The December 31, 1997 balance sheet of MBI Company included the following:

- Common stock, 20 million shares outstanding at $1 par: $20,000,000
- Paid-in-capital - excess of par: 100,000,000
- Retained earnings: 115,000,000

MBI had the following transactions in 1997 relating to treasury stock:

- March 17, 1997 reacquired 2 million shares at $10
- May 17, 1997 reacquired 2 million shares at $9
- August 10, 1997 sold 3 million shares at $12

**Required:**
Assuming MBI uses the cost method, prepare journal entries to record the foregoing transactions on a FIFO basis.

- **March 17, 1997**
  - Treasury stock (2M x $10)
  - Cash
  - 20,000,000

- **May 17, 1997**
  - Treasury stock (2M x $9)
  - Cash
  - 18,000,000

- **August 10, 1997**
  - Cash (3M x $12)
  - Treasury stock *
  - Paid-in-capital - reacquired shares
  - 36,000,000
  - *2M x $10 = $20,000,000
  - 1M x $9 = $9,000,000
  - $29,000,000

Bestword, Inc. offers a variety of stock-based compensation plans to its employees. Under its nonqualified stock option plan, the company grants options to key officers on January 1, 1997. The options permit holders to acquire 5 million shares of $1 par common stock for $15 per share within the next 5 years, but not before January 1, 2000 (the vesting date). The market price per share on the grant date was $18 per share. The fair value of the options, estimated by an appropriate option pricing model, is $4 per option. Bestword chooses NOT to follow the fair value approach.

**Required:**
1. Determine the total compensation cost pertaining to the stock option plan.
3. Record the exercise of the options if all are exercised on May 11, 2001, when the market price per share is $20.

- **18-110**
  1. \((18-15) \times 5M\) shares = $15,000,000
     - Compensation expense ($15M/3yrs) 5,000,000
     - Paid-in-capital - stock options 5,000,000
  3. Cash ($15 x 5M)
     - 75,000,000
     - Paid-in-capital - stock options 15,000,000
     - Common stock 5,000,000
     - Paid-in-capital - excess of par 85,000,000
113. Tobac Company reported a pretax operating loss of $50,000 for financial reporting and tax purposes in 2000. The enacted tax rate is 40% for 2000 and subsequent years. Assume that Tobac requests a refund of taxes already paid by electing a loss carryback. Taxable income, tax rates, and income taxes paid in Tobac's first four years of operations were as follows:

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rates</th>
<th>Taxes paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996 $30,000</td>
<td>30%</td>
<td>$9,000</td>
</tr>
<tr>
<td>1997 35,000</td>
<td>30%</td>
<td>10,500</td>
</tr>
<tr>
<td>1998 42,000</td>
<td>35%</td>
<td>14,700</td>
</tr>
<tr>
<td>1999 40,000</td>
<td>40%</td>
<td>16,000</td>
</tr>
</tbody>
</table>

Required:
1.) Prepare the journal entry to record Tobac's income taxes for the year 2000. Show well-labeled computations.
2.) Compute Tobac's net loss for 2000

Difficulty: Medium

Answer:
1. Receivable income tax refund ($14,700 + $3,200) = 17,900
Income tax benefit operating loss (to balance) = 17,900

<table>
<thead>
<tr>
<th>Prior years</th>
<th>Current year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>1999</td>
</tr>
<tr>
<td>Operating loss</td>
<td>$(42,000)</td>
</tr>
<tr>
<td>Loss carryback</td>
<td>$(8,000)</td>
</tr>
<tr>
<td>Tax rates</td>
<td>35%</td>
</tr>
<tr>
<td>Tax refund</td>
<td>$(14,700)</td>
</tr>
</tbody>
</table>

(2.) Net loss for 2000 is $32,100 (50,000 - 17,900 tax benefit of NOL)

17-58 The following information is related to the defined benefit pension plan of Desksoft Company for 1997:

- Service cost: $80,000
- Contributions to pension plan: $140,000
- Benefits paid to retirees: $110,000
- Plan assets (fair value), January 1: $540,000
- Plan assets (fair value), December 31: $650,000
- Actual return on plan assets: $80,000
- PBO, January 1: $800,000
- PBO, December 31: $870,000
- Settlement rate: 10%
- Long-term expected return on plan assets: 9%

Assuming no other relevant data exists, what is the pension expense for 1997?

a. $80,000
b. $220,600
c. $111,400
d. $144,000

Explanation: $80,000 + (10% x $800,000) - (9% x $540,000) = $111,400
Recognizing tax benefits in a loss year due to a net operating loss carryforward requires
a. creating a deferred tax liability.
b. footnot disclosure only.
c. creating a new carryforward.
d. creating a deferred tax asset.

