1. Which of the following accounts would not be considered when calculating the quick ratio?
   A. Marketable securities.
   B. Inventory.
   C. Accounts receivable.
   D. Accounts payable.

2. Which of the following describes an accrued liability?
   A. It is an expense that has been both incurred and paid.
   B. It is an expense that has been incurred but not yet paid.
   C. It is an expense that has been prepaid but not yet consumed.
   D. It is a liability where the cash flow has taken place but the revenue has yet to be earned.

3. Miranda Company borrowed $100,000 cash on September 1, 2010, and signed a one-year 6%, interest-bearing note payable. Assuming no adjusting entries have been made during the year, the required adjusting entry at the end of the accounting period, December 31, 2010, would be which of the following?
   A. Interest expense  
      Interest payable  
      2,000  
      2,000
   B. Interest expense  
      Interest payable  
      6,000  
      6,000
   C. Notes payable  
      Interest expense  
      100,000  
      6,000  
      Cash  
      106,000
   D. Interest payable  
      Interest expense  
      2,000  
      2,000

4. Miranda Company borrowed $100,000 cash on September 1, 2010, and signed a one-year 6%, interest-bearing note payable. The interest and principal are both due on August 31, 2011. Assume that the appropriate adjusting entry was made on December 31, 2010 and that no adjusting entries have been made during 2011. The required journal entry to pay the note on August 31, 2011 would be which of the following?
   A. Interest expense  
      Cash  
      6,000  
      6,000
   B. Interest expense  
      Interest payable  
      Notes payable  
      Cash  
      4,000  
      2,000  
      100,000  
      106,000
   C. Notes payable  
      Interest expense  
      Cash  
      100,000  
      6,000  
      106,000
   D. Interest payable  
      Notes payable  
      Cash  
      2,000  
      100,000  
      102,000

5. Landseeker's Restaurants reported cost of goods sold of $322 million and accounts payable of $83 million for 2011. In 2010, cost of goods sold was $258 million and accounts payable was $72 million. What was Landseeker's accounts payable turnover ratio in 2011?
   A. 4.23
   B. 4.15
   C. 4.04
   D. 3.91
6. Failure to make a necessary adjusting entry for accrued interest on a note payable would result in which of the following?
   A. An understatement of both liabilities and stockholders' equity.
   B. Net income to be overstated and assets to be understated.
   C. Net income to be understated and liabilities to be understated.
   D. An overstatement of net income, an understatement of liabilities, and an overstatement of stockholders' equity.

7. Houston Company is involved in a lawsuit. In which of the following situations is only footnote disclosure of the contingent liability reported within the financial statements?
   A. When the loss is remote and the amount cannot be reasonably estimated.
   B. When the loss is probable and the amount can be reasonably estimated.
   C. When the loss is reasonably possible and the amount can be reasonably estimated.
   D. When the loss is remote and the amount can be reasonably estimated.

8. Darwin Corporation's attorney has provided the following summaries of three lawsuits against Darwin:
   - lawsuit A: The loss is probable and the loss can be reasonably estimated.
   - lawsuit B: The loss is reasonably possible and the loss can't be reasonably estimated.
   - lawsuit C: The loss is reasonably possible and the loss can be reasonably estimated.

   Which of the following statements is incorrect?
   A. A disclosure note is required for lawsuit A.
   B. A disclosure note is required for lawsuit C.
   C. A disclosure note is not required for lawsuit B.
   D. Lawsuit A is reported on the balance sheet as a liability.

9. Smith Corporation entered into the following transactions:
   - Purchased inventory on account.
   - Collected an account receivable.
   - Purchased equipment using cash.

   Which of the following statements is correct?
   A. The inventory purchase on account increased working capital.
   B. Collecting an account receivable increases working capital.
   C. The equipment purchase decreases working capital.
   D. The inventory purchase on account increased the quick ratio.

10. Rachel Corporation purchased a building by paying $90,000 cash on the purchase date, agreeing to pay $50,000 every year for the next nine years and $100,000 ten years from the purchase date; the first payment is due one year after the purchase date. Rachel's incremental borrowing rate is 10%. At what amount would the liability be reported at on the balance sheet as of the purchase date, after the initial $90,000 payment was made?
    A. $326,500
    B. $460,000
    C. $287,950
    D. $416,500

11. Which of the following correctly describes the accounting for leases?
    A. A capital lease is not reported on the balance sheet as a liability.
    B. A capital lease reports an asset on the balance sheet.
    C. An operating lease reports an operating asset on the balance sheet.
    D. An operating lease reports a liability on the balance sheet.
12. How much needs to be invested today if your goal is to be able to withdraw $5,000 for each of the next ten years beginning one year from today? The return on the investment is expected to be 12%.
   A. $44,645  
   B. $36,291  
   C. $28,251  
   D. $50,000

13. When a company prepares a bond indenture, certain provisions of the bonds are included. Which of the following is/are not specified in the indenture?
   A. Dates of each interest payment.  
   B. The stated interest rate.  
   C. The maturity date.  
   D. The market rate of interest.

14. Which of the following bonds does not have specific assets pledged to guarantee repayment?
   A. Debenture bond  
   B. Callable bond  
   C. Discount bond  
   D. Convertible bond

15. The annual interest rate specified within a bond indenture is called which of the following?
   A. The stated rate of interest.  
   B. The market rate of interest.  
   C. The effective rate of interest.  
   D. The actual rate of interest.

16. Which of the following statements best describes callable bonds?
   A. They can be turned in for early retirement at the option of the bondholder.  
   B. They can be converted to common stock at the option of the bondholder.  
   C. They can be called for early retirement at the option of the issuer.  
   D. They can be called for early retirement at the option of the lien holder.

17. Which of the following statements best describes convertible bonds?
   A. They can be turned in for early retirement at the option of the bondholder.  
   B. They can be converted to common stock at the option of the bondholder.  
   C. They can be called for early retirement at the option of the issuer.  
   D. They can be converted to common stock at the option of the issuer.

18. Which of the following is not an advantage of issuing bonds versus issuing stock to finance expansion?
   A. Stockholders remain in control as bondholders cannot vote or share in the company's earnings.  
   B. Interest expense is tax deductible but dividends are not.  
   C. Money can usually be borrowed at a lower rate and then invested to earn a higher return on assets.  
   D. The fixed payment dates for the interest and maturity value.

19. Which of the following statements is not correct?
   A. The bond principal is the amount due at the maturity date of the bond.  
   B. The stated interest rate is used to determine the cash interest payments.  
   C. The bond principal is used to determine the cash interest payments.  
   D. The market rate of interest is used to determine the cash interest payments.

20. Which of the following statements is correct?
   A. A secured bond has specific assets pledged as collateral to secure it.  
   B. An unsecured bond can be paid at the option of the issuer.  
   C. A bond trustee is appointed to represent the issuing company.  
   D. The bond indenture specifies the market rate of interest the investors will earn.
21. Assuming no adjusting journal entries have been made, the journal entry to record the cash interest payment on the due date for bonds issued at their par value results in which of the following?
A. An increase in expenses and a decrease in liabilities.
B. An increase in expenses and a decrease in assets.
C. A decrease in both liabilities and stockholders' equity.
D. A decrease in both assets and liabilities.

