Reading 31: Non-current (Long-term) Liabilities

Question #1 of 74

Question ID: 414597

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

A) the market rate.

B) the coupon payment.

C) the unamortized bond discount.

Question #2 of 74

Question ID: 456302

Samson Therapeutics records all leases as operating leases. Compared to recording capital leases, this results in lower:

A) inventory.

B) expenses.

C) leverage.

Question #3 of 74

Question ID: 414637

For a given lease payment and term, which of the following is *least accurate* regarding the effects of the classification of the lease as a finance lease as compared to an operating lease?

A) The lessee's asset turnover will be lower for a finance lease.

B) The lessee's current ratio will be higher for a finance lease.

C) The lessee's debt-to-equity ratio will be higher for a finance lease.

Question #4 of 74

Question ID: 414646

Which of the following is *least likely* disclosed in the financial statement footnotes of a lessee?

A) The lease interest rate.

B) A general description of the leasing arrangement.

C) The lease payments to be paid in each of the next five years.

Question #5 of 74

Question ID: 414650

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.

Question #6 of 74

Question ID: 414622

The lessee has an incentive to classify a lease as an operating lease, rather than as a finance lease, because an operating lease:

A) has payments that are less than a capital lease's payments.

B) does not appear on the balance sheet.

C) has no risk involved because the lessor assumes all risk.

Question #7 of 74

Question ID: 414651

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 decrease its coverage ratios.

B) increase its leverage ratios and increase its coverage ratios.

C) decrease its leverage ratios and increase its coverage ratios.

Question #8 of 74

Question ID: 414616

Which of the following provisions would *least likely* be included in the bond covenants? The borrower must:

A) maintain a debt-to-equity ratio of no less than 2:1.

B) maintain insurance on the collateral that secures the bond.

C) not increase dividends to common shareholders while the bonds are outstanding.

Question #9 of 74

Question ID: 414645

Classifying a lease as an operating lease for a lessee, as opposed to a finance lease, will result in:

	Current Ratio	Debt/Equity Ratio	Asset Turnover Ratio
A)	Higher	Lower	Higher
B)	Lower	Lower	Higher
C)	Higher	Lower	Lower

Question #10 of 74

Question ID: 414607

When bonds are issued at a premium:

A) earnings of the firm decrease over the life of the bond as the bond premium is amortized.

B) earnings of the firm increase over the life of the bond as the bond premium is amortized.

C) coupon interest paid decreases each period as bond premium is amortized.

Question #11 of 74

Question ID: 414641

The Mader Corporation leases an asset for five years with lease payments of $10,000 per year. If Mader classifies the lease as a finance lease, which financial statements are affected at the end of the first year?

A) Income statement and balance sheet only.

B) Statement of cash flows, income statement, and balance sheet.

C) Income statement only.

Question #12 of 74

Question ID: 414625

An analyst compares two companies that are identical except that Company X uses finance leases and Company Y uses operating leases. The analyst would expect Company X's debt-to-equity ratio, relative to Company Y's, to be:

A) higher.

B) lower.

C) the same.

Question #13 of 74

Question ID: 414595

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) 855.

C) 1023.

Question #14 of 74

Question ID: 414594

Which of the following statements regarding zero-coupon bonds is *most* accurate?

A) 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.

B) Interest expense is a combination of operating and financing cash flows.

C) A company should initially record zero-coupon bonds at their discounted present value.

Question #15 of 74

Question ID: 498763

A debt covenant is *most likely* to restrict a firm from:

A) issuing new common shares.

B) repurchasing common shares.

C) decreasing its common dividends.

Question #16 of 74

Question ID: 414638

Which of the following statements about leases is *least* accurate?

A) In the first years of a finance lease, the lessee's current ratio is greater than it would have been had the firm used an operating lease.

B) All else equal, when a lease is capitalized the lessee's income will rise over the term of the lease.

C) In the first years of a finance lease, the lessee's debt to equity ratio is greater than it would have been if the firm had used an operating lease.

