1. Costa issues $1 000 000 worth of bonds at par. Which account is relevant for the journal entry?

|  |  |
| --- | --- |
| Cash | 1,000,000 |
| ? | 1,000,000 |

1. Bonds payable
2. Notes payable
3. Accounts payable
4. Interest payable

Ans: A, bonds are recorded under Bonds payable

2. Costa issued bonds at a coupon rate of 7% when the yield was 5%. At the time of issue, the cash received from the sales of the bond is less than the liability incurred i.e. bonds payable. True or False?

Ans: False. Since interest rate is higher than market return, it is a premium bond, meaning the cash received in higher than the bonds payable.

3. Costa issued $1,000,000 worth of 5-year bonds at a 4% coupon rate paid semi-annually. The yield was estimated to be 6%. Find the discount/premium on bonds payable.

A. Discount, 914,698
B. Discount, 85,302
C. Premium, 30,486
D. Premium, 1,030,486

Ans: B,

4. Costa issued $300 000 worth of 3-year bonds at a 5% coupon rate paid annually. The yield was estimated to be 4%. Find the bond price.

A. 291,675
B. 283,349
C. 308,325
D. 316,651

Ans: C,

5. Interest payment in every period is constant for bonds at par value but not for bonds issued at a discount or premium. True or False?

Ans: False, interest payment every period is always a constant of the principal multiplied by the coupon rate of the bond divided by the number of periods.

6. Interest expense in every period is constant for bonds at par value but not for bonds issued at a discount or premium. True or False?

Ans: True, interest expense is the yield divided by the number of periods multiplied by the carrying value of the bond. For bonds issued at par, the carrying value is constant and equal to the principal.

7. Costa issued bonds the previous year. Record the payment of interest in the current period given that the interest expense is $4,100 and the coupon payment made is $4,500.

|  |  |
| --- | --- |
| Interest Expense | 4,100 |
| ? on bonds payable | 400 |
| Cash | 4,500 |

1. Premium
2. Discount
3. Amortization
4. Depreciation

Ans: A. When the interest expense is lower than the interest payment, it is a bond premium. Note that the 400 refers to the amount of premium amortized during the period.

8. Costa plans to issue $1,000,000 worth of 10-year bonds. The yield is 5%. By choosing to issue the bonds at a coupon of 3% paid semi-annually instead of at par value, Costa incurs how much additional interest expense over the life of the bond?

A. $154435
B. $155892
C. Trick question, Costa incurs less interest expense for issuing bonds at a discount
D. Trick question, regardless of whether the bond is issued at a premium or discount, the total interest expense paid out is the same.

Ans: B. Note that this value is the same as the discount on bonds payable at issue.

9. Costa issues a 10-year bond with a 10% coupon rate paying interest semi-annually worth $200,000, on 1 May 2018. If the bonds were issued at par, complete the relevant journal entry for the first coupon payment.

|  |  |
| --- | --- |
| Interest expense | ??? |
| Cash | ??? |

A. 20,000
B. 10,000
C. 5,000
D. 1,000

Ans: B.

10. Costa issues a 10-year bond with a 10% coupon that pays interest semi-annually worth $200,000, on 1 May 2018. If the bonds were issued at par, complete the relevant adjusting entry for 31 December 2018.

|  |  |
| --- | --- |
| Interest expense | ??? |
| Cash | ??? |

A. 6,667
B. 3,333
C. 1,667
D. 10,000

Ans: B. 2 months of accrued interest,

11. Costa issues a 10-year bond at a 12% coupon rate, paying interest semi-annually, worth $200,000 on 1 May 2018. If the yield is 10%, complete the journal entry for the first coupon payment.

|  |  |
| --- | --- |
| Interest expense | ??? |
| Premium on bond payable |  |
| Cash |  |

A. 224,924
B. 224,578
C. 22,492
D. 11,246

Ans: D. Bond price:

Interest expense: 0.10/2 X 224,924 = 11,246

12. Costa issues a 10-year bond at a 12% coupon rate paying interest semi-annually, worth $200,000 on 1 May 2018. If the market yield is 10%, complete the journal entry for 30 April 2019.

|  |  |
| --- | --- |
| Interest expense | ??? |
| Premium on bond payable |  |
| Cash |  |

A. 13495
B. 26949
C. 13406
D. 26812

Ans: C.

|  |  |  |  |
| --- | --- | --- | --- |
| Period | Interest paid | Interest expense | Carry Value |
| 1 May | - | - | 224924 |
| 30 Oct | 12 000 | 13495 | 223429 = 224924 – (13495 – 12000)  |
| 30 April | 12 000 | 13406 = 223429 x 0.06 |  |