Multiple Choice (1 point each): Circle the best answer from among those listed.

1. When the fair value of a company's portfolio of available-for-sale equity securities is less than its
   book value, the difference should be:
   A) Added as an impairment
   B) Added to stockholders' equity of the investee
   C) Recorded on the company's income statement
   D) Subtracted from the investment account
   E) French fried for human consumption

2. Which of the following statements is not true of the fair-value method of accounting for
   marketable securities?
   A) The investment account is recorded at current fair value on the balance sheet.
   B) Interim changes in the investments' fair value may or may not affect income depending on the
      securities' classification.
   C) This method is used when the reporting company generally has no significant influence over
      the investee.
   D) Dividends are treated as a return of the capital invested.
   E) The fair value of the investment is both recorded and disclosed in the financial reports.

3. Paris Corporation purchases an investment in Hollywood, Inc. at a purchase price of $8 million
   cash, representing 40% (at book value) of Hollywood. During the year, Hollywood reports net
   income of $800,000 and pays $200,000 of cash dividends. At the end of the year, the market
   value of Paris's investment is $9.2 million. What amount of equity earnings would be reported by
   Paris Corporation?
   A) $80,000
   B) $320,000
   C) $240,000
   D) $800,000
   E) $1,520,000

4. Which of the following would not be considered an intangible asset?
   A) Trademarks and internet domain names
   B) Plant, Property, and Equipment
   C) Patents and computer software
   D) Customer lists, production backlog, and customer contracts
   E) Data bases and trade secrets.

5. During the current year, BiblioTech purchases 10% of E-text Inc. for $5,000,000 and accounts for
   it as an available-for-sale security. During the year E-text reports a net loss of $1,000,000 and
   pays total dividends of $600,000. At the end of the current year, the BiblioTech investment in E-
   Text, Inc. has a fair market value of $4,800,000. Which of the following describes the change in
   BiblioTech's investment in E-text during the year?
   A) The investment increases by $40,000.
   B) The investment decreases by $200,000.
   C) The investment decreases by $240,000.
   D) The investment decreases by $40,000.
   E) The investment decreases by $600,000.
6. Which of the following statements is FALSE?
   A) It is desirable to have lower accounts payable turnover.
   B) Accounts payable are a short-term source of non-interest-bearing financing.
   C) A convertible bond is typically convertible into preferred stock.
   D) Unearned revenue arises when a company receives cash before services are performed.
   E) A bond perpetuity has no due date.

7. When a bond is sold at a discount, which of the following statements must be TRUE:
   A) The market yield is higher than the face rate of the bond.
   B) The face amount of each bond must be more than $1,000.
   C) The interest expense will be calculated as the yield times the face amount of the bond.
   D) The interest expense will be less than the cash payment each time period.
   E) The bond discount amortization will increase the cash interest payments made each 6 months.

8. Bond ratings include an analysis of:
   A) The risks that a company will default on the bond issue.
   B) The risks inherent in the bond issuer's industry.
   C) The quality of management.
   D) The capital structure of the company.
   E) All of the above.

9. This bond feature allows the exchange of the bond for common stock:
   A) Perpetuity.
   B) Indenture.
   C) Convertible.
   D) Term of the bond.
   E) Line of credit.

10. Which best describes the book value of a common stock?
    A) An amount set in the corporate charter for each share of stock
    B) The owners' equity per share of common shares outstanding.
    C) The current market value of the stock
    D) The value at which stock shares were originally issued
    E) The owners' equity per share of common shares issued.

11. Which of the following statements is FALSE?
    A) When a large stock dividend is paid out, retained earnings are reduced by the par value of the stock.
    b) When there is a purchase or sale of common stock, there is never a gain or loss recorded.
    C) Retained earnings is a type of earned capital that can be paid out as dividends.
    D) When employee stock options are granted, compensation expense should be recorded.
    E) When common stock is sold, the cash account generally decreases.

12. Which of the following equity carve outs would be categorized as a "spit-off":
    A) ABC, Inc. declared a dividend to its regular stockholders the shares of West Texas Systems, Inc.
    B) DEF, Inc. sold its Dallas regional stores for cash to Costco, Inc.
    C) GHI, Inc. traded its San Antonio Motels to Motel 6 for common stock of Motel 6.
    D) JKL, Inc. traded its shares of Home Restaurants, Inc. for shares of JKL common stock.
    E) MNO, Inc. received cash for shares of Local Hardware, Inc.
13. As part of a bankruptcy process, the 2014 financial statements of Imagoner Corporation report that the company paid $112,402,000 to its preferred shareholders before a remainder amount of $6,048 was paid to its common shareholders. This practice is called:

A) Liquidation preference  
B) Treasury preference  
C) Dividend preference  
D) Stock ownership preference  
E) Fixed stock preference

14. Which of the following in NOT a correct statement about “noncontrolling interest”?  
A) Noncontrolling interest is reported as a component of stockholders’ equity on the balance sheet.  
B) Noncontrolling interest represents their claim to their proportionate share of the net assets and net income of the subsidiary in which they own stock.  
C) Noncontrolling interests are entitled to convert their shares to common stock of the parent company.  
D) Noncontrolling interest is a residual claim, similar to other shareholders.  
E) All of the above are correct statements.

