9 EMPLOYEE COMPENSATI... MPLOYMENT & SHARE BASED

1. Wes Livingston is the founder and CEO of Bigwell Corporation. Livingston is interested in Bigwell being acquired by a larger competitor and wants to have his company's financial statements appear as attractive as possible to a potential suitor. In order to decrease the projected benefit obligation (PBO) of the company's pension plan, which of the following changes in actuarial assumptions could be made?
   (A) Increase the rate of compensation growth.
   (B) Increase the discount rate.
   (C) Decrease the discount rate.

2. Which of the following statements regarding pension accounting is most accurate?
   (A) Changes in actuarial assumptions and past service costs fully and immediately affect the income statement.
   (B) Changes in the projected benefit obligation (PBO) and plan assets fully and immediately affect the balance sheet.
   (C) A reconciliation between the funded status and the net pension asset (liability) reported on the balance is required.

3. The actuarial present value of all future pension benefits earned to date, based on expected future salary increases, is called the:
   (A) pension liability.
   (B) projected benefit obligation (PBO).
   (C) total projected pension cost.

4. For the valuation of the CEO's stock options granted on January 1, 2013, Gasline estimated a fair value of $100,000 by using Monte Carlo simulation.
   In accordance with SFAS No. 123(R), which of the following statements is most accurate? Gasline's accounting treatment of the options is:
   (A) in compliance because the firm can elect to use either the intrinsic value model or the fair value model in the valuation of stock option plans.
   (B) in compliance because a Monte Carlo simulation is an acceptable method of valuing options in the absence of a market-based instrument.
   (C) not in compliance because the fair value must be established by using the Black-Scholes option model.

5. If management increases the assumed discount rate, the least likely effect is that the:
   (A) plan assets will increase.
   (B) funded status will improve.
   (C) pension expense reported in P&L will decrease.

6. Regarding Gasline's defined benefit pension plan: if management increases the expected return on plan assets, the most likely effect is that the:
   (A) total periodic pension cost would decrease.
   (B) pension expense reported in P&L would decrease.
   (C) funded status would improve.

7. For this question only, assume that Gasline's reports under IFRS. If changes in actuarial assumptions affecting the PBO lead to an actuarial gain, the most likely effect is that the:
   (A) pension expense reported in P&L would decrease.
   (B) total periodic pension cost would decrease.
   (C) plan assets would increase.

8. Which of the following statements regarding the projected benefit obligation (PBO) and the value of the pension plan assets is most accurate?
   (A) The fair value of plan assets is increased by the amount of the expected return on assets.
   (B) If the PBO and the plan assets are the same, then nothing needs to be reported on the balance sheet.
   (C) Plan amendments during the year generally result in a decrease of the PBO at the end of the year.

9. Tim Gresham, CFO of Alpha Logistics is concerned about changes in the business environment which could lead to Alpha violating some of the covenants of their outstanding debentures.

   Specifically Gresham is concerned about leverage and profitability ratios. Gresham reviews Alpha's most recent financial statements and decides that changing the assumptions for the company's defined benefit pension plan may provide some relief in the short-run. Alpha reports under U.S. GAAP.

   Which of the following changes in the pension plan's assumptions would most likely lead to lower reported leverage and higher reported profitability?
   (A) Increasing the discount rate.
   (B) Increasing the growth rate in compensation expense.
   (C) Increasing expected return on plan assets.

10. The balance sheet asset/liability related to Longhorn's pension plan is closest to:
    (A) a liability of $14,110,000.
    (B) an asset of $6,115,000.
    (C) a liability of $6,115,000.

11. Moore reads in the footnotes to Longhorn's financial statements that the pension plan's PBO increased by $5,000,000 last year. Of this amount, approximately 50% was attributed to benefits earned by its employees that year. The remaining 50% was attributed to a change in the pension plan's actuarial assumptions. Which of the following changes to actuarial assumptions is most likely to cause an increase in PBO? A decrease in the:
    (A) rate of compensation growth.
    (B) discount rate.
    (C) expected rate of return.

12. Longhorn's adjusted operating profit is closest to:
    (A) $14,110,000
    (B) $18,527,000.
    (C) $15,843,000.

13. Assume for this question only that the actual return on plan assets was $981,200 higher than the expected return of $5,308,800. The amount of benefits paid to plan participants was closest to:
    (A) $5,192,000.
    (B) $8,485,000.
    (C) $1,285,000.

