### COMPREHENSIVE EXAMINATION C

#### PART 3

(Chapters 10-14)

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<td>C-I</td>
<td>Multiple Choice—Tangible and Intangible Assets.</td>
<td>39 min.</td>
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<td>Assignment of Costs.</td>
<td>6 min.</td>
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<td>C-III</td>
<td>Research and Development.</td>
<td>15 min.</td>
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<td>C-IV</td>
<td>Exchange of Assets.</td>
<td>25 min.</td>
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<td>C-V</td>
<td>Long-Term Debt.</td>
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<td>C-VII</td>
<td>Current Liabilities.</td>
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<td>C-VIII</td>
<td><em>Troubled Debt Restructurings.</em></td>
<td>10 min.</td>
</tr>
</tbody>
</table>

*This topic is dealt with in an Appendix to the chapter.*
Problem C-I — Multiple Choice — Tangible and Intangible Assets.

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

____ 1. When the sum-of-the-years'-digits method is used, depreciation expense for a given asset will
   a. decline by a constant amount each year.
   b. be the same each year.
   c. decrease rapidly and then slowly over the life of the asset.
   d. vary from year to year in relation to changes in output.

____ 2. Marsh Corporation acquired land, buildings, and equipment from a bankrupt company at a lump-sum price of $88,000. At the time of acquisition Marsh paid $8,000 to have the assets appraised. The appraisal disclosed the following values:
   
<table>
<thead>
<tr>
<th>Asset</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>$64,000</td>
</tr>
<tr>
<td>Buildings</td>
<td>$51,200</td>
</tr>
<tr>
<td>Equipment</td>
<td>$12,800</td>
</tr>
</tbody>
</table>

   What cost should be assigned to the land, buildings, and equipment, respectively?
   a. $64,000, $51,200, and $12,800.
   b. $44,000, $35,200, and $8,800.
   c. $48,000, $38,400, and $9,600.
   d. $32,000, $32,000, and $32,000.

____ 3. In accordance with GAAP, the maximum period over which any intangible asset can be amortized is
   a. 17 years.
   b. 28 years.
   c. 40 years.
   d. 50 years.

____ 4. Purchased goodwill represents
   a. excess of price paid over fair market value of net assets obtained in a combination.
   b. excess of price paid over the book value of the net assets obtained in a combination.
   c. the difference in the aggregate amount of the market prices of the stock of the combining companies.
   d. a tangible asset.

Use the following data to answer questions 5 through 9 below:

Wilson Company purchased a new piece of equipment on July 1, 1998 at a cost of $180,000. The equipment has an estimated useful life of 5 years and an estimated salvage value of $15,000. The current year end is 12/31/99. Wilson records depreciation to the nearest month.

____ 5. What is straight-line depreciation for 1999?
   a. $16,500.
   b. $18,000.
   c. $33,000.
   d. $36,000.
6. What is sum-of-the-years'-digits depreciation for 1999?
   a. $44,000.
   b. $49,500.
   c. $54,000.
   d. $55,000.

7. What is double-declining balance depreciation for 1999?
   a. $43,200.
   b. $57,600.
   c. $66,000.
   d. $72,000.

8. If Wilson expensed the total cost of the equipment at 7/1/98, what was the effect on 1998 and 1999 income before taxes, assuming Wilson uses straight-line depreciation?
   a. $147,000 understated and $33,000 overstated.
   b. $162,000 understated and $18,000 overstated.
   c. $163,500 understated and $33,000 overstated.
   d. $180,000 understated and $18,000 overstated.

9. If, at the end of 2000, Wilson Company decides the equipment still has five more years of life beyond 12/31/00, with a salvage value of $15,000, what is straight-line depreciation for 2000? (Assume straight-line used in all years.)
   a. $18,000.
   b. $19,250.
   c. $21,750.
   d. $33,000.

Use the following data for questions 10 through 17. Each question is independent of the other questions.

Grant Corporation has a Super-Duper Machine (Machine A) that it acquired on 1/1/98 for $40,000. On 12/31/98 such machines have a selling price and fair market value of $46,000. When used in production, such machines have an estimated useful life of 10 years with no salvage value. Use the straight-line method.

Adams Corporation has a Super-Duper Machine (Machine B) that it acquired on 1/1/98 for $54,000. On 12/31/98 such machines have a selling price and fair market value of $40,000. When used in production, such machines have an estimated useful life of 10 years with no salvage value. Use the straight-line method.

On 12/31/98 Adams gave Machine B plus $6,000 cash to Grant in return for Machine A.

10. Assume that both Grant and Adams are new machine sales dealerships of Super-Duper Machines and that the machines are still new. At what amount will Super-Duper Machine A be recorded on Adams’ books?
    a. $54,000.
    b. $46,000.
    c. $60,000.
    d. $40,000.
11. Given the assumptions in 10 above, at what amount will Machine B be recorded on Grant’s books?
   a. $34,783.
   b. $54,000.
   c. $40,000.
   d. $46,783.

12. Assume that instead of dealerships, both Grant and Adams are multi-plant, multi-location manufacturers of Super-Dupers and use the machines in production. At what amount will Adams record Machine A?
   a. $40,000.
   b. $46,000.
   c. $54,000.
   d. $60,000.

13. Given the assumption in 12 above, at what amount will Grant record Machine B?
   a. $41,304.
   b. $30,000.
   c. $37,304.
   d. $31,304.

14. Given the assumption in 12 above except that the fair market values of Machines A and B are $56,000 and $50,000, respectively, at what amount will Adams record Machine A?
   a. $48,600.
   b. $56,000.
   c. $50,000.
   d. $54,600.

15. Return to the original problem. Assume that Grant is a dealership selling new Super-Duper Machines and that Adams is a manufacturer of Super-Dupers. Also assume that Adams’ asset is a truck that has been used to deliver Super-Dupers to customers. For this transaction, at what amount will Grant record the truck?
   a. $40,000.
   b. $54,600.
   c. $46,000.
   d. $48,600.

16. Given the assumptions in 15 above, at what amount will Adams record Machine A?
   a. $40,000.
   b. $46,000.
   c. $45,000.
   d. $40,500.

17. Given the assumptions in 15 above except that the selling prices and fair market values of A and B are $56,000 and $50,000, respectively, at what amount will Adams record Machine A?
   a. $48,600.
   b. $45,000.
   c. $56,000.
   d. $50,000.
For the following two questions, indicate the nature of the account or accounts to be debited when recording each transaction.

18. A replacement, which extended the life but did not increase the quality of units produced by the asset, cost $15,000.
   a. Asset(s) only.
   b. Accumulated amortization, or depletion or depreciation only.
   c. Expense only.
   d. Asset(s) and expense.

19. Joe Sloan and Ned Pratt, maintenance repairmen, spent five days in unloading and setting up a new $30,000 precision machine in the plant. Their wages earned in this five-day period totaled $800.
   a. Asset(s) only.
   b. Accumulated amortization, depletion, or depreciation only.
   c. Expense only.
   d. Asset(s) and expense.

20. Property, plant & equipment are conventionally presented in the balance sheet at
   a. replacement cost less accumulated depreciation.
   b. historical cost less salvage value.
   c. original cost less accumulated depreciation.
   d. acquisition cost less net book value thereof.

21. As generally used in accounting, what is depreciation?
   a. It is a process of asset valuation for balance sheet purposes.
   b. It applies only to long-lived intangible assets.
   c. It is used to indicate a decline in market value of a long-lived asset.
   d. It is an accounting process which allocates long-lived asset cost to accounting periods.

Use the following data for questions 22 and 23:

Tyler Company is considering acquiring Frank Company. The following information relates to Frank Company:

Net tangible assets at cost $3,000,000
Net tangible assets at fair market value $3,300,000
Average net income for the past four years $285,000
Normal rate of return for the industry 8%

22. What is the amount of goodwill if average excess earnings for the past four years are to be capitalized at the normal rate of return for the industry?
   a. $240,000.
   b. $262,500.
   c. $264,000.
   d. $300,000.

23. What is the total amount that Tyler should be willing to pay for Frank if average excess earnings for the past four years are to be capitalized at 14%?
   a. $3,450,000.
   b. $3,420,000.
   c. $2,760,000.
   d. $3,150,000.
Problem C-II — Assignment of Costs.

