In the space provided, write the word or words to either replace the question mark or answer the question.

1. The terms of the borrowing for a bond issue are contained in a master contract between the corporation and the bondholders. The master contract is known as the _?_. ____________________

2. When all of the bonds of a particular bond issue mature on a single date they are called _?_ bonds. ____________________

3. When the bonds of a particular bond issue mature in installments, they are called _?_ bonds. ____________________

4. A _?_ bond is a debt instrument generally backed by securities pledged to the trustee, who is empowered to liquidate them in the event of default. ____________________

5. Unsecured bonds are called _?_. ____________________

6. _?_ bonds give the owner the right to exchange the bonds for a fixed number of shares of the issuing company's common stock. ____________________

7. If the issuer of bonds reserves the right to call and retire the bonds prior to maturity, they are _?_ bonds. ____________________

8. Bearer, or _?_ bonds are not recorded in the name of the owner, and interest on such bonds is paid to persons presenting, periodically, the proper interest documents. ____________________

9. If the bond interest is remitted by individual checks made payable to the "holder of record", the bonds are called _?_ bonds. ____________________

In the space provided, write the word or words to either replace the question mark or answer the question.

1. The issuance of a long-term, non-interest bearing note results in the use of a contra-liability account called _?_. ______________________

2. According to APB Opinion No. 21, the discount on a long-term note payable should be amortized using the _?_ method. ______________________

Circle the letter of the best answer.

1. 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
   E. none of the above

2. When all the bonds of a particular bond issue mature on a single date, they are called
   A. debentures
   B. term bonds
   C. redeemable bonds
   D. serial bonds
   E. registered bonds

3. When the bonds of a particular bond issue mature in installments, they are called
   A. registered bonds
   B. serial bonds
   C. redeemable bonds
   D. term bonds
   E. debentures

4. A debenture is
   A. a bond that includes a pledge of specific assets as a guarantee of repayment
   B. a certificate issued to bondholders
   C. detachable coupons that are sent to the issuing company in order to receive periodic interest payments
   D. all of the above
   E. none of the above

5. Convertible bonds may be exchanged for common stock of the issuing corporation
   A. only if the conversion price exceeds the market price of the common stock
   B. at the end of the life of the bond
   C. at the option of the bondholder
   D. when the bonds become unsecured

6. The principal tax advantage of raising capital by issuing bonds instead of capital stock is that
   A. more investors will be interested in purchasing bonds because they can be issued at a discount and the price will be less than the price of capital stock
   B. interest payments are deductible for income tax purposes; dividends are not
   C. SEC approval is required for issuance of capital stock but not for bonds
   D. the issuing corporation must pay income taxes whenever capital stock is sold, but only when bonds are sold at a premium

7. When do bonds usually sell at a premium?
   A. when the market rate of interest is greater than the stated rate of interest on the bonds
   B. when the stated rate of interest on the bonds is greater than the market rate of interest
   C. when the price of the bonds is greater than their maturity value
   D. in none of the above cases

8. When bonds are sold between interest dates, any accrued interest is credited to
   A. Interest Payable
   B. Interest Revenue
   C. Interest Receivable
   D. Bonds Payable

9. The effective interest rate on bonds is lower than the stated rate when bonds sell
   A. at maturity value
   B. above face value
   C. below face value
   D. at face value

10. The market price of a bond issued at a discount is the present value of its principal amount at the market (effective) rate of interest
   A. less the present value of all future interest payments at the market (effective) rate of interest
   B. less the present value of all future interest payments at the rate of interest stated on the bond
   C. plus the present value of all future interest payments at the market (effective) rate of interest
   D. plus the present value of all future interest payments at the rate of interest stated on the bond

11. A $10,000, 20-year, 8% term bond sold to yield 9% will have sold for
    A. more than $10,000 plus accrued interest, if any
    B. less than $10,000 plus accrued interest, if any
    C. $10,000 plus accrued interest, if any
    D. the answer cannot be determined based on the information given above

