10. Explain the difference between the intrinsic value method and the fair value method of pricing stock options and how it affects the balance sheet and the income statement.

Intrinsic value method values the stock option based on the remaining months in the year.

Fair value method takes into account the remaining months in the year and the rest of the months in a 12 month time frame.

21-25. Listed below are reporting classifications for a statement of cash flows using the indirect method for reporting operating cash flows. Indicate the reporting classification that would apply to each of the five transactions described below by placing the letter of the reporting classification in the space provided by each transaction.

Terms:
A. Operating activity, no adjustment to net income
B. Operating activity, negative adjustment to net income
C. Operating activity, positive adjustment to net income
D. Investing cash inflow
E. Investing cash outflow
F. Financing cash inflow
G. Financing cash outflow
H. Noncash financing and investing activity

Phrases:
21. B. Increase in inventory account.
22. E. Payment of cash dividends.
23. C. Cash sales.
24. B. Prepayment of an insurance premium for six months.
25. D. Cash proceeds from sale of equipment.

Terms:
A. Operating activity, no adjustment to net income
B. Operating activity, negative adjustment to net income
C. Operating activity, positive adjustment to net income
D. Investing cash inflow
E. Investing cash outflow
F. Financing cash inflow
G. Financing cash outflow
H. Noncash financing and investing activity

Phrases:
26. B. Payment of semi-annual interest on bonds payable.
27. E. Acquisition of a building for cash.
28. C. Depreciation expense.
29. F. Issuance of bonds at a discount for cash.
30. B. Decrease in account payable.

The balance sheets of Baldwin Corporation for December 31, 1997 and 1998 are shown below:

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$ 16,300</td>
<td>$ 32,000</td>
</tr>
<tr>
<td>Receivables, net</td>
<td>47,000</td>
<td>41,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>179,000</td>
<td>182,000</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>6,200</td>
<td>5,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>208,200</td>
<td>134,000</td>
</tr>
<tr>
<td>Accumulated depreciation</td>
<td>(42,600)</td>
<td>(28,800)</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>$414,100</strong></td>
<td><strong>$365,200</strong></td>
</tr>
</tbody>
</table>

| Accounts payable | $118,600 | $77,600  |
| Long-term bonds payable (net) | 36,800   | 84,800   |
| Common stock, no par | 160,000  | 140,000  |
| Retained earnings | 98,700   | 62,800   |
| **Total equities** | **$414,100** | **$365,200** |

The company's income statement and ledger accounts revealed the following additional information:

a. Net income for 1998 was $54,400.
b. Fully depreciated equipment that had cost $4,800 was discarded, and its cost and accumulated depreciation were removed from the accounts.
c. A portion of the bond issue was retired by an open market purchase of $52,000. The loss of $3,000 was included in net income. No new bonds were issued during the year, and $1,000 of bond discount was amortized.
d. During the year, equipment with a fair value of $20,000 was acquired in exchange for 1,000 shares of Baldwin common stock. Since the stock is not publicly traded, the value of the equipment was used to value the transaction.

**REQUIRED:** Prepare a statement of cash flows for the year ended December 31, 1998. Use the indirect method of computing cash provided by operating activities.
Rumsfeld Corporation leased a machine on December 31, 2006, for a three-year period. The lease agreement calls for annual payments in the amount of $16,000 on December 31 of each year beginning on December 31, 2006. Rumsfeld has the option to purchase the machine on December 31, 2009, for $20,000 when its fair value is expected to be $30,000. The machine’s estimated useful life is expected to be 5 years with no residual value. Rumsfeld uses straight-line depreciation for this type of machinery. The appropriate interest rate for this lease is 12%.

<table>
<thead>
<tr>
<th>n/i</th>
<th>PV of $1</th>
<th>PV, ordinary annuity</th>
<th>PV, annuity due</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 period, 12%</td>
<td>0.89286</td>
<td>0.89286</td>
<td>1.00000</td>
</tr>
<tr>
<td>2 periods, 12%</td>
<td>0.79719</td>
<td>1.69005</td>
<td>1.89286</td>
</tr>
<tr>
<td>3 periods, 12%</td>
<td>0.71178</td>
<td>2.40183</td>
<td>2.69005</td>
</tr>
</tbody>
</table>

(1.) Calculate the amount to be recorded as a leased asset and the associated lease liability.
(2.) Prepare Rumsfeld’s journal entries for this lease for 2006 and 2007.

