

# [Keysor-roth corp. senior debenture essay sample](https://assignbuster.com/keysor-roth-corp-senior-debenture-essay-sample/)

1. List all the restrictions imposed on this debenture.

The restrictions include dividend restrictions, additional debt restriction, and indenture modification.

2. Identify all restrictions that are a function of accounting numbers.

The dividend restriction will influence the dividend, retained earning and equity. Which means the company cannot pay dividend and issue new stock under some certain situation.

The additional debt restriction will effect the term of liability in the balance sheet. The company cannot issue more debt if the net working capital is less than the funded debt. What’s more, the company cannot issue more senior debenture under some certain circumstance.

The dividend restriction, additional debt restriction, and the indenture modification all have positive affections on the attraction on the senior debenture. However, the provision of callable has a negative affection, the sinking fund has a positive affection.

3. List the accounting items that have been included in the accounting based restrictions. Indicate one accounting method change that would influence at least one of these accounting items.

The items involved in the restrictions are dividend, retained earning, equity, long-term liability, total liability, interest expense, and bond payable.

The one accounting method change can be issuing bond at a discount rate or a premium rate. The choice will influence the net liability. What is more, if the company choose the discount rate, there was unamortized discount in the balance sheet, otherwise, there was premium in the balance sheet instead.

The discounted cash flow model implies that, other things being equal, it is always desirable to take a tax deduction earlier rather than later. Moreover, if prices rise, LIFO will generate earlier tax deductions than FIFO. By switching from LIFO to FIFO, Chrysler deliberately boosted its tax bills by $53 million in exchange for real or imagined benefits in terms of its credit rating and the attractiveness of its common stock as compared with its competitors in the auto industry.

Was this a wise decision? Many critics thought it harmed rather than helped stockholders because the supposed benefits were illusory. For example, these critics maintain that mounting evidence about efficient stock markets shows that the investment community is not fooled by whether a company is on LIFO or FIFO—that its stock price will be unaffected. An American Accounting Association committee (Accounting Review, Supplement to Vol. XLVIII, p. 248) commented: “ If the capital markets are efficient in the semi-strong form, this change was totally unnecessary and, from the point of view of Chrysler’s shareholders, constitutes a waste of resources.”

In sum, Chrysler gave up badly needed cash in the form of higher income taxes in exchange for a higher current ratio (FIFO inventory would be much higher than LIFO inventory) and higher reported net income. In light of Chrysler’s deteriorating cash position in the late 1970s, Chrysler’s tradeoff was unwise.