14. The Board of Directors of Prime Bank has asked management to make changes in the accounting of its pension plan obligations in order to decrease the reported service cost. Management determines that there are two changes in actuarial assumptions that will result in a lower service cost. Which of the following pairs of changes in actuarial assumptions will best achieve the desired effect? Prime Bank can either:
    (A) decrease the discount rate or increase the expected rate of return.
    (B) decrease the rate of compensation growth or increase the expected rate of return.
    (C) increase the discount rate or decrease the rate of compensation growth.

15. In determining the fair value of employee stock options, which of the following statements is most appropriate?
    (A) A lower risk-free rate will usually increase the estimated fair value.
    (B) Absent a market-based instrument, U.S. GAAP and IFRS prefer firms to use the Black-Scholes option-pricing model.
    (C) A higher than expected dividend yield will decrease the estimated fair value.

16. An analyst views the assumptions made by a company reporting under U.S. GAAP regarding its pension liabilities as unrealistic, and thinks the discount rate and expected rate of return should both be increased. The most likely effect of increasing the discount rate and expected rate of return on the pension benefit obligation (PBO) is:

	Discount rate	Expected rate of return
(A)	Decrease	No effect
(B)	No effect	Decrease
(C)	Increase	Decrease

17. The following information relates to Nazarali Inc. (Nazarali) and its defined-benefit pension plan for the year:

Contributions	\$3.0 million
Reported pension expense	\$2.8 million
Total periodic pension cost	\$3.1 million

Based on the information above, which of the following statements is most accurate?

(A) There is a reduction in the overall pension obligation of \$100,000.

(B) There is a source of borrowing of \$100,000.

(C) There is a reduction in the overall pension obligation of \$200,000.

18. Peak Productions is a publicly traded company that manufactures consumer electronics products in the U.S. The company has been in operation nearly fifty years, and has a considerable pension plan liability on its financial statements. Peak has a well-deserved reputation among analysts of utilizing aggressive accounting practices with regard to its pension plan. Which of the treatments of the following actuarial assumptions is the best example of aggressive accounting for a pension plan?

(A) A high discount rate.

(B) A high calculated projected benefit obligation (PBO).

(C) A high compensation growth rate.

19. Which of the following measures is least sensitive to changes in pension plan actuarial assumptions?

(A) Balance sheet asset or liability.

(B) Projected benefit obligation (PBO).

(C) Total periodic pension cost.

20. A company reporting under U.S. GAAP reduced the discount rate for its pension obligation from 10% to 8%, reduced the expected long-term rate of return on the assets in its pension plan from 8% to 6%, and changed its compensation growth rate assumption from 4% to 5%. What is the most likely impact of these changes on the current year ending defined benefit obligation and pension expense?

(A) The decrease in the long-term rate of return will have no impact on the defined benefit obligation and will increase reported pension expense.

(B) The decrease in the long-term rate of return on plan assets will decrease reported pension expense.

(C) The reduction in the discount rate will decrease the defined benefit obligation and will increase reported pension expense.

21. When considering the major differences between a defined contribution and a defined benefit pension plan, which of the following statements is most accurate?

(A) Among the different types of pension plans, accounting for a pay-related defined benefit plan is the most complicated because of the required actuarial assumptions.

(B) A company with a defined contribution plan will report on its balance sheet the net difference between the value of the pension fund assets and the value of the pension liability.

(C) Accounting for a defined contribution pension plan is the most complicated because of the many investment options available to the employees.

22. Roberto Perez, CFA, is the Chief Financial Officer for Home Stores, Inc., a large home improvement retailer with stores located across the United States. Home Stores is preparing for a secondary stock offering to secure the necessary capital to pursue an aggressive expansion campaign. Perez has received a directive from his boss to make every legitimate effort to present Home Stores' upcoming financial statements in the best possible light. Perez determines that certain assumptions in the pension plan can be changed to fulfill this request. Which of the following pension plan assumptions can be changed by a firm to manipulate its reported results?

	Change	Result
(A)	decreased rate of compensation growth	decreased service cost
(B)	increased expected rate of return	decreased service cost
(c)	decreased discount rate	increased expected return

23. Consider a situation at a firm where the differences in its cash flow and economic pension expense are considered material to the financial statements. The relevant tax rate is 30%. The expected return on plan assets is $120,000, interest cost is $85,000, employer's contribution is $215,000, service cost is $450,000, and the actual return on plan assets is $50,000. Based on the information provided and for analytical purposes only, which of the following statements is most appropriate?