22. Which of the following statements correctly describes the accounting for bonds that were issued at a discount?
A. The market rate of interest is less than the stated interest rate.
B. The interest expense over the life of the bonds will be less than the cash interest payments.
C. The present value of the bonds' future cash flows is greater than the bonds' maturity value.
D. The book value of the bond liability increases when interest payments are made on the due dates.

23. On November 1, 2009, Davis Company issued $30,000, ten-year, 7% bonds for $29,100. The bonds were dated November 1, 2009, and interest is payable each November 1 and May 1. How much is the amount of straight-line discount amortization on each semi-annual interest date?
A. $90
B. $45
C. $900
D. $450

24. On November 1, 2009, Davis Company issued $30,000, ten-year, 7% bonds for $29,100. The bonds were dated November 1, 2009, and interest is payable each November 1 and May 1. How much is the semi-annual interest expense when the straight-line method is utilized?
A. $2,010
B. $2,190
C. $1,095
D. $2,055

25. On January 1, 2009, Jason Company issued $5 million of 10-year bonds at a 10% stated interest rate to be paid annually. The following present value factors have been provided:

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Interest</th>
<th>PV of $1</th>
<th>PV of a $1 Annuity</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>10%</td>
<td>.386</td>
<td>6.145</td>
</tr>
<tr>
<td>10</td>
<td>8%</td>
<td>.463</td>
<td>6.710</td>
</tr>
<tr>
<td>10</td>
<td>12%</td>
<td>.522</td>
<td>5.650</td>
</tr>
</tbody>
</table>

What was the issuance price of the bonds if the market rate of interest was 8%?
A. $5,000,000
B. $5,670,000
C. $5,387,500
D. $5,712,500

26. On July 1, 2010, Garden Works, Inc. issued $300,000 of ten-year, 7% bonds for $303,000. The bonds were dated July 1, 2010, and semi-annual interest will be paid each December 31 and June 30. Garden Works Inc. uses straight-line amortization. What is the bond liability to be reported on the December 31, 2010 balance sheet?
A. $300,000
B. $302,850
C. $302,700
D. $303,000
27. Mayberry, Inc., issued $100,000 of 10 year, 12% bonds dated April 1, 2009, for $102,360 on April 1, 2009. The bonds pay interest annually on April 1. Straight-line amortization is used by the company. What entry is needed at April 1, 2010 for the first interest payment?

A. Interest expense 11,764
   Premium on bonds payable 236
   Cash 12,000

B. Interest expense 12,236
   Premium on bonds payable 236
   Cash 12,000

C. Interest expense 12,000
   Premium on bonds payable 236
   Cash 12,236

D. Interest expense 12,000
   Cash 12,000

28. Skylar Corporation issued $50,000,000 of its 10% bonds at par on January 1, 2010. On December 31, 2010 the bonds were trading on the bond exchange at 102.5. Since the issue date, what has happened to the market rate of interest?
   A. The market rate increased.
   B. The market rate decreased.
   C. The market rate stayed the same.
   D. The change in the market rate can't be determined.

29. Eaton Company issued $5 million of bonds. The stated rate of interest was 10% and the market rate was 11%. Which of the following statements is correct?
   A. The bonds were issued at a premium.
   B. Annual interest expense will exceed the company's actual cash payments for interest.
   C. Annual interest expense will be $500,000.
   D. The book value of the bond will decrease as the bond matures.

30. RKJ Company has provided the following:
   • 100,000 shares of $5 par value common stock are authorized;
   • 70,000 shares have been issued;
   • 65,000 shares are outstanding.

Which of the following statements is correct?
   A. RKJ has 35,000 shares of treasury stock.
   B. RKJ has 30,000 shares of treasury stock.
   C. RKJ can reissue an additional 35,000 shares of common stock.
   D. RKJ can issue an additional 30,000 shares of common stock.

31. RKJ Company has provided the following:
   • 100,000 shares of $5 par value common stock are authorized;
   • 70,000 shares were issued for $9 per share;
   • 65,000 shares are outstanding.

Which of the following statements is correct based only on the above facts?
   A. Common stock is reported at $630,000 on the balance sheet.
   B. Additional-paid in capital is reported at $260,000 on the balance sheet.
   C. Common stock is reported at $350,000 on the balance sheet.
   D. Treasury stock is reported at $45,000 on the balance sheet.

32. Which of the following represents the maximum number of shares of stock issuable to the public?
   A. Authorized shares
   B. Issued shares
   C. Outstanding shares
   D. Treasury shares
33. Which of the following statements regarding earnings per share (EPS) is correct?
   A. It equals net income divided by the number of authorized common shares.
   B. It equals net income divided by the number of outstanding common shares.
   C. It equals net income divided by the number of issued common shares.
   D. It equals net income divided by the number of treasury shares.

34. Rye Company has provided the following information:
   • Number of issued common shares, 225,000;
   • Net income, $500,000;
   • Number of authorized common shares, 400,000;
   • Number of treasury shares, 25,000.

   What is Rye's earnings per share?
   A. $2.50
   B. $1.25
   C. $2.22
   D. $1.33

35. Which of the following journal entries is correct when no-par common stock is initially issued for cash?

   A. Cash
      Common stock
   B. Cash
      Common stock
      Capital in excess of par
   C. Cash
      Common stock
      Retained earnings
   D. Cash
      Common stock
      Gain on sale of stock

36. During 2010, Thomas Corporation repurchased some shares of its own common stock. What effect did this transaction have on 2010 stockholders' equity and earnings per share, respectively?

<table>
<thead>
<tr>
<th>Stockholders' Equity</th>
<th>Earnings Per Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Decrease</td>
<td>No effect</td>
</tr>
<tr>
<td>B. Increase</td>
<td>No effect</td>
</tr>
<tr>
<td>C. Decrease</td>
<td>Decrease</td>
</tr>
<tr>
<td>D. Decrease</td>
<td>Increase</td>
</tr>
</tbody>
</table>

   A. Option A
   B. Option B
   C. Option C
   D. Option D
37. Which of the following entries would be recorded when a company reissues 1,000 shares of treasury stock for $50 per share when they were repurchased at a cost of $47 per share and have a $1 par value?

A. Cash 50,000
   Treasury Stock 47,000
   Capital in excess of par value 3,000

B. Cash 50,000
   Treasury Stock 47,000
   Retained earnings 3,000

C. Cash 50,000
   Common Stock 1,000
   Capital in excess of par value 49,000

D. Cash 50,000
   Treasury Stock 47,000
   Gain on sale of treasury stock 3,000

A. Option A
B. Option B
C. Option C
D. Option D

38. Which of the following entries would be recorded when a company reissues 1,000 shares of treasury stock for $40 per share when they were repurchased at a cost of $44 per share and have a $1 par value?