15. Which of the following statements is FALSE about an employee stock option plan?  
A) Employees may purchase the shares of stock under the stock option at any time.  
B) At the time the option program is awarded, the employees have completed the work required to receive the stock option.  
C) Compensation expense is recorded at the time the options are awarded.  
D) The number of shares involved is determined when employees are awarded the stock options.  
E) Compensation expense is recorded as employees complete the work required by the stock option.

16. During fiscal 2011, Abercrombie & Fitch reported the exercise of 1,573,351 shares at a weighted-average exercise price of $29.62. If Abercrombie’s stock was trading at $59.64 in January and $18.31 in December, which of the following details an impact of this transaction on Abercrombie’s accounts?  
a. A decrease of $46,602,657 to additional paid-in capital.  
b. An increase of $61,321,377 to cash.  
c. A decrease of $93,834,654 to additional paid-in capital.  
d. An increase of $46,602,657 to cash.  
e. A decrease of $47,231,997 to cash.

17. Which of the following costs is best classified as fixed costs with respect to volume?  
A) Raw food used in the production of restaurant meals  
B) Maintenance of a commercial aircraft  
C) Training of corporate administrative staff  
D) Inspection cost for a home builder  
E) Processing of customer orders

18. The range of operations over which the cost estimation model is appropriate is referred to as the:

A) Linear average  
B) Semblance range  
C) Marginal range  
D) Operating range  
E) Relevant range
19. Which of the following is an example of a committed fixed cost?
   (A) Depreciation of manufacturing facilities
   (B) Donations to charitable organizations
   (C) Salaries of production supervisors
   (D) Indirect materials used in the production area
   (E) Plant and equipment purchases for the coming year

20. Maintenance of facilities used in manufacturing smartphones would best be classified as what type of cost?
   (A) Variable cost
   (B) Fixed cost
   (C) Mixed cost
   (D) Step cost
   (E) Swipe cost

21. As volume increases, which of the following statements is not correct?
   (A) Variable cost per unit will remain the same.
   (B) Total fixed cost per unit will decrease.
   (C) Average cost per unit will decrease.
   (D) Total variable costs will increase.
   (E) Total costs will remain the same.

22. Comparing least-squares regression to high-low estimation:
   (A) Least-squares regression better predicts costs outside the range of past observations
   (B) Least-squares regression requires fewer calculations
   (C) In least squares regression the points are graphed and a line is hand fit to the data
   (D) Least-squares regression makes fuller use of the data
   (E) High-low regression better predicts costs outside the range of past observations

23. The following procedure performed by a dairy is the best example of a facility-level activity:
   (A) Delivering dairy products to a grocery store
   (B) Filling milk into half-gallon cartons
   (C) Homogenizing milk in specially designed tanks
   (D) Receiving milk from farms
   (E) Paying property taxes and insurance for the dairy farm.

24. Which of the following statements is false?
   (A) Cost-volume-profit analysis is useful for planning volume levels.
   (B) Contribution margin is the difference between total revenues and fixed costs.
   (C) Functional income statements are useful for cost-volume-profit analysis.
   (D) Selling price, variable cost per unit, and fixed costs are used to find breakeven.
   (E) Desired profits are stated on a before-tax basis.

25. A basic assumption of the cost-volume-profit model is that:
   (A) All costs are proportional to volume
   (B) Cost drivers can be organized into unit-level, batch level, product-level and facility-level factors
   (C) Higher volumes of product unit sales require lower prices
   (D) The mix of products changes over time
   (E) All costs and revenues increase linearly over the relevant range
26. Useful for determining the percentage impact on profits of a percentage change in sales:
A) Contribution margin ratio
B) Operating leverage
C) Gross margin percent
D) Margin of safety
E) Contribution margin per unit

27. In a contribution income statement:
A) All fixed costs are grouped together and subtracted from gross profit.
B) Net income plus all fixed expenses equal the gross margin.
C) The contribution margin is computed as the difference between sales revenue and fixed costs.
D) The gross margin is computed as the difference between sales revenue and the cost of goods sold.
E) Income plus fixed costs plus variable costs equals sales revenues.