Match the following cost items with these appropriate accounts:

a. Land  
b. Buildings  
c. Land Improvements  
d. Other

1. Fences.
2. Back taxes on purchased plot of land to be used for building site.
3. Assessment by city for drainage system.
4. Building permits.
5. Landscaping shrubs planted after building has been constructed.
6. Demolition costs of building on land bought for plant site.
7. Interest cost incurred after completion of building construction.
8. Recording fees for land.
10. Grading and filling building site.
11. Parking lots.
12. Interest cost incurred during building construction.

Problem C-III — Research and Development.

Identify (in accordance with FASB Statement No. 2) each of the following activities as:

a. Research and development  
b. Not research and development

1. Testing in search for, or evaluation of, product or process alternatives.
2. Routine design of tools, jigs, molds, and dies.
3. Adaptation of an existing capability to a particular requirement or customer’s need.
4. Design, construction, and testing of pre-production prototypes and models.
5. Routine, on-going efforts to refine, enrich, or improve the qualities of an existing product.
6. Engineering activity required to advance the design of a product to the manufacturing stage.
7. Searching for applications of new research findings.
8. Laboratory research aimed at discovery of a new knowledge.
9. Conceptual formulation and design of possible product or process alternatives.
11. Periodic design changes to existing products.

12. Modification of the design of a product or process.

13. Design of tools, jigs, molds, and dies involving new technology.


16. Activity, including design and construction engineering related to the construction, relocation, rearrangement, or start-up of facilities or equipment.

17. Quality control during commercial production including routine testing.

18. Legal work on patent applications, sale, licensing, or litigation.

Problem C-IV — Exchange of Assets.

Assume that the following cases are independent and rely on the following data. Make entries on the books of both companies.

<table>
<thead>
<tr>
<th>Equipment (cost)</th>
<th>Beatty Co.</th>
<th>Dent Co.</th>
</tr>
</thead>
<tbody>
<tr>
<td>$180,000</td>
<td>$330,000</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Accumulated depreciation</th>
<th>Beatty Co.</th>
<th>Dent Co.</th>
</tr>
</thead>
<tbody>
<tr>
<td>58,000</td>
<td>180,000</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fair market value of equipment</th>
<th>Beatty Co.</th>
<th>Dent Co.</th>
</tr>
</thead>
<tbody>
<tr>
<td>140,000</td>
<td>140,000</td>
<td></td>
</tr>
</tbody>
</table>

1. Beatty Co. and Dent Co. traded the above equipment. They are dissimilar productive assets.

   Beatty Co.’s Books: 
   Dent Co.’s Books: 

2. Beatty Co. and Dent Co. traded the above equipment. They are similar productive assets.

   Beatty Co.’s Books: 
   Dent Co.’s Books: 

Assume that the following cases are independent and rely on the following data. Make entries on the books of both companies.

<table>
<thead>
<tr>
<th>Equipment (cost)</th>
<th>Beatty Co.</th>
<th>Dent Co.</th>
</tr>
</thead>
<tbody>
<tr>
<td>$180,000</td>
<td>$330,000</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Accumulated depreciation</th>
<th>Beatty Co.</th>
<th>Dent Co.</th>
</tr>
</thead>
<tbody>
<tr>
<td>58,000</td>
<td>210,000</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fair market value of equipment</th>
<th>Beatty Co.</th>
<th>Dent Co.</th>
</tr>
</thead>
<tbody>
<tr>
<td>112,000</td>
<td>140,000</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Cash received (paid)</th>
<th>Beatty Co.</th>
<th>Dent Co.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(28,000)</td>
<td>28,000</td>
<td></td>
</tr>
</tbody>
</table>

3. Beatty Co. and Dent Co. traded the above equipment. They are dissimilar productive assets.

   Beatty Co.’s Books: 
   Dent Co.’s Books: 

4. Beatty Co. and Dent Co. traded the above equipment. They are similar productive assets.

   Beatty Co.’s Books: 
   Dent Co.’s Books: 
Problem C-V — Long-Term Debt.

1. On March 31, 1995, the Faver Corporation sold $600,000 of its 8%, 10-year bonds for $576,900 including accrued interest. The bonds were dated January 1, 1995. Interest is paid semiannually on January 1 and July 1. On April 1, 1999, Faver purchased 1/2 of the bonds on the open market at 99 plus accrued interest and canceled them. Faver uses the straight-line method for amortization of bond premiums and discounts.