1) \[
\frac{16,000 \times 2.69005}{20,000 \times 0.71178} = \frac{43,041}{14,236} = \frac{57,277}{57,277}
\]

Dec 31, 2006

<table>
<thead>
<tr>
<th>Lease equipment 57,277</th>
<th>Lease payable 57,277</th>
</tr>
</thead>
</table>

Lease payable

<table>
<thead>
<tr>
<th>Cash 16,000</th>
<th>16,000</th>
</tr>
</thead>
</table>

Dec 31, 2007

<table>
<thead>
<tr>
<th>Lease payable 11,557</th>
<th>Interest Expense 4,953</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Cash 16,000</th>
<th>Depreciation Expense 11,455</th>
</tr>
</thead>
</table>

| Accumulated depreciation 11,455 |

3. Prepare an amortization schedule for this lease.

<table>
<thead>
<tr>
<th>Payments</th>
<th>Excess interest</th>
<th>Reduction in balance</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec 06 16,000</td>
<td>0</td>
<td>16,000</td>
<td>41,277</td>
</tr>
<tr>
<td>Dec 07 16,000</td>
<td>4,953</td>
<td>11,047</td>
<td>30,230</td>
</tr>
<tr>
<td>Dec 08 16,000</td>
<td>3,628</td>
<td>12,372</td>
<td>17,858</td>
</tr>
</tbody>
</table>
140. On December 31, 2005, Jackson Company had 100,000 shares of common stock outstanding and 30,000 shares of 7%, $50 par, cumulative preferred stock outstanding. On February 28, 2006, Jackson purchased 24,000 shares of common stock on the open market as treasury stock $35 per share. Jackson sold 6,000 treasury shares on September 30, 2006, for $37 per share. Net income for 2006 was $180,905. Also outstanding during the year were stock options giving key personnel the option to buy 50,000 common shares at $40. During 2006, the average market price of the common shares was $38 with a closing price of $39 on December 31, 2006.

**Required:**
- Compute Jackson's basic and diluted earnings per share for 2006.

\[
\text{Basic} = \frac{180,905 - 105,000}{100,000 - 24,000 \left(\frac{10}{12}\right) + 6,000 \left(\frac{3}{12}\right)} = \frac{75,905}{81,500} = 0.93
\]

\[
\text{Diluted} = \frac{180,905 - 105,000}{100,000 - 24,000 \left(\frac{10}{12}\right) + 6,000 \left(\frac{3}{12}\right) + (50,000 - 52,631)} = \frac{75,905}{78,369} = 0.96
\]

\[
\frac{50,000}{2 \text{ Million}} = \frac{5 \text{ Million}}{2 \text{ Million}} = 2.5
\]

137. On January 1, 2006, Shamu Corporation had 100,000 shares of common stock outstanding. The following transactions occurred during 2006:

- March 1: Reacquired 3,000 shares, accounted for as treasury stock.
- September 30: Sold all the treasury shares.
- December 1: Sold 12,000 new shares for cash.
- December 31: Reported a net income of $198,500.

The following transactions occurred during 2007:

- January 10: Declared and issued a 25% stock dividend.
- December 31: Reported a net income of $268,800.

**Required:**
- Calculate Shamu's basic earnings per share for both years for presentation in comparative financial statements that will be prepared at the end of 2007.
123. Steverino Inc. offers a restricted stock award plan to its vice presidents. On January 1, 2006, the corporation granted 10 million of its $5 par common shares, subject to forfeiture if employment is terminated within 2 years. The common shares have a market value of $10 per share on the date the award is granted.

**Required:**
(1.) Assume that no shares are forfeited. Determine the total compensation cost pertaining to the restricted shares.
(2.) Prepare the appropriate journal entries related to the restricted stock through December 31, 2007.

1) \( 10,000,000 \times 10 = 100,000,000 \)

2) **Dec 31, 2006**

   Retained earnings 50,000,000
   Paid in capital - restricted stock 25,000,000
   Common stock 25,000,000

Dec 31, 2007

   Retained Earnings 50,000,000
   Paid in capital - restricted stock 25,000,000
   Common stock 25,000,000

---

I AM GOING TO WORK FOR/HAVE INTERNSHIP WITH:
Baldwin Corp
Statement of Cash Flows
Year Ended Dec 31, 1998

Operating Activities
Net Income 54,400
Increase in Accounts Receivables (6,000)
Decrease in Inventory 3,000
Increase in prepaid expenses (1200)
Depreciation Expense 13,300
Increase in Accounts payable 41,000
Loss on Sale of bond 3,000
Amortization of bond discount 1,000
Net cash flows from operating activities 109,000

Investing Activities
Equipment (74,200)

Net cash flows from investing activities (74,200)

Financing Activities
Bonds Payable 52,000
Dividends Paid (44,000)
(35,100)

Net cash flows from financing activities (31,900)

Change in cash
Beginning balance in cash 15,700
Ending balance in cash 32,000
16,300

Net cash flows from operating activities 109,000
Net cash flows from investing activities (74,200)
Net cash flows from financing activities (31,900)
Change in cash 16,300
Beginning balance in cash 32,000
Ending balance in cash 16,300