A. Cash 40,000
   Capital in excess of par value 4,000
   Treasury Stock 44,000

B. Cash 40,000
   Loss on sale of treasury stock 4,000
   Treasury Stock 44,000

C. Cash 40,000
   Capital in excess of par value 4,000
   Common Stock 44,000

D. Cash 40,000
   Common Stock 1,000
   Capital in excess of par value 39,000

A. Option A
B. Option B
C. Option C
D. Option D

39. A company reported the following asset and liability balances at the end of 2009 and 2010:

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets</td>
<td>$6,800,000</td>
<td>$7,600,000</td>
</tr>
<tr>
<td>Total Liabilities</td>
<td>3,200,000</td>
<td>3,600,000</td>
</tr>
</tbody>
</table>

During 2010, cash dividends of $50,000 were declared and paid, and common stock was issued for $100,000. How much was the 2010 net income?
A. $400,000
B. $480,000
C. $350,000
D. $300,000

40. Which of the following correctly describes the affect of declaring and distributing a common stock dividend?
A. Total stockholders' equity decreases.
B. Total stockholders' equity remains the same.
C. The number of shares outstanding increases while the par value of each share decreases.
D. The number of shares outstanding decreases while the par value of each share increases.
41. A stock dividend
   A. results in a transfer of retained earnings to contributed capital.
   B. increases the number of shares outstanding and involves a pro rata reduction in the par value per share.
   C. is accounted for in exactly the same manner as a stock split.
   D. Results in a transfer of retained earnings to contributed capital and also increases the number of shares outstanding and involves a pro rata reduction in the par value per share.

42. DORA Company declared and distributed a 10% stock dividend on 20,000 shares of issued and outstanding $5 par value common stock. The market price per share on the declaration date was $9 and was $10 on the distribution date. Which of the following correctly describes the accounting for the declaration and distribution of the stock dividend?
   A. Retained earnings decreased $20,000.
   B. Capital in excess of par increased $10,000.
   C. Common stock increased $18,000.
   D. Retained earnings decreased $18,000.

43. Chicago Clock Corporation issued a 3-for-2 stock split of its common stock, which had a par value of $100 before the split. What dollar amount of retained earnings should be transferred to the common stock account?
   A. Par value of $100 per share.
   B. Market value per share on the issue date.
   C. Half of the previous total amount in the common stock account.
   D. Retained earnings aren't transferred to the common stock account.

44. A company has 4 million common shares authorized, 2.5 million shares issued and 100,000 treasury shares. The par value is $1 per share and the market price is $30 when the company declares a 4-for-1 stock split. Which of the following is correct?
   A. There will be a transfer of $2.4 million from retained earnings to contributed capital.
   B. Only the shares outstanding will quadruple to 49.86 million and the par value will be reduced to $.25 per share.
   C. The shares authorized, issued, outstanding, and held in treasury will all quadruple while the par value will be reduced to $.25 per share.
   D. The company will be unable to declare a 4-for-1 split because they do not have enough authorized shares to issue the needed 49.86 million shares.

45. What is the correct entry for the sale of 1,000 shares of $10 par value preferred stock for $50,000 cash?

<table>
<thead>
<tr>
<th>Option</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.</td>
<td>Cash 50,000</td>
<td>50,000</td>
</tr>
<tr>
<td></td>
<td>Preferred stock 10,000</td>
<td></td>
</tr>
<tr>
<td>B.</td>
<td>Cash 10,000</td>
<td>10,000</td>
</tr>
<tr>
<td></td>
<td>Preferred stock 50,000</td>
<td></td>
</tr>
<tr>
<td>C.</td>
<td>Cash 50,000</td>
<td>40,000</td>
</tr>
<tr>
<td></td>
<td>Gain on sale of preferred stock 10,000</td>
<td></td>
</tr>
<tr>
<td>D.</td>
<td>Cash 50,000</td>
<td>10,000</td>
</tr>
<tr>
<td></td>
<td>Preferred stock 10,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Capital in excess of par value 40,000</td>
<td></td>
</tr>
</tbody>
</table>

   A. Option A
   B. Option B
   C. Option C
   D. Option D

46. Which of the following doesn't correctly describe preferred stock?
   A. Preferred stock has a higher priority status relative to common stock.
   B. Preferred shareholders are guaranteed to receive dividends.
   C. Preferred stock usually does not carry voting rights.
   D. Preferred stockholders receive dividends in arrears only if the shares are cumulative.
47. Assume the following capital structure:
   Preferred stock, 6%, $50 par value, 1,000 shares issued and outstanding with dividends in arrears for three prior years (2007 - 2009).
   Common stock, $100 par value, 2,000 shares issued and outstanding.
   Total dividends declared and paid in 2010 were $50,000. How much of the 2010 dividend will be paid to the common stockholders assuming the preferred stock is cumulative?
   A. $12,000
   B. $50,000
   C. $47,000
   D. $38,000

48. Assume the following capital structure:
   Preferred stock, 6%, $50 par value, 1,000 shares issued and outstanding with dividends in arrears for three prior years (2007 - 2009).
   Common stock, $100 par value, 2,000 shares issued and outstanding.
   Total dividends declared and paid in 2010 were $50,000. How much of the 2010 dividend will be paid to the common stockholders assuming the preferred stock is noncumulative?
   A. $12,000
   B. $3,000
   C. $47,000
   D. $38,000

49. A company reported total stockholders' equity of $170,000 on its balance sheet dated December 31, 2010. During the year ended December 31, 2011, the company reported net income of $20,000, declared and paid a cash dividend of $4,000, declared and distributed a 10% stock dividend with a $5,000 total market value, and issued additional common stock for $40,000. What is total stockholders' equity as of December 31, 2011?
   A. $234,000
   B. $226,000
   C. $231,000
   D. $221,000

50. Which of the following statements is not correct?
   A. Issuance of common stock creates a financing activities cash inflow.
   B. Payment of a common stock cash dividend creates an operating activities cash outflow.
   C. Purchase of treasury stock creates a financing activities cash outflow.
   D. Issuance of preferred stock creates a financing activities cash inflow.
Exam 3 chapters 9-11 Libby 7ed Key

1. Which of the following accounts would not be considered when calculating the quick ratio?
   A. Marketable securities.
   B. Inventory.
   C. Accounts receivable.
   D. Accounts payable.

   Quick assets include cash, marketable securities, and accounts receivable.

   AACSB: Reflective Thinking
   AICPA BB: Critical Thinking
   AICPA FN: Measurement
   Blooms: Understand
   Difficulty: Medium
   Learning Objective: 09-02 Use the quick ratio.
   Libby - Chapter 09 #35
   Topic Area: Liabilities Defined And Classified

2. Which of the following describes an accrued liability?
   A. It is an expense that has been both incurred and paid.
   B. It is an expense that has been incurred but not yet paid.
   C. It is an expense that has been prepaid but not yet consumed.
   D. It is a liability where the cash flow has taken place but the revenue has yet to be earned.

   An accrued liability is recorded when an expense is incurred but not yet paid.

   AACSB: Reflective Thinking
   AICPA BB: Critical Thinking
   AICPA FN: Reporting
   Blooms: Understand
   Difficulty: Medium
   Learning Objective: 09-01 Define; measure; and report current liabilities
   Libby - Chapter 09 #44
   Topic Area: Liabilities Defined And Classified

3. Miranda Company borrowed $100,000 cash on September 1, 2010, and signed a one-year 6%,
   interest-bearing note payable. Assuming no adjusting entries have been made during the year, the
   required adjusting entry at the end of the accounting period, December 31, 2010, would be which of
   the following?

