Multiple choice (4 points each) CIRCLE the letter of the best answer to each question

Use the following information for the next TWO questions

On January 1, 2004, Nen Co. has the following balances:

<table>
<thead>
<tr>
<th>Balance</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Projected benefit obligation</td>
<td>$2,800,000</td>
</tr>
<tr>
<td>Fair value of plan assets</td>
<td>$2,500,000</td>
</tr>
</tbody>
</table>

The settlement rate is 10%. Other data related to the pension plan for 2004 are:

- Service cost: $160,000
- Amortization of unrecognized prior service costs: $36,000
- Contributions: $180,000
- Benefits paid: $150,000
- Actual return on plan assets: $176,000
- Amortization of unrecognized net gain: $12,000
- Liability gains/losses arising during 2004: 0

1. The balance of the projected benefit obligation at December 31, 2004 is
   a. $3,048,000.
   b. $3,060,000.
   c. $3,086,000.
   d. $3,090,000.

2. The fair value of plan assets at December 31, 2004 is
   a. $2,354,000.
   b. $2,526,000.
   c. $2,706,000.
   d. $2,856,000.

3. On October 1, 2004, Porter Co. purchased to hold to maturity, 1,200, $1,000, 9% bonds for $1,188,000 which includes $18,000 accrued interest. The bonds, which mature on February 1, 2013, pay interest semiannually on February 1 and August 1. Porter uses the straight-line method of amortization. The market value of the bonds on December 31, 2004 is $1,188,000. The bonds should be reported in the December 31, 2004 balance sheet at a carrying value of
   a. $1,170,000.
   b. $1,170,900.
   c. $1,188,000.
   d. $1,188,360.

4. Which of the following is not correct in regard to trading securities?
   a. They are held with the intention of selling them in a short period of time
   b. Unrealized holding gains and losses are reported as part of net income
   c. Any discount or premium is not amortized.
   d. All of these are correct.
5. Presented below is information related to Marley Inc. pension data for 2004:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service cost</td>
<td>$1,200,000</td>
</tr>
<tr>
<td>Actual return on plan assets</td>
<td>280,000</td>
</tr>
<tr>
<td>Interest on projected benefit obligation</td>
<td>520,000</td>
</tr>
<tr>
<td>Amortization of unrecognized net loss</td>
<td>120,000</td>
</tr>
<tr>
<td>Amortization of unrecognized prior service cost</td>
<td>220,000</td>
</tr>
<tr>
<td>Expected return on plan assets</td>
<td>240,000</td>
</tr>
</tbody>
</table>

What amount should be reported for pension expense in 2004?

a. $1,820,000.
b. $1,780,000.
c. $2,020,000.
d. $1,540,000.

6. Use the following information for the next TWO questions:

Stone Co. owns 3,000 of the 10,000 outstanding shares of Maye Corp. common stock. During 2004, Maye earns $180,000 and pays cash dividends of $50,000. The market price of Maye at the end of 2004 was $94 per share.

If the beginning balance in the investment account was $270,000, the balance at December 31, 2004 should be

a. $270,000.
b. $309,000.
c. $282,000.
d. $400,000.

7. Stone should report investment revenue for 2004 of

a. $15,000.
b. $39,000.
c. $45,000.
d. $54,000.

8. Mory Company has a deferred tax asset resulting from a loss carryforward of $300,000 with a valuation allowance of $120,000 at the beginning of 2004. During 2004, taxable income and book income before tax are $800,000 and the tax rate is 30% for all periods. At the end of 2004, the deferred tax asset is $60,000 and it is determined that no valuation allowance is necessary. What is net income for 2004?

a. $560,000.
b. $800,000.
c. $680,000.
d. $440,000.

9. An unguaranteed residual

a. Is ignored when determining the lease obligation by the lessee.
b. Is deducted from sales and cost of goods sold at its present value by the lessor when there is a sales type lease.
c. Is included in the lease payments receivable at its present value on a direct financing lease by the lessor.
d. All of the above.
10. A minimum liability for pension expense is necessary when
   a. the projected benefit obligation exceeds the fair value of pension plan assets.
   b. the accumulated benefit obligation exceeds the fair value of pension plan assets.
   c. the pension expense reported for the period is greater than the funding amount for the same period.
   d. vested benefits exceed the fair value of pension plan assets.