28. Montoya's income statement is as follows:

<table>
<thead>
<tr>
<th>Sales (20,000 units)</th>
<th>$120,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less variable costs</td>
<td>-60,000</td>
</tr>
<tr>
<td>Contribution margin</td>
<td>$60,000</td>
</tr>
<tr>
<td>Less fixed costs</td>
<td>-22,500</td>
</tr>
<tr>
<td>Net income</td>
<td>$37,500</td>
</tr>
</tbody>
</table>

What is the margin of safety ratio?
A) 30.0%
B) 62.5%
C) 100.0%
D) 160.0%
E) 37.5%

29. Jane Company sells one product at a price of $10 per unit. Variable expenses are 60 percent of sales, and fixed expenses are $10,000. The sales dollars level required to break even are:
A) $ 2,500
B) $25,000
C) $33,333
D) $16,667
E) $1,667

30. All of the following are reasonable ways to increase the margin of safety ratio, EXCEPT:
A) Reduce fixed costs
B) Reduce variable costs per unit
C) Increase the selling price
D) Create a new product with higher margins
E) Reduce the selling price to zero
EXERCISES

Exercise A (8 points) On April 2, 2014, Parent Company bought 100% of Sub Company for $120,000. Sub Company's other assets were undervalued by $20,000 on the date of acquisition. Use the following table to consolidate the balance sheets of the two companies as of the acquisition date.

<table>
<thead>
<tr>
<th></th>
<th>Parent</th>
<th>Sub</th>
<th>Consolidating adjustments</th>
<th>Consolidated Balance Sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment in Sub</td>
<td>$120,000</td>
<td></td>
<td>(120,000)</td>
<td>0</td>
</tr>
<tr>
<td>Other assets</td>
<td>$80,000</td>
<td>$70,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Goodwill</td>
<td></td>
<td></td>
<td>(50,000)</td>
<td></td>
</tr>
<tr>
<td>Total assets</td>
<td>$180,000</td>
<td>$70,000</td>
<td>(50,000)</td>
<td></td>
</tr>
<tr>
<td>Liabilities</td>
<td>$80,000</td>
<td>$20,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stock</td>
<td></td>
<td></td>
<td>(10,000)</td>
<td></td>
</tr>
<tr>
<td>Retained earnings</td>
<td>$80,000</td>
<td>$40,000</td>
<td>(80,000)</td>
<td></td>
</tr>
<tr>
<td>Total liabilities &amp; stockholders' equity</td>
<td>$180,000</td>
<td>$70,000</td>
<td>(80,000)</td>
<td></td>
</tr>
</tbody>
</table>

Exercise B (6 points) Dustville, Inc. needed financing to purchase new equipment. On June 30th, 2013, Dustville issued $20,000,000 of 10-year bonds with a 10% coupon rate (payments due on December 31st and June 30th). The effective interest rate was 6%. Use the present-value tables at the end of the exam.

a) How much cash did Dustville, Inc. receive on June 30th, 2013?

\[
\text{PV} = \frac{20,000,000 \times 0.55368}{1.07346} = \frac{11,073,450}{1.41871} = 7,595,107 \text{D}
\]

b) What is the amount of the interest expense on this bond issue for 2013?

\[
0.1 \times 7,595,107 = 759,510.7
\]

c) What is the net book value of this bond on December 31, 2013?

\[
\begin{align*}
2,595,107 & \text{D} \\
+ 778,532 & \text{D} \\
\hline
2,773,639 & \text{D}
\end{align*}
\]

Exercise C (6 points) Following is the stockholders' equity section of the 2014 balance sheet for Clozer Corp.:

<table>
<thead>
<tr>
<th>STOCKHOLDERS' EQUITY</th>
<th>March 31 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common stock: $0.50 par value, authorized 600,000 shares; 200,000 shares issued</td>
<td>$100,000 572,000</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
<td>472,000</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>330,000</td>
</tr>
<tr>
<td>Treasury stock: 10,000 shares</td>
<td>(250,000)</td>
</tr>
<tr>
<td>Total stockholders' equity</td>
<td>$652,000</td>
</tr>
</tbody>
</table>

a) Compute the number of shares outstanding at March 31, 2014.

\[
\frac{200,000 - 10,000}{209,000} = 970,000
\]

b) At what average issue price were the shares issued?

\[
\frac{572,000}{209,000} = \$2.71
\]

c) At what average cost were the treasury shares purchased?

\[
\frac{250,000}{10,000} = \$25.00
\]
**Exercise D (6 points)** Flour Co. had the following accounts in their owners’ equity as of December 31, 2013:

- Common stock: $1 par value, authorized 500,000 shares; 400,000 shares issued and outstanding: $400,000
- Additional paid-in capital: 220,000
- Retained earnings: 3,000,000
- Total stockholders’ equity: $3,620,000

Flour had net income of $800,000 during 2014. On July 1, 2014 the company declared a 10% stock dividend when the share price was $15 per share. On December 31, 2013 the company declared and paid a $3 per share cash dividend.