To help assess the uncertainties that surround a defined benefit pension plan, corporation frequently hire
a(n)

a. CPA.
b. lawyer.
c. investment analyst.
d. actuary.

Indicate by letter whether each of the transactions listed below increases (I), decreases (D), or has no effect (N) on retained earnings. Assume the shareholders' equity of the transacting company includes only common stock, paid-in-capital - excess of par, and retained earnings.

Transactions

N 1. Sale of common stock
D 2. Declaration of a property dividend
E 3. Net income for the year
D 4. Declaration of a cash dividend
N 5. Payment of a previously declared cash dividend
N 6. Issuance of convertible bonds for cash
D 7. Declaration of a 5% stock dividend
N 8. Retirement of common stock at a cost less than the original issue price
D 9. Retirement of common stock at a cost greater than the original issue price
N 10. A stock split

The purpose of interperiod tax allocation is to

a. recognize an asset or liability for the tax outcome of temporary differences that exist on the balance sheet date.
b. amortize the deferred tax asset that exists on the balance sheet.
c. allocate the deferred tax liability that exists on the balance sheet.
d. allow corporations to average their tax liability over a period of fiscal years.

Of the following temporary differences, which one ordinarily creates a deferred tax asset?

a. depreciation.
b. installment sales.
c. completed-contract method for long-term construction contracts.
d. accrued warranty expense.

Under SFAS 87, delayed recognition of gains and losses achieves

a. income averaging.
b. expense averaging.
c. income optimization.
d. income smoothing.
On January 1, 1994, Requisite Corporation purchased a building for $20,000,000. Requisite uses straight-line depreciation for financial reporting and MACRS for tax purposes. At December 31, 1996, the carrying value of the building was $18,000,000 and its tax basis was $15,000,000. At December 31, 1997, the carrying value of the building was $16,000,000 and its tax basis was $11,000,000. There were no other temporary differences and no non-temporary differences. Pretax accounting income for 1997 was $25,000,000.

Income tax expense (to balance) 8,750,000
Deferred tax liability (see below) 700,000
Income tax payable (see below) 8,050,000

<table>
<thead>
<tr>
<th>Book income</th>
<th>1997</th>
<th>Future taxable amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>$25,000,000</td>
<td></td>
<td>$5,000,000 (16M - 11M)</td>
</tr>
</tbody>
</table>

Depreciation diff (18M - 15M) - (16M - 11M) (2,000,000)
Taxable income 23,000,000
Tax rate 35%
Current income tax payable 8,050,000
Deferred tax liability (5M x 35%) 1,750,000
Less beginning balance (18M - 15M) x 35% 1,050,000
Change in deferred tax balance 700,000

The following information relates to Compto Company's defined benefit pension plan during 1998:

- Plan assets at fair value, January 1 $500,000,000
- Expected return on plan assets 50,000,000
- Actual return on plan assets 40,000,000
- Contributions to the pension fund (end of year) 80,000,000
- Amortization of unrecognized loss 10,000,000
- Pension benefits paid (end of year) 12,000,000
- Pension expense 60,000,000

Required:

Determine the amount of pension plan assets at fair value on December 31, 1998.

Plan assets beginning of 1998 $500,000,000
Actual return 40,000,000
Cash contributions 80,000,000
Retiree benefits (12,000,000)
Plan assets end of 1998 $608,000,000

CONTRAST APB 11 INCOME STATEMENT METHOD WITH FASB 96 & 109 ASSET-LIABILITY METHOD. (BONUS +5)

APB 11: BOOK INCOME X TAX RATE = TAX EXPENSE - TAX PAYABLE - DEFERRED T.
FASB 109: CURRENT TAX PAYABLE + DEFERRED TAX LIABILITY = TAX EXPENSE

THIS TEST WAS: