CH 14 LONG-TERM LIABILITIES SELF-STUDY QUESTIONS

(note from Dr. N: I have deleted questions for you to omit, but did not renumber the remaining questions)

1. Which of the following is not typically classified as a long-term liability?
   A. Unearned Revenue.
   B. Bonds Payable.
   C. Lease Payable.
   D. Mortgage Payable.

2. All of the following statements related to bonds are correct except bonds:
   A. arise from a contract known as a bond debenture.
   B. represent a promise to pay a sum of money plus periodic interest.
   C. usually pay interest annually.
   D. typically have a $1,000 face value.

3. The covenants and other terms of the agreement between the issuer of bonds and the lender are set forth in the
   A. bond indenture.
   B. bond debenture.
   C. registered bond.
   D. bond coupon.

4. Bonds that are not recorded in the name of the bondholder are called unsecured bonds.
   A. True
   B. False

5. Convertible bonds give the issuer the right to retire bonds prior to maturity.
   A. True
   B. False

6. A bond that matures in installments is called a:
   A. term bond.
   B. serial bond.
   C. callable bond.
   D. bearer bond.

7. Bonds which do not pay interest unless the issuing company is profitable are called
   A. income bonds.
   B. term bonds.
   C. debenture bonds.
   D. secured bonds.
8. A bond for which the issuer has the right to call and retire the bonds prior to maturity is a
   A. convertible bond.
   B. callable bond.
   C. retirable bond.
   D. debenture bond.

9. A debenture bond is a (an):
   A. callable bond.
   B. secured bond.
   C. term bond.
   D. unsecured bond.

10. A bond issued in the name of the owner is a:
    A. bearer bond.
    B. convertible bond.
    C. income bond.
    D. registered bond.

11. When the effective rate of a bond is lower than the stated rate, the bond sells at a discount.
    A. True
    B. False

12. If a bond sold at 98 1/2, the market rate was:
    A. equal to the stated rate.
    B. less than the stated rate.
    C. greater than the stated rate.
    D. equal to the coupon rate.

14. On January 1, Franco Inc. issued $10,000,000, 9% bonds at 102. The journal entry to record the issuance of the
    bonds will include
    A. a credit to Bonds Payable for $10,200,000.
    B. a credit to Premium on Bonds Payable for $200,000.
    C. a debit to Cash for $10,000,000.
    D. a credit to Interest Expense for $200,000.

15. When bonds sell between interest payment dates, the purchaser will pay the seller:
    A. the price of the bonds only.
    B. the price of the bonds less the accrued interest.
    C. the price of the bonds plus the accrued interest.
    D. the face value of the bonds.
16. The selling price of a bond is the sum of the present values of the principal and the periodic interest payments. The present values are determined by using the:
   A. stated rate.
   B. nominal rate.
   C. coupon rate.
   D. market rate.

17. The interest rate actually earned by bondholders is called the:
   A. stated rate.
   B. coupon rate.
   C. effective rate.
   D. nominal rate.

18. The interest rate written in the terms of the bond indenture is known as the
   A. effective rate.
   B. market rate.
   C. yield rate.
   D. coupon rate, nominal rate, or stated rate.

19. The printing costs and legal fees associated with the issuance of bonds should
   A. be expensed when incurred.
   B. be reported as a deduction from the face amount of bonds payable.
   C. be accumulated in a deferred charge account and amortized over the life of the bonds.
   D. not be reported as an expense until the period the bonds mature or are retired.

20. Stone, Inc. issued bonds with a maturity amount of $2,000,000 and a maturity ten years from date of issue. If the bonds were issued at a premium, this indicates that
   A. the market rate of interest exceeded the stated rate.
   B. the stated rate of interest exceeded the market rate.
   C. the market and stated rates coincided.
   D. no necessary relationship exists between the two rates.