11. Trey, Inc. reports a taxable and financial loss of $390,000 for 2004. Its pretax financial income for the last two years was as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$100,000</td>
</tr>
<tr>
<td>2003</td>
<td>240,000</td>
</tr>
</tbody>
</table>

   It is estimated that only 60% of any carryforward will be more likely than not to be realized. The amount that Trey, Inc. reports as a net loss for financial reporting purposes in 2004, assuming that it uses the carryback provisions, and that the tax rate is 30% for all periods affected, is
   a. $390,000 loss.
   b. $279,000 loss
   c. $288,000 loss.
   d. $273,000 loss.

12. Alpo Company has a defined benefit pension plan that has accumulated unrecognized net gains of $400,000 on January 1, 2004. The PBO on that date is $5,600,000, the market related value of plan assets is $5,000,000. During 2004, gains arise of $340,000. On January 1, 2005, the PBO is $6,000,000 and the market related value of plan assets is $6,500,000. The average remaining service life of active employees is 10 years. How much corridor amortization would be necessary in 2004 and 2005 respectively?
   a. $0; $0
   b. $40,000; $30,000
   c. $0; $9,000
   d. $16,000; $8,400

13. Barkley Corporation received the following report from its actuary at the end of the year:

<table>
<thead>
<tr>
<th>December 31, 2004</th>
<th>December 31, 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Projected benefit obligation</td>
<td>$4,800,000</td>
</tr>
<tr>
<td>Market-related and fair value of asset value</td>
<td>4,200,000</td>
</tr>
<tr>
<td>Accumulated benefit obligation</td>
<td>3,900,000</td>
</tr>
<tr>
<td>Prepaid pension cost</td>
<td>240,000</td>
</tr>
</tbody>
</table>

   The journal entry to record additional pension liability would include:
   a. a credit to additional liability for $120,000
   b. a credit to additional liability for $480,000
   c. a credit to additional liability of $180,000
   d. there would be no entry for additional liability.
14. A company has a depreciable asset that has a book value of $700,000 and a fair value of $800,000, with a 10 year remaining life and no residual. The company sells the asset to a leasing company for $800,000 and immediately leases it back for 10 years. The present value of the lease payments is $800,000. What is the net amount of annual depreciation expense that the company should record related to the leased asset?

a. $80,000
b. $70,000
c. $75,000
d. $90,000

15. Tax rates other than the current tax rate are used to calculate the deferred income tax amount on the balance sheet if

a. it is probable that a future tax rate change will occur.
b. it appears likely that a future tax rate will be greater than the current tax rate.
c. the future tax rates have been enacted into law.
d. it appears likely that a future tax rate will be less than the current tax rate.

Use the following information for the next TWO questions:

Rock Company has a portfolio of available for sale securities that cost $440,000 originally. At the end of 2004, the securities had a market value of $415,000, and at the end of 2005 the securities had a market value of $473,000. There was no change in the securities in the portfolio, and dividends of $15,000 were received in 2005.

16. What is the impact of these transactions on net income for 2005?

a. Net income would be unaffected.
b. Net income would be increased by $15,000.
c. Net income would be increased by $38,000.
d. Net income would be increased by $73,000.

17. Which of the following would be included in the adjusting entry recorded on December 31, 2005?

a. a debit to Unrealized gains/losses - equity for $33,000.
b. a credit to Unrealized gains/losses - equity for $58,000.
c. a credit to Unrealized gains/losses - income for $33,000.
d. a credit to unrealized gains/losses - equity for $33,000.
Problems – show your work to receive partial credit

1. (12 points) Earl Co. at the end of 2004, its first year of operations, prepared reconciliation between pretax financial income and taxable income as follows:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Pretax financial income</td>
<td>$500,000</td>
</tr>
<tr>
<td>Estimated warranty expenses deductible for taxes when paid</td>
<td>800,000</td>
</tr>
<tr>
<td>Extra depreciation</td>
<td>(900,000)</td>
</tr>
<tr>
<td>Taxable income</td>
<td>$400,000</td>
</tr>
</tbody>
</table>

Estimated warranty expense of $530,000 will be deductible in 2005, $200,000 in 2006, and $70,000 in 2007. The use of the depreciable assets will result in taxable amounts of $300,000 in each of the next three years.