**REQUIRED:**

a. How many shares are outstanding at the end of 2014? 

b. What is the amount of the “Additional paid-in capital” at the end of 2014?

c. What is the balance in Retaining earnings at the end of 2014?

**Exercise E (6 points)** Feeble Company manufactures and sells specialty items. The following representative direct labor-hours and production costs are provided for a four-month period:

<table>
<thead>
<tr>
<th>Month</th>
<th>Hrs. Direct Labor</th>
<th>Production Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>3,900</td>
<td>$450,202</td>
</tr>
<tr>
<td>February</td>
<td>4,100</td>
<td>462,402</td>
</tr>
<tr>
<td>March</td>
<td>5,200</td>
<td>519,115</td>
</tr>
<tr>
<td>April</td>
<td>4,800</td>
<td>506,303</td>
</tr>
<tr>
<td>Total</td>
<td>16,000</td>
<td>$1,938,022</td>
</tr>
</tbody>
</table>

**Required:**

a. Estimate the variable and fixed production costs using the high-low method.

\[ \text{Variable cost} = \frac{(5,191,15 - 4,501,202)}{(5,191,15 - 3,900)} = 53.01 \]

\[ \text{Fixed cost} = 5,191,15 - 53.01 \times 5,200 = 2,434,63 \]

b. Estimate the total production costs for May when the labor hours are expected to be 5,000.

\[ 2,434,63 + 53.01 \times 5,000 = 5,088,573 \]
Exercise F (6 points) The WestTex Trucking Company used multiple regression to estimate the fixed and variable truck maintenance costs for long-haul (more than 500 miles) and short-haul (less than 500 miles) trips. WestTex used 17 months data with the following results:

<table>
<thead>
<tr>
<th>Regression Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multiple R</td>
</tr>
<tr>
<td>R Square</td>
</tr>
<tr>
<td>Adjusted R Square</td>
</tr>
<tr>
<td>Standard Error</td>
</tr>
<tr>
<td>Observations</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ANOVA</th>
</tr>
</thead>
<tbody>
<tr>
<td>df</td>
</tr>
<tr>
<td>Regression</td>
</tr>
<tr>
<td>Residual</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
</tr>
<tr>
<td>Standard Error</td>
</tr>
<tr>
<td>t Stat</td>
</tr>
<tr>
<td>P-value</td>
</tr>
<tr>
<td>Lower 95%</td>
</tr>
<tr>
<td>Upper 95%</td>
</tr>
<tr>
<td>Long-Haul</td>
</tr>
<tr>
<td>Standard Error</td>
</tr>
<tr>
<td>t Stat</td>
</tr>
<tr>
<td>P-value</td>
</tr>
<tr>
<td>Lower 95%</td>
</tr>
<tr>
<td>Upper 95%</td>
</tr>
<tr>
<td>Short-Haul</td>
</tr>
<tr>
<td>Standard Error</td>
</tr>
<tr>
<td>t Stat</td>
</tr>
<tr>
<td>P-value</td>
</tr>
<tr>
<td>Lower 95%</td>
</tr>
<tr>
<td>Upper 95%</td>
</tr>
</tbody>
</table>

**REQUIRED:**

a. Did the regression analysis fit the data well or poorly? How can you tell? **Very well.**

b. What is the estimate of fixed costs? **$10,501.52**

c. What are the estimates of variable truck maintenance costs per mile for
   a. Long-Hauls? **353.453**
   b. Short-Hauls? **75.7967**

d. What would be the estimated total maintenance cost for month with 100,000 miles of long hauls and 70,000 miles of short hauls? **$905,707**

\[10501.52 + 353.453 \times 100 + 75.7967 \times 70 = 905,707\]
Exercise G (10 points) The Hortle Delivery income statement for the month of April 2014 is presented below.

