## Current Liabilities/Contingencies

**CPC-1** The controller for A & A Products, neglected to have her staff accrue the payroll for the last week in December, 2012. The following data should have been considered and accounted for in A & A Products' books.

Total payroll = $1,350,000
Income taxes to be withheld = $150,000
FICA taxes applicable to the payroll accrual = $28,000
FUTA taxes on accrued payroll = $4,000
Total compensated absences related to the payroll = $75,000 vacation time and $85,000 sick time. Employees who do not take vacation will receive compensation in lieu of time taken off. Sick time does not vest and if the employee does not use their sick time it is forfeited back to the company. Union dues that should have been withheld from employees' payroll = $12,000.

Required: Journalize all entries that are necessary to accrue the above payroll. Include the entries in your adjusted pre-closing trial balance for A & A Products.

**CPC-2** On November 1, 2012 P & P Products entered into an agreement whereby P & P Products accepted a discounted note payable for $2,000,000 (A & A Products received cash). The terms were 0% interest (market rate of interest is 6%) and payable on May 1, of 2013. Make all necessary entries on the books of A & A Products for 2012.

**CPC-3** Robert, one of A & A Products' independent auditors, discovered that A & A Products failed to record a transaction on October 1st of 2012. On that date, A & A Products received a $50,000 deposit from the ABC Company for the delivery of some corrugated boxes to be delivered in January of 2013. Prepare all necessary entries for 2012.

**CPC-4** During the year A & A Products was involved in two lawsuits. The first (A & A Products is the defendant) involves liability for potentially defective containers that came apart during loading and injured two workers. The company's attorney has determined that there is a high probability that the jury will grant punitive damages of $1,000,000. The second lawsuit involves A & A Products as the plaintiff who is suiting a vendor for failure to comply with design specifications and caused the injuries discussed above regarding the $1,000,000. A & A Products is suing for $2,500,000 for damages to cover payment for the first lawsuit and damage to the company's reputation. The company's attorney is confident that the company will be successful.

## Leases

**LS-1** A & A Products entered into a lease agreement with P & P Products, Inc. to purchase a piece of equipment on January 1, 2012. The terms of the lease are: 8%, 5 years lease with a 6 year useful life. The machine has a fair value of $600,000. The residual value is zero. A & A Products does not know the interest rate that P & P Products uses. Assume that the entries have not yet been made on the books of A & A Products.

Requirement: Prepare a five year amortization schedule. Make all necessary entries on the books of A & A Products for the first year.

**LS-2** Requirement: Assume that the lessor's (P & P Products) interest rate is also 8% and that the lease qualifies as a direct financing lease, using the above information in **LS-1**: Prepare the lessor's amortization table for the duration of the lease and make all necessary entries on the books of P & P Products for the first two years.

**Long-term Liabilities**

**LTL-1** Calculate the amount that the following bonds would be sold. The bonds pay 8% interest on February 1st and August 1st of each year and are dated February 1st of 2012.. They are 5 year bonds with a face value of $10,000 and the market rate of interest is 10%. They are sold on February 1, 2012. Use an interest table, not your computer, to calculate the amount.

**LTL-2** The following information is relevant to a bond issue. A & A Products issued $1,800,000 face value of bonds on April 1st of 2012. The bonds are sold for $1,908,000. They pay 8% interest each year on December, 31st and become due in 10 years from their date of January 1st, 2012. One half of the bonds are redeemed on January 1st of 2015 for $918,000. The company uses the effective interest method to amortize the bonds.

Required: Prepare an amortization schedule for the first 5 years and make entries for the issuance, payment of interest for years 2012 through 2014 and the redemption of the bonds.

**LTL-3** On Janurary 1st of 2012 P & P Products purchased $1,000,000 of 8%, 5 year A & A Products bonds on the open market for $960,000. The bonds are dated and were issued by A & A Products on January 1st 2010. The bonds pay interest each January 1st and July 1st. The effective interest method is used.

Requirement: Make any necessary entries for A & A Products.

**Property, Plant and Equipment**

**PPE-1** A & A Products is relocating their Human Resources department to an unused space closer to the main administration building. The 4000 square foot space is empty and has not been used in several years. Jane, the VP of Personnel, is overseeing the conversion and relocation of the HR department. A & A Products' maintenance people will actually perform the work. Jane has asked George, the maintenance foreman, to prepare a list of what needs to be done to bring the space to the point where the HR department can move. George provided the following short list, assume the labor will be performed by contractors and the cost given includes the labor:

1. Painting (the current walls have paint peeling) – estimated cost $15,000
2. Removal of old asbestos in the ceiling – estimated cost $12,000
3. Replacing the wood floors with tile to increase the life of the space - $34,000
4. Installing wiring for computers - $18,000
5. Installing modular units for work space - $124,000

Required: Prepare the potential entries for the items above.

