**Concept Based**

**1. Question:**

When a company issues bonds at a discount, which of the following best describes the impact on the financial statements over time?

**A)** The carrying value of the bond decreases, and interest expense is lower than the cash paid.  
**B)** The carrying value of the bond increases, and interest expense is higher than the cash paid.  
**C)** The carrying value remains constant, but interest expense fluctuates with market rates.  
**D)** The carrying value decreases, but interest expense equals the cash paid each period.

**2. Question:**

A company issues callable bonds at par. If interest rates decline significantly after issuance, what is the most likely accounting implication?

**A)** The company must recognize an immediate loss equal to the call premium.  
**B)** The bonds’ carrying value increases due to the lower market rates.  
**C)** The company may refinance the debt, recognizing a gain or loss on extinguishment.  
**D)** No accounting impact occurs until the bonds are actually called.

**3. Question:**

Under IFRS, how is a convertible bond’s equity component initially recorded?

**A)** As a liability at face value, with no separate equity component.  
**B)** As a compound instrument, splitting proceeds between liability and equity.  
**C)** As equity only, since conversion is likely.  
**D)** As a liability, with equity recognized upon conversion.

**4. Question:**

A company leases a building under a finance lease but mistakenly records it as an operating lease. How does this error affect Year 1’s financial ratios?

**A)** Overstates current ratio and understates debt-to-equity.  
**B)** Understates asset turnover and overstates interest coverage.  
**C)** Overstates return on assets and understates leverage.  
**D)** Understates net income but has no effect on total liabilities.

**5. Question:**

When a bond’s stated rate is 5% and the market rate is 7%, which of the following is true at issuance?

**A)** The bond will be issued at a premium, and interest expense will exceed cash payments.  
**B)** The bond will be issued at a discount, and interest expense will exceed cash payments.  
**C)** The bond will be issued at par, and interest expense equals cash payments.  
**D)** The bond will be issued at a premium, but interest expense equals cash payments.

**6. Question:**

Under U.S. GAAP, how is debt issuance cost for bonds recorded initially?

**A)** Expensed immediately in the income statement.  
**B)** Capitalized as a separate asset and amortized.  
**C)** Deducted from the bond’s carrying value (liability).  
**D)** Recorded as a contra-equity account.

**7. Question:**

A company redeems bonds before maturity at 102% of face value. The bonds were originally issued at a premium. How is the redemption gain/loss calculated?

**A)** Redemption price minus face value.  
**B)** Redemption price minus carrying value.  
**C)** Face value minus unamortized premium.  
**D)** Carrying value minus redemption price.

**8. Question:**

Which of the following best explains why zero-coupon bonds always issue at a discount?

**A)** They lack periodic interest payments, so investors demand a higher yield.  
**B)** Their face value includes accrued interest, reducing issuance proceeds.  
**C)** They are inherently riskier, requiring a premium at issuance.  
**D)** GAAP prohibits recording them at par.

**9. Question:**

How does capitalizing interest during construction align with accounting principles?

**A)** It violates matching by deferring interest expense.  
**B)** It reflects the asset’s cost to bring it to intended use.  
**C)** It artificially inflates net income in the short term.  
**D)** It is required only for tax purposes, not GAAP.

**10. Question:**

A company with high leverage wants to improve its debt-to-equity ratio without reducing total liabilities. Which off-balance-sheet action could achieve this?

**A)** Lease assets under operating leases instead of purchasing.  
**B)** Issue convertible debt and classify it entirely as equity.  
**C)** Reclassify short-term debt as long-term.  
**D)** Use securitization to remove receivables from the balance sheet.

**Math Based**

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1. Question:

A company issues $1,000,000 of 6% bonds at 97 on January 1, 2025, maturing in 10 years. The bonds pay interest semiannually. Using the straight-line method, what is the total interest expense for the first year?

A) $60,000

B) $63,000

C) $58,200

D) $61,500

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2. Question:

A company issues $500,000 of 5-year, 8% bonds when the market rate is 10%. Using the effective-interest method, what is the carrying value after the first interest payment? (PV of $1 @ 5% for 10 periods = 0.6139; PV of annuity @ 5% for 10 periods = 7.7217).

A) $462,092

B) $468,620

C) $475,482

D) $481,546

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3. Question:

A company retires $200,000 of bonds at 102% of face value. The bonds had an unamortized premium of $4,000. What is the gain/loss on extinguishment?

A) $8,000 loss

B) $4,000 loss

C) $0

D) $4,000 gain

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4. Question:

A company leases equipment with a fair value of $100,000 for 5 years, with annual payments of $23,000 at year-end. The implicit rate is 8%. What is the lease liability at inception? (PV of annuity @ 8%, 5 periods = 3.9927).

A) $100,000

B) $91,832

C) $115,000

D) $85,000

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5. Question:

A company issues convertible bonds with a face value of $1,000,000 at 105. The bonds are convertible into 50,000 shares ($20 par value). At issuance, the market value of the bonds without conversion is $980,000. What is the equity component?

A) $50,000

B) $70,000

C) $20,000

D) $0

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6. Question:

A bond with a face value of $500,000 and a 10% coupon rate is issued at 92. The bonds mature in 8 years. Using the effective-interest method, if the market rate is 12%, what is the interest expense in Year 1?

A) $50,000

B) $55,200

C) $60,000

D) $46,000

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7. Question:

A company extinguishes $300,000 of bonds at 98% when the unamortized discount is $6,000. What is the gain/loss?

A) $12,000 loss

B) $0

C) $6,000 gain

D) $12,000 gain

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8. Question:

A company capitalizes $2,000,000 of interest during construction. If the average accumulated expenditures were $5,000,000 and the interest rate on specific borrowing was 6%, what is the avoidable interest?

A) $300,000

B) $120,000

C) $200,000

D) $2,000,000

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9. Question:

A bond with a face value of $1,000,000 and a 5% coupon rate is issued at 103 when the market rate is 4%. What is the premium amortization in Year 1 using the effective-interest method?

A) $3,000

B) $1,200

C) $5,000

D) $0

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10. Question:

A company leases a machine with a fair value of $200,000 for 4 years, with annual payments of $55,000. The implicit rate is 7%. What is the interest expense in Year 2? (PV of annuity @ 7%, 4 periods = 3.3872).

A) $14,000

B) $12,390

C) $15,450

D) $10,500

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