   A. Interest expense 2,000
      Interest payable 2,000
   B. Interest expense 6,000
      Interest payable 6,000
   C. Notes payable 100,000
      Interest expense 6,000
      Cash 106,000
   D. Interest payable 2,000
      Interest expense 2,000

   Interest expense ($2,000) = Amount borrowed ($100,000) × Interest rate (6%) × Number of months
   borrowed relative to a year (4 ÷ 12)

   AACSB: Analytic
   AICPA BB: Critical Thinking
   AICPA FN: Reporting, Measurement
   Blooms: Apply
   Difficulty: Medium
   Learning Objective: 09-04 Report notes payable and explain the time value of money.
   Libby - Chapter 09 #45
   Topic Area: Liabilities Defined And Classified
4. Miranda Company borrowed $100,000 cash on September 1, 2010, and signed a one-year 6%, interest-bearing note payable. The interest and principal are both due on August 31, 2011. Assume that the appropriate adjusting entry was made on December 31, 2010 and that no adjusting entries have been made during 2011. The required journal entry to pay the note on August 31, 2011 would be which of the following?

A. Interest expense
   Cash
   6,000
   6,000

B. Interest expense
   Interest payable
   4,000
   2,000
   Notes payable
   Cash
   100,000
   106,000

C. Notes payable
   Interest expense
   100,000
   6,000
   Cash
   106,000

D. Interest payable
   Notes payable
   2,000
   100,000
   Cash
   102,000

December 31, 2010: Interest expense ($2,000) = Amount borrowed ($100,000) × Interest rate (6%) × Number of months borrowed relative to a year (4 ÷ 12).
August 31, 2011: Interest expense ($4,000) = Amount borrowed ($100,000) × Interest rate (6%) × Number of months borrowed relative to a year (8 ÷ 12).
The credit to cash ($106,000) equals the amount borrowed ($100,000) plus the interest for one-year ($6,000).

AACC: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium

Learning Objective: 09-04 Report notes payable and explain the time value of money.
Libs - Chapter 09 #46

Topic Area: Liabilities Defined And Classified

5. Landseeker's Restaurants reported cost of goods sold of $322 million and accounts payable of $83 million for 2011. In 2010, cost of goods sold was $258 million and accounts payable was $72 million. What was Landseeker's accounts payable turnover ratio in 2011?

A. 4.23
B. 4.15
C. 4.04
D. 3.91

Accounts payable turnover (4.15) = Cost of goods sold ($322 million) ÷ Average accounts payable ($83 million + $72 million) ÷ 2

AACC: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Apply
Difficulty: Medium

Learning Objective: 09-03 Analyze the accounts payable turnover ratio.
Libs - Chapter 09 #47

Topic Area: Liabilities Defined And Classified
6. Failure to make a necessary adjusting entry for accrued interest on a note payable would result in which of the following?
A. An understatement of both liabilities and stockholders' equity.
B. Net income to be overstated and assets to be understated.
C. Net income to be understated and liabilities to be understated.
**D.** An overstatement of net income, an understatement of liabilities, and an overstatement of stockholders' equity.

The adjusting entry increases interest payable and interest expense, which decreases both net income and stockholders’ equity. Failure to make the entry causes both net income and stockholders’ equity to be overstated, and liabilities to be understated.

**AACSB:** Analytic
**AICPA BB:** Critical Thinking
**AICPA FN:** Reporting, Measurement
**Blooms:** Apply
**Difficulty:** Medium
**Learning Objective:** 09-04 Report notes payable and explain the time value of money.
**Libby** - Chapter 09 #53
**Topic Area:** Liabilities Defined And Classified

7. Houston Company is involved in a lawsuit. In which of the following situations is only footnote disclosure of the contingent liability reported within the financial statements?
A. When the loss is remote and the amount cannot be reasonably estimated.
B. When the loss is probable and the amount can be reasonably estimated.
C. **When the loss is reasonably possible and the amount can be reasonably estimated.**
D. When the loss is remote and the amount can be reasonably estimated.

A contingent liability that is reasonably possible and can reasonably be estimated is disclosed in the notes to the financial statements.

**AACSB:** Reflective Thinking
**AICPA BB:** Critical Thinking
**AICPA FN:** Reporting
**Blooms:** Understand
**Difficulty:** Medium
**Learning Objective:** 09-05 Report contingent liabilities
**Libby** - Chapter 09 #59
**Topic Area:** Liabilities Defined And Classified

8. Darwin Corporation's attorney has provided the following summaries of three lawsuits against Darwin:

- **l**awsuit A: The loss is probable and the loss can be reasonably estimated.
- **l**awsuit B: The loss is reasonably possible and the loss can't be reasonably estimated.
- **l**awsuit C: The loss is reasonably possible and the loss can be reasonably estimated.

Which of the following statements is incorrect?
A. A disclosure note is required for lawsuit A.
B. A disclosure note is required for lawsuit C.
C. **A disclosure note is not required for lawsuit B.**
D. Lawsuit A is reported on the balance sheet as a liability.

A contingent liability that is reasonably possible is disclosed in the notes to the financial statements regardless of whether it can be reasonably estimated.

**AACSB:** Reflective Thinking
**AICPA BB:** Critical Thinking
**AICPA FN:** Reporting
**Blooms:** Apply
**Difficulty:** Medium
**Learning Objective:** 09-05 Report contingent liabilities
**Libby** - Chapter 09 #63
**Topic Area:** Liabilities Defined And Classified
9. Smith Corporation entered into the following transactions:
   • Purchased inventory on account.
   • Collected an account receivable.
   • Purchased equipment using cash.

Which of the following statements is correct?
A. The inventory purchase on account increased working capital.
B. Collecting an account receivable increases working capital.
C. The equipment purchase decreases working capital.
D. The inventory purchase on account increased the quick ratio.

The cash payment decreases current assets and therefore working capital. The equipment is a long-term asset.

AACSB: Reflective Thinking  
AICPA BB: Critical Thinking  
AICPA FN: Reporting  
Blooms: Apply  
Difficulty: Medium  
Learning Objective: 09-06 Explain the importance of working capital and its impact on cash flows.  
Libby - Chapter 09 #64  
Topic Area: Focus On Cash Flows

10. Rachel Corporation purchased a building by paying $90,000 cash on the purchase date, agreeing to pay $50,000 every year for the next nine years and $100,000 ten years from the purchase date; the first payment is due one year after the purchase date. Rachel's incremental borrowing rate is 10%. At what amount would the liability be reported at on the balance sheet as of the purchase date, after the initial $90,000 payment was made?
A. $326,500  
B. $460,000  
C. $287,950  
D. $416,500

The liability ($326,500) is equal to the present value of the nine annual payments [$50,000 × 5.7590 (present value of a 10%, 9-period ordinary annuity)] plus the present value of the payment due ten years from today [$100,000 × .3855 (present value of a 10-period, 10% single sum)].