**PPE-2** In addition to the above cost Jane asked the IT department to give her a pricing list for equipment.

1. Fourteen new computers - $140,000, additional $2,000 for freight and 6% tax on $140,000. Estimated useful life is 5 years with 5% salvage value. They are treated as a single unit for financial reporting purposes.

2. Ten existing computers will be traded in (total trade-in value $10,000) for the new computers. The computers are treated as a single unit with an original cost of $80,000 and book value of $8,000. The remainder was paid in cash.

3. Additional IT personnel to support the additional workload created by the HR department - $200,000 annually which includes fringe benefits and taxes.

Required: Prepare the potential journal entries for the above items (considered not having commercial substance).

**PP-3** Refer to the above (PPE-2). Also assume the old computers cost $100,000 and book value of $18,000. Make the necessary potential entries.

**PPE-4** During 2012 P & P Products finished the construction of a new warehouse in the North Carolina. Construction began on January 1, 2011. The cost of the new warehouse was $3M with the cost incurred evenly throughout the construction. The following information is provided:

P & P Products's incremental interest rate is 10%
Actual interest incurred during 2012 was $135,000.
The average accumulated expenditures was $1,5M
Requirement:
a. How much interest should be calculated?
b. What is the entry to capitalize the interest?

**PPE-5** A & A Products, during 2012, began and completed a small warehouse. Construction on the warehouse began January 2, of 2012. Expenditures were made as follows: January 2, $1,000,000, March 1, $900,000, July 1, $400,000 and Oct. 1, $800,000. A & A Products financed the project by issuing $1,000,000 in stock at the beginning of 2012 and borrowed $1,200,000 from The Last National Bank at an interest rate of 8%. In addition the company had the following debt: $1,000,000, interest rate of 9% borrowed in 2010, $2,000,000, 11% note borrowed in 2009.

Requirements:
a. Calculate the 2012 weighted average accumulated expenditures
b. How much is avoidable interest
c. How much is actual interest
d. Make the entry capitalizing the interest.

**Deferred Taxes**

**DT-1** Provide three examples of how the account deferred tax liabilities could be increased.

1. Excess depreciation book over tax
2. Warranty expense for book purposes on accrual basis but actual amount for tax purposes.
3. Income items recorded for financial statement before tax (ie. Percentage of completion for book and completed contract for tax)

**DT-2** During 2012 A & A Products purchased some computer equipment with an estimated life of 5 years for $20,000 with no salvage value. A & A Products depreciates computer equipment using the straight-line method and uses MACRS for tax purposes and is in the 20% tax bracket. This creates a difference in depreciation of $3,000. A & A Products erroneously recorded the computers as equipment expense.

Requirements:

a. Make correcting entry
b. Calculate the deferred tax effect due to the equipment

**DT-3** The following information is provided:

Income before taxes $900,000

Income before taxes included the following

Interest income of = $80,000 (from municipal bonds)

Rental income was collected in advance in 2011 and earned in 2012 = $20,000

A piece of equipment was purchased in 2012. Depreciation per books = $40,000 and per income taxes $100,000.

Warranty expense in 2012 was $20,000 but for tax purposed only $5,000 was deductible.

Assume that at the beginning of 2012 deferred tax asset = $8,000 due to the rent income.

Tax rate for 2012 and the foreseeable future is 40%.

Requirements:

a. Calculate taxable income
b. Make the necessary tax entry. (include the amounts for tax expense and deferred taxes.

**DT-4** Assume that last year (2011) A & A Products had a net operating loss of $50,000 and for this problem A & A Products reported tax expense for 2012 of $70,000. Also assume that in 2010 A & A Products had income of $10,000 and a tax rate of 20% (ignore any earlier years). This year, 2012, A & A Products reported net income of $70,000 and a tax rate of 20%. Prepare the entry that A & A Products should have made in 2011. Prepare an entry for 2012 recording the effect on A & A Products' books of the 2011 NOL.

