COMPREHENSIVE EXAMINATION A

PART 1

(Chapters 1-6)

<table>
<thead>
<tr>
<th>Problem</th>
<th>Topic</th>
<th>Approximate Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>A-I</td>
<td>Multiple Choice (Various Topics).</td>
<td>15 min.</td>
</tr>
<tr>
<td>A-II</td>
<td>Adjusting and Reversing Entries.</td>
<td>30 min.</td>
</tr>
<tr>
<td>A-III</td>
<td>Key Conceptual Terms.</td>
<td>15 min.</td>
</tr>
<tr>
<td>A-IV</td>
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<td>10 min.</td>
</tr>
<tr>
<td>A-V</td>
<td>Balance Sheet Classifications.</td>
<td>10 min.</td>
</tr>
<tr>
<td>A-VI</td>
<td>Balance Sheet Form.</td>
<td>20 min.</td>
</tr>
<tr>
<td>A-VII</td>
<td>Future Value and Present Value.</td>
<td>20 min.</td>
</tr>
</tbody>
</table>

*This topic is dealt with in an Appendix to the chapter.*
Problem A-I — Multiple Choice.

Choose the best answer for each of the following questions and enter the identifying letter in the space provided.

___ 1. How does failure to record accrued revenue distort the financial reports?
   a. It understates revenue, net income, and current assets.
   b. It understates net income, capital, and current liabilities.
   c. It overstates revenue, capital, and current liabilities.
   d. It understates current assets and overstates capital.

___ 2. A contingent liability which is normally accrued is
   a. notes receivable discounted.
   b. accommodation endorsements on customer notes.
   c. additional compensation that may be payable on a dispute now being arbitrated.
   d. estimated claims under a service warranty on new products sold.

___ 3. Which of the following items is a current liability?
   a. Bonds due in three months (for which there is an adequate sinking fund classified as a long-term investment).
   b. Bonds due in three years.
   c. Bonds (for which there is an adequate appropriation of retained earnings) due in eleven months.
   d. Bonds to be refunded when due in eight months, there being no doubt about the marketability of the refunding issue.

___ 4. On June 15, 1998 Hope Corporation accepted delivery of merchandise which it purchased on account. As of June 30 Hope had not recorded the transaction or included the merchandise in its inventory. The effect of this error on its balance sheet for June 30, 1998 would be
   a. assets and owners' equity were overstated but liabilities were not affected.
   b. owners' equity was the only item affected by the omission.
   c. assets and liabilities were understated but owners' equity was not affected.
   d. assets and owners' equity were understated but liabilities were not affected.

___ 5. Reversing entries are most commonly used in relation to year-end adjusting entries which
   a. allocate the expired portion of a depreciable asset to expense.
   b. amortize intangible assets.
   c. provide for bad debts expense.
   d. accrue interest revenue on notes receivable.

___ 6. Of the following adjusting entries, which one would cause an increase in assets at the end of the period?
   a. The entry to record the earned portion of rent received in advance.
   b. The entry to accrue unrecorded interest expense.
   c. The entry to accrue unrecorded interest revenue.
   d. The entry to record expiration of prepaid insurance.
7. Why is it necessary to make adjusting entries?
   a. The accountant has made errors in recording external transactions.
   b. Certain facts about the affairs of the business are not included in the ledger as built up from external transactions.
   c. The accountant wants to show the largest possible net income for the period.
   d. The accountant wants to show the net cash flow for the year.

8. Notes to financial statements should not be used to
   a. describe the nature and effect of a change in accounting principles.
   b. identify substantial differences between book and tax income.
   c. correct an improper financial statement presentation.
   d. indicate basis for asset valuation.

9. The characteristic of consistency is best demonstrated when
   a. expenses are reported as charges against the period in which incurred.
   b. the effect of changes in accounting procedure is properly disclosed.
   c. extraordinary gains and losses are not reported on the income statement.
   d. accounting procedures are adopted which give a consistent rate of net income.