Instructions
(a) Prepare a table of future taxable and deductible amounts.
(b) Assume that the currently enacted tax rates for all periods is 35%. Prepare the journal entry to record income tax expense, deferred income taxes, and income taxes payable for 2004.
(c) Assume the currently enacted tax rates for 2004 and 2005 are 40%, and for 2006 and 2007 are 35%. Prepare the journal entry to record income tax expense, deferred income taxes, and income taxes payable for 2004.

```
(a) Warranty Exp   Dep Exp
                 0.4   0.5   0.6   0.7
  800,000      (530,000) (200,000) (70,000)
(900,000)      300,000  300,000  300,000

(b) Tax Expense   175,000
     Def. Tax Asset  280,000

   Tax Payable   140,000
     Def. Tax Payable  315,000

   ** 0.4 x 530,000 + .35(200,000 + 70,000)

   * 0.4 x 300,000 + .35(300,000 + 300,000)

(c) Tax Expense   183,500 **
     Def. Tax Asset  306,500 **
      Def. Tax Liab. 330,000 *
     Tax Payable   160,000
```
2. (20 points) On January 1, 2004, Lessor Company leases property with a cost of $400,000 and a fair value of $500,000 to Lessee company under the following terms:

Lessee will make 3 payments of $160,000 at the beginning of each year, with the first payment on January 1, 2004. At the end of year of the third year (December 31, 2006), Lessee may buy the property for $82,939. The fair value of the property is expected to be $180,000 on December 31, 2006. The economic life of the leased property is 10 years, and its expected residual to the at the end of that time is $6,000. Group II criteria are met for the Lessor Company. Lessor's rate implicit in the lease, which is known to Lessee, is 10%.

(a) Identify what type of lease this is to Lessee and Lessor Company and provide a rational for your answer.

Lessee - Capital lease because of bargain purchase option.

Lessor - Sales Type lease because

(i) APO

(ii) Group II criteria

(iii) FV > Cash to Lessor.

(b) Prepare the entry that Lessee would make on January 1, 2004 to record the lease.

<table>
<thead>
<tr>
<th>Lease Payments Receivable</th>
<th>500,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>COGS</td>
<td>400,000</td>
</tr>
<tr>
<td>Inventories</td>
<td>400,000</td>
</tr>
<tr>
<td>Sales</td>
<td>300,000</td>
</tr>
</tbody>
</table>

(c) Prepare an amortization schedule that can be used by the Lessee and the Lessor. You may not need all the rows or columns shown.

<table>
<thead>
<tr>
<th>Date</th>
<th>Rent</th>
<th>Int</th>
<th>Tot</th>
<th>Prin</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/1/04</td>
<td>160,000</td>
<td>0</td>
<td>160,000</td>
<td>0</td>
<td>350,000</td>
</tr>
<tr>
<td>1/1/05</td>
<td>160,000</td>
<td>3,900</td>
<td>163,900</td>
<td>163,900</td>
<td>214,000</td>
</tr>
<tr>
<td>1/1/06</td>
<td>160,600</td>
<td>21,900</td>
<td>182,500</td>
<td>182,500</td>
<td>154,400</td>
</tr>
<tr>
<td>12/31/06</td>
<td>82,939</td>
<td>7,000</td>
<td>89,939</td>
<td>89,939</td>
<td>75,939</td>
</tr>
</tbody>
</table>

(d) Prepare all the entries necessary for Lessee for all of 2004.

<table>
<thead>
<tr>
<th>Date</th>
<th>Rent</th>
<th>Int</th>
<th>Tot</th>
<th>Prin</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/1/04</td>
<td>160,000</td>
<td>0</td>
<td>160,000</td>
<td>0</td>
<td>350,000</td>
</tr>
<tr>
<td>1/1/05</td>
<td>160,000</td>
<td>3,900</td>
<td>163,900</td>
<td>163,900</td>
<td>214,000</td>
</tr>
<tr>
<td>1/1/06</td>
<td>160,600</td>
<td>21,900</td>
<td>182,500</td>
<td>182,500</td>
<td>154,400</td>
</tr>
<tr>
<td>12/31/06</td>
<td>82,939</td>
<td>7,000</td>
<td>89,939</td>
<td>89,939</td>
<td>75,939</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>Rent</th>
<th>Int</th>
<th>Tot</th>
<th>Prin</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/1/04</td>
<td>160,000</td>
<td>0</td>
<td>160,000</td>
<td>0</td>
<td>350,000</td>
</tr>
<tr>
<td>1/1/05</td>
<td>160,000</td>
<td>3,900</td>
<td>163,900</td>
<td>163,900</td>
<td>214,000</td>
</tr>
<tr>
<td>1/1/06</td>
<td>160,600</td>
<td>21,900</td>
<td>182,500</td>
<td>182,500</td>
<td>154,400</td>
</tr>
<tr>
<td>12/31/06</td>
<td>82,939</td>
<td>7,000</td>
<td>89,939</td>
<td>89,939</td>
<td>75,939</td>
</tr>
</tbody>
</table>