**Investments**

**IN-1** The following are available-for-trading securities being held by P & P Products. The amounts are in $1,000s.

| | End of fiscal year 2012 | | End of fiscal year 2011 | |
|---|---|---|---|---|
| | Cost | FMV | Cost | FMV |
| Stock in Able Company | $900 | $1,400 | $900 | $1,200 |
| Stock in Baker Company | $900 | $1,100 | $900 | $800 |
| Stock in Charlie Company | $1,000 | $700 | $1,100 | $1,000 |
| Stock in Delta Company | $1,000 | $700 | $1,100 | $1,500 |
| | $3,800 | $3,900 | $4,000 | $4,500 |

Requirements:
a. How much did P & P Products report on their 2011 balance sheet to reflect the above securities?
b. How much did P & P Products report on their 2012 balance sheet to reflect the above securities?
c. How much did they report as unrealized gain or loss in 2012 to reflect the above securities?

**IN-2** Assume the above securities are classified as trading securities.
Requirements:
a. Determine the amount of unrealized gain or loss to be recognized in 2011.
b. Determine the amount of unrealized gain or loss to be recognized in 2012.
c. Determine the amount to report for these investments on the end of the year 2011 and 2012 balance sheets.

**IN-3** Determine how the following investment items would be reported in a statement of cash flows. Use the following categories for your answers. Deducted from operations, Added to operations, No Cash Effect, Added under Investing, Deducted from Investing, Added to Financing, Deducted from Financing.

a. Unrealized gains on trading securities
b. Unrealized losses on trading securities
c. Unrealized gains on available for sale securities
d. Unrealized losses on available for sale securities
e. Realized losses on investments
f. Realized gains on investments
g. Purchases of available for sale and/or held to maturity securities
h. Sales of available for sale and/or held to maturity securities
i. Purchase of trading securities

**Stockholders' Equity and Earnings Per Share**

**STK-1** During 2012 A & A Products made several treasury stock transactions. For each of the following give the entry(s) that A & A Products would have made. A & A Products uses the cost method and the par value of common stock is $10a. On February 1st A & A Products purchased in the stock market 1000 shares of their $10 par value stock. They paid $15 per share.

**STK-2** Also during 2012 A & A Products made the following common stock transactions (class B stock). For each of the following give the entry(s) that A & A Products would have made. The common stock has a par value of $10. (Each of the following scenarios are independent)

a. On January 5th , A & A Products issued a property dividend. Investments (stock in the ABC company) comprising of 1000 shares was issued. The stock has a fair market value of $25 per share. The stock cost A & A Products $20 per share. They issued the ABC stock one month later.

b. On February 14, A & A Products declared a 10% stock dividend (assume 92,623 shares of $10 par outstanding stock). On that date market value of the stock was $14. One month later they issued the common stock dividend.

c. On August 12th, A & A Products declared a cash dividend of $.50 per share of common stock.

d. On October 14th, A & A Products issued a 2 for 1 stock split.

e. On May 15th, A & A Products issued 5,000 shares of cumulative 8% preferred stock with a par value of $100 for $112 per share.

d. Assume the following: At the end of the year there were 92,623 shares of common stock outstanding and 5,000 shares of non-cumulative/non-participating preferred stock outstanding. A & A Products wants to issue cash dividends totaling $77,050. Calculate how much goes to preferred stock holders and common stock holders.

**STK-3** Refer to STK-2 (e). Assume that A & A Product had net income of $91,855 and 92623 shares outstanding common stock.

Calculate basic EPS.

**STK-4** Refer to <u>STK-3</u> information and your answer. Assume that A & A Products had 1000 convertible bonds payable outstanding. The bonds pay 2% interest annually and mature in 2020. Further assume that the bonds are convertible at the rate of 100 shares of $10 par value stock per bond. The stock's market value is $12 per share. Calculate diluted earnings per share. The marginal tax rate is 30%.