12. A $50,000, 20-year, 9% term bond sold to yield 7% will have sold for
    A. more than $50,000 plus accrued interest, if any
    B. less than $50,000 plus accrued interest, if any
    C. $50,000 plus accrued interest, if any
    D. the answer cannot be determined based on the information given above

13. When bonds are first issued, the liability is entered in the bonds payable account at the bond's
    A. face value
    B. face value plus any discount
    C. issuance price
    D. par value plus interest to be paid

14. Vaso Company issued bonds payable with a face value of $200,000 and a maturity date ten years from date of issue. If the bonds were issued at a premium, this indicated that
    A. the yield (effective or market) rate of interest exceeded the stated (nominal) rate
    B. the stated (nominal) rate of interest exceeded the yield (effective or market) rate
    C. the yield (effective or market) and stated (nominal) rates of interest were the same
    D. no necessary relationship exists between the yield (effective or market) rate of interest and the stated (nominal) rate of interest

15. In theory (disregarding any other marketplace variables) the proceeds from the sale of a bond will be equal to
    A. the face amount of the bond
    B. the present value of the principal amount due at the end of the life of the bond plus the present value of the interest payments made during the life of the bond, each discounted at the prevailing market rate of interest
    C. the face amount of the bond plus the present value of the interest payments made during the life of the bond discounted at the prevailing market rate of interest
    D. the sum of the face amount of the bond and the periodic interest payments
    E. none of the above

16. Should the following bond issue costs be expensed as incurred?

	Legal fees	Underwriting costs
A.	no	no
B.	no	yes
C.	yes	no
D.	yes	yes

17. DV Company issued bonds payable and incurred underwriting, registration, and other issue costs, which amounted to 1 1/2% of the maturity value of the bonds. These costs should be
    A. reported as a deferred charge
    B. combined with the discount and reported along with it
    C. reported as an unusual or infrequent expense
    D. recorded as expense in the period of sale
    E. none of the above

18. RCM Corporation, a calendar-year firm, is authorized to issue $200,000 of 10 percent, 20-year bonds dated January 1, 20x4, with interest payable on January 1 and July 1 of each year.
    If the bonds were issued on April 1, 20x4, the amount of accrued interest on the date of sale is
    A. $20,000
    B. $10,000
    C. $ 5,000
    D. $ 2,500

19. RCM Corporation, a calendar-year firm, is authorized to issue $200,000 of 10 percent, 20-year bonds dated January 1, 20x4, with interest payable on January 1 and July 1 of each year.
    If the bonds were issued at 97 on April 1, 20x4, the amount of cash received by RCM Corporation would be
    A. $200,000
    B. $194,000
    C. $199,000
    D. none of the above

20. On June 1, 20x3, Eads Corporation issued $2,000,000 of 10-year, 12% bonds payable. Interest is payable semiannually, each April 1 and October 1. The bonds are issued at face plus accrued interest for the months since the last interest date. The journal entry to record the issuance of the bonds includes
    A. a debit to Bond Interest Expense of $40,000
    B. a debit to Cash of $2,040,000
    C. a credit to Premium on Bonds Payable of $40,000
    D. a credit to Bond Interest Payable of $80,000

21. The total interest expense on a $200,000, 10 percent, 10-year bond issued at 95 would be
    A. $190,000
    B. $195,000
    C. $200,000
    D. $210,000

22. On January 1, 20x4, Deily Corporation issued $500,000 of 10 percent, 10-year bonds at 88.5. Interest is payable on December 31. If the market rate of interest was 12 percent at the time the bonds were issued, how much cash was paid for interest in 20x4?
    A. $44,250
    B. $50,000
    C. $53,100
    D. $60,000

23. Bonds that were authorized on January 1, 20x4, and that pay interest on January 1 and July 1 of each year were issued on October 1, 20x4. If the issuer's accounting year ends on December 31, for how many months would any discount or premium be amortized in 20x4?
    A. 3 months
    B. 6 months
    C. 9 months
    D. 12 months