10. The current section of a balance sheet should never include
   a. a receivable from a customer not collectible for over one year.
   b. premium paid on temporary bond investment.
   c. goodwill arising from the purchase of a going business.
   d. customers' accounts with credit balances.

Problem A-II — Adjusting and Reversing Entries.

The following list of accounts and their balances represents the unadjusted trial balance of Byrd Company at December 31, 1998:

<table>
<thead>
<tr>
<th>Account</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$48,210</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>69,000</td>
</tr>
<tr>
<td>Allowance for Doubtful Accounts</td>
<td>$ 500</td>
</tr>
<tr>
<td>Inventory</td>
<td>54,720</td>
</tr>
<tr>
<td>Prepaid Rent</td>
<td>18,000</td>
</tr>
<tr>
<td>Investment in Allen Corp. Bonds</td>
<td>70,000</td>
</tr>
<tr>
<td>Plant and Equipment</td>
<td>156,000</td>
</tr>
<tr>
<td>Accumulated Depreciation</td>
<td>14,740</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>11,370</td>
</tr>
<tr>
<td>Bonds Payable</td>
<td>90,000</td>
</tr>
<tr>
<td>Common Stock</td>
<td>170,000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>97,380</td>
</tr>
<tr>
<td>Sales</td>
<td>222,000</td>
</tr>
<tr>
<td>Purchases</td>
<td>150,000</td>
</tr>
<tr>
<td>Purchase Discounts</td>
<td>3,400</td>
</tr>
<tr>
<td>Transportation-Out</td>
<td>11,000</td>
</tr>
<tr>
<td>Transportation-In</td>
<td>4,400</td>
</tr>
<tr>
<td>Salaries and Wages Expense</td>
<td>32,000</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>2,040</td>
</tr>
<tr>
<td>Rent Revenue</td>
<td>10,800</td>
</tr>
<tr>
<td>Miscellaneous Expense</td>
<td>890</td>
</tr>
<tr>
<td>Insurance Expense</td>
<td>3,930</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$620,190</strong></td>
</tr>
</tbody>
</table>
Additional Data:

1. The balance in the Insurance Expense account contains the premium costs of three policies:
   - Policy 1, remaining cost of $1,530, 1-yr. term, taken out on May 1, 1997;
   - Policy 2, original cost of $1,620, 3-yr. term, taken out on Oct. 1, 1998;

2. On September 30, 1998, Byrd received $10,800 rent from its lessee for an eighteen month lease beginning on that date.

3. The regular rate of depreciation is 20% per year. Acquisitions and retirements during a year are depreciated at half this rate. There were no purchases during the year. On December 31, 1997, the balance of the Plant and Equipment account was $230,000.

4. On December 28, 1998, the bookkeeper incorrectly credited sales for a receipt on account in the amount of $10,000.

5. At December 31, 1998, salaries accrued but unpaid were $4,200.

6. Based upon an aging of the accounts, Byrd estimates that 10% of the Accounts Receivable balance on December 31, 1998 will become uncollectible.

7. On August 1, 1998, Byrd purchased, as a temporary investment, 70 $1,000, 9% bonds of the Allen Corp. at par. The bonds mature on August 1, 2001. Interest payment dates are July 31 and January 31.

8. Per a physical inventory, inventory on hand at December 31, 1998 was $43,700. Prepare the entry needed to update the inventory and close the related nominal accounts to a "Cost of Goods Sold" account.

9. On April 30, 1998, Byrd rented a warehouse for $1,500 per month, paying $18,000 in advance.

Instructions

(a) Record the necessary correcting and adjusting entries.

(b) Indicate which of the adjusting entries may be reversed at the beginning of the next accounting period.
Problem A-III — Key Conceptual Terms.

