DISCLAIMER: The following problems are from prior years’ exams. They are distributed for review purposes only. You should not assume that the questions on this semester’s exam will be similar to these review problems.

PROBLEM 1: COMPENSATED ABSENCES

Sposa Co. began operations on January 2, 1995. It employs 12 people who work 8-hour days. Each employee earns 10 paid vacation days annually. Vacation days may be taken after January 10 of the year following the year in which they are earned. The average hourly wage rate was $9.00 in 1995 and $10 in 1996. The average vacation days used by each employee in 1996 was 8. Sposa Co. accrues the cost of compensated absences at rates of pay in effect when earned.

Required: a. Prepare the journal entry to record the accrual of the compensated absences during 1995.
   b. Prepare the journal entry to record the payment for vacation days taken in 1996.
   c. Calculate the balance in the Vacation Wages Payable account on the December 31, 1996 Balance Sheet?

PROBLEM 2: WARRANTIES

Network Equipment Company sells small business computers for $3,000 each. Every computer sold includes a 4-year warranty that requires the company to perform periodic services and to replace defective parts. During 1995, the company sold 400 computers. Based on past experience, the company has estimated the total 4-year warranty costs as $50 for parts and $150 for labor. In 1996, Network incurred actual warranty costs relative to 1995 computer sales of $4,500 for parts and $10,500 for labor.

The company accounts for these warranties using the expense warranty accrual method.

Required: a. Prepare journal entries to reflect the above 1995 transactions.
   b. Prepare journal entries to reflect the above 1996 transactions.

PROBLEM 3: ISSUANCE OF BONDS

Langer Corporation issued $200,000 of 10% bonds on October 1, 1995, due on October 1, 2000. The interest is to be paid twice a year on April 1 and October 1. The bonds were sold to yield 12% effective annual interest.

Required: Calculate the issue price of the bonds.
PROBLEM 4: RECORDING BOND TRANSACTIONS

On January 1, 1996, Shark Apparel issued $300,000 face value, 8% bonds for $369,344. Interest is payable semiannually on January 1 and July 1. The bonds were sold to yield 6%. Shark Apparel uses the effective interest method of amortization; its accounting period ends on December 31.

Required: Prepare journal entries to record the following transactions relating to the long-term bonds of Shark Apparel:

a. The January 1, 1996 issuance of the bonds.
b. The payment of interest and the amortization of the premium on July 1, 1996.
c. The accrual of interest and the amortization of the premium on December 31, 1996.

PROBLEM 5: RETIREMENT OF BONDS

The December 31, 1995 balance sheet of Baker Co. included the following items:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>7.5% bonds payable due December 31, 2003</td>
<td>$400,000</td>
</tr>
<tr>
<td>Unamortized discount on bonds payable</td>
<td>$30,000</td>
</tr>
<tr>
<td>Unamortized bond issue costs</td>
<td>$10,000</td>
</tr>
</tbody>
</table>

Interest on these bonds is payable semiannually on June 30 and December 31. On January 1, 1996, Baker called and retired $100,000 face value of these bonds at 102.

Required: a. Prepare the journal entry to record the retirement of the bonds on January 1, 1996.

b. Indicate the income statement treatment of the gain or loss from the retirement.

PROBLEM 6: CONTINGENT LIABILITIES

A lawsuit for breach of contract seeking damages of $1,000,000 was filed by an author against Dart Co. on October 4, 1996. Dart’s legal counsel believes that an unfavorable outcome is probable. A reasonable estimate of the award to the plaintiff is between $200,000 and $600,000. No amount within this range is a better estimate of potential damages than any other amount.

Required: Discuss the proper accounting treatment on the 1996 financial statements, including any required disclosures, for the above situation. Give the rationale for your answer.
PROBLEM 7: REFINANCING OF SHORT-TERM DEBT

On December 31, 1995, Hall Co. has $1,600,000 of short-term notes payable due on April 15, 1996. Hall Co. intends to refinance these notes on a long-term basis. On February 10, 1996, Hall signed a noncancelable long-term loan commitment from a capable lender for $1,250,000 which Hall intends to use to pay as payment on the short-term notes payable. As of March 5, 1996, the date Hall issues its financial statements, Hall has not obtained a long-term financing commitment for the remaining $350,000 of the short-term notes. However, they are confident that such financing will be obtained by the time the notes come due.

Required: What amount of the short-term notes payable should be reported as current liabilities on the December 31, 1995 balance sheet which is issued on March 5, 1996? Give the rationale for your answer.

PROBLEM 8: NONINTEREST BEARING NOTES PAYABLE

On January 1, 1996, the Johnson Company acquired a parcel of land. There was no established exchange price for the property, and Johnson gave a $1,500,000 noninterest-bearing note payable in 3 equal annual installments of $500,000, with the first payment due December 31, 1996. The market rate of interest for a note of this type is 10%. Johnson Company uses the effective interest method of amortization. Its fiscal year end is December 31.

Required: Prepare all required journal entries that Johnson should record on the following dates:

b. December 31, 1996.