24. On January 1, 20x4, $50,000 of 20-year, 6 percent debentures were issued for $56,275.20. Interest payment dates on the bonds are January 1 and July 1. The amount of premium to be amortized on July 1, 20x4, when using the straight-line method is
    A. $313.76
    B. $156.88
    C. $776.50
    D. $ 93.11

25. RCM Corporation, a calendar-year firm, is authorized to issue $200,000 of 10 percent, 20-year bonds dated January 1, 20x4, with interest payable on January 1 and July 1 of each year.
    If the bonds were issued at 97 on April 1, 20x4, the amount of the discount amortized on July 1 (using the straight-line method) would be approximately
    A. $ 25
    B. $ 76
    C. $ 67
    D. $152

26. RCM Corporation, a calendar-year firm, is authorized to issue $200,000 of 10 percent, 20-year bonds dated January 1, 20x4, with interest payable on January 1 and July 1 of each year.
    The entry to account for the discount amortization and accrual of interest on December 31, 20x4, would include a
    A. debit to Discount on Bonds Payable
    B. credit to Cash
    C. credit to Interest Payable
    D. debit to Bonds Payable

27. When interest expense is calculated using the effective-interest amortization method, interest expense (assuming that interest is paid annually) always equals the
    A. actual amount of interest paid
    B. book value of the bonds multiplied by the stated interest rate
    C. book value of the bonds multiplied by the effective-interest rate
    D. maturity value of the bonds multiplied by the effective-interest rate

28. On January 1, 20x4, Felipe Hospital issued a $250,000, 10 percent, 5-year bond for $231,601. Interest is payable on June 30 and December 31. Felipe uses the effective-interest method to amortize all premiums and discounts. Assuming an effective-interest rate of 12 percent, how much interest expense should be recorded on June 30, 20x4?
    A. $11,935.14
    B. $12,500.00
    C. $13,896.06
    D. $14,729.82

29. On July 1, 20x2, Day Co. received $103,288 for $100,000 face amount, 12% bonds, a price that yields 10%. Interest expense for the six months ended December 31, 20x2, should be
    A. $6,197
    B. $6,000
    C. $5,164
    D. $5,000

30. For the issuer of a ten-year term bond, the amount of amortization using the interest method would increase each year if the bond was sold at a

	Discount	Premium
A.	no	no
B.	yes	yes
C.	no	yes
D.	yes	no

31. On March 1, 20x2, Clark Co. issued bonds at a discount. Clark incorrectly used the straight-line method instead of the effective interest method to amortize the discount. How were the following amounts, as of December 31, 20x2, affected by the error?

	Bond carrying amount	Retained earnings
A.	overstated	overstated
B.	understated	understated
C.	overstated	understated
D.	understated	overstated

32. How would the amortization of premium on bonds payable affect each of the following?

	Carrying value of bond	Net income
A.	increase	decrease
B.	increase	increase
C.	decrease	decrease
D.	decrease	increase

33. If bonds are initially sold at a discount and the straight-line method of amortization is used, interest expense in the earlier years
    A. will exceed what it would have been had the effective interest method of amortization been used
    B. will be less than what it would have been had the effective interest method of amortization been used
    C. will be the same as what it would have been had the effective interest method of amortization been used
    D. will be less than the stated (nominal) rate of interest
    E. none of the above

34. For the issuer of a ten-year term bond, the amount of amortization using the effective interest method would increase each year if the bond was sold at a

	Discount	Premium
A.	no	no
B.	yes	yes
C.	no	yes
D.	yes	no

35. The effective interest method of amortization results in
    A. a constant amount of interest expense form one period to the next
    B. an increasing amount of interest expense each period
    C. a decreasing amount of interest expense each period
    D. either an increasing or a decreasing amount of interest expense each period, depending upon whether the bonds were issued at a discount or a premium

Circle the letter of the best answer.