(a) What was the amount of the gain or loss on retirement of the bonds?

(b) Prepare the journal entry needed at April 1, 1999 to record retirement of the bonds. Assume that interest and premium or discount amortization have been recorded through January 1, 1999. Record interest and amortization on only the bonds retired.

(c) Prepare the journal entry needed at July 1, 1999 to record interest and premium or discount amortization.

2. On January 1 of the current year, the Fryman Corporation issued $200,000 of 10% debenture bonds on a basis to yield 9%, receiving $208,972. Interest is payable annually on December 31 and the bonds mature in 6 years. The effective interest method is used.

(a) What is the interest expense for the first year?

(b) What is the interest expense for the second year?

3. On October 1, 1998, the Meyer Company issued $400,000 par value, 10%, 10-year bonds dated July 1, 1998, with interest payable semiannually on January 1 and July 1. The bonds are issued at $454,200 (to yield 8%) plus accrued interest. The effective interest method is used.

(a) Prepare the journal entry at the date the bonds are issued.

(b) Prepare the adjusting entry at December 31, 1998, the end of the fiscal year.

(c) Prepare the entry for the interest payment on January 1, 1999.
Problem C-VI — Depreciation Methods.

A high-speed multiple-bit drill press costing $360,000 has an estimated salvage value of $30,000 and a life of ten years. What is the annual depreciation for each of the first two full years under the following depreciation methods?

1. Double-declining balance method:
   a. Year one, $______________.
   b. Year two, $______________.

2. Units of production (activity) method (lifetime output is estimated at 110,000 units; the press produced 12,000 units in year one and 18,000 in year two):
   a. Year one, $______________.
   b. Year two, $______________.

3. Sum-of-the-years'-digits method:
   a. Year one, $______________.
   b. Year two, $______________.

4. Straight-line depreciation method:
   a. Year one, $______________.
   b. Year two, $______________.

Problem C-VII — Current Liabilities.

Riley Company includes 1 coupon in each box of soap powder that it packs, 20 coupons being redeemable for a premium consisting of a kitchen utensil. In 1998, Riley Company purchased 5,000 premiums at $1.50 each and sold 160,000 boxes of soap powder @ $4.00 per box. Based on past experience it is estimated that 60% of the coupons will be redeemed. During 1998, 44,000 coupons were presented for redemption.

During 1999, 9,000 premiums were purchased at $1.60. The company sold 400,000 boxes of soap at $4.00 and 170,000 coupons were presented for redemption.

Instructions

Prepare all the entries that would be made relative to sales of soap powder and to the premium plan in both 1998 and 1999. Assume a FIFO inventory flow.
*Problem C-VIII — Accounting for Troubled Debt Restructurings.

On December 31, 1998, National Bank enters into a debt restructuring agreement with Gant Company which is experiencing financial difficulties. The bank restructures a $2,000,000 note receivable by:

1. Reducing the principal obligation from $2,000,000 to $1,600,000.
2. Extending the maturity date from 12/31/98 to 12/31/01, and
3. Reducing the interest rate from 12% to 6%.

Interest has been paid up to date as of 12/31/98.

Instructions

Discuss the nature of this transaction, indicating whether any gain or loss is recognized by either party and preparing any 12/31/98 journal entries that may be required by the debtor (Gant).
Solutions — Comprehensive Examination C

Problem C-I — Solution.

1. a 7. b 13. d 19. a
2. c 8. c 14. d 20. c
3. c 9. b 15 a 21. d
4. a 10. b 16. b *22. b
5. c 11. a 17. c *23. a
6. b 12. b 18. b

Solutions to selected computational Multiple Choice questions.

6. \((165,000 \times \frac{5}{15} \times \frac{1}{2}) + (165,000 \times \frac{4}{15} \times \frac{1}{2}) = 49,500\).

7. \(180,000 \times .4 \times \frac{1}{2} = 36,000; (180,000 - 36,000) \times .4 = 57,600\).

9. \((180,000 - 49,500 - 15,000) \times \frac{1}{6} = 19,250\).

11. \(40,000 - (40/46 \times 6,000) = 34,783\).

13. \(40,000 - (40/46 \times 10,000) = 31,304\).

