24 Non-Current (Long-Term) Liabilities

1. At the beginning of 20X3, Creston Company issues $10 million face amount of 6% coupon bonds when the market rate of interest is 7%. The bonds mature in four years and pay interest annually. Assuming the effective interest rate method, what is the bond liability Creston will report at the end of 20X3?
   (A) $9,661,279
   (B) $9,737,568
   (C) $10,346,511

2. A company issues $10,000,000 face value of 5% annual coupon, 3-year bonds on January 1, 20X1, raising $8,000,000 in cash proceeds. Using the effective interest method, and ignoring issuance costs, interest expense for the year ending December 31, 20X2 is closest to:
   (A) $1,163,000.
   (B) $500,000.
   (C) $1,084,000.

3. A firm can recognize a gain or loss on derecognition of a bond the firm has issued:
   (A) at maturity, but not before maturity.
   (B) before maturity, but not at maturity.
   (C) either before maturity or at maturity.

4. Assume a city issues a $5 million semiannual-pay bond to build a new arena. The bond has a coupon rate of 8% and will mature in 10 years. When the bond is issued its yield to maturity is 9%. Interest expense in the second semiannual period is closest to:
   (A) $200,000.
   (B) $210,336.
   (C) $210,833.

5. The difference between the fair value of a defined benefit pension plan's assets and its estimated benefit obligation is recognized:
   (A) as an actuarial adjustment in other comprehensive income.
   (B) on the balance sheet as a net pension asset or liability.
   (C) on the income statement as pension expense.

6. Which of the following is least likely to be disclosed in the financial statements of a bond issuer?
   (A) The market rate of interest on the balance sheet date.
   (B) The amount of debt that matures in each of the next five years.
   (C) Collateral pledged as security in the event of default.

7. A $1,000 bond is issued with an 8% semiannual coupon rate and 5 years to maturity when market interest rates are 10%. What is the initial liability?
   (A) 923.
   (B) 1023.
   (C) 855.

8. Other things equal, and ignoring issuance costs, a firm that raises cash by issuing a new bond is most likely to:
   (A) increase its leverage ratios and increase its coverage ratios.
   (B) decrease its leverage ratios and increase its coverage ratios.
   (C) increase its leverage ratios and decrease its coverage ratios.

9. Assuming all else equal, if the coupon rate offered on a bond is less than the corresponding market rate of interest, the bond will be issued at:
   (A) a discount.
   (B) a premium.
   (C) par.

10. A lessor retains the leased asset on its balance sheet for:
   (A) neither finance leases not operating leases.
   (B) finance leases, but not operating leases.
   (C) operating leases, but not finance leases.

11. A firm issues a 4-year semiannual-pay bond with a face value of $10 million and a coupon rate of 10%. The market interest rate is 11% when the bond is issued. The balance sheet liability at the end of the first semiannual period is closest to:
   (A) $9,683,250.
   (B) $9,650,700.
   (C) $9,715,850.

12. For a firm financed with common stock and long-term fixed-rate debt, an analyst should most appropriately adjust which of the following items for a change in market interest rates?
    (A) Interest paid.
    (B) Cash flow from financing.
    (C) Debt-to-equity ratio.

13. When bonds are issued at a premium:
    (A) coupon interest paid decreases each period as bond premium is amortized.
    (B) earnings of the firm decrease over the life of the bond as the bond premium is amortized.
    (C) earnings of the firm increase over the life of the bond as the bond premium is amortized.

14. No Company has a $10 million face value bond issue outstanding. These bonds include a call option that permits No to redeem the bonds at any time for 101% of par. These bonds were issued at a premium and have a carrying value of $10,200,000. If IVo calls the bonds, its income statement will reflect:
    (A) a loss on redemption.
    (B) neither a gain nor a loss on redemption.
    (C) a gain on redemption.

15. A debt covenant is most likely to restrict a firm from:
    (A) decreasing its common dividends.
    (B) issuing new common shares.
    (C) repurchasing common shares.

16. A bond is issued at the end of the year 20X0 with an 8% semiannual coupon rate, 5 years to maturity, and a par value of $1,000. The bond's yield at issuance is 10%. Using the effective interest method, if the yield has decreased to 9% at the end of the year 20X1, the balance sheet liability for the bond is closest to:
    (A) $923.
    (B) $935.
    (C) $967.