(A) There is a reclassification of $270,000 from operating cash flow to financing cash flow.

(B) There is a reclassification of $189,000 from operating cash flow to financing cash flow.

(C) There is a reclassification of $140,000 from operating cash flow to financing cash flow.

24. Which of the following is NOT an advantage of share based compensation over cash compensation?
    (A) In a share based compensation plan, expense is not recognized, unless the exercise price is set below the market price.
    (B) Share based compensation serves to align employee interest with the interests of stockholders.
    (C) Share based compensation does not require a cash outlay.

25. Which of the following statements about the methods of valuing employee stock options is least accurate?
    (A) With the fair value method, compensation expense is allocated in the income statement for the period between the grant date and the vesting date.
    (B) Once the options are in-the-money, compensation expense is recognized on the income statement.
    (C) With either method, the offset to compensation expense recognized is an increase in paid-in capital.

26. As of January 1^{st}, 2007, the fair value of plan assets was $19 million. Which three components are necessary to calculate the fair value of the plan assets at the end of the year?
    (A) actual return on assets, employer contributions, and benefits paid.
    (B) service cost, interest cost, and benefits paid.
    (C) expected return on plan assets, employer and participant contributions, and benefits paid.

27. Current U.S. GAAP pension accounting standards require public companies to report which of the following in the balance sheet??
    (A) The expected return on plan assets.
    (B) The pension liability adjusted for unrecognized items.
    (C) The funded status of the plan.

28. As of December 31^{st}, 2007, the fair value of plan assets was $21 million. For this question only, assume that the sum of the unrecognized prior service cost and the unrecognized actuarial losses equals $1.5 million. Calculate the amount attributable to Midwest's pension plan as of December 31^{st}, 2007 that must be reported on the balance sheet under U.S. GAAP.
    (A) $2.0 million.
    (B) -$2.0 million.
    (C) -$500,000.

29. Which of the following statements regarding the U.S. GAAP pension accounting standards is most accurate?
   (A) The balance sheet will now reflect the true economic position of the pension plan, but the income statement will not necessarily reflect a true measure of economic pension expense.
   (B) For most companies, the pension liability will increase while financial leverage may increase or decrease as a result of applying the standard.
   (C) The changes in GAAP now cause U.S. standards to be consistent with the International Financial Reporting Standards (IFRS) for pension plans.

30. Total Periodic Pension Cost (TPPC) is most likely to:
   (A) take into account expected return on plan assets.
   (B) be reported on the income statement.
   (C) be computed the same under IFRS and US GAAP.

31. Which of the following statement about stock-based compensation are correct or incorrect?

   Statement #1: The grant date of a service-based award is the date when the employees' benefits are fully vested.

   Statement #2: When two or more performance conditions must be satisfied, the requisite service period ends when the first condition is met.

   (A) Both are incorrect.
   (B) Both are correct.
   (C) Only one is correct.

32. Under current U.S. GAAP, the assets and liabilities of a defined benefit pension plan are:
   (A) off balance sheet items which are shown only in the footnotes.
   (B) reported in the appropriate section of the balance sheet, with pension obligations shown under liabilities and plan assets shown under assets.
   (C) netted against each other, and only the net asset or liability amount is reported on the company's balance sheet.

33. In order to decrease the projected benefit obligation (PBO) of a pension plan, which of the following changes in pension assumptions can be made to yield the desired result?
   (A) Decrease the discount rate.
   (B) Increase the expected rate of return.
   (C) Decrease the rate of compensation growth.

34. Federal Companies reported the following information in the footnotes to its most recent financial statements:

Beginning Projected Benefit Obligation (PBO)	$65,000,000
Ending PBO	90,000,000

Service Cost	27,000,000
Interest Cost	3,000,000
Benefits Paid	5,000,000
Actual Return on Plan Assets	7,500,000
Expected Return on Plan Assets	8,500,000

Given the information above, calculate Federal's total periodic pension cost for the year.

(A) $41,000,000.00.

(B) $22,500,000.00.

(C) $27,500,000.00.

35. The projected benefit obligation (PBO) is defined as the:

(A) actuarial present value of all future pension benefits earned to date and based on current salary levels.

(B) actuarial present value of all future pension benefits earned to date based on expected future salary increases.

(C) actuarial future value of all post-retirement healthcare benefits earned to date.

36. Under U.S. GAAP, capitalized periodic pension costs included in the value of ending inventory is most likely:

(A) to be expensed as part of cost of goods sold when the inventory is sold.