Question #17 of 74

Question ID: 414605

Which of the following statements is *least* accurate? When a bond is issued at a discount:

A) the interest expense will increase over time.

B) cash flows from financing will be increased by the par value of the bond issue.

C) the interest expense will be equal to the coupon payment plus the amortization of the discount.

Question #18 of 74

Question ID: 414618

Which of the following is *least likely* to be disclosed in the financial statements of a bond issuer?

A) Collateral pledged as security in the event of default.

B) The amount of debt that matures in each of the next five years.

C) The market rate of interest on the balance sheet date.

Question #19 of 74

Question ID: 467388

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) 967.

B) 923.

C) 935.

Question #20 of 74

Question ID: 414613

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) 10,100,000 CFF outflow.

B) $10,100,000 CFO outflow.

C) $10,000,000 CFF outflow and $100,000 CFO outflow.

Question #21 of 74

Question ID: 414598

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) $300,000.

B) $350,000.

C) $316,448.

Question #22 of 74

Question ID: 414604

A zero coupon bond, compared to a bond issued at par, will result in higher:

A) cash flows from financing (CFF).

B) cash flows from operations (CFO).

C) interest expense.

Question #23 of 74

Question ID: 414615

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.

Question #24 of 74

Question ID: 414620

Compared to a finance lease, an operating lease results in which of the following on the lessee's balance sheet?

A) Lower liabilities.

B) Higher liabilities.

C) Higher assets.

Question #25 of 74

Question ID: 414623

Compared to a finance lease, an operating lease is *most likely* to be favored when:

A) management compensation is not based on returns on invested capital.

B) the lessee has bond covenants relating to financial policies.

C) at the end of the lease, the lessee may be better able to sell the asset than the lessor.

Question #26 of 74

Question ID: 414592

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

Question #27 of 74

Question ID: 485784

Crawford Corp. and Vernon Corp. are lessors who have leased assets on identical terms to firms with similar credit ratings. Crawford reports its lease as a sales-type lease and Vernon reports its lease as a direct financing lease. It is *most likely* that:

A) Vernon reports under IFRS.
B) both firms report under U.S. GAAP.
C) Crawford retains the leased asset on its balance sheet.

Question #28 of 74

Question ID: 414590

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.

Question #29 of 74

Question ID: 414606

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) $1,200,000.
B) $1,346,549.
C) $1,600,000.

Question #30 of 74

Question ID: 627887

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) Debt-to-equity ratio.
B) Interest paid.
C) Cash flow from financing.

Question #31 of 74

Question ID: 500860

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.

Question #32 of 74

Question ID: 414649

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 income statement as pension expense.

C) on the balance sheet as a net pension asset or liability.

Question #33 of 74

Question ID: 414608

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.

Question #34 of 74

Question ID: 414626

Under an operating lease (versus a finance lease) which of the following is higher for the lessee?

A) Cash flow from financing.

B) Cash flow from operations.

C) Assets.

Question #35 of 74

Question ID: 434313

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.

Question #36 of 74

Question ID: 434310

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) $3,495.

C) $1,209.

Question #37 of 74

Question ID: 414628

Which of the following statements about the impact of leases on the financial statements of the lessee is *least* accurate?

A) A finance lease results in higher liabilities compared to an operating lease.

B) Net income is lower in the early years of a finance lease than an operating lease.

C) Cash flow from investing is higher for a finance lease than an operating lease.

Question #38 of 74

Question ID: 414612

A firm can recognize a gain or loss on derecognition of a bond the firm has issued:

A) either before maturity or at maturity.

B) before maturity, but not at maturity.

C) at maturity, but not before maturity.

Question #39 of 74

Question ID: 414648

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.

Question #40 of 74

Question ID: 414600

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)	10,181,495	2,437,893
B)	11,099,495	2,437,893
C)	10,181,495	2,962,107

Question #41 of 74

Question ID: 434311

An 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) cash flow from investing by $9.626 million.

B) liabilities by $10.0 million.

C) assets by $9.626 million.