AACSB: Analytic  
AICPA BB: Critical Thinking  
AICPA FN: Reporting, Measurement  
Blooms: Apply  
Difficulty: Medium  
Learning Objective: 09-09 Apply present value concepts to liabilities. Apply present value concepts to liabilities.  
Libby - Chapter 09 #80  
Topic Area: Present Value Concepts

11. Which of the following correctly describes the accounting for leases?
A. A capital lease is not reported on the balance sheet as a liability.  
B. A capital lease reports an asset on the balance sheet.  
C. An operating lease reports an operating asset on the balance sheet.  
D. An operating lease reports a liability on the balance sheet.

A capital lease reports both an asset and a liability on the balance sheet.

AACSB: Reflective Thinking  
AICPA BB: Critical Thinking  
AICPA FN: Reporting  
Blooms: Understand  
Difficulty: Medium  
Libby - Chapter 09 #96  
Topic Area: Long-Term Liabilities
12. How much needs to be invested today if your goal is to be able to withdraw $5,000 for each of the next ten years beginning one year from today? The return on the investment is expected to be 12%.
   A. $44,645  
   B. $36,291  
   C. $28,251  
   D. $50,000

The investment ($28,251) is equal to the payments ($5,000) multiplied by the present value of a $1 annuity, 10-period, 12% table value (5.6502).

13. When a company prepares a bond indenture, certain provisions of the bonds are included. Which of the following is/are not specified in the indenture?
   A. Dates of each interest payment.  
   B. The stated interest rate.  
   C. The maturity date.  
   D. The market rate of interest.

The market rate of interest is determined at the time of the bond issue and is not specified in the bond indenture.

14. Which of the following bonds does not have specific assets pledged to guarantee repayment?
   A. Debenture bond  
   B. Callable bond  
   C. Discount bond  
   D. Convertible bond

An unsecured (debenture) bond does not have any assets pledged to secure it.
15. The annual interest rate specified within a bond indenture is called which of the following?
   A. The stated rate of interest.
   B. The market rate of interest.
   C. The effective rate of interest.
   D. The actual rate of interest.

   The stated interest rate is specified in the bond indenture.

   AACS: Reflective Thinking
   AICPA BB: Critical Thinking
   AICPA FN: Risk Analysis
   Blooms: Remember
   Difficulty: Easy
   Learning Objective: 10-01 Describe the characteristics of bonds.
   Libby - Chapter 10 #34
   Topic Area: Characteristics Of Bonds Payable

16. Which of the following statements best describes callable bonds?
   A. They can be turned in for early retirement at the option of the bondholder.
   B. They can be converted to common stock at the option of the bondholder.
   C. They can be called for early retirement at the option of the issuer.
   D. They can be called for early retirement at the option of the lien holder.

   A callable bond may be retired early by the issuer.

   AACS: Reflective Thinking
   AICPA BB: Critical Thinking
   AICPA FN: Risk Analysis
   Blooms: Remember
   Difficulty: Easy
   Learning Objective: 10-01 Describe the characteristics of bonds.
   Libby - Chapter 10 #35
   Topic Area: Characteristics Of Bonds Payable

17. Which of the following statements best describes convertible bonds?
   A. They can be turned in for early retirement at the option of the bondholder.
   B. They can be converted to common stock at the option of the bondholder.
   C. They can be called for early retirement at the option of the issuer.
   D. They can be converted to common stock at the option of the issuer.

   A convertible bond may be converted into common stock at the option of the bondholder.

   AACS: Reflective Thinking
   AICPA BB: Critical Thinking
   AICPA FN: Risk Analysis
   Blooms: Remember
   Difficulty: Easy
   Learning Objective: 10-01 Describe the characteristics of bonds.
   Libby - Chapter 10 #36
   Topic Area: Characteristics Of Bonds Payable
18. Which of the following is not an advantage of issuing bonds versus issuing stock to finance expansion?
A. Stockholders remain in control as bondholders cannot vote or share in the company's earnings.
B. Interest expense is tax deductible but dividends are not.
C. Money can usually be borrowed at a lower rate and then invested to earn a higher return on assets.
**D.** The fixed payment dates for the interest and maturity value.

The fixed payment dates create inflexibility and therefore increases bankruptcy risk.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Risk Analysis
Bloom's: Remember
Difficulty: Medium
Learning Objective: 10-01 Describe the characteristics of bonds.
Libys - Chapter 10 #37
Topic Area: Characteristics Of Bonds Payable

19. Which of the following statements is not correct?
A. The bond principal is the amount due at the maturity date of the bond.
B. The stated interest rate is used to determine the cash interest payments.
C. The bond principal is used to determine the cash interest payments.
**D.** The market rate of interest is used to determine the cash interest payments.

The market rate of interest is used to determine the selling price of the bond, not the cash interest payments.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Bloom's: Remember
Difficulty: Medium
Learning Objective: 10-01 Describe the characteristics of bonds.
Libys - Chapter 10 #38
Topic Area: Characteristics Of Bonds Payable

20. Which of the following statements is correct?
**A.** A secured bond has specific assets pledged as collateral to secure it.
B. An unsecured bond can be paid at the option of the issuer.
C. A bond trustee is appointed to represent the issuing company.
D. The bond indenture specifies the market rate of interest the investors will earn.

A secured bond is secured by specific pledged assets.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Risk Analysis
Bloom's: Remember
Difficulty: Medium
Learning Objective: 10-01 Describe the characteristics of bonds.
Libys - Chapter 10 #39
Topic Area: Characteristics Of Bonds Payable
21. Assuming no adjusting journal entries have been made, the journal entry to record the cash interest payment on the due date for bonds issued at their par value results in which of the following?
   A. An increase in expenses and a decrease in liabilities.
   B. An increase in expenses and a decrease in assets.
   C. A decrease in both liabilities and stockholders' equity.
   D. A decrease in both assets and liabilities.

   When a bond sells for par value, the cash interest payments result in an increase in interest expense and a decrease in assets (cash).

   AACSB: Reflective Thinking
   AICPA BB: Critical Thinking
   AICPA FN: Reporting, Measurement
   Blooms: Understand
   Difficulty: Medium
   Learning Objective: 10-03 Report bonds payable and interest expense for bonds sold at a discount.
   Libby - Chapter 10 #43
   Topic Area: Reporting Bond Transactions

22. Which of the following statements correctly describes the accounting for bonds that were issued at a discount?
   A. The market rate of interest is less than the stated interest rate.
   B. The interest expense over the life of the bonds will be less than the cash interest payments.
   C. The present value of the bonds' future cash flows is greater than the bonds' maturity value.
   D. The book value of the bond liability increases when interest payments are made on the due dates.

   The payment of interest expense on the due date results in amortization of the discount on bonds payable account, a contra-liability account. Amortizing (reducing) a contra-liability account increases the book value of the bond liability.

   AACSB: Reflective Thinking
   AICPA BB: Critical Thinking
   AICPA FN: Reporting, Measurement
   Blooms: Understand
   Difficulty: Medium
   Learning Objective: 10-03 Report bonds payable and interest expense for bonds sold at a discount.
   Libby - Chapter 10 #44
   Topic Area: Reporting Bond Transactions

23. On November 1, 2009, Davis Company issued $30,000, ten-year, 7% bonds for $29,100. The bonds were dated November 1, 2009, and interest is payable each November 1 and May 1. How much is the amount of straight-line discount amortization on each semi-annual interest date?
   A. $90
   B. $45
   C. $900
   D. $450

   The straight-line discount amortization ($45) = Discount on bonds payable ($30,000 - $29,100) ÷ 20 semi-annual interest payments.