(B) not allowed.

(C) to be amortized over the service lives of employees.

37. The financial statements of Pace Industries issued over the past five years show a progressively increasing net difference between the value of its pension fund and the projected future pension liability on the balance sheet. Pace most likely offers which of the following types of pension plans to its employees?

(A) A defined contribution plan.

(B) A defined benefit plan.

(C) A 401(k) plan.

38. When accounting for pension liabilities in the U.S., a company must make fundamental assumptions to estimate the future liability and expense for each employee. How are the following assumptions required to be treated in the pension footnotes?

	Required disclosure	Not required to be Disclosed
(A)	Rate of compensation growth	Expected length of employment
(B)	Discount rate	Expected return on plan assets
(C)	Discount rate	Rate of compensation growth

39. What effect will an increased discount rate and increased expected rate of return have on a company's projected benefit obligation (PBO) and fair value of plan assets (FVPL) as reflected in the financial statements?

(A) Both will decrease.

(B) Both will increase.

(C) Only one will decrease.

40. Prime Doors has recorded a net pension liability of $1.5 million on its balance sheet. According to current U.S. accounting standards, Prime Doors is required to:
   (A) record $375,000 as additional pension expense on its balance sheet.
   (B) immediately recognize $2,125,000 as additional pension expense in its income statement.
   (C) record $2,125,000 as additional pension liability on its balance sheet

41. Which of the following statements regarding the treatment of pension plan amendments under U.S. GAAP standards is most accurate? A plan amendment results in:
   (A) an unrecognized prior service cost that is amortized over the expected remaining service life of the affected employees.
   (B) the disclosure in the pension plan footnotes of the nature of the amendment and the projected future financial impact.
   (C) an immediate increase in pension expense equal to the amount of the amendment.

42. Which of the following statements about stock appreciation rights, performance stock, and phantom stock is most accurate?
   (A) Phantom stock payoffs are based on the performance of the firm's actual shares.
   (B) Stock appreciation rights never have any dilution effect on the existing shareholders.
   (C) Performance stock cannot be sold by the employee until vesting has occurred.

43. Wonderful Manufacturing has implemented a change in its pension plan, that will increase the future benefits for all of its current employees. Which of the following is the most likely effect on the company's financial statements of this change in promised benefits under current U.S. GAAP standards?
   (A) The pension expense for the next reporting period will increase by the projected increase in pension benefits due to employees.
   (B) The firm's prior financial statements will be adjusted to reflect the increase in benefits.
   (C) The net pension liability will increase immediately by the projected increase in pension benefits due to employees.

44. Which of the following statements regarding pension accounting under U.S. GAAP standards and/or under International Financial Reporting Standards (IFRS) is most accurate?
   (A) Under IFRS, the funded status (difference in the PBO and the plan assets) is reported on the balance sheet.
   (B) Under IFRS and U.S. GAAP, the calculation of pension expense is the same.
   (C) Under U.S. GAAP, firms are required to provide a reconciliation of the funded status and the reported net pension asset or liability.

45. Fly-By-Night Airlines is a U.S. company planning to change its pension plan so that it can reduce its costs. It is considering reducing its defined benefit percentage from 10% to 5% of ending salary, retroactive for 10 years. In addition, since the firm is anticipating substantially reduced salary increases in the future, it is planning to reduce its compensation growth rate assumption. From a pension accounting perspective, the change in the:
    (A) Benefit percentage is a past service cost that will be amortized into and thus increase pension expense over the remaining service lives of its employees.
    (B) Benefit percentage is a change in actuarial assumption that will be recognized in full in current period pension expense.
    (C) Compensation growth rate assumption is a change in actuarial assumption that will reduce the defined benefit obligation and future pension expense.

46. Which of the following statements regarding total periodic cost is least accurate?
    (A) It is equal to the change in the funded status for the period.
    (B) It is equal to the sum of all the changes in projected benefit obligation (PBO) for the period (expect for benefits paid) minus the actual return on assets.
    (C) It is more volatile measure of pension expense than reported pension expense.

47. Financial analysts can use select data from a company's financial statements to derive total periodic pension cost in order to better reflect the company's truth economic pension cost. Which of the following will most accurately calculate a company's true pension expense?
    (A) Service cost + interest cost – actual return on plan assets – benefits paid.
    (B) Beginning fair value of plan assets + service cost + interest cost – ending fair value of plan assets.
    (C) Service cost + interest cost + plan amendments – actual on plan assets.