

Module 8 – Financial Accounting for MBAs, 4th edition by Easton, Halsey, Wild & McAnally

Practice Quiz

1. **Deere & Company's** 2005 10-K reports the following footnote relating to long-term debt. Deere's borrowings include \$200 million, 6.55% debentures (unsecured bonds), due in 2028 (highlighted below).

Long-term borrowings at October 31 consisted of the following in millions of dollars:

Notes and debentures	2005	2004
Medium-term notes:		
Average interest rate of 9.2%—2004		\$ 20
5-7/8% U.S. dollar notes due 2006: (\$250 principal)		
Swapped \$170 to Euro at average variable interest rates of 3.1%—2004		250
7.85% debentures due 2010	\$ 500	500
6.95% notes due 2014: (\$700 principal)		
Swapped to variable interest rates of 5.2%—2005, 3.1%—2004	744	786
8.95% debentures due 2019	200	200
8-1/2% debentures due 2022	200	200
6.55% debentures due 2028	200	200
8.10% debentures due 2030	250	250
7.125% notes due 2031	300	300
Other notes	29	22
Total	<u>\$2,423</u>	<u>\$2,728</u>

A recent price quote (from www.BondPage.com) on Deere's 6.55% debentures follows.

Credit ratings	Issuer name Issue	Coupon rate Maturity	Price quote Yield
A3/A- Industrial	Deere & Co Non Callable, NYBE, DE	6.550 10-01-2028	108.104 5.890

This price quote indicates that Deere's bonds have a market price of 108.104 (108.104% of face value), resulting in a yield to maturity of 5.89%.

How much cash would Deere have to pay to repurchase the 6.55% debentures at the quoted market price of 108.104? (Assume no interest is owed when Deere repurchases the debentures.)

- a. \$200.000 million
- b. \$213.100 million
- c. \$211.780 million
- d. \$216.208 million

2. **CVS Corporation** discloses the following footnote in its 10-K relating to its debt.

BORROWING AND CREDIT AGREEMENTS

Following is a summary of the Company's borrowings as of the respective balance sheet dates.

In millions	Dec. 31, 2005	Jan. 1, 2005
Commercial paper	\$ 253.4	\$ 885.6
5.625% senior notes due 2008	300.0	300.0
3.875% senior notes due 2007	300.0	300.0
4.0% senior notes due 2009	650.0	650.0
4.875% senior notes due 2014	550.0	550.0
8.52% ESOP notes due 2008	114.0	140.9
Mortgage notes payable	21.0	14.8
Capital lease obligations	0.7	0.8
	<u>2,189.1</u>	<u>2,842.1</u>
Less:		
Short-term debt	(253.4)	(885.6)
Current portion of long-term debt	(341.6)	(30.6)
	<u>\$1,594.1</u>	<u>\$1,925.9</u>

CVS also discloses the following information.

Interest expense, net—Interest expense was \$117.0 million, \$64.4 million and \$53.9 million, and interest income was \$6.5 million, \$5.7 million and \$5.8 million, in 2005, 2004 and 2003, respectively. Interest paid totaled \$135.9 million in 2005, \$70.4 million in 2004 and \$64.9 million in 2003.

What is the average coupon rate (interest paid) and the average effective rate (interest expense) on CVS' long-term debt? (*Hint:* Use the disclosure for interest expense, net.)

- a. Coupon Rate: 4.81% Effective Rate: 4.80%
 - b. Coupon Rate: 5.02% Effective Rate: 6.12%
 - c. Coupon Rate: 5.20% Effective Rate: 5.03%
 - d. Coupon Rate: 5.40% Effective Rate: 4.65%
3. On April 30, one year before maturity, Romo Company retired \$300,000 of its 8% bonds payable at the current market price of 102 (102% of the bond face amount, or \$300,000 x 1.02 = \$306,000). The bond book value on April 30 is \$296,100, reflecting an unamortized discount of \$3,900. Bond interest is currently fully paid and recorded up to the date of retirement. What is the gain or loss on retirement of these bonds?
- a. \$6,000 gain
 - b. \$9,900 loss
 - c. \$3,900 loss
 - d. \$3,900 gain

4. Which of the following liability-related accounts is not a balance sheet account?
- Gain on Bond Retirement
 - Discount on Bonds Payable
 - Mortgage Notes Payable
 - Bonds Payable
5. Compute total interest accrued for all of the following notes payable owed by Petry Company, as of December 31, 2009 (use a 365-day year).

Lender	Issuance Date	Principal	Coupon Rate (%)	Term
Nissim	10/30/09	\$20,000	11%	120 days
Klein	12/1/09	15,000	8	90 days
Bildersee	12/21/09	17,000	10	60 days

- \$1,298.63
 - \$518.91
 - \$528.22
 - \$322.52
6. Bushman, Inc., issues \$400,000 of 8% bonds that pay interest semiannually and mature in 8 years. Compute the bond issue price assuming that the prevailing market rate of interest is 10% per year compounded semiannually.
- \$356,648
 - \$400,000
 - \$381,293
 - \$436,172
7. Bushman, Inc., issues \$400,000 of zero coupon bonds that mature in 8 years. Compute the bond issue price assuming that the bonds' market rate is 8% per year compounded semiannually.
- \$400,000
 - \$228,195
 - \$213,564
 - \$317,462
8. Cizmar Company sells a television that carries a 90-day unconditional warranty against product failure. From prior years' experience, Cizmar estimates that 4% of units sold each period will require repair at an average cost of \$150 per unit. During the current period, Cizmar sold 22,000 units and repaired 200 units. How much warranty expense must Cizmar report in its current period income statement?
- \$138,000
 - \$132,000
 - \$102,000
 - \$30,000

9. Crazy Corporation issued \$300,000 of 10%, 20-year bonds at 106 on January 1, 2003. Interest is payable semiannually on June 30 and December 31. Through January 1, 2008, Crazy amortized \$3,000 of the bond premium. On January 1, 2008, Crazy retires the bonds at 102. What is the gain on bond retirement at January 1, 2008?
- a. \$9,000
 - b. \$18,000
 - c. \$12,000
 - d. \$3,000
10. Schwer, Inc. issued \$500,000 of 10%, 15-year bonds at 95 on July 1, 2003. Interest is payable semiannually on December 31 and June 30. Through June 30, 2008, Schwer amortized \$6,000 of the bond discount. On July 1, 2008, Schwer retired the bonds at 102. Calculate the loss on bond retirement at July 1, 2008.
- a. \$29,000
 - b. \$25,000
 - c. \$6,000
 - d. \$19,000