   AACSB: Analytic
   AICPA BB: Critical Thinking
   AICPA FN: Reporting, Measurement
   Blooms: Apply
   Difficulty: Easy
   Learning Objective: 10-03 Report bonds payable and interest expense for bonds sold at a discount.
   Libby - Chapter 10 #47
   Topic Area: Reporting Bond Transactions
24. On November 1, 2009, Davis Company issued $30,000, ten-year, 7% bonds for $29,100. The bonds were dated November 1, 2009, and interest is payable each November 1 and May 1. How much is the semi-annual interest expense when the straight-line method is utilized?

A. $2,010
B. $2,190
C. $1,095
D. $2,055

The straight-line discount amortization ($45) = Discount on bonds payable ($30,000 - $29,100) ÷ 20
semi-annual interest payments.
Semi-annual interest expense ($1,095) = Semi-annual cash payment ($30,000 × .07 × 6/12) + Discount on bonds payable amortization ($45).

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 10-03 Report bonds payable and interest expense for bonds sold at a discount.
Libby - Chapter 10 #48
Topic Area: Reporting Bond Transactions

25. On January 1, 2009, Jason Company issued $5 million of 10-year bonds at a 10% stated interest rate to be paid annually. The following present value factors have been provided:

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Interest</th>
<th>PV of $1</th>
<th>PV of a $1 Annuity</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>10%</td>
<td>.386</td>
<td>6.145</td>
</tr>
<tr>
<td>10</td>
<td>8%</td>
<td>.463</td>
<td>6.710</td>
</tr>
<tr>
<td>10</td>
<td>12%</td>
<td>.322</td>
<td>5.650</td>
</tr>
</tbody>
</table>

What was the issuance price of the bonds if the market rate of interest was 8%?
A. $5,000,000
B. $5,670,000
C. $5,387,500
D. $5,712,500

Bond issue price ($5,670,000) = Present value of the bond maturity value ($5,000,000 × .463) + Present value of the bond interest payments ($5,000,000 × .10) × 6.710

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 10-04 Report bonds payable and interest expense for bonds sold at a premium.
Libby - Chapter 10 #57
Topic Area: Reporting Bond Transactions
26. On July 1, 2010, Garden Works, Inc. issued $300,000 of ten-year, 7% bonds for $303,000. The bonds were dated July 1, 2010, and semi-annual interest will be paid each December 31 and June 30. Garden Works Inc. uses straight-line amortization. What is the bond liability to be reported on the December 31, 2010 balance sheet?

A. $300,000  
B. $302,850  
C. $302,700  
D. $303,000

The straight-line premium amortization ($150) = Premium on bonds payable ($303,000 - $300,000) ÷ 20 semi-annual interest payments. December 31, 2010 bond liability ($302,850) = July 1, 2010 book value ($303,000) - December 31, 2010 premium on bond payable amortization ($150).

AACSB: Analytic  
AICPA BB: Critical Thinking  
AICPA FN: Reporting, Measurement  
Blooms: Apply  
Difficulty: Medium  
Learning Objective: 10-04 Report bonds payable and interest expense for bonds sold at a premium.  
Libbs - Chapter 10 #66  
Topic Area: Reporting Bond Transactions

27. Mayberry, Inc., issued $100,000 of 10 year, 12% bonds dated April 1, 2009, for $102,360 on April 1, 2009. The bonds pay interest annually on April 1. Straight-line amortization is used by the company. What entry is needed at April 1, 2010 for the first interest payment?

A. Interest expense 11,764  
   Premium on bonds payable 236  
   Cash 12,000

B. Interest expense 12,236  
   Premium on bonds payable 236  
   Cash 12,000

C. Interest expense 12,000  
   Premium on bonds payable 236  
   Cash 12,236

D. Interest expense 12,000  
   Cash 12,000

The straight-line premium amortization ($236) = Premium on bonds payable ($102,360 - $100,000) ÷ 10 annual interest payments.

AACSB: Analytic  
AICPA BB: Critical Thinking  
AICPA FN: Reporting, Measurement  
Blooms: Apply  
Difficulty: Medium  
Learning Objective: 10-04 Report bonds payable and interest expense for bonds sold at a premium.  
Libbs - Chapter 10 #69  
Topic Area: Reporting Bond Transactions
28. Skylar Corporation issued $50,000,000 of its 10% bonds at par on January 1, 2010. On December 31, 2010 the bonds were trading on the bond exchange at 102.5. Since the issue date, what has happened to the market rate of interest?
   A. The market rate increased.
   B. The market rate decreased.
   C. The market rate stayed the same.
   D. The change in the market rate can't be determined.

Given that the bonds sold for par value on January 1, 2010, the stated interest rate equaled the market rate of interest. As of December 31, 2010, the bonds were selling at a premium, which means that the stated rate was greater than the market rate on December 31, 2010, therefore the market rate of interest decreased.

29. Eaton Company issued $5 million of bonds. The stated rate of interest was 10% and the market rate was 11%. Which of the following statements is correct?
   A. The bonds were issued at a premium.
   B. Annual interest expense will exceed the company's actual cash payments for interest.
   C. Annual interest expense will be $500,000.
   D. The book value of the bond will decrease as the bond matures.

Given that the market rate of interest exceeded the stated rate of interest, the bonds sold at a discount. The annual interest expense exceeds the cash interest payments by the initial amount of discount on bonds payable.

30. RKJ Company has provided the following:
   • 100,000 shares of $5 par value common stock are authorized;
   • 70,000 shares have been issued;
   • 65,000 shares are outstanding.

Which of the following statements is correct?
   A. RKJ has 35,000 shares of treasury stock.
   B. RKJ has 30,000 shares of treasury stock.
   C. RKJ can reissue an additional 35,000 shares of common stock.
   D. RKJ can issue an additional 30,000 shares of common stock.

RKJ can issue an additional 30,000 shares of common stock (100,000 shares authorized minus 70,000 shares already issued).
RKJ Company has provided the following:
• 100,000 shares of $5 par value common stock are authorized;
• 70,000 shares were issued for $9 per share;
• 65,000 shares are outstanding.

Which of the following statements is correct based only on the above facts?
A. Common stock is reported at $630,000 on the balance sheet.
B. Additional-paid in capital is reported at $260,000 on the balance sheet.
C. Common stock is reported at $350,000 on the balance sheet.
D. Treasury stock is reported at $45,000 on the balance sheet.

Common stock ($350,000) = Issued shares (70,000) × Par value ($5)

Which of the following represents the maximum number of shares of stock issuable to the public?
A. Authorized shares
B. Issued shares
C. Outstanding shares
D. Treasury shares

The maximum number of shares that can be issued equals the number of authorized shares.

Which of the following statements regarding earnings per share (EPS) is correct?
A. It equals net income divided by the number of authorized common shares.
B. It equals net income divided by the number of outstanding common shares.
C. It equals net income divided by the number of issued common shares.
D. It equals net income divided by the number of treasury shares.