17. A firm issues a $5 million zero coupon bond with a maturity of four years when market rates are 8%. Assuming semiannual compounding periods, the total interest on this bond is:
    (A) $1,346,549.
    (B) $1,600,000.
    (C) $1,200,000.

18. A lessor will remove the leased asset from its balance sheet and record interest income from the lease only if the lease is classified as:
    (A) a finance lease.
    (B) an operating lease.
    (C) a sales-type lease.

19. A bond is issued with the following data:
    - $10 million face value.
    - 9% coupon rate.
    - 8% market rate.
    - 3-year bond with semiannual payments.

    Assuming market rates do not change, what will the bond's market value be one year from now and what is the total interest expense over the life of the bond?

Value in 1-Year	Total Interest Expense
(A) 11,099,495	2,437,893
(B) 10,181,495	2,437,893
(C) 10,181,495	2,962,107

20. A company has issued new 3-year bonds at par in each of the last five years. On the company's balance sheet, principal due on its bonds will appear as:
    (A) both current and long-term liabilities.
    (B) long-term liabilities only.
    (C) current liabilities only.

21. On December 31, 20X3 Okay Company issued 10,000 $1000 face value 10-year, 9% bonds to yield 7%. The bonds pay interest semi-annually. On its financial statements (prepared under U.S. GAAP) for the year ended December 31, 20X4, the effect of this bond on Okay's cash flow from operations is:
    (A) -$900,000.
    (B) -$755,735.
    (C) -$700,000.

22. Proceeds from issuing a bond are recorded on the statement of cash flows as an inflow from:
    (A) financing.
    (B) operations.
    (C) investing.

23. A company issues an annual-pay bond with a face value of $135,662, maturity of 4 years, and 7% coupon, while market interest rates for its bonds are 8%. What is the unamortized discount at the end of the first year?
    (A) $538.
    (B) $1,209.
    (C) $3,495.

24. When a lessee recognizes a balance sheet asset and liability for a new lease:
    (A) the asset and liability are equal.
    (B) the asset is typically greater than the liability.
    (C) the liability is typically greater than the asset.

25. Which of the following statements is least accurate? When a bond is issued at a discount:
    (A) cash flows from financing will be increased by the par value of the bond issue.
    (B) the interest expense will be equal to the coupon payment plus the amortization of the discount.
    (C) the interest expense will increase over time.

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26. On December 31, 2004, Newberg, Inc. issued 5,000 $1,000 face value seven percent bonds to yield six percent. The bonds pay interest semi-annually and are due December 31, 2011. On its December 31, 2005, income statement, Newburg should report interest expense of:
    (A) $316,448.
    (B) $300,000.
    (C) $350,000.

27. Over time, the reported amount of the annual interest expense on a long-term bond issued at a discount will:
    (A) decrease.
    (B) increase.
    (C) remain constant.

28. A firm issues a $5 million zero coupon bond with a maturity of four years when market rates are 8%. Assume semi-annual compounding.
    What is the firm's initial liability and the value of the liability in six months?

Initial liability	Liability in 6 months
(A) $3,653,451	$3,799,589
(B) $5,000,000	$5,000,000
(C) $3,675,149	$3,675,149

29. For a long-term lease, the amount recorded initially by the lessee as a liability is:
    (A) the present value of the lease payments.
    (B) the total of the lease payments.
    (C) the fair value of the leased asset.

30. A company redeems $10,000,000 of bonds that it issued at par value for 101% of par or $10,100,000. In its statement of cash flows, the company will report this transaction as a:
    (A) $10,000,000 CFF outflow and $100,000 CFO outflow.
    (B) 10,100,000 CFF outflow.
    (C) $10,100,000 CFO outflow.

31. An airline leases a new airplane from its manufacturer for 10 years. For financial reporting, the airline must record an asset and a liability on its balance sheet:
    (A) regardless of whether the lease is a finance or operating lease.
    (B) only if the lease is an operating lease.
    (C) only if the lease is a finance lease.

32. Compared to issuing a bond at par value, and holding all else equal, when a company issues a bond at a premium, its effect on the debt/equity ratio will be:
    (A) a decreasing trend in the ratio over the life of the bond.
    (B) no effect on the ratio over the life of the bond.
    (C) an increasing trend in the ratio over the life of the bond.

33. A company issues $50 million face value of bonds with a 4.0% coupon rate, when the market interest rate on the bonds is 4.5%. Proceeds raised from these bonds will be:
    (A) equal to $50 million.
    (B) greater than $50 million.
    (C) less than $50 million.

