

**Module 7 – Financial Statement Analysis & Valuation, 4<sup>th</sup> Edition by Easton, McAnally, Sommers & Zhang**

**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 ( $\$200 \text{ million} \times 108.104\%$ ). 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  $[(\$2,189.1 \text{ million} + \$2,842.1 \text{ million}) / 2]$ . 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  $[(\$2,189.1 \text{ million} + \$2,842.1 \text{ million}) / 2]$  for an average effective (yield) rate of 4.65%.

LO: 2

3. Answer: b

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

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:	$\$20,000 \times 0.11 \times 62/365 =$	\$373.70
Klein:	$\$15,000 \times 0.08 \times 30/365 =$	98.63
Bildersee:	$\$17,000 \times 0.10 \times 10/365 =$	<u>46.58</u>
		<u>\$518.91</u>

LO: 2

6. Answer: a

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

Present value of principal repayment ( $\$400,000 \times 0.45811^a$ ) .....	\$183,244
Present value of interest payments ( $\$16,000 \times 10.83777^b$ ) .....	<u>173,404</u>
Selling price of bonds .....	<u>\$356,648</u>

<sup>a</sup> Table 1, 16 periods at 5%.

<sup>b</sup> 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 ( $\$400,000 \times 0.53391^a$ ) = \$213,564

<sup>a</sup>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 ( $22,000 \times 0.04$ ) .....	880
Average cost per failure .....	<u>x \$150</u>
Total warranty expense for the current period .....	<u>\$132,000</u>

LO: 2

9. Answer: a

(in \$000's)

(in \$000's)		Balance Sheet							Income Statement						
Transaction		Cash Asset	+	Noncash Assets	=	Liabilities	+	Contrib. Capital	+	Earned Capital	Revenues	-	Expenses	=	Net Income
LTD	315														
Cash	306														
GN	9														
<u>LTD</u>															
315															
To retire bonds at															
102, remove															
unamortized															
premium and report															
gain on bond															
retirement*															
Cash		-306			=	-300				+9	+9				+9
		Cash				Long-Term Debt				Retained Earnings	Gain on Bond Retirement				
						-15									
						Premium on Bonds									
<u>GN</u>															
9															

\* 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

Balance Sheet										Income Statement				
Transaction	Cash Asset	+	Noncash Assets	=	Liabilities	+	Contrib. Capital	+	Earned Capital	Revenues	-	Expenses	=	Net Income
LTD      481 LS        29 Cash      510														
<u>LTD</u> To retire bonds at					-500									
481					Long-Term Debt									
	-510			=					-29			29		
<u>LS</u> loss on bond	Cash				+19				Retained Earnings	-		Loss on		-29
29					Discount on Bonds							Bond Retirement		
Cash      retirement*														
<u>Cash</u> 510														

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