Various accounting assumptions, principles, constraints, and characteristics are listed below. Select those which best justify the following accounting procedures and indicate the corresponding letter(s) in the space(s) provided. A letter may be used more than once or not at all.

a. Historical cost  f. Economic entity  k. Revenue recognition
b. Relevance  g. Materiality  l. Full disclosure
c. Monetary unit  h. Conservatism  m. Substance over form
d. Going concern  i. Periodicity  n. Industry practices
e. Consistency  j. Matching  o. Reliability

  1. Using the lower of cost or market approach in valuing inventories.
  2. Describing the depreciation methods used in the financial statements.
  3. Applying the same accounting treatment to similar accounting events.
  4. The quality which helps users make predictions about present, past, and future events.
  5. Recording a transaction when goods or services are exchanged for cash or claims to cash.
  6. Preparing consolidated statements.
  7. Expensing, when acquired, metal office wastebaskets having a life of ten years.
  8. Provides the figure at which to record a liability.
  9. The preparation of timely reports on continuing operations.
 10. Accrual accounting (do not use "going concern").
 11. Reporting those items which are significant enough to affect decisions. Select two (11 and 12).
 12. See item 11 above.
 13. Ignoring the phenomenon of general price-level change (do not use "historical cost").
 14. Not reporting assets at liquidation prices (do not use "historical cost").
 15. Reporting information which is faithfully representative of economic events.
 16. Establishment of an allowance for doubtful accounts.
 17. Additivity of financial statement figures relating to different time periods.
 18. Carrying inventories at sales price less distribution costs.
 19. Use of estimating procedures for amortization policies. Select two (do not use "periodicity") (19 and 20).
 20. See item 19 above.
*Problem A-IV — Special Journals.

Haley Corp. employs the following specialized journals and a general journal in the format illustrated in the textbook:

a. Sales journal  
b. Cash receipts journal  
c. Cash payments journal  
d. Purchases journal  
e. General journal

Indicate the letter or letters of the above journals in which each of the following transactions would be recorded.

____ 1. Borrowed money from the local bank.

____ 2. Received a refund of 1996 federal income tax.

____ 3. Closed the nominal accounts.

____ 4. Received a partial payment from a customer whose account was previously written off as uncollectible.

____ 5. Merchandise purchased on account is returned to supplier.

____ 6. Purchased merchandise on account.

____ 7. Sold accounts receivable to a finance company.

____ 8. Adjusted salaries expense for those salaries incurred but not paid at the end of the year.

____ 9. Sold merchandise on account to a customer of Haley Corp.


____ 11. Wrote off an uncollectible account receivable against the allowance account.

____ 12. Purchased a new truck in exchange for an old truck and $15,000.
Problem A-V — Balance Sheet and Income Statement Classifications.

Specify, to the left of each account, the letter of the financial statement classification the account would appear in. Use only the classifications shown.

<table>
<thead>
<tr>
<th>Balance Sheet</th>
<th>Income and Retained Earnings Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Current Assets</td>
<td>j. Sales Revenue</td>
</tr>
<tr>
<td>b. Investments</td>
<td>k. Cost of Goods Sold</td>
</tr>
<tr>
<td>c. Property, Plant, and Equipment</td>
<td>l. Operating Expenses</td>
</tr>
<tr>
<td>d. Intangible Assets</td>
<td>m. Other Revenues and Gains</td>
</tr>
<tr>
<td>e. Other Assets</td>
<td>n. Other Expenses and Losses</td>
</tr>
<tr>
<td>f. Current Liabilities</td>
<td>o. Extraordinary Item</td>
</tr>
<tr>
<td>g. Long-term Debt</td>
<td>p. Retained Earnings Section</td>
</tr>
<tr>
<td>h. Capital Stock</td>
<td>q. Not on the Statements</td>
</tr>
<tr>
<td>i. Retained Earnings</td>
<td></td>
</tr>
</tbody>
</table>

Account balances taken from the ledger of the Morin Company on December 31, 1999 follow:

___ 2. Purchases                      ___ 17. Salaries and Wages Expense
___ 3. Buildings                      ___ 18. Merchandise on order with supplier
___ 4. Office Expense                 ___ 19. Interest Revenue
___ 5. Allowance for Doubtful Accounts___ 20. Selling Expense
___ 6. Notes Payable—Short Term       ___ 21. Interest Expense
___ 10. Freight-In                    ___ 25. Long-Term Investments
___ 12. Dividends Declared            ___ 27. Land
___ 15. Purchase Discounts            ___ 30. Gain from early extinguishment of debt
Problem A-VI — Balance Sheet Form.