PROBLEM 9: PREMIUMS AND COUPONS

In an effort to increase sales, Stadler Company inaugurated a sales promotional campaign on June 30, 1996, whereby Stadler placed a coupon in each package of razor blades sold, the coupons being redeemable for a premium. Each premium costs Stadler $1.50 and 10 coupons must be presented by a customer to receive a premium. Stadler estimated that only 60% of the coupons issued will be redeemed. For the six months ended December 31, 1996, the following information is available:

<table>
<thead>
<tr>
<th>Packages of Razor Blades Sold</th>
<th>Premiums Purchased</th>
<th>Coupons Redeemed</th>
</tr>
</thead>
<tbody>
<tr>
<td>450,000</td>
<td>30,000</td>
<td>140,000</td>
</tr>
</tbody>
</table>

Required: a. What is the premium expense for 1996?
   b. What is the estimated liability for premium claims outstanding at December 31, 1996.
PROBLEM 1: COMPENSATED ABSENCES

a. Wages Expense 8,640
   Vacation Wages Payable 8,640
   (12 people X 8 hours per day X 10 days per year X $9 per hour)

b. Vacation Wages Payable (12 X 8 X 8 X $9) 6,912
   Wages Expense 768
   Cash (12 X 8 X 8 X $10) 7,680

c. Beginning Balance, 1/1/96 8,640
   Less: Vacation days used (6,912)
   Add: Vacation days earned in 1996 (12 X 8 X 10 X $10) 9,600
   Ending Balance, 12/31/96 11,328

PROBLEM 2: WARRANTIES

a. Cash or Accounts Receivable ($3,000 X 400) 1,200,000
   Sales 1,200,000
   Warranty Expense (400 X $200) 80,000
   Estimated Liability Under Warranties 80,000

b. Estimated Liability Under Warranties 15,000
   Parts Inventory 4,500
   Accrued Payroll 10,500

PROBLEM 3: ISSUANCE OF BONDS

PV of Face Value: $200,000 X .55839 $111,678
PV of Interest Payments: $10,000 X 7.36009 73,601
Issue Price of Bonds 185,279

n = 10
I = 6%
PROBLEM 4: RECORDING BOND TRANSACTIONS

a. Cash 369,344
   Bonds Payable 300,000
   Premium on Bonds Payable 69,344

b. Bond Interest Expense ($369,344 X 3%) 11,080
   Premium on Bonds Payable 920
   Cash 12,000

c. Bond Interest Expense (($369,344 - $920) X 3%) 11,053
   Premium on Bonds Payable 947
   Interest Payable 12,000

PROBLEM 5: RETIREMENT OF BONDS

a. Bonds Payable 100,000
   Loss on Retirement of Bonds 12,000
   Unamortized Bond Issue Costs (10,000 X ¼) 2,500
   Discount on Bonds Payable ($30,000 X ¼) 7,500
   Cash ($100,000 X 102%) 102,000

b. The loss on retirement of bonds is an Extraordinary Item. It should be presented net of taxes after “Income from Continuing Operations” and “Results of Discontinued Operations” (if any).

PROBLEM 6: CONTINGENT LIABILITIES

Since the loss is probable and reasonably estimable, it should be accrued and reported on Dart’s 1996 financial statements. Since no estimate within the range is a better estimate than any other amount, Dart should record a loss and accrue a liability of $200,000 (see FASB Current Text, C59.124). Dart should disclose the nature of the liability and the exposure to an additional amount of loss of up to $600,000.

PROBLEM 7: REFINANCING OF SHORT-TERM DEBT

Since Hall has secured financing for $1,250,000 of the notes due on April 15, 1996, this amount should be classified as long-term on the December 31, 1995 balance sheet. However, the remaining $350,000 must be reported as a current liability on company’s December 31, 1995 balance sheet since the company has not yet obtained a long-term financing commitment for this amount. Intention to refinance is not sufficient to permit classification of the debt as long-term.
**PROBLEM 8: NONINTEREST BEARING NOTES PAYABLE**

a. PV of Note: \( \$500,000 \times 2.48685 \) (Table 6-4, \( n = 3 \), \( i = 10\% \)) = \( \$1,243,425 \)

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>1,243,425</td>
</tr>
<tr>
<td>Discount on Notes Payable ( $1,500,000 - $1,243,425 )</td>
<td>256,575</td>
</tr>
<tr>
<td>Notes Payable</td>
<td>1,500,000</td>
</tr>
</tbody>
</table>

b. Interest Expense \( \$1,243,425 \times 10\% \) = \( \$124,343 \)

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Expense</td>
<td>124,343</td>
</tr>
<tr>
<td>Discount on Notes Payable</td>
<td>124,343</td>
</tr>
<tr>
<td>Notes Payable</td>
<td>500,000</td>
</tr>
<tr>
<td>Cash</td>
<td>500,000</td>
</tr>
</tbody>
</table>

c. Interest Expense \( \left( \$1,000,000 - (256,575 - 124,343) \right) \times 10\% \) = \( \$86,777 \)

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Expense</td>
<td>86,777</td>
</tr>
<tr>
<td>Discount on Notes Payable</td>
<td>86,777</td>
</tr>
<tr>
<td>Notes Payable</td>
<td>500,000</td>
</tr>
<tr>
<td>Cash</td>
<td>500,000</td>
</tr>
</tbody>
</table>

**PROBLEM 9: PREMIUMS AND COUPONS**

a. 450,000 coupons \( \times 60\% = 270,000 \) coupons expected to be redeemed

\[ \frac{270,000}{10} = 27,000 \text{ premiums expected to be distributed} \]

\[ 27,000 \times \$1.50 = \$40,500 \text{ 1996 Premium Expense} \]

b. \( \$40,500 - \left( \frac{140,000}{10} \times \$1.50 \right) = \$19,500 \text{ Balance in Estimated Liability for Premiums at December 31, 1996} \)

\[ \text{OR} \]

\[ (270,000 - 140,000) = 130,000 \]

\[ (130,000/10) \times \$1.50 = \$19,500 \]