Question #42 of 74

Question ID: 414591

At the date of issuance the market interest rate was above the coupon rate. Bonds of this nature would sell for:

A) premium.

B) par.

C) discount.

Question #43 of 74

Question ID: 414617

In analyzing disclosures related to the financing liabilities of a company, which of the following disclosures would be *least* 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.

Question #44 of 74

Question ID: 485783

A company issues 5% semiannual coupon, 3-year, $1,000 par value bonds on January 1, 20X0, when the market interest rate is 13.3%. The sale proceeds are $800. Under the effective interest rate method, what amount of interest expense per $1,000 par value will the company record for the year ending December 31, 20X1?

A) $66.29.

B) $116.29.

C) $106.40.

Question #45 of 74

Question ID: 414614

Ivo Company has a $10 million face value bond issue outstanding. These bonds include a call option that permits Ivo 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.

Question #46 of 74

Question ID: 414633

Compared to an operating lease, a lessee using a finance lease is *least likely* to have:

A) higher cash flow from financing during the lease period.

B) lower net income in the earlier years of the lease.

C) a lower current ratio.

Question #47 of 74

Question ID: 498764

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) current liabilities only.

B) both current and long-term liabilities.

C) long-term liabilities only.

Question #48 of 74

Question ID: 414589

Proceeds from issuing a bond are recorded on the statement of cash flows as an inflow from:

A) operations (CFO).

B) investing (CFI).

C) financing (CFF).

Question #49 of 74

Question ID: 414621

A firm is *most likely* to lease an asset rather than purchasing it if the asset:

A) may be made obsolete by rapid technological advances.

B) is costly to move from place to place.

C) has a high salvage value relative to its cost.

Question #50 of 74

Question ID: 414630

According to U.S. GAAP, which of the following would *least likely* require a lessee to capitalize a lease?

A) The lease term is 75% or more of the estimated life of the leased asset.

B) The lessee has an option to purchase the asset for its fair market value at the end of the lease.

C) The present value of the minimum lease payments is 90% or more of the fair value of the leased asset.

Question #51 of 74

Question ID: 414593

When the market rate is greater than the coupon rate, the bond is called a:

A) premium bond.

B) par bond.

C) discount bond.

Question #52 of 74

Question ID: 414596

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) $2,246.65.

B) $1,748.07.

C) $498.58.

Question #53 of 74

Question ID: 414640

Which of the following statements regarding the effect of a finance lease on the lessee's statement of cash flows is *least* accurate?

A) The change in the finance lease liability on the balance sheet is a cash flow from financing.

B) The interest expense portion of the lease payments reduces cash flow from operations.

C) The rental expense serves to reduce the cash flow for financing because it is an investment expense.

Question #54 of 74

Question ID: 414647

The present value of benefits earned during the current period by participants in a defined benefit pension plan is *best* described as the plan's:

A) service cost.

B) past service cost.

C) net pension liability.

Question #55 of 74

Question ID: 414610

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) -$700,000.

C) -$755,735.

Question #56 of 74

Question ID: 414627

Which of the following statements that classify a lease as a finance lease under U.S. GAAP is *least* accurate?

A) The present value of the lease payments is at least 80% of the fair market value of the asset.

B) A bargain purchase option exists.

C) Title is transferred at the end of the lease period.

Question #57 of 74

Question ID: 414624

A lessee *most likely* has an incentive to structure a lease as an operating lease rather than a finance lease when it:

A) does not have debt covenants.

B) is very profitable.

C) has a high debt-to-equity ratio.

Question #58 of 74

Question ID: 414632

For a finance lease, the amount recorded initially by the lessee as a liability will *most likely*:

A) equal the present value of the minimum lease payments at the beginning of the lease.

B) be less than the fair value of the leased asset.

C) equal the total of the minimum lease payments.

Question #59 of 74

Question ID: 414629

Which of the following is *least likely* one of the criteria under U.S. GAAP for classifying a lease as a finance lease? The:

A) term of the lease is 75% or more of the estimated economic life of the leased property.

B) lease contains a bargain purchase option.