EPS is calculated by dividing net income by the number of outstanding shares of common stock.
34. Rye Company has provided the following information:

- Number of issued common shares, 225,000;
- Net income, $500,000;
- Number of authorized common shares, 400,000;
- Number of treasury shares, 25,000.

What is Rye's earnings per share?
A. $2.50  
B. $1.25  
C. $2.22  
D. $1.33

Earnings per share ($2.50) = Net income ($500,000) ÷ Outstanding shares (225,000 - 25,000)

35. Which of the following journal entries is correct when no-par common stock is initially issued for cash?
A. Cash
   Common stock  
B. Cash
   Common stock  
   Capital in excess of par  
C. Cash
   Common stock
   Retained earnings  
D. Cash
   Common stock
   Gain on sale of stock

Common stock is credited for the cash selling price when the stock doesn't have a par value (no-par).
36. During 2010, Thomas Corporation repurchased some shares of its own common stock. What effect did this transaction have on 2010 stockholders’ equity and earnings per share, respectively?

<table>
<thead>
<tr>
<th>Stockholders’ Equity</th>
<th>Earnings Per Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Decrease</td>
<td>No effect</td>
</tr>
<tr>
<td>B. Increase</td>
<td>No effect</td>
</tr>
<tr>
<td>C. Decrease</td>
<td>Decrease</td>
</tr>
<tr>
<td>D. Decrease</td>
<td>Increase</td>
</tr>
</tbody>
</table>

A. Option A
B. Option B
C. Option C  **D. Option D**

Treasury stock is a contra-equity account, which therefore reduces stockholders’ equity. Purchasing treasury stock reduces the number of shares outstanding, which increases earnings per share given that the number of outstanding shares is the earnings per share denominator.

**AACSB: Reflective Thinking**
**AICPA BB: Critical Thinking**
**AICPA FN: Reporting, Measurement**
**Blooms: Apply**

*Learning Objective: 11-03 Describe the characteristics of common stock and analyze transactions affecting common stock.*

*Libby - Chapter 11 #49*

**Topic Area: Common Stock Transactions**

37. Which of the following entries would be recorded when a company reissues 1,000 shares of treasury stock for $50 per share when they were repurchased at a cost of $47 per share and have a $1 par value?

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Cash 50,000</td>
<td>Treasury Stock 47,000</td>
</tr>
<tr>
<td></td>
<td>Capital in excess of par value 3,000</td>
</tr>
<tr>
<td>B. Cash 50,000</td>
<td>Treasury Stock 47,000</td>
</tr>
<tr>
<td></td>
<td>Retained earnings 3,000</td>
</tr>
<tr>
<td>C. Cash 50,000</td>
<td>Common Stock 1,000</td>
</tr>
<tr>
<td></td>
<td>Capital in excess of par value 49,000</td>
</tr>
<tr>
<td>D. Cash 50,000</td>
<td>Treasury Stock 47,000</td>
</tr>
<tr>
<td></td>
<td>Gain on sale of treasury stock 3,000</td>
</tr>
</tbody>
</table>

A. Option A
B. Option B
C. Option C
D. Option D

Treasury stock is credited for its original cost ($47,000) and capital in excess of par value is credited for $3,000, the difference between the selling price ($50,000) and the original cost ($47,000).

**AACSB: Analytic**
**AICPA BB: Critical Thinking**
**AICPA FN: Reporting, Measurement**
**Blooms: Apply**

*Learning Objective: 11-03 Describe the characteristics of common stock and analyze transactions affecting common stock.*

*Libby - Chapter 11 #50*

**Topic Area: Common Stock Transactions**
38. Which of the following entries would be recorded when a company reissues 1,000 shares of treasury stock for $40 per share when they were repurchased at a cost of $44 per share and have a $1 par value?

A. Cash 40,000
   Capital in excess of par value 4,000
   Treasury Stock 44,000
B. Cash 40,000
   Loss on sale of treasury stock 4,000
   Treasury Stock 44,000
C. Cash 40,000
   Capital in excess of par value 4,000
   Common Stock 44,000
D. Cash 40,000
   Common Stock 1,000
   Capital in excess of par value 39,000

Treasury stock is credited for its original cost ($44,000) and capital in excess of par value is debited for $4,000, the difference between the selling price ($40,000) and the original cost ($44,000).

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium

Learning Objective: 11-03 Describe the characteristics of common stock and analyze transactions affecting common stock.
Libby - Chapter 11 #51
Topic Area: Common Stock Transactions

39. A company reported the following asset and liability balances at the end of 2009 and 2010:

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets</td>
<td>$6,800,000</td>
<td>$7,600,000</td>
</tr>
<tr>
<td>Total Liabilities</td>
<td>3,200,000</td>
<td>3,600,000</td>
</tr>
</tbody>
</table>

During 2010, cash dividends of $50,000 were declared and paid, and common stock was issued for $100,000. How much was the 2010 net income?

A. $400,000
B. $480,000
C. $350,000
D. $300,000

(1) 2009 stockholders’ equity ($3,600,000) = Assets ($6,800,000) - Liabilities ($3,200,000).
(2) 2010 stockholders’ equity ($4,000,000) = Assets ($7,600,000) - Liabilities ($3,600,000).
(3) The change in stockholders’ equity during 2010 ($400,000) = 2010 equity ($4,000,000) - 2009 equity ($3,600,000).
(4) The change in stockholders’ equity during 2010 ($400,000) = The change in contributed capital ($100,000) + The change in retained earnings ($300,000).
(5) The change in retained earnings ($300,000) = Net income ($350,000) - Dividends ($50,000).

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Hard

Learning Objective: 11-04 Discuss dividends and analyze transactions.
Libby - Chapter 11 #52
Topic Area: Common Stock Transactions
40. Which of the following correctly describes the affect of declaring and distributing a common stock dividend?

A. Total stockholders' equity decreases.
B. Total stockholders' equity remains the same.
C. The number of shares outstanding increases while the par value of each share decreases.
D. The number of shares outstanding decreases while the par value of each share increases.

The declaration and distribution affects stockholder equity accounts only; retained earnings decreases, common stock and capital in excess of par increases in total by an amount equal to the retained earnings decrease.

AACSB: Reflective Thinking  
AICPA BB: Critical Thinking  
AICPA FN: Reporting  
Blooms: Understand  
Difficulty: Medium  

Learning Objective: 11-06 Discuss the purpose of stock dividends and stock splits; and report transactions.  
Libby - Chapter 11 #55  
Topic Area: Financial Analysis

41. A stock dividend

A. results in a transfer of retained earnings to contributed capital.
B. increases the number of shares outstanding and involves a pro rata reduction in the par value per share.
C. is accounted for in exactly the same manner as a stock split.
D. results in a transfer of retained earnings to contributed capital and also increases the number of shares outstanding and involves a pro rata reduction in the par value per share.

The declaration and distribution of a stock dividend affects stockholder equity accounts only; retained earnings decreases, common stock and capital in excess of par (the sum of these two accounts is contributed capital) increases in total by an amount equal to the retained earnings decrease.

