Module 7 – Financial & Managerial Accounting for MBAs, 4th Edition
by Easton, Halsey, McAnally, Hartgraves, and Morse

Solutions to Practice Quiz

LO: 2

1. Answer: d

   Because the bonds trade at a premium in the market (108.104), Deere would be paying more to retire the bonds than their balance sheet (carrying) value. Deere's cash outflow would be $216.208 million ($200 million × 108.104%). This would result in a loss on repurchase of debentures of 16.208 million, which would lower current income. This loss would be reported in current income from continuing operations unless it meets the test for an extraordinary item (unusual and infrequent).

LO: 2

2. Answer: d

   CVS paid $135.9 million for interest in 2005. Its average long-term debt during 2005, is $2,515.6 million [($2,189.1 million + $2,842.1 million) / 2]. Therefore, the average coupon rate is 5.40%, computed as $135.9 / $2,515.6.

   CVS reports 2005 interest expense of $117.0 million on average long-term debt of $2,515.6 million [($2,189.1 million + $2,842.1 million) / 2] for an average effective (yield) rate of 4.65%.

LO: 2

3. Answer: b

Amount paid to retire bonds ($300,000 × 102%): …………………….	$306,000
Book value of retired bonds, net of $3,900 unamortized discount: …….	296,100
Loss on bond retirement	$ 9,900

LO: 2

4. Answer: a

   Gain on Bond Retirement: Income Statement—included with other (nonoperating) income and expense section unless it meets the tests for extraordinary treatment (i.e., unusual and infrequent).

   Discount on Bonds Payable: Balance Sheet—shown as a deduction from Long-term Debt (Bonds Payable); a contra long-term liability in the balance sheet, which is netted in the presentation of long-term liabilities.

   Mortgage Notes Payable: Balance Sheet—Long-term liability.

   Bonds Payable: Balance Sheet—Long-term liability.

LO: 1

5. Answer: b

Nissim:	$20,000 × 0.11 × 62/365 =	$373.70
Klein:	$15,000 × 0.08 × 30/365 =	98.63
Bildersee:	$17,000 × 0.10 × 10/365 =	46.58
		$518.91

LO: 2

6. Answer: a

Selling price for $400,000, 8% bonds discounted at 10% (5% semiannually):

Present value of principal repayment ($400,000 × 0.45811[a]) ……..	$183,244
Present value of interest payments ($16,000 × 10.83777[b]) ………..	173,404
Selling price of bonds ………………………………………………..	$356,648

[a]Table 1, 16 periods at 5%. [b]Table 2, 16 periods at 5%.

Calculator inputs: N=16, I/YR=5, PMT=16,000, FV=400,000

LO: 2

7. Answer: c

Selling price of zero coupon bonds discounted at 8%

Present value of principal repayment ($400,000 × 0.53391[a]) = $213,564

[a]Table 1, 16 periods at 4%

Calculator inputs: N=16, I/YR=4, PMT=0, FV=400,000

LO: 1

8. Answer: b

Total expected failures from units sold (22,000 × 0.04)……..	880
Average cost per failure ……………………………………….	× $150
Total warranty expense for the current period ………………	$132,000

LO: 2

9. Answer: a

(in $000's)

LTD 315
Cash 306
GN 9

	Balance Sheet									Income Statement				
Transaction	Cash Asset	+	Noncash Assets	=	Liabil-ities	+	Contrib. Capital	+	Earned Capital	Revenues	–	Expen-ses	=	Net Income
To retire bonds at 102, remove unamortized premium and report gain on bond retirement*	-306 Cash			=	-300 Long-Term Debt -15 Premium on Bonds				+9 Retained Earnings	+9 Gain on Bond Retirement	–		=	+9

LTD: 315 (debit)
Cash: 306 (credit)
GN: 9 (credit)

* Retirement price = $306,000 = $300,000 × 102%
Original premium = ($300,000 × 106%) - $300,000 = $18,000
Unamortized premium = $18,000 - $3,000 = $15,000

LO: 2

10. Answer: a

LTD 481
LS 29
Cash 510

	Balance Sheet									Income Statement				
Transaction	Cash Asset	+	Noncash Assets	=	Liabil-ities	+	Contrib. Capital	+	Earned Capital	Rev-enues	–	Expen-ses	=	Net Income
To retire bonds at 102, remove unamortized discount and report loss on bond retirement*	-510 Cash			=	-500 Long-Term Debt +19 Discount on Bonds				-29 Retained Earnings		–	29 Loss on Bond Retirement	=	-29

LTD: 481 (debit)
LS: 29 (debit)
Cash: 510 (credit)

* Retirement price = $510,000 = $500,000 × 102%
Original discount = (100% – 95%) × $500,000 = $25,000
Unamortized discount = $25,000 - $6,000 = $19,000