1. If the present value of a note issued in exchange for a plant asset is less than its face amount, the difference should be
   A. included in the cost of the asset
   B. amortized as interest expense over the life of the note
   C. amortized as interest expense over the life of the asset
   D. included in interest expense in the year of issuance

2. The issuance of a long-term, non-interest bearing note results in the use of an account called Unamortized Discount on Long-Term Notes. This account should be shown as
   A. an operating expense in the income statement
   B. an "Other Asset" on the balance sheet
   C. a deduction from Long-Term Notes Payable on the balance sheet
   D. an addition to Long-Term Notes Payable on the balance sheet
   E. none of the above

3. On January 1, 20x4, the Canyon Company sold property to the Parks Company which originally cost Canyon $300,000. There was no established exchange price for this property. Parks gave Canyon a $500,000 non-interest bearing note payable in five equal annual installments of $100,000 with the first payment due December 31, 20x4. The note has ready market. The prevailing rate of interest for a note of this type is 15%. The present value of a $500,000 note payable in five equal annual installments of $100,000 at a 15% rate of interest is $335,200. What is the amount of interest expense method?
   A. $ 0
   B. $33,520
   C. $50,280
   D. $75,000
   E. none of the above

4. On January 1, 20x4, Chris Thompson loaned $1,000 to Andrew Franklin. A non-interest bearing note was exchanged solely for cash; no other rights or privileges were exchange. The note is to be repaid on December 31, 20x6. The prevailing rate of interest for a loan of this type is 15%. The present value of a $1,000 loan at 15% for three years is $658. What amount of interest expense (rounded to the nearest whole dollar) should Mr. Franklin recognize in 20x4?
   A. $ 66
   B. $ 99
   C. $114
   D. $150
   E. none of the above

Circle the letter of the best answer.

1. Troubled debt restructuring occurs when a debtor encounters difficulty in paying debts. Troubled debt restructuring
   A. includes a concession by the creditor to the debtor
   B. requires the debtor to record an extraordinary gain
   C. may involve a reduction of principal, and interest, or both
   D. all of the above are correct
   E. none of the above is correct

2. Under terms of a debt restructure, assume the total future cash payments by the debtor to the creditor will exceed the pre-restructure carrying amount of the debt, but will amount to less than the agreed payments before the restructure
   A. the debtor must recognize a gain and the creditor must recognize a loss at the date of restructure
   B. the debtor does not recognize a gain but the creditor must recognize a loss at the date of restructure
   C. both parties must compute a new, lower interest rate which is implicit in the restructure agreement
   D. neither party is required to disclose the restructure agreement
   E. none of the above

3. Which of the following means of restructuring a troubled debt always will cause recognition of a gain or loss by the debtor or creditor (as prescribed for accounting)?
   A. transfer of assets from debtor to creditor
   B. transfer of equity interest from debtor to creditor
   C. modification of terms -- restructured total future cash to be paid by the debtor is less than the pre-restructured carrying value of the debt
   D. modification of terms -- restructured total future cash to be paid by the debtor is more than the pre-restructured carrying value of the debt
   E. none of the above

4. For a troubled debt restructuring involving only a modification of terms, it is appropriate for a debtor to recognize a gain when the carrying amount of the debt
   A. exceeds the total future cash payments specified by the new terms
   B. is less than the total future cash payments specified by the new terms
   C. exceeds the present value specified by the new terms
   D. is less than the present value specified by the new terms

5. A debtor agrees as one element of the restructure of its “troubled” debt to transfer to the creditor investments with a market value of $60,000. The investments are reflected on the debtor’s books as $65,000. The debt restructuring will result in the recognition of a $5,000 gain to the debtor, ignoring the gain or loss on transfer of the investment shares to the creditor. Based on these data, the debtor will recognize the following
   A. $5,000 ordinary gain and a $5,000 extraordinary loss
   B. $5,000 ordinary loss and a $5,000 extraordinary loss
   C. $5,000 ordinary gain and a $5,000 extraordinary gain
   D. $5,000 ordinary loss and a $5,000 extraordinary gain
   E. none of the above

6. The entry to record a bond retirement at maturity usually involves
   A. no gain or loss
   B. a credit to Gain on Retirement
   C. a debit to Loss on Retirement
   D. a credit to Bonds Payable