C) lessor retains ownership of the property at the end of the lease term.

Question #60 of 74

Question ID: 414619

As compared to purchasing an asset, which of the following is least likely an incentive to structure a transaction as a finance lease?

A) The lease enhances the balance sheet by the lease liability.

B) Risk of obsolescence is reduced because the asset is returned to the lessor.

C) The terms of the lease can be negotiated to better meet each party's needs.

Question #61 of 74

Question ID: 414634

Under a finance lease (versus an operating lease) which of the lessee's financial ratios will be higher?

A) Return on equity.

B) Asset turnover.

C) Debt/equity.

Question #62 of 74

Question ID: 598674

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) $80,000.

B) $210,830.

C) $106,550.

Question #63 of 74

Question ID: 414636

If a lease is treated as a finance lease, as compared to being treated as an operating lease, the effect on the lessee's current ratio and the debt/equity ratio will be an:

	Current Ratio	Debt/Equity Ratio
A)	Increase	Decrease
B)	Decrease	Increase
C)	Increase	Increase

Question #64 of 74

Question ID: 414644

Which of the following statements regarding finance and operating leases is *least* accurate?

A) Asset turnover is higher for the lessee with an operating lease than a finance lease.

B) During the life of an operating lease, the rent expense equals the lease payment.

C) For financial reporting of finance and operating leases, no entry is required on the lessee's balance sheet at the inception of the lease.

Question #65 of 74

Question ID: 414602

Nomad Company issued $1,000,000 face value 2-year zero coupon bonds on December 31, 20X2 to yield 8% interest. Bond proceeds were $857,339. In 20X3 Nomad recorded interest expense of $68,587. In 20X4 Nomad recorded interest expense of $74,074 and paid out $1,000,000 to redeem the bonds. Based on these transactions only, Nomad's Statement of Cash Flows would show cash flow from operations (CFO) of:

A) -$68,587 in 20X3 and -$74,074 in 20X4.

B) zero in all years.

C) -$142,661 in 20X4.

Question #66 of 74

Question ID: 414643

Penguin Company is planning to lease a $5 million machine to produce goods for eventual sale. Penguin is able to structure the lease so as to classify it as either an operating or a finance lease. Advantages to Penguin of classifying this lease as an operating lease are *least likely* to include that:

A) the lease is not reported as debt on Penguin's balance sheet, so leverage ratios are not increased.

B) depreciation is not recorded.

C) no disclosures of payments due under the lease are required.

Question #67 of 74

Question ID: 414635

On the lessee's cash flow statement, the principal portion of a finance lease payment is a:

A) operating cash flow.

B) investing cash flow.

C) financing cash flow.

Question #68 of 74

Question ID: 414611

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) $10,346,511

B) $9,737,568

C) $9,661,279

Question #69 of 74

Question ID: 434312

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) $1,209.

B) $538.

C) $1,750.

Question #70 of 74

Question ID: 414588

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 premium.

B) par.

C) a discount.

Question #71 of 74

Question ID: 414639

If a lessee enters into a finance lease rather than an operating lease, it can expect to have a:

A) lower debt-to-equity ratio.

B) higher return on assets.

C) higher debt-to-equity ratio.

Question #72 of 74

Question ID: 414603

For a given par value, which of the following debt issues will have the highest cash flows from financing?

A) Bonds issued at discount.

B) Bonds issued at premium.

C) Zero-coupon bond.

Question #73 of 74

Question ID: 414631

In a direct-financing lease, the implicit rate is such that the present value of the minimum lease payments:

A) equals the sale price of the leased asset.

B) equals the cost of the leased asset.

C) is lower than the cost of the leased asset.

Question #74 of 74

Question ID: 414642

Which of the following statements regarding a direct financing lease is *least* accurate?

A) The lessor recognizes no gross profit at the inception of the lease.

B) Interest revenue on the lessor's income statement equals the implicit interest rate times the lease payment.

C) The principal portion of the lease payment is a cash inflow from investing on the lessor's cash flow statement.