Problem C-II — Solution.

1. c 6. a 11. c
2. a 7. d 12. b
3. a 8. a
4. b 9. b
5. a 10. a

Problem C-III — Solution.

1. a 7. a 13. a
2. b 8. a 14. b
3. b 9. a 15. a
4. a 10. b 16. b
5. b 11. b 17. b
6. a 12. a 18. b
### Problem C-IV — Solution.

1. **Beatty Co.'s Books**
   - Equipment: 140,000
   - Accum. Depreciation: 58,000
   - Gain on Exchange: 18,000
   - Equipment: 180,000

   **Dent Co.'s Books**
   - Equipment: 140,000
   - Accum. Depreciation: 180,000
   - Loss on Exchange: 10,000
   - Equipment: 330,000

2. Equipment: 122,000
   - Accum. Depreciation: 58,000
   - Equipment: 180,000

3. Equipment: 140,000
   - Accum. Depreciation: 58,000
   - Loss on Exchange: 22,000
   - Cash: 28,000

   **Equipment:** 180,000
   - Gain on Exchange: 20,000
   - Cash: 40,000

   **Equipment:** 330,000

4. Same as 3.
   - Equipment: 96,000
   - Accum. Depreciation: 210,000
   - Cash: 28,000
   - Gain on Exchange: 4,000
   - Equipment: 330,000

   ![Math equation]

### Problem C-V — Solution.

1. **(a) Face amount of bonds**
   - Total selling price: $576,900
   - Less accrued interest ($600,000 × 0.08 × 3/12): 12,000
   - Carrying value at 3/31/95: $564,900
   - Discount at 3/31/95: $35,100
   - Less discount amortized ($35,100 ÷ 117 mos. × 48 months): 14,400
   - Unamortized discount at 4/1/99: 20,700
   - Carrying value at 4/1/99: $579,300
   - Carrying value of 1/2 of the bonds: $289,650
   - Less acquisition price ($600,000 × 0.99 × 1/2): 297,000
   - Loss (extraordinary) on retirement: $7,350

   **(b) Interest Expense**
   - Discount on Bonds Payable ($150 × 3): 450
   - Cash: 6,000
   - (To accrue interest to 4/1/99: $600,000 × 0.08 × 3/12 × 1/2 = $6,000)

   **Bonds Payable** 300,000
   - **Loss (Extraordinary) on Retirement of Bonds** 7,350
   - **Discount on Bonds Payable** 10,350
   - **Cash** 297,000
   - (To remove carrying value of bonds)
(c) Interest Expense ......................................................... 12,900
  Discount on Bonds Payable ........................................ 900
  Cash ................................................................. 12,000
  (Discount amortization:
   $35,100 ÷ 117 mos. × 6 mos. × 1/2 = $900)

2. (a) First year interest expense:
   $208,972 × .09 = $18,807.48

(b) Second year interest expense:
   $20,000 - $18,807.48 = $1,192.52  Premium amortization (First year).
   $208,972 - $1,192.52 = $207,779.48  Book value of bonds at the beginning of the
   second year.
   $207,779.48 × .09 = $18,700.15  Interest expense.

3. (a) Cash ................................................................. 464,200
    Bonds Payable ................................................. 400,000
    Premium on Bonds Payable .............................. 54,200
    Interest Payable ............................................. 10,000

(b) Interest Expense ..................................................... 9,084
    Premium on Bonds Payable .............................. 916
    Interest Payable ............................................. 10,000
    (Interest expense: $454,200 × .08 × 3/12 = $9,084)

(c) Interest Payable ..................................................... 20,000
    Cash ............................................................. 20,000

Problem C-VI — Solution.

1. a. $72,000
   b. $57,600

2. a. $36,000
   b. $54,000

3. a. $60,000
   b. $54,000

4. a. $33,000
   b. $33,000
Problem C-VII — Solution.