AACSB: Reflective Thinking  
AICPA BB: Critical Thinking  
AICPA FN: Reporting  
Blooms: Understand  
Difficulty: Medium  

Learning Objective: 11-06 Discuss the purpose of stock dividends and stock splits; and report transactions.  
Libby - Chapter 11 #56  
Topic Area: Financial Analysis

42. DORA Company declared and distributed a 10% stock dividend on 20,000 shares of issued and outstanding $5 par value common stock. The market price per share on the declaration date was $9 and was $10 on the distribution date. Which of the following correctly describes the accounting for the declaration and distribution of the stock dividend?

A. Retained earnings decreased $20,000.
B. Capital in excess of par increased $10,000.
C. Common stock increased $18,000.
D. Retained earnings decreased $18,000.

The retained earnings decrease ($18,000) equals the number of shares issued (20,000 × 10%) multiplied by the market price per share ($9) on the declaration date.

AACSB: Analytic  
AICPA BB: Critical Thinking  
AICPA FN: Reporting  
Blooms: Apply  
Difficulty: Medium  

Learning Objective: 11-06 Discuss the purpose of stock dividends and stock splits; and report transactions.  
Libby - Chapter 11 #57  
Topic Area: Financial Analysis
43. Chicago Clock Corporation issued a 3-for-2 stock split of its common stock, which had a par value of $100 before the split. What dollar amount of retained earnings should be transferred to the common stock account?
   A. Par value of $100 per share.
   B. Market value per share on the issue date.
   C. Half of the previous total amount in the common stock account.
   D. Retained earnings aren't transferred to the common stock account.

   Retained earnings and common stock are unaffected by stock splits. Stock splits reduce the par value per share and increase the number of common shares authorized, issued and outstanding.

   AACSB: Reflective Thinking
   AICPA BB: Critical Thinking
   AICPA FN: Reporting
   Bloom: Understand
   Difficulty: Medium
   Learning Objective: 11-06 Discuss the purpose of stock dividends and stock splits; and report transactions.
   Libby - Chapter 11 #58
   Topic Area: Financial Analysis

44. A company has 4 million common shares authorized, 2.5 million shares issued and 100,000 treasury shares. The par value is $1 per share and the market price is $30 when the company declares a 4-for-1 stock split. Which of the following is correct?
   A. There will be a transfer of $2.4 million from retained earnings to contributed capital.
   B. Only the shares outstanding will quadruple to 49.86 million and the par value will be reduced to $.25 per share.
   C. The shares authorized, issued, outstanding, and held in treasury will all quadruple while the par value will be reduced to $.25 per share.
   D. The company will be unable to declare a 4-for-1 split because they do not have enough authorized shares to issue the needed 49.86 million shares.

   Four shares of $.25 par value common stock will be issued for every share of $1 par value common stock.

   AACSB: Analytic
   AICPA BB: Critical Thinking
   AICPA FN: Reporting, Measurement
   Bloom: Apply
   Difficulty: Medium
   Learning Objective: 11-06 Discuss the purpose of stock dividends and stock splits; and report transactions.
   Libby - Chapter 11 #60
   Topic Area: Financial Analysis
45. What is the correct entry for the sale of 1,000 shares of $10 par value preferred stock for $50,000

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<td>A.</td>
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<td>D.</td>
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<td>Capital in excess of par value 40,000</td>
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cash?
A. Option A
B. Option B
C. Option C
D. Option D

The preferred stock credit is for par value (1,000 x $10) and the capital in excess of par credit is for the excess of the selling price over par value {($50 - $10) x 1,000}.

AASB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium

Learning Objective: 11-07 Describe the characteristics of preferred stock and analyze transactions affecting preferred stock.
Libby - Chapter 11 #64
Topic Area: Financial Analysis

46. Which of the following doesn't correctly describe preferred stock?
A. Preferred stock has a higher priority status relative to common stock.
B. Preferred shareholders are guaranteed to receive dividends.
C. Preferred stock usually does not carry voting rights.
D. Preferred stockholders receive dividends in arrears only if the shares are cumulative.

Preferred shareholders only are entitled to dividends when they are declared. There is no guarantee they will receive dividends.

AASB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Risk Analysis
Blooms: Apply
Difficulty: Medium

Learning Objective: 11-07 Describe the characteristics of preferred stock and analyze transactions affecting preferred stock.
Libby - Chapter 11 #65
Topic Area: Financial Analysis
47. Assume the following capital structure:
Preferred stock, 6%, $50 par value, 1,000 shares issued and outstanding with dividends in arrears for three prior years (2007 - 2009).
Common stock, $100 par value, 2,000 shares issued and outstanding.
Total dividends declared and paid in 2010 were $50,000. How much of the 2010 dividend will be paid to the common stockholders assuming the preferred stock is cumulative?
A. $12,000
B. $50,000
C. $47,000
D. $38,000

The preferred stock annual dividend ($3,000) = Preferred stock par value (1,000 x $50) multiplied times 6%.
The 2010 dividend payment to the preferred stockholders ($12,000) equals the annual dividend ($3,000) multiplied by four years (2007 - 2010).
The 2010 dividend payment to the common stockholders ($38,000) equals the 2010 dividend declaration ($50,000) minus the dividend payment to the preferred stockholders ($12,000).

48. Assume the following capital structure:
Preferred stock, 6%, $50 par value, 1,000 shares issued and outstanding with dividends in arrears for three prior years (2007 - 2009).
Common stock, $100 par value, 2,000 shares issued and outstanding.
Total dividends declared and paid in 2010 were $50,000. How much of the 2010 dividend will be paid to the common stockholders assuming the preferred stock is noncumulative?
A. $12,000
B. $3,000
C. $47,000
D. $38,000

The preferred stock annual dividend ($3,000) = Preferred stock par value (1,000 x $50) multiplied times 6%. The preferred stockholders do not receive the dividends in arrears because the preferred stock is noncumulative.
The 2010 dividend payment to the common stockholders ($47,000) equals the 2010 dividend declaration ($50,000) minus the dividend payment to the preferred stockholders ($3,000).
49. A company reported total stockholders' equity of $170,000 on its balance sheet dated December 31, 2010. During the year ended December 31, 2011, the company reported net income of $20,000, declared and paid a cash dividend of $4,000, declared and distributed a 10% stock dividend with a $5,000 total market value, and issued additional common stock for $40,000. What is total stockholders' equity as of December 31, 2011?

A. $234,000
B. $226,000
C. $231,000
D. $221,000

December 31, 2011 stockholders' equity ($226,000) = December 31, 2010 stockholders' equity ($170,000) + 2011 net income ($20,000) - 2011 cash dividend declarations ($4,000) + 2011 common stock issued ($40,000). Stock dividends do not affect total stockholders' equity.

50. Which of the following statements is not correct?

A. Issuance of common stock creates a financing activities cash inflow.
B. Payment of a common stock cash dividend creates an operating activities cash outflow.
C. Purchase of treasury stock creates a financing activities cash outflow.
D. Issuance of preferred stock creates a financing activities cash inflow.

Cash dividends are financing activities cash outflows.
# Exam 3 chapters 9-11 Libby 7ed Summary

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