21. Hamilton Company issues $10,000,000, 6%, 5-year bonds dated January 1, 2012 on January 1, 2012. The bonds pay interest semiannually on June 30 and December 31. The bonds are issued to yield 5%. What are the proceeds from the bond issue?
<table>
<thead>
<tr>
<th>Present value of a single sum for 5 periods</th>
<th>2.5%</th>
<th>3.0%</th>
<th>5.0%</th>
<th>6.0%</th>
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<td>Present value of a single sum for 10 periods</td>
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   A. $10,000,000
   B. $10,432,988
   C. $10,437,618
   D. $10,434,616
22. The effective interest method is preferred when amortizing bond premiums and discounts.
   A. True
   B. False

23. Bonds with a face value of $100,000, and stated interest rate of 8%, were sold for $92,278 to yield 10%. Using the effective interest method of amortization, interest expense for the first six months would be $4,000.
   A. True
   B. False

24. The adjusting entry for bond premium amortization increases interest expense and decreases the balance in premium on bonds payable.
   A. True
   B. False

25. The effective interest method calculates interest expense by multiplying the carrying value of the bonds by the stated rate of interest.
   A. True
   B. False

26. Both discount on bonds payable and premium on bonds payable are:
   A. adjunct accounts.
   B. contra accounts.
   C. nominal accounts.
   D. valuation accounts.

27. If bonds are initially sold at a discount and the straight-line method of amortization is used, interest expense in the earlier years will
   A. exceed what it would have been had the effective-interest method of amortization been used.
   B. be less than what it would have been had the effective-interest method of amortization been used.
   C. be the same as what it would have been had the effective-interest method of amortization been used.
   D. be less than the stated (nominal) rate of interest.

ADDITIONAL SELF-STUDY QUESTIONS

1. Bangor Company issues $5,000,000, 7.8%, 20-year bonds to yield 8% on January 1, 2012. Interest is paid on June 30 and December 31. The proceeds from the bonds are $4,901,036. Bangor uses effective-interest amortization. What amount of interest expense will Bangor record for the June 30 payment?
   A. $195,000
   B. $196,041
   C. $200,000
   D. $392,082
2. Peterson Company issues $20,000,000, 7.8%, 20-year bonds to yield 8% on January 1, 2012. Interest is paid on June 30 and December 31. The proceeds from the bonds are $19,604,145. The company uses effective-interest amortization. Interest expense reported on the 2012 income statement will total
   A. $1,529,115
   B. $1,560,000
   C. $1,568,498
   D. $1,600,000

3. Under the effective interest method, interest expense:
   A. always increases each period the bonds are outstanding.
   B. always decreases each period the bonds are outstanding.
   C. is the same annual amount as straight-line interest expense.
   D. is the same total amount as straight-line interest expense over the term of the bonds.

4. When a bond sells at a premium, Bond Interest Expense will be:
   A. equal to the bond interest payment.
   B. greater than the bond interest payment.
   C. less than the bond interest payment.
   D. None of the above.

5. On January 1, 2012, Blanco Inc. issued $5,000,000, 9% bonds for $4,695,000. The market rate of interest for these bonds is 10%. Interest is payable annually on December 31. Blanco uses the effective-interest method of amortizing bond discount. At December 31, 2012, Blanco should report unamortized bond discount of
   A. $274,500.
   B. $285,500.
   C. $258,050.
   D. $255,000.

6. Gains and losses on early extinguishment of debt are reported as other gains and losses on the income statement.
   A. True
   B. False

7. On June 30, 2012, Rosen Co. had outstanding 8%, $3,000,000 face amount, 15-year bonds maturing on June 30, 2022. Interest is payable on June 30 and December 31. The unamortized balances in the bond discount and deferred bond issue costs accounts on June 30, 2012 were $105,000 and $30,000, respectively. On June 30, 2012, Rosen acquired all of these bonds at 94 and retired them. What net carrying amount should be used in computing gain or loss on this early extinguishment of debt?
   A. $2,970,000.
   B. $2,895,000.
   C. $2,865,000.
   D. $2,820,000.
8. An early extinguishment of bonds payable, which were originally issued at a premium, is made by purchase of the bonds between interest dates. At the time of reacquisition
   A. any costs of issuing the bonds must be amortized up to the purchase date.
   B. the premium must be amortized up to the purchase date.
   C. interest must be accrued from the last interest date to the purchase date.
   D. all of these.

