A. Multiple choice (30%):choose the best answer.

1. Which of the following statements about materiality is not correct?
a. An item must make a difference or it need not be disclosed.
b. Materiality is a matter of relative size of importance.
c. An item is material if its inclusion or omission would influence or change the judgment of a reasonable person.
d. All of these are correct statements about materiality.

2. On May 15, 1993, Munn, Inc. approved a plan to dispose of a segment of its business. It is expected that the sale will occur on February 1, 1994 at a selling price of $500,000. During 1993, disposal costs incurred by Munn totaled $75,000. The segment had actual or estimated operating losses as follows:

1/1/93 to 5/14/93	$130,000
5/15/93 to 12/31/93	50,000
1/1/94 to 1/14/94	15,000

The carrying amount of the segment at the date of sale was expected to be $850,000. Before income taxes, what amount should Munn report as a loss on disposal of the segment in its 1993 income statement?
a. $490,000.
b. $475,000.
c. $440,000.
d. $425,000.
e. None of the above.

3. On January 3, 1993, Ard Corp. owned a machine that had cost $60,000. The accumulated depreciation was $50,000, estimated salvage value was $5,000, and fair market value was $90,000. On January 4, 1993, this machine was irreparably damaged by Rice Corp. and became worthless. In October 1993, a court awarded damages of $90,000 against Rice in favor of Ard. At December 31, 1993, the final outcome of this case was awaiting appeal and was, therefore, uncertain. However, in the opinion of Ard's attorney, Rice's appeal will be denied. At December 31, 1993, what amount should Ard accrue for this contingency?
a. $90,000.
b. $80,000.
c. $75,000.
d. $0.
e. none of the above.

4. On July 1, 1993, James Rago signed an agreement to operate as a franchisee of Fast Foods, Inc., for an initial franchise fee of $60,000. Of this amount, $20,000 was paid when the agreement was signed and the balance is payable in four equal annual payments of $10,000 beginning July 1, 1994. The agreement provides that the down payment is not refundable and future services are required of the franchisor. Rago's credit rating indicates that he can borrow money at 14% for a loan of this type. Information on present and future value factors is as follows:

Present value of 1 at 14% for 4 periods	0.59
Future amount of 1 at 14% for 4 periods	1.69
Present value of an ordinary annuity of 1 at 14% for 4 periods	2.91

Rago should record the acquisition cost of the franchise on July 1, 1993 at
a. $36,900.
b. $49,100.
c. $60,000.
d. $20,000.
e. none of the above.

5. Information concerning the capital structure of Krone Corporation as of Dec. 31, 1993 is as follows:

Common stock	100,000 shares
Convertible preferred stock	10,000 shares
9% convertible bonds	$1,000,000

The capital structure is the same as last year.
During 1993, Krone paid dividends of $1.00 per share on its common stock and $2.50 per share on its preferred stock. The preferred stock is convertible into 20,000 shares of common stock, but is not considered a common stock equivalent. The 9% convertible bonds are convertible into 50,000 shares of common stock and are considered common stock equivalents. The net income for the year ended December 31, 1993, was $400,000. Assume that the income tax rate was 30%. What should be the primary earnings per share for the year ended December 31, 1993, rounded to the nearest penny?
a. $2.67.
b. $2.50.
c. $2.92.
d. $3.09.
e. none of the above.

6. Dart Co. is making a four-column bank reconciliation at June 30 from the following data. The amounts per bank statement were: Balance May 31, $5,200; June Receipts, $10,400; June Disbursements, $11,000. The amounts per books were: Balance May 31, $6,335; June Receipts, $8,948; June Disbursements, $11,235; Balance June 30, $4,048.

	May 31	June 30
Deposits in transit	$1,200	$1,500
Outstanding checks	670	840
The bank overlooked a check for $75 when recording a deposit on June 10.		
Note collected by bank, recorded after receiving the bank statement		1,800
Service charge, recorded after receiving the bank statement	45	60
NSF checks recorded after receiving the bank statement	560	480
Dart recorded a $374 check received from a customer in June as $347.		

The corrected balance per bank on June 30 is
a. $5,185.
b. $5,260.
c. $5,335.
d. $6,175.
e. none of the above.

7. Which of the following is true when a company changes to LIFO from another method of inventory valuation?
a. The cumulative effect of the change must be reported on the income statement in the year of the change.
b. Formal journal entries are required to restate the inventory in all cases except where the change is to LIFO from a lower of cost or market approach.
c. A prior-period adjustment is made to restate the reported net incomes of prior years.
d. The base-year inventory for all subsequent LIFO computations is the opening inventory of the year LIFO is adopted.
e. none of the above.

8. On December 31, 1992, Beal Co. has $1,600,000 of short-term notes payable due on February 14, 1993. On January 10, 1993, Beal arranged a line of credit with City Bank which allows Beal to borrow up to $1,200,000 at one percent above the prime rate for three years. On February 2, 1993, Beal borrowed $1,000,000 from City Bank and used $450,000 additional cash to liquidate $1,450,000 of the short-term notes payable. The amount of the short-term notes payable that should be reported as current liabilities on the December 31, 1992 balance sheet which is issued on March 5, 1993 is
a. $0.
b. $150,000.
c. $400,000.
d. $600,000.
e. none of the above.

