were \$1,085,302. **Make the journal entries (separately) to record the first two interest payments made by Kyle** (assume that Kyle recognizes interest expense when he actually pays it) assuming Kyle uses the effective interest amortization method. (Round journal entries to the nearest dollar. 3 points).

Interest Expense	32,559
Premium on B/P	7,441
Cash	40,000

Interest Expense	32,336
Premium on B/P	7,664
Cash	40,000

3. Ignore question 1. Continue to assume that Kyle sold 5-year, 8% coupon, \$1,000,000 face value bonds making semi-annual interest payments. The proceeds from this bond issue were \$1,085,302. Kyle uses the effective interest amortization method. After 1 year, Kyle retires the bonds for 104 percent of face value. **Make the journal entry to record the retirement of Kyle's bond.** (Round to the nearest dollar - 4 points)

B/P	1,000,000
Premium on B/P	77,861
Gain on Retirement	37,186
Cash	1,040,000

4. E 8-8 During January, Luxury Cruise Lines pays employee salaries of \$2 million. Withholdings in January are 153,000 for the employee portion of FICA, 300,000 for federal income tax, 125,000 for state income tax, and 20,000 for the employee portion of health insurance. The company incurs an additional \$124,000 for federal and state unemployment tax and \$60,000 for the employer portion of health insurance.

Record the employee salary expense, withholdings, and salaries payable. (4 points)

Salary Expense	2,000,000	
withholdings {	employee FICA payable	153,000
	Fed income tax	300,000
	State income tax	125,000
	Health	20,000
	Salaries Payable	1,402,000

5. ☒ True or false. A low current ratio could indicate that a company will have trouble paying off its current liabilities. (2 points)

$$\frac{\text{Current assets}}{\text{Current liabilities}}$$

6. Deferred tax liabilities are recorded when (2 points):

a) A company has higher taxable income than accounting income in the current year and will receive a future tax benefit from the amount of taxes it must pay in the current year.

b) A company owes taxes to the IRS based on its taxable income in the current year but does not pay those taxes until the following year.

☒ c) A company has higher accounting income than taxable income in the current year and will have to pay additional taxes in some future year that is related to income recorded in the current year's financial reports.

7. Kyle signs a lease for some equipment that he will use in his store. He determines that the lease should be treated as an operating lease. What effect will this have on Kyle's total debt to equity ratio? (2 points)

a) The debt-to-equity ratio will increase

☒ b) The debt-to-equity ratio will stay the same

c) The debt-to-equity ratio will decrease

d) It is not possible to answer the question with the information given

8) (Extra Credit – 1 point). Did you attend the Apple Cup (Be honest. If you don't know what I'm asking, the answer is no)?

yes

+

9) (Extra Credit – 1 point). True or false. Coach Sarkisian's only loss as a quarterback his senior year of college was against UW. (Only answer this question if you answered no to question 8).