9. The generally accepted method of accounting for gains or losses from the early extinguishment of debt is to treat them as
   A. an adjustment to the cost basis of the asset obtained by the debt issue.
   B. an amount that should be considered a cash adjustment to the cost of any other debt issued over the remaining life of the old debt instrument.
   C. an amount received or paid to obtain a new debt instrument and, as such, should be amortized over the life of the new debt.
   D. a difference between the reacquisition price and the net carrying amount of the debt which should be recognized in the period of redemption.

10. Long-term notes payable are valued at their face value.
    A. True
    B. False

11. The discount on a zero-interest-bearing note is amortized to interest expense in the period the note is issued.
    A. True
    B. False

12. A long-term note is valued at its:
    A. face value.
    B. market value.
    C. maturity value.
    D. present value.

13. A debt instrument with no ready market is exchanged for property whose fair market value is currently indeterminable. When such a transaction takes place
    A. the present value of the debt instrument must be approximated using an imputed interest rate.
    B. it should not be recorded on the books of either party until the fair market value of the property becomes evident.
    C. the board of directors of the entity receiving the property should estimate a value for the property that will serve as a basis for the transaction.
    D. the directors of both entities involved in the transaction should negotiate a value to be assigned to the property.

14. When a note is exchanged for property in a bargained transaction, the stated interest rate is presumed to be fair unless:
    A. no interest rate is stated.
    B. the stated interest rate is unreasonable.
    C. the stated face amount of the note is materially different from the current cash sales price for similar items.
    D. All of the above are correct.
15. Which one of the following statements relating to mortgage notes payable is **not** correct?
   A. Mortgage notes payable are the most common form of long-term notes payable.
   B. A mortgage note payable is a promissory note secured by a document that pledges title to property as security for the loan.
   C. Mortgage notes payable are payable in full at maturity or in installments.
   D. Mortgage notes payable are always reported as a long-term liability.

16. On January 1, 2012, Gise loaned $90,156 to Carter in exchange for a 3 year, zero-interest-bearing note with a face amount, $120,000. The prevailing rate of interest for a loan of this type is 10%. The adjusting journal entry made by Carter at December 31, 2012 with regard to the note will include
   A. a credit to Discount on Notes Payable for $9,016.
   B. a debit to Interest Expense for $12,000.
   C. a credit to Interest Payable for $6,000.
   D. a debit to Interest Expense for $2,985.

19. Which of the following is not an example of off-balance-sheet financing?
   A. Consolidated subsidiary.
   B. Special purpose entity.
   C. Operating leases.
   D. All of the above are examples of off-balance-sheet financing.

20. When a business enterprise enters into what is referred to as off-balance-sheet financing, the company
   A. is attempting to conceal the debt from shareholders by having no information about the debt included in the balance sheet.
   B. wishes to confine all information related to the debt to the income statement and the statement of cash flow.
   C. can enhance the quality of its financial position and perhaps permit credit to be obtained more readily and at less cost.
   D. is in violation of generally accepted accounting principles.

24. Note disclosures for long-term debt generally include all of the following except
   A. assets pledged as security.
   B. call provisions and conversion privileges.
   C. restrictions imposed by the creditor.
   D. names of specific creditors.

28. Long-term debt that matures within one year and is to be converted into stock should be reported
   A. as a current liability.
   B. in a special section between liabilities and stockholders’ equity.
   C. as non-current.
   D. as non-current and accompanied with a note explaining the method to be used in its liquidation.
## SOLUTIONS

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