# CASH FLOW

**A & A Products**
**Balance Sheet**
**Fiscal years 2012 and 2011**

**ASSETS**

| | 2,012 | 2,011 | Difference |
|---|---|---|---|
| ent Assets: | | | |
| Cash in Bank | $519,955 | $368,606 | 151,349 |
| Net Accounts receivables | | | 0 |
| (net of the allowance account) | 127,615 | 130,244 | -2,629 |
| Inventories | 873,766 | 588,139 | 285,627 |
| Prepaid expenses | 56,155 | 60,204 | -4,049 |
| Investment in securities (increase due to purchase of securities-available for sale) | 480,991 | 331,694 | 149,297 |
| al Current Assets | 2,058,482 | 1,478,887 | 579,595 |
| | | | 0 |
| erty, plant, & equipment, at cost | | | 0 |
| Land | 82,250 | 103,250 | -21,000 |
| Buildings | 276,263 | 243,250 | 33,013 |
| Machinery and equipment | 540,845 | 535,800 | 5,045 |
| Automotive equipment | 99,425 | 90,125 | 9,300 |
| Office furniture and fixtures | 106,433 | 99,775 | 6,658 |
| | 1,105,216 | 1,072,200 | 33,016 |
| Less accumulated depreciation | 316,661 | 252,239 | 64,422 |
| | 788,555 | 819,961 | -31,406 |
| 'AL ASSETS | $2,847,037 | $2,298,848 | 548,189 |

**LIABILITIES AND STOCKHOLDERS' EQUITY**

| | | | |
|---|---|---|---|
| ent Liabilities: | | | |
| Accounts payable | $223,161 | $140,649 | 82,512 |
| Accrued liabilities | 219,823 | 191,613 | 28,210 |
| Notes payable | 125,000 | | 125,000 |
| Dividends payable | 17,575 | 13,875 | 3,700 |
| Income taxes payable | 63,772 | 14,230 | 49,542 |
| tal current liabilities | 649,331 | 360,367 | 288,964 |
| il Liabilities | 649,331 | 360,367 | 288,964 |
| kholders' Equity: | | | |
| Common stock, par value $100, authorized 20,000 shares, issued and outstanding 9,250 shares | 925,000 | 925,000 | 0 |
| Contributed capital in excess of par value | 736,550 | 736,550 | 0 |
| Unrealized gain<loss>on investments | 6,473 | 4,496 | 1,977 |
| Retained earnings | 529,683 | 272,435 | 257,248 |
| tal Stockholders' Equity | 2,197,706 | 1,938,481 | 259,225 |
| 'AL LIABILITIES AND STOCKHOLDERS' EQUITY | $2,847,037 | $2,298,848 | 548,189 |

**A & A Products**
**Income Statement**
**Year 2012**

| | 2,012 |
|---|---|
| sales and other revenues | $3,876,757 |
| Cost of goods sold | 1,596,800 |
| ss margin | 2,279,957 |
| rating expenses: | |
| Selling, general, and administrative | 1,817,457 |
| Depreciation | 64,422 |
| | 1,881,879 |
| rating Income | 398,078 |
| er income (expense) and adjustments: | |
| Interest | (27,500) |
| Other income | 9,379 |
| Gain on sale of fixed assets | 18,638 |
| income before federal income taxes | 18,638 |
| ision for income taxes | 123,772 |
| ' INCOME | ($105,134) |

**quirements:**

**'repare the operating sec the statement of cash flows using the indirect method.**

**Pensions**

**PEN**-1 The following facts pertain to the Eastvaco's pension plan for 2012. Expected return on plan assets is 15%, the FMV of plan assets, on January 1, 2012 is $ 100,000, the FMV on December 31, 2012 is $130,000, contributions to pension plan was $14,000 and benefits paid to retired employees was $8,000.

Requirement: Determine the actual return on plan assets component of net pension cost for 2012. Assume contribution and benefit payments were made at year-end.

**PEN-2** Refer to PEN-1, Consider the following information as of the beginning of 2012. The projected benefit obligation or PBO was $135,000, the accumulated gain (loss) in other comprehensive income (OCI) was $20,000 and the average remaining service period of active employees 20 years.

Requirements:

a. Determine the difference between the actual and expected return on plan assets for 2012.
b. Determine the amortization of the net gain or loss accumulated in OCI.
c. Determine the gain or loss recognized as a component of pension cost in 2012.
d. Determine the accumulated gain or loss that would be carried forward in OCI in 2013.

## Disclosures

D-1 How does P and P Products primarily account for inventories?

D-2 Goodwill allocated to each of the company's segments at December 31, 2011 and 2010 was?

D-3 As part of the consideration for the sale of certain large-tract forestlands in 2007, P & P Products received an installment note for how much?

D-4 In 2011 P & P entered into a bank credit agreement for how much and with what bank?

D-5 How much gain or loss was recognized in comprehensive income for 2011 due to cash flow hedges?

D-6 The P&P Products Corporation Compensation Plan for Non-Employee Directors provides for the grant of stock awards up to how many shares to outside directors in the form of stock options or restricted stock units..

D-7 What valuation model does P & P use to account for stock options?