Question #1 of 64

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

B) depreciation is not recorded.

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

Question #2 of 64

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	Increase
B)	Increase	Decrease
C)	Decrease	Increase

Question #3 of 64

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 64

A 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) assets by $9.626 million.

B) cash flow from investing by $9.626 million.

C) liabilities by $10.0 million.

Question #5 of 64

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

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

B) equals the sale price of the leased asset.

C) equals the cost of the leased asset.

Question #6 of 64

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)	$3,675,149	$3,675,149
C)	$5,000,000	$5,000,000

Question #7 of 64

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) an increasing trend in the ratio over the life of the bond.

C) no effect on the ratio over the life of the bond.

Question #8 of 64

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

A) a lower current ratio.

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

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

Question #9 of 64

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 no risk involved because the lessor assumes all risk.

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

C) does not appear on the balance sheet.

Question #10 of 64

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) 935.

C) 923.

Question #11 of 64

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) a discount.

C) par.

Question #12 of 64

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) $350,000.

B) $300,000.

C) $316,448.

Question #13 of 64

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 #14 of 64

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

A) higher return on assets.

B) higher debt-to-equity ratio.

C) lower debt-to-equity ratio.

Question #15 of 64

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 #16 of 64

Over time, the reported amount of the annual interest expense on a long-term bond issued at a discount will:

A) increase.

B) remain constant.

C) decrease.

Question #17 of 64

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

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

Question #18 of 64

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

A) Cash flow from operations.

B) Assets.

C) Cash flow from financing.

Question #19 of 64

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 #20 of 64

The difference between the fair value of a defined benefit pension plan's assets and its estimated benefit obligation is recognized:

A) on the income statement as pension expense.

B) as an actuarial adjustment in other comprehensive income.

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

Question #21 of 64

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) $1,748.07.

B) $498.58.

C) $2,246.65.

Question #22 of 64

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

Question #23 of 64

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

A) investing cash flow.

B) operating cash flow.

C) financing cash flow.

Question #24 of 64

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	Lower
B)	Higher	Lower	Higher
C)	Lower	Lower	Higher

Question #25 of 64

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

B) Income statement and balance sheet only.

C) Income statement only.

Question #26 of 64

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) 1023.

B) 923.

C) 855.

Question #27 of 64

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

A) premium bond.

B) discount bond.

C) par bond.

Question #28 of 64

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) 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.

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

Question #29 of 64

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) -$700,000.

B) -$900,000.

C) -$755,735.

Question #30 of 64

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

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

B) The lease interest rate.

C) A general description of the leasing arrangement.

Question #31 of 64

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 #32 of 64

A firm is more solvent if it has:

A) high leverage and coverage ratios.

B) low leverage ratios and high coverage ratios.

C) low leverage and coverage ratios.

Question #33 of 64

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

A) Debt/equity.

B) Return on equity.

C) Asset turnover.

Question #34 of 64

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) lease contains a bargain purchase option.

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

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

Question #35 of 64

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) $9,737,568

B) $10,346,511

C) $9,661,279

Question #36 of 64

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 gain on redemption.

B) neither a gain nor a loss on redemption.

C) a loss on redemption.

Question #37 of 64

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 #38 of 64

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

B) $10,100,000 CFO outflow.

C) 10,100,000 CFF outflow.

Question #39 of 64

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) Cash flow from financing.

B) Interest paid.

C) Debt-to-equity ratio.

Question #40 of 64

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

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

B) is costly to move from place to place.

C) may be made obsolete by rapid technological advances.

Question #41 of 64

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 contribution plan.

B) the defined benefit plan.

C) both of these pension plans.

Question #42 of 64

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 #43 of 64

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) equal the total of the minimum lease payments.

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

Question #44 of 64

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

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

Question #45 of 64

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 #46 of 64

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

A) at maturity, but not before maturity.

B) either before maturity or at maturity.

C) before maturity, but not at maturity.

Question #47 of 64

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

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

B) 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.

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

Question #48 of 64

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

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

Question #49 of 64

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

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

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

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

Question #50 of 64

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

A) A bargain purchase option exists.

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

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

Question #51 of 64

When bonds are issued at a premium:

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

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

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

Question #52 of 64

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

A) expenses.

B) inventory.

C) leverage.

Question #53 of 64

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 #54 of 64

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

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

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

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

Question #55 of 64

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) the same.

B) higher.

C) lower.

Question #56 of 64

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 #57 of 64

Other things equal, and ignoring issuance costs, a firm that raises cash by issuing a new bond is *most likely* to:

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

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

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

Question #58 of 64

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

A) par.

B) premium.

C) discount.

Question #59 of 64

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

A) Higher assets.

B) Higher liabilities.

C) Lower liabilities.

Question #60 of 64

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) Crawford retains the leased asset on its balance sheet.

B) Vernon reports under IFRS.

C) both firms report under U.S. GAAP.

Question #61 of 64

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 value of the bond will be amortized toward zero over the life of the bond.

C) The bond will be shown on the balance sheet at the premium value.

Question #62 of 64

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) past service cost.

B) service cost.

C) net pension liability.

Question #63 of 64

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) $1,600,000.

B) $1,346,549.

C) $1,200,000.

Question #64 of 64

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.