7. A corporation that wishes to retire its bonds payable
   A. must wait until the maturity date
   B. must pay bondholders a price equal to the carrying value of the bonds payable
   C. will recognize an extraordinary loss on the retirement if the price paid is greater than the **face value** of the bonds payable
   D. will recognize an extraordinary gain on the retirement if the price paid is less than the **carrying value** of the bonds payable

8. A $50,000 bond with a carrying value of $52,000 was called at 103 and retired. In recording the retirement, the issuing company should
   A. record no gain or loss
   B. record a $1,500 loss
   C. record a $2,000 gain
   D. record a $500 gain

9. On June 30, 20x2, King Co. had outstanding 9%, $5,000,000 face value bonds maturing on June 30, 20x7. Interest was payable semiannually every June 30 and December 31. On June 30, 20x2, after amortization was recorded for the period, the unamortized bond premium and bond issue costs were $30,000 and $50,000 respectively. On that date, King acquired all its outstanding bonds on the open market at 98 and retired them. At June 30, 20x2, what amount should King recognize as gain before income taxes on redemption of bonds?
   A. $ 20,000
   B. $ 80,000
   C. $120,000
   D. $180,000

10. On January 1, 20x13, Hart, Inc. redeemed its 15-year bonds of $500,000 par value for 102. They were originally issued on January 1, 20x1 at 98 with a maturity date of January 1, 20x16. The bond issue costs relating to this transaction were $20,000. Hart amortizes discounts, premiums, and bond issue costs using the straight-line method. what amount of extraordinary loss should Hart recognizes on the redemption of these bonds?
   A. $16,000
   B. $12,000
   C. $10,000
   D. $ 0

11. Gains or losses from the early extinguishment of debt, if material, should be
   A. recognized in income before taxes in the period of extinguishment
   B. recognized as an extraordinary item in the period of extinguishment
   C. amortized over the life of the new issue
   D. amortized over the remaining original life of the extinguished issue

12. APB Opinion No. 26, "Early Extinguishment of Debt" specifies the appropriate accounting for early extinguishment of debt. The Opinion states that the gain or loss on early extinguishment of debt
   A. should be amortized over what would have been the remaining life of the old debt
   B. should be recognized currently in the income of the period of extinguishment
   C. should be amortized over the life of any new debt that was created to obtain funds to pay off the old debt
   D. none of the above

13. On December 31, 20x1, Wright Corp. placed cash of $875,000 in an irrevocable trust that meets the necessary defeasance requirements. The trust's assets are to be used solely for satisfying obligations on Wright's 6%, $1,100,000, 30-year bond payable. Wright has not been legally released from its obligations under the bond agreement, but any additional liability is considered remote. On December 31, 20x1, the bond's carrying amount was $1,050,000, and its present value was $800,000. Disregarding income taxes, what amount of extraordinary gain (loss) should Wright report in its 20x1 income statement?
    A. $ (75,000)
    B. $175,000
    C. $225,000
    D. $250,000

14. In-substance defeasance, related to an outstanding debt and to a trust fund set up to pay the debt, has the following characteristic
    A. it permits the debtor to offset any balance in the trust fund against the outstanding debt without any conditions except as to the balance in the trust fund
    B. the fund must be restricted to monetary assets in order for offsetting to occur
    C. the fund must have cash sufficient to meet all of the payments required by the debt, as they occur, if offsetting is to occur
    D. the trust fund must provide for the payment of both interest payments and the principal, as they occur, if offsetting is to occur
    E. all of the above are characteristics of in-substance defeasance

15. Which of the following is true of a premium on bonds payable?
    A. it is a contra-stockholders' equity account
    B. it is an account that appears only on the books of the investor
    C. it increases when amortization entries are made until it reaches its maturity value
    D. it decreases when amortization entries are made until its balance reaches zero at the maturity date

16. A bond discount is reported on the financial statements in the
    A. liabilities section of the balance sheet
    B. expenses section of the income statement
    C. asset section of the balance sheet
    D. revenues section of the income statement