1998

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium Inventory (1998)</td>
<td>7,500</td>
</tr>
<tr>
<td>Cash (or Accounts Payable)</td>
<td>7,500</td>
</tr>
<tr>
<td>(5,000 × $1.50)</td>
<td></td>
</tr>
<tr>
<td>Cash (or Accounts Receivable)</td>
<td>640,000</td>
</tr>
<tr>
<td>Sales</td>
<td>640,000</td>
</tr>
<tr>
<td>(160,000 × $4.00)</td>
<td></td>
</tr>
<tr>
<td>Premium Expense</td>
<td>3,300</td>
</tr>
<tr>
<td>Premium Inventories (1998)</td>
<td>3,300</td>
</tr>
<tr>
<td>(44,000 ÷ 20 = 2,200 × $1.50 = $3,300)</td>
<td></td>
</tr>
<tr>
<td>Premium Expense</td>
<td>3,900</td>
</tr>
<tr>
<td>Estimated Liability for Premiums</td>
<td>3,900</td>
</tr>
<tr>
<td>(160,000 × .60 = 96,000 coupons)</td>
<td></td>
</tr>
<tr>
<td>96,000 - 44,000 = 52,000 ÷ 20 = 2,600 premiums</td>
<td></td>
</tr>
<tr>
<td>2,600 × $1.50 = $3,900)</td>
<td></td>
</tr>
</tbody>
</table>

1999

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium Inventory (1999)</td>
<td>14,400</td>
</tr>
<tr>
<td>Cash (or Accounts Payable)</td>
<td>14,400</td>
</tr>
<tr>
<td>(9,000 × $1.60)</td>
<td></td>
</tr>
<tr>
<td>Cash (or Accounts Receivable)</td>
<td>1,600,000</td>
</tr>
<tr>
<td>Sales</td>
<td>1,600,000</td>
</tr>
<tr>
<td>(400,000 × $4.00)</td>
<td></td>
</tr>
<tr>
<td>Estimated Liability for Premiums</td>
<td>3,900</td>
</tr>
<tr>
<td>Premium Inventories (1998)</td>
<td>3,900</td>
</tr>
<tr>
<td>(2,600 × $1.50 = $3,900; balance of 1998 coupons redeemed)</td>
<td></td>
</tr>
<tr>
<td>Premium Expense</td>
<td>9,420</td>
</tr>
<tr>
<td>Premium Inventories (1998)</td>
<td>300</td>
</tr>
<tr>
<td>[5,000 - 2,200 - 2,600 = 200 × $1.50 = $300]</td>
<td></td>
</tr>
<tr>
<td>Premium Inventories (1999)</td>
<td>9,120</td>
</tr>
<tr>
<td>[170,000 ÷ 20 = 8,500 - (200 + 2,600) = 5,700 × $1.60 = $9,120]</td>
<td></td>
</tr>
<tr>
<td>Premium Expense</td>
<td>9,760</td>
</tr>
<tr>
<td>Estimated Liability for Premiums</td>
<td>9,760</td>
</tr>
<tr>
<td>[Total 1999 coupons estimated to be redeemed: 400,000 × .60 = 240,000]</td>
<td></td>
</tr>
<tr>
<td>Coupons redeemed in 1999</td>
<td>170,000</td>
</tr>
<tr>
<td>Coupons redeemed in 1999 attributable to 1998</td>
<td>(52,000)</td>
</tr>
<tr>
<td>Coupons estimated to be redeemed subsequent to 1999</td>
<td>122,000</td>
</tr>
<tr>
<td>Estimated liability (122,000 ÷ 20 = 6,100 × $1.60)</td>
<td>$9,760</td>
</tr>
</tbody>
</table>
Problem C-VIII — Solution.

The transaction between Gant Company and National Bank represents a "troubled debt restructuring," wherein there is a continuation of the debt with a modification of terms. Because the total future cash flows after restructuring of $1,888,000 are less than the total prerestructure carrying amount of $2,000,000, the debtor must record a gain and the creditor must record a loss due to the restructuring of the debt.

Gant Company would record the debt restructure as follows on December 31, 1998:

Note Payable ....................................................................................... 112,000*
Gain on Restructured Debt (Extraordinary) ........................................ 112,000

*[$2,000,000 - ($1,600,000 + $96,000 + $96,000 + $96,000)]

Because the new effective interest rate is 0%, all of the future cash flows reduce the principal balance, and no interest expense would be recognized by the debtor throughout the remainder of the note.

National Bank would calculate its loss based upon the expected future cash flows discounted at the historical effective rate of the loan. The loss on restructuring is written off against the allowance account and the note receivable is reduced.