Financial Statement Analysis & Valuation, 5th Edition
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Practice Quiz

Module 10 – Analyzing Leases, Pensions, and Taxes

1. Assume United Airlines discloses the following in the footnotes to its 10-K report relating to its leasing activities.

Year ending December 31 ($ millions)	Capital Leases	Aircraft Operating Leases
2016…………………………………………………	$ 39	$ 1,003
2017…………………………………………………	40	966
2018…………………………………………………	46	955
2019…………………………………………………	16	910
2020………………………………………………….	16	924
Later years…………………………………………….	457	6,310
Total minimum lease payments……………………….	614	$11,068
Less: amount representing interest…………………..	341	
Present value of capital leases……………………….	273	
Less: current maturities of capital leases……………	22	
Long-term capital leases………………………………	$251	

Compute the present value of United's operating lease payments assuming a 7% discount rate and round the remaining lease term to the nearest whole year.

a. $11,068 million
b. $8,752 million
c. $7,464 million
d. $5,170 million

2. Assume American Express discloses the following pension footnote in its 10-K report.

(Millions)	2016
Service cost…………………………………….	$104
Interest cost…………………………………….	117
Expected return on plan assets………………	(141)
Other……………………………………………	32
Net periodic pension benefit cost……………	$112

How much pension expense does American Express report in its 2016 income statement?

a. $104 million
b. $221 million
c. $80 million
d. $112 million

3. Assume YUM! Brands, Inc., discloses the following pension footnote in its 10-K report.

Pension Benefits ($ millions)	2016	2015
Benefit obligation at beginning of year…	$700	$629
Service cost………………………………	33	32
Interest cost………………………………	43	39
Plan amendments………………………	-	1
Curtailment gain………………………..	(2)	(2)
Settlement loss…………………………	1	—
Benefits and expenses paid…………..	(33)	(26)
Actuarial (gain) loss……………………	73	27
Benefit obligation end of year…………..	$815	$700

The fair market value of YUM!'s plan assets is $610 million, as of 2016. What is the funded status of the plan, and how will this be reflected on YUM!'s balance sheet?

a. Underfunded, $205 million liability
b. Underfunded, $205 million asset
c. Underfunded, not reflected on the balance sheet
d. Underfunded, $815 million liability

4. Assume Fortune Brands, Inc., reports the following footnote relating to its leased facilities in its 2016 10-K report.

Future minimum rental payments under noncancelable operating leases as of December 31, 2016 are as follows:

(In millions)	
2017……………………………………………….	$ 45.6
2018…………………………………………….	33.5
2019…………………………………………….	26.9
2020…………………………………………….	20.2
2021…………………………………………….	15.7
Remainder…………………………………….	37.3
Total minimum rental payments……………….	$179.2

Compute the present value of these operating leases using a discount rate of 7% and round the remaining lease term to the nearest whole year.

a. $140.7 million
b. $179.2 million
c. $127.3 million
d. $154.9 million

5. Assume Verizon Communications, Inc., provides the following footnote relating to its leasing activities in its 10-K report.

   The aggregate minimum rental commitments under noncancelable leases for the periods shown at December 31, 2016, are as follows:

Years (dollars in millions)	**Capital Leases**	**Operating Leases**
2017…………………………………………………………	$ 37	$1,184
2018…………………………………………………………	28	791
2019…………………………………………………………	21	652
2020…………………………………………………………	13	504
2021…………………………………………………………	12	316
Thereafter……………………………………………………	55	1,050
Total minimum rental commitments………………………	166	$4,497
Less interest and executory costs…………………………	(54)	
Present value of minimum lease payments………………	112	
Less current installments…………………………………	(17)	
Long-term obligation at December 31, 2016……………..	$ 95	

   Assuming that this is the only available information relating to its leasing activities, what amount does Verizon report on its balance sheet for its total lease obligations?

   a. $95 million
   b. $112 million
   c. $166 million
   d. $4,452 million

6. Assume Ford Motor Company reports the following pension footnote in its 10-K report.

	Pension Benefits	
($ millions)	U.S. Plans 2016	Non-U.S. Plans 2016
Change in Benefit Obligation		
Benefit obligation at January 1…………………	$43,077	$29,452
Service cost………………………………………	734	630
Interest cost……………………………………..	2,398	1,408
Amendments…………………………………….	-	218
Separation programs…………………………….	179	422
Plan participant contributions……………..	41	146
Benefits paid…………………………………….	(2,856)	(1,355)
Foreign exchange translation………………..	—	(2,936)
Divestiture………………………………………..	(400)	(163)
Actuarial (gain) loss……………………………..	722	2,878
Benefit obligation December 31…………..	$43,895	$30,700
Change in Plan Assets		
Fair value of plan assets at January 1…….	$39,628	$20,595
Actual return on plan assets…………………	3,922	3,239
Company contributions………………………	1,432	1,355
Plan participant contributions……………	41	150
Benefits paid…………………………………….	(2,856)	(1,355)
Foreign exchange translation………………	—	(1,924)
Divestiture……………………………………….	(309)	(95)
Other………………………………………………	(1)	(38)
Fair value of plan assets at December 31…..	$41,857	$21,927

What is the total amount paid to retirees during fiscal 2016 for its U.S. and non-U.S. plans?

a. $1,364 million
b. $187 million
c. $2,787 million
d. $4,211 million

7. Assume the Abercrombie & Fitch 10-K report contains the following footnote relating to its leasing activities. This is the only information it discloses relating to its leasing activity.

   At January 28, 2017, the Company was committed to non-cancelable leases with remaining terms of one to 15 years. A summary of operating lease commitments under non-cancelable leases follows (thousands):

2017	$187,674
2018	$187,397
2019	$178,595
2020	$169,856
2021	$155,670
Thereafter	$538,635

   Assuming that its operating leases relate to real estate, and that A&F depreciated such assets on a straight-line basis with no salvage value and useful life of 8 years, estimate the effect on the company's 2017 income before tax of capitalizing these operating leases. Use a 7% discount rate and round remaining lease life to the nearest whole year.

   a. Reduce income before taxes by $10,585,000
   b. Increase income before taxes by $187,674,000
   c. Reduce income before taxes by $187,674,000
   d. Reduce income before taxes by $198,259,000

8. Which of the following is *not* a component of net pension expense?

   a. Interest cost
   b. Expected return on plan assets
   c. Benefits paid to retirees
   d. Amortization of prior service cost

9. Assume Cisco Systems reports the following footnote disclosure to its 10-K report ($ millions).

($ millions)	**July 30, 2016**
Federal	
Current	$1,340
Deferred	497
	1,837
State	
Current	496
Deferred	(292)
	204
Foreign	
Current	404
Deferred	(150)
	254
Total	$2,295

What amount of income tax expense does Cisco report in its income statement for 2016?

a. $2,240 million
b. $2,295 million
c. $ 55 million
d. $1,837 million

10. The income tax footnote to the financial statements of Chambers, Inc. follows.

The components of the provision for income taxes for the years ended May 31 were as follows:

($ millions)	**2017**	**2016**
Current provision		
Domestic		
Federal ……………………	$371	$112
State and local …………..	54	28
Foreign ……………………..	85	39
	510	179
Deferred provision (benefit)		
Domestic		
Federal ……………………	(22)	304
State and local …………..	(7)	25
Foreign ……………………..	—	—
	(29)	329
Provision for income taxes …..	$481	$508

What percentage of total tax expense is currently payable in 2016 and 2017?

a. 2016: 65% 2017: (6)%
b. 2016: 100% 2017: 100%
c. 2016: 82% 2017: 73%
d. 2016: 35% 2017: 106%