17. The net amount of a bond liability that appears on the balance sheet is
    A. call price of the bond plus bond discount or minus bond premium
    B. face value of the bond plus related premium or minus related discount
    C. face value of the bond plus related discount or minus related premium
    D. maturity value of the bond plus related discount or minus related premium

18. For bonds payable with a term of 20 years, originally issued at a discount and outstanding for 10 years, the theoretically preferred presentation in the statement of financial position is the
    A. amount expected to be paid to the bondholders at bond maturity date less the present value of interest to be paid in future period
    B. face amount of the bonds less the discount at the date of issue
    C. bond maturity value less the unamortized discount when the effective interest method of amortization is used
    D. face amount of the bonds

19. The issuer of a 10-year term bond sold at par three years ago with interest payable May 1 and November 1 each year, should report on its December 31 balance sheet a(n)
    A. liability for accrued interest
    B. addition to bonds payable
    C. increase in deferred charges
    D. contingent liability

20. On January 1, 20x5, Gilson Corporation issued for $1,030,000, one thousand of its 9%, $1,000 callable bonds. The bonds are dated January 1, 20x5, and mature on December 31, 20x19. Interest is payable semiannually on January 1 and July 1. The bonds can be called by the issuer at 102 on any interest payment date after December 31, 20x9. The unamortized bond premium was $14,000 at December 31, 20x12, and the market price of the bonds was 99 on this date. In its December 31, 20x12, balance sheet, at what amount should Gilson report the carrying value of the bonds?
    A. $1,020,000
    B. $1,016,000
    C. $1,014,000
    D. $ 990,000

1. Under what conditions of bond issuance does a discount on bonds payable arise?

2. Under what conditions of bond issuance does a premium on bonds payable arise?

3. Under what conditions of bond issuance are the face amount of the bond and the issuance price the same?

4. How should a person distinguish between the following interest rates for bonds payable?
   - yield rate
   - nominal rate
   - stated rate
   - market rate
   - effective rate

5. What two methods may be used to allocate a premium or discount over the life of a bond issue? Briefly describe each method.

6. What arguments can be offered in support of each method of allocating bond premiums and discounts?

7. The appropriate method of amortizing a premium or discount on issuance of bonds is the effective yield method. What is the effective yield method of amortization and how is it different from and similar to the straight line method of amortization? How is amortization computed using the effective yield method, and why and how do amounts obtained using the effective yield method differ from amounts computed under the straight line method?

8. How will the amount of interest expense recorded each period be affected by the amortization of a bond premium using the straight line method?

9. How will the amount of interest expense recorded each period be affected by the amortization of a bond discount using the straight line method?

10. How will the amount of interest expense recorded each period be affected by the amortization of a bond premium using the effective yield method?

11. How will the amount of interest expense recorded each period be affected by the amortization of a bond discount using the effective yield method?

12. Mossi Co. sells its bonds at a discount and applies the effective interest method in amortizing the premium.
    a. Will the annual interest expense increase or decrease over the life of the bonds? Why?
    b. How is the effective interest method in accordance with the matching principle?

13. What is the proper balance sheet presentation for bonds maturing within the coming year?

14. How would the account Premium on Bonds Payable be shown on the financial statements?

15. How would the account Discount on Bonds Payable be shown on the financial statements?

1. How would the account "Discount on Long-Term Notes Receivable" be shown in the financial statements?

2. How would the account "Discount on Long-Term Notes Payable" be shown in the financial statements?

1. What is meant by early extinguishment of debt?

2. What three alternatives are theoretically available to account for gains or losses on bond refundings?

3. Gains or losses from the early extinguishment of debt that is refunded can theoretically be accounted for in three ways:
   a. amortized over remaining life of old debt
   b. amortized over the life of the new debt issue
   c. recognized in the period of extinguishment

   Required:
   1. Discuss the supporting arguments for each of the three theoretical methods of accounting for gains and losses from the early extinguishment of debt.
   2. Which of the above methods is generally accepted and how should the appropriate amount of gain or loss be shown in a company's financial statements?

4. What method did the APB favor for handling gains or losses on bond refundings?

5. How are gains and losses from extinguishment of debt classified in the income statement?