Sales (100,000 units) $4,000,000
Less variable costs (2,500,000)
Contribution margin $1,500,000
Less fixed costs (900,000)
Income before taxes $600,000
Income taxes (40%) 240,000
Net income $360,000

REQUIRED:

a. Breakeven volume in dollars = \[
\frac{900,000}{37.5\%} = 2,400,000
\]

b. Sales dollars required to earn a monthly net income of $547,407 = \[
\frac{912,345 + 600,000}{.375} = 632,192.00
\]

c. Margin of safety ratio for April 2014 = \[
\frac{400,000 - 2,400,000}{4,000,000} = 40\%
\]

d. If sales increased by 10%, what would be the % impact on income? 25%

e. Hortle is considering a change in the production technology that will increase fixed costs by $500,000 but reduce variable costs by 20%. With this new technology, what will the new breakeven volume in dollars required?

\[
\frac{900,000 + 500,000}{1 - (.625 - .0625)} \times .4375 = 3,200,000
\]

SHORT ANSWER (2 points each)

A. When the intent is to hold a bond to maturity, how are unrealized gains and losses treated? Not Recorded

B. For the equity method,
   a. What is recognized as earnings? % x earnings
   b. How are dividends treated? Reduction in Investment

C. What impact would an increase in the market rate for a bond have on its market price? Decrease

D. What is a bond perpetuity? No due date for bond

E. What are the consequences if a common stock were issued below the par value? Original issue discount is a liability to first purchasers of shares. Illegal in most states

F. At what price is a small stock dividend recorded? Market Value of Shares
   At what price is a large stock dividend recorded? Par Value
G. What’s wrong with the statements: “Our committed fixed costs are too high for next month! Let’s cut them in half.”

H. The difference between a fixed cost and a variable cost at zero volume would equal Fixed Costs.

I. If fixed costs are zero, then the margin of safety ratio must be 100%.

J. What’s wrong with the statement: “While our operating leverage is quite high, our margin of safety is running at about 80%.”
<table>
<thead>
<tr>
<th>Pr. Val of $1</th>
<th>1%</th>
<th>2%</th>
<th>3%</th>
<th>4%</th>
<th>5%</th>
<th>6%</th>
<th>7%</th>
<th>8%</th>
<th>9%</th>
<th>10%</th>
<th>11%</th>
<th>12%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.99010</td>
<td>0.98039</td>
<td>0.97087</td>
<td>0.96154</td>
<td>0.95238</td>
<td>0.94340</td>
<td>0.93458</td>
<td>0.92593</td>
<td>0.91743</td>
<td>0.90909</td>
<td>0.90090</td>
<td>0.89286</td>
</tr>
<tr>
<td>2</td>
<td>0.98030</td>
<td>0.96117</td>
<td>0.94260</td>
<td>0.92456</td>
<td>0.90703</td>
<td>0.89000</td>
<td>0.87344</td>
<td>0.85734</td>
<td>0.84168</td>
<td>0.82645</td>
<td>0.81162</td>
<td>0.79719</td>
</tr>
<tr>
<td>3</td>
<td>0.97059</td>
<td>0.94232</td>
<td>0.91514</td>
<td>0.88900</td>
<td>0.86384</td>
<td>0.83962</td>
<td>0.81630</td>
<td>0.79383</td>
<td>0.77218</td>
<td>0.75131</td>
<td>0.73119</td>
<td>0.71178</td>
</tr>
<tr>
<td>4</td>
<td>0.96098</td>
<td>0.92385</td>
<td>0.88849</td>
<td>0.85480</td>
<td>0.82270</td>
<td>0.79209</td>
<td>0.76290</td>
<td>0.73503</td>
<td>0.70843</td>
<td>0.68301</td>
<td>0.65873</td>
<td>0.63552</td>
</tr>
<tr>
<td>5</td>
<td>0.95147</td>
<td>0.90573</td>
<td>0.86261</td>
<td>0.82193</td>
<td>0.78353</td>
<td>0.74726</td>
<td>0.71299</td>
<td>0.68058</td>
<td>0.64993</td>
<td>0.62092</td>
<td>0.59345</td>
<td>0.56743</td>
</tr>
<tr>
<td>6</td>
<td>0.94205</td>
<td>0.88797</td>
<td>0.83748</td>
<td>0.79031</td>
<td>0.74522</td>
<td>0.70496</td>
<td>0.66634</td>
<td>0.63017</td>
<td>0.59627</td>
<td>0.56447</td>
<td>0.53464</td>
<td>0.50663</td>
</tr>
<tr>
<td>7</td>
<td>0.93272</td>
<td>0.87056</td>
<td>0.81309</td>
<td>0.75992</td>
<td>0.71068</td>
<td>0.66506</td>
<td>0.62275</td>
<td>0.58349</td>
<td>0.54703</td>
<td>0.51316</td>
<td>0.48166</td>
<td>0.45235</td>
</tr>
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