List the corrections needed to present in good form the balance sheet below. Errors include misclassifications, lack of adequate disclosure, and poor terminology. Do not concern yourself with the arithmetic. If an item can be classified in more than one category, select the category most favored by the authors of your textbook.

Miller Corporation
Balance Sheet
For the year ended December 31, 1998

Assets

Current Assets:
Cash $18,000
Trading securities (fair value, $32,000) 27,000
Accounts receivable 75,000
Merchandise inventory 60,000
Supplies inventory 3,000
Stock investment in subsidiary company 60,000 $243,000

Investments:
Treasury stock 78,000

Tangible Fixed Assets:
Buildings and land 213,000
Less: Reserve for depreciation 60,000 153,000

Deferred Charges:
Unamortized discount on bonds payable 3,000

Other Assets:
Cash surrender value of life insurance 54,000
531,000

Liabilities and Capital

Current Liabilities:
Accounts payable $45,000
Reserve for income taxes 42,000
Customer's accounts with credit balances 3 $87,003

Long-Term Liabilities:
Bonds payable 120,000
Total Liabilities 207,003

Capital Stock:
Capital stock 225,000
Earned surplus 74,997
Cash dividends declared 24,000 323,997
$531,000
Problem A-VII — Future Value and Present Value.

In computing your answers to the cases below, you can round your answer to the nearest dollar. Present value tables are provided on the next page.

Use the following information in answering Cases 1 and 2 below:

On January 1, 1993, Dell Company sold $400,000 of 10% bonds, due January 1, 2003. Interest on these bonds is paid on July 1 and January 1 each year. According to the terms of the bond contract, Dell must establish a sinking fund for the retirement of the bond principal starting no later than January 1, 2001. Since Dell was in a tight cash position during the years 1993 through 1998, the first contribution into the fund was made on January 1, 1999.

Case 1: Assume that, starting with the January 1, 1999 contribution, Dell desires to make a total of four equal annual contributions into this fund. Compute the amount of each of these contributions assuming the interest rate is 8% compounded annually.

Case 2: Assume, instead, that starting with a January 1, 2001 contribution, Dell desires to make a total of five equal semiannual contributions into this fund. Compute the amount of each of these contributions assuming the annual interest rate is 12%, compounded semiannually.

Case 3: On January 2, 1998, Nance Company loaned $60,000 to Olin Company. The terms of this loan agreement stipulate that Olin is to make 5 equal annual payments to Nance at 10% interest compounded annually. Assume the payments are to begin on December 31, 1998. Compute the amount of each of these payments.

Case 4: Pete Huston, a lawyer contemplating retirement on his 65th birthday, decides to create a fund on an 8% basis which will enable him to withdraw $30,000 per year beginning June 30, 2001, and ending June 30, 2005. To provide this fund, he intends to make equal contributions on June 30 of each of the years 1996 through 2000.

(a) How much must the balance of the fund equal after the last contribution on June 30, 2000 in order for him to satisfy his objective?

(b) What are each of his contributions to the fund?
Table 1
Future Value of 1

<table>
<thead>
<tr>
<th>Periods</th>
<th>6%</th>
<th>8%</th>
<th>9%</th>
<th>10%</th>
<th>12%</th>
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</thead>
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<td>1.08000</td>
<td>1.09000</td>
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Table 2
Present Value of 1

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<tr>
<th>Periods</th>
<th>6%</th>
<th>8%</th>
<th>9%</th>
<th>10%</th>
<th>12%</th>
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<tbody>
<tr>
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<td>0.92593</td>
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<td>0.68058</td>
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</table>