9. Peterson Corporation owns 80 percent of Sibley Company which, in turn, owns 10 percent of Peterson Corporation. Both acquisition were at book value. Both companies report net income for the year and declared no dividends. What effect do the traditional allocation and treasury stock method have on Peterson's equity basis net income?
a. It will be the same under either allocation method.
b. It will be higher under the traditional allocation method.
c. It will be higher under the traditional allocation method if, and only if, Peterson's net income exceeds Sibley's net income.
d. It will be lower under the traditional allocation method.
e. None of the above

10. Relevant data for Perkins and its 80-percent owned subsidiary Sloan for 1992 and 1993 are as follows:

	1992	1993
Intercompany sales	40,000	60,000
Intercompany cost of goods sold	24,000	39,000
Inventory at 12/31 of merchandise purchased intercompany	5,000	12,000
Net income from own operations:		
Perkins		80,000
Sloan		20,000

What is 1993 consolidated net income if the intercompany sales are upstream?
a. $92,160
b. $93,800
c. $94,240
d. $97,800
e. None of the above

B. 4 Problems (70%)

I.(20%) Lily Inc. began business on January 1, 1992. Its pretax financial income for the first 2 years was as follows:

1992	$ 50,000
1993	120,000

The following items caused the only differences between pretax financial income and taxable income.

1. In 1992 the company collected $36,000 of rent; of this amount, $12,000 was earned in 1992; the other $24,000 will be earned equally over the 1993-1994 period. The full $36,000 was included in taxable income in 1992.

2. In 1992 the company recorded $30,000 of goodwill and is amortizing this amount on the books over 10 years (a full year's amortization was taken in 1992). Goodwill amortization is not deductible for tax purposes.

3. In 1993 the company terminated a top executive and agreed to $24,000 of severance pay. The amount will be paid $8,000 per year for 1993-1995. The 1993 payment was made. The $24,000 was expensed in 1993. For tax purposes, the severance pay is deductible as it is paid.

The enacted tax rates existing at December 31, 1992 and 1993 are:

12/31/92		12/31/93	
1992 . . . 40%	1994 . . . 30%	1993 ... 30%	1995 ... 30%
1993 . . . 35%	1995 . . . 30%	1994 ... 30%	

Required:(a) Prepare the journal entry to record income taxes for 1992 and 1993.
(b) Show how the deferred income taxes should be reported on the balance sheet at December 31, 1993.

II.(15%) Rose Company began construction of a small building on January 1, 1993. The company's only debt during the first quarter was an unrelated long-term $300,000 note bearing interest at 11% per annum, maturity date, December 31, 1995. On May 1, 1993, the company borrowed $100,000 on a 9% construction note; the note matures on April 30, 1994. The company capitalizes interest on the building on the basis of average quarterly cumulative expenditures. As of the end of each quarter of the six-month construction period, construction expenditures (not including interest) are as shown below. Rose's reporting year ends on December 31. Interest is paid quarterly.

Date, 1993	Expenditure		Date, 1993	Expenditure	
Jan. 1	Land	$ 20,000	April 30	Construction	$200,000
Jan. 31	Construction	70,000	May 31	Construction	170,000
Feb. 28	Construction	100,000	Jun 30	Construction	80,000
March 31	Construction	180,000			

Required: Give all journal entries related to construction and interest cost during the construction period. (assume that the company prepares the entries at the end of each quarter)

III.(20%)Carnation Company has a defined benefit pension plan that has been in operation for several years. At the end of 1992, the company's balance sheet includes the following items related to this pension plan:

Prepaid/Accrued pension cost (debit balance)	\$25,700
Additional pension liability (credit balance)	72,000
Intangible pension assets (debit balance)	72,000

Management has correctly determined the following information for 1993:

Net periodic pension cost for year	\$150,000
Funding into pension plan for year	150,000
Accumulated benefit obligation at end of year	751,000
Fair value of plan assets at end of year	655,000
Unrecognized prior service cost at end of year	67,000

Required: (a) Prepare the journal entries required to record the annual expense and funding and the adjustment to the additional liability.

(b) Show the pension related amounts on partial financial statements.

IV.(15%) The December 31, 19xx trial balance of a German subsidiary is as follows:

Cash and Receivables........................	DM	240,000	
Property, Plant, and Equipment (net).........		360,000	
Current Payables............................			80,000
Long-Term Debt..............................			120,000
Capital Stock...............................			40,000
Retained Earnings...........................			150,000
Service Revenue.............................			600,000
Depreciation Expense........................		40,000	
Other Expenses..............................		350,000	
	DM	990,000	990,000

The following exchange rates for the German mark are available:

Spot rate at Jan. 1	0.6025
Spot rate at Dec. 31.................	0.6450
Weighted average rate for 19xx.......	0.6225

The US parent acquired the stock of the subsidiary on January 1, 19xx. The fixed asset accounts had a net balance of DM 400,000 at that time, Cash and Receivables were DM 50,000, and total liabilities were DM 260,000. The change in the fixed asset balance is due to the current year's depreciation.

Required: Assume that the German mark is the functional currency. Prepare in US dollars
(a) an income statement; (b) a balance sheet.