34. In analyzing disclosures related to the financing liabilities of a company, which of the following disclosures would be /east helpful to the analyst?
    (A) Filings with the Securities and Exchange Commission (SEC) that disclose all outstanding securities and their features.
    (B) The interest expense for the period as provided on the income statement or in a footnote.
    (C) The present value of the future bond payments discounted at the coupon rate of the bonds.

35. For an operating lease, the leased physical asset appears on the balance sheet of:
   (A) neither the lessor nor the lessee.
   (B) the lessor.
   (C) the lessee.

36. Larry Purcell, an entry-level fixed income analyst at Knowlton & Smeades LLC, was discussing debt covenants with his supervisor, Andy Holzman. During the meeting Purcell made the following statements regarding bond covenants:

   Statement 1: If a firm violates any of its debt covenants, the company will immediately go into bankruptcy and the creditors of the firm will take over the liquidation of its assets.

   Statement 2: Debt covenants are important in evaluating a firm's credit risk and to better understand how the restrictions of the covenants can affect the firm's growth prospects and choice of accounting policies.

   With respect to these statements:
   (A) Only one is correct
   (B) both are incorrect.
   (C) both are correct.

37. Robbins, Inc., reports under IFRS and uses the effective interest rate method for valuing its bond liabilities. Robbins sells a 10-year, $100 million, 5% annual coupon bond issue for $98 million and paid $500,000 in issuance costs. Two years later, the bond liability Robbins will report on its balance sheet for this debt is closest to:
   (A) $97.9 million.
   (B) $98.0 million.
   (C) $98.1 million.

38. A firm is more solvent if it has:
   (A) low leverage ratios and high coverage ratios.
   (B) low leverage and coverage ratios.
   (C) high leverage and coverage ratios.

39. A company issues an annual-pay bond with the following characteristics:

Face value	$67,831
Maturity	4 years
Coupon	7%
Market interest rates	8%

   What is the unamortized discount at the end of the first year?
   (A) $499.
   (B) $1,209.
   (C) $1,750.

40. A firm is issuing a bond with the following characteristics:
- Face value = $10.0 million
- Annual coupon = 5.6%
- Market yield at issuance = 6.5%
- 5 year maturity

Ignoring flotation costs, at issuance the bond will increase:

(A) assets by $9.626 million.

(B) cash flow from investing by $9.626 million.

(C) liabilities by $10.0 million.

41. The primary purpose of bond covenants is to:

(A) clearly define the responsibilities of the borrower and the lender.

(B) define bond characteristics.

(C) protect bondholders from the actions of equity owners.

42. A company issued a bond with a face value of $67,831, maturity of 4 years, and 7% annual-pay coupon, while the market interest rates are 8%.

What is the unamortized discount when the bonds are issued?

(A) $498.58.

(B) $2,246.65.

(C) $1,748.07.

43. Interest expense is reported on the income statement as a function of:

(A) the coupon payment

(B) the unamortized bond discount

(C) the market rate.

44. An employer offers a defined benefit pension plan and a defined contribution pension plan. The employer's balance sheet is most likely to present an asset or liability related to:

(A) the defined benefit plan.

(B) both of these pension plans.

(C) the defined contribution plan.

45. Which of the following statements for a bond issued with a coupon rate above the market rate of interest is least accurate?

(A) The associated interest expense will be lower than that implied by the coupon rate.

(B) The bond will be shown on the balance sheet at the premium value.

(C) The value of the bond will be amortized toward zero over the life of the bond.

46. Which of the following provisions would least likely be included in the bond covenants? The borrower must:
    - (A) not increase dividends to common shareholders while the bonds are outstanding.
    - (B) maintain a debt-to-equity ratio of no less than 2:1.
    - (C) maintain insurance on the collateral that secures the bond.

47. A firm is most likely to lease an asset rather than purchasing it if the asset:
    - (A) has a high salvage value relative to its cost.
    - (B) may be made obsolete by rapid technological advances.
    - (C) is costly to move from place to place.

48. Which of the following statements regarding zero-coupon bonds is most accurate?
    - (A) A company should initially record zero-coupon bonds at their discounted present value.
    - (B) Interest expense is a combination of operating and financing cash flows.
    - (C) The interest expense in each period is found by applying the discount rate to the book value of debt at the end of the period.