Table 3
Future Value of an Ordinary Annuity of 1

<table>
<thead>
<tr>
<th>Periodic Rents</th>
<th>6%</th>
<th>8%</th>
<th>9%</th>
<th>10%</th>
<th>12%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
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<td>1.00000</td>
<td>1.00000</td>
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<tr>
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<td>2.08000</td>
<td>2.09000</td>
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<tr>
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<td>5.86660</td>
<td>5.98471</td>
<td>6.10510</td>
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</table>

Table 4
Present Value of an Ordinary Annuity of 1

<table>
<thead>
<tr>
<th>Periodic Rents</th>
<th>6%</th>
<th>8%</th>
<th>9%</th>
<th>10%</th>
<th>12%</th>
</tr>
</thead>
<tbody>
<tr>
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<td>0.92593</td>
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<td>0.90909</td>
<td>0.89286</td>
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<tr>
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<td>1.69005</td>
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<tr>
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<td>2.57710</td>
<td>2.53130</td>
<td>2.48685</td>
<td>2.40183</td>
</tr>
<tr>
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<td>3.31213</td>
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<td>3.03735</td>
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<tr>
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<td>3.88965</td>
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</tbody>
</table>

Table 5
Present Value of an Annuity Due of 1

<table>
<thead>
<tr>
<th>Periodic Rents</th>
<th>6%</th>
<th>8%</th>
<th>9%</th>
<th>10%</th>
<th>12%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1.00000</td>
<td>1.00000</td>
<td>1.00000</td>
<td>1.00000</td>
<td>1.00000</td>
</tr>
<tr>
<td>2</td>
<td>1.94340</td>
<td>1.92593</td>
<td>1.91743</td>
<td>1.90909</td>
<td>1.89286</td>
</tr>
<tr>
<td>3</td>
<td>2.83339</td>
<td>2.78326</td>
<td>2.75911</td>
<td>2.73554</td>
<td>2.69005</td>
</tr>
<tr>
<td>4</td>
<td>3.67301</td>
<td>3.57710</td>
<td>3.53130</td>
<td>3.48685</td>
<td>3.40183</td>
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<tr>
<td>5</td>
<td>4.46511</td>
<td>4.31213</td>
<td>4.23972</td>
<td>4.16986</td>
<td>4.03735</td>
</tr>
</tbody>
</table>
Solutions — Comprehensive Examination A

Problem A-I — Solution.

1. a 4. c 7. b 10. c
2. d 5. d 8. c
3. c 6. c 9. b

Problem A-II — Solution.

(a) 1. Prepaid Insurance .............................................................. 1,485
    Insurance Expense .......................................................... 1,485
    (Both Policies 1 and 3 have expired and their costs
     belong in Insurance Expense. The monthly premium
     on Policy 2 is $1,620/36 = $45. At 12/31/98, 33 mos.
     of insurance, or $1,485, remains unexpired)

2. Rent Revenue ................................................................. 9,000
    Unearned Rent ............................................................. 9,000
    (Monthly rent is $10,800/18 = $600. At 12/31/98,
     15 mos. of rent, or $9,000, remains unearned)

3. Depreciation Expense ......................................................... 38,600
    Accumulated Depreciation ............................................. 38,600
    [(Equipment retired during 1998 =
    $230,000 - $156,000 = $74,000)
    20% of $156,000 = $31,200
    10% of $ 74,000 = 7,400
    Total depreciation = $38,600]

4. Sales ................................................................. 10,000
    Accounts Receivable .................................................. 10,000
    (To correct the entry made in error)

5. Salaries and Wages Expense .............................................. 4,200
    Salaries and Wages Payable ....................................... 4,200

6. Bad Debts Expense ....................................................... 5,400
    Allowance for Doubtful Accounts ................................ 5,400
    (Corrected ending Accounts Receivable is
    $69,000 - $10,000 = $59,000. 10% of $59,000 is
    $5,900. Since the Allowance contains $500, the
    adjustment is $5,900 - $500 = $5,400)

7. Interest Receivable ....................................................... 2,625
    Interest Revenue ....................................................... 2,625
    (Monthly interest is $70,000 × .09 × 1/12 = $525.
    5 months’ accrued interest is $2,625)
8. Inventory (ending) ................................................................. 43,700
   Cost of Goods Sold .......................................................... 162,020
   Transportation-In ............................................................ 4,400
   Purchases .................................................................... 150,000
   (To update the inventory and close the related
   nominal accounts to Cost of Goods Sold)

9. Rent Expense ................................................................. 12,000
   (To record 8 months’ of rent expired at $1,500 per
   month)

(b) 1, 2, 5, and 7. Items No. 1 and No. 2 represent prepaid items that were initially recorded in
nominal accounts. Items No. 5 and No. 7 represent accrued items.

Problem A-III — Solution.
1. h  6. f  11. l  16. j
2. l  7. g  12. g or b  17. c
3. e  8. a  13. c  18. n
5. k  10. j or k  15. o  20. j

Problem A-IV — Solution.
1. b  4. b and e  7. b  10. c
2. b  5. e  8. e  11. e
3. e  6. d  9. a  12. c

Problem A-V — Solution.
1. h  7. c  13. p  19. m  25. b
2. k  8. g  14. a  20. l  26. a
3. c  9. k  15. k  21. n  27. c
4. l  10. k  16. k  22. f  28. f
5. a  11. j  17. l  23. l  29. p
6. f  12. p  18. q  24. l  30. o
Problem A-VI —— Solution.

1. "For the year ended" in the title should be deleted.

2. Trading securities should be reported at their fair value.

3. The amount of Allowance for Doubtful Accounts should be disclosed and deducted from Accounts Receivable.

4. The inventory costing method (cost, lower of cost or market) and the basis for pricing the inventory (LIFO, FIFO, etc.) should be disclosed.

5. Stock Investment in Subsidiary should be classified as an investment.

6. Treasury Stock is misclassified under Investments. It should appear as a deduction from the Stockholders’ Equity section.

7. Buildings and Land should be separated.

8. "Reserve for" Depreciation should be either "Allowance for" or "Accumulated" Depreciation.

9. Unamortized Discount on Bonds Payable should be classified with and deducted from Bonds Payable.

10. Cash Surrender Value of Life Insurance should be classified among Investments.

11. "Reserve" for Income Taxes should be titled Income Taxes Payable.

12. The small balance of $3 for customer’s accounts with credit balances while not erroneously classified might be offset against and buried in the Accounts Receivable because it is so small in amount.

13. The maturity date and the interest rate should be disclosed for the Bonds Payable.

14. "Capital Stock" should be "Stockholders' Equity" or "Owners' Equity."

15. More information relative to the capital stock, such as par value and the number of shares authorized, issued, and outstanding should be disclosed.

16. "Earned surplus" should not be used; Retained Earnings is the preferred title.

17. Cash dividends declared is actually Dividends Payable and should be classified as a current liability.
Problem A-VII — Solution.

Case 1. $400,000 is the amount of an 8% annuity due for 4 periods. Use the table factor for the future value of an 8% ordinary annuity for 4 periods, and multiply by (1.08):

\[ 4.50611 \times (1.08) = 4.86660. \]

Periodic payments = $400,000 ÷ 4.86660 = $82,193

Case 2. Since interest is compounded semiannually, divide the 12% annual interest rate by 2, and use the table factor for the future value of a 6% ordinary annuity for 5 periods.

Periodic payments = $400,000 ÷ 5.63709 = $70,959

Case 3. $60,000 is the present value of a 10% ordinary annuity for 5 periods.

Periodic payments = $60,000 ÷ 3.79079 = $15,828

Case 4. (a) At June 30, 2000, the balance in the fund is the present value of an 8% ordinary annuity of $30,000 for 5 periods.

Balance in the fund = $30,000 × 3.99271 = $119,781

(b) At June 30, 2000, $119,781 is the future value of an 8% ordinary annuity for five periods.

Periodic payments = $119,781 ÷ 5.8666 = $20,417