

# Financial accounting questions

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Financial Accounting of Establishment Financial Accounting When would disposal of an asset result in no gain or loss? If the carrying amount of an asset at the date of disposal is equivalent to the sale earnings, there is neither profit nor loss. The asset's book value is determined by calculating the accumulated depreciation on the asset for all the years and subtracting this value from the cost of the asset. If the asset is disposed off at the book value, then it does not result to any gain or loss.

2. Why would a company spend millions of dollars on goodwill?

Goodwill helps to keep old customers loyal to the business while at the same time attracting new customers through word-of-mouth recommendations and publicity. Obtaining loans from banks and attracting potential investors is easier when a company has built goodwill. With goodwill, new avenues open up for the company and it's able to tap into fresh opportunities. Clients of a company are usually more willing to forgive it when it makes a mistake if it has built a good relationship with them. If a company ever needs to liaise with others or expand or sell, with goodwill it's much easier to get partners and buyers for the business due to the trust placed in it. Goodwill places the company ahead of competition as customers are more likely to favour the company with goodwill when making a decision on which products and services to consume (Weil, Schip & Francis, 2014).

3. Why does the market price of a bond fall over time?

As interest rates rise, prices of bonds fall and when interest rates drop, bond prices rise. This is due to the concept of opportunity cost. Investors compare the returns they are getting on their present investments to other investments in the market. A bond coupon rate is fixed; therefore investors are ready to pay extra or less for a bond depending on how attractive the

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interest rates. Suppose a company offers a new issue of bonds carrying a 7% coupon which is \$70 a year in interest. If you purchase a \$1000, then later, interest rates go up to 8%, it means the interest will be \$80 and buyers will be less willing to pay the face value of \$1000 for the bond and you would have to offer it at a discount. However, if interest rates fell, it would be more attractive to prospective buyers as it would be carrying a higher interest rate than whatever is already in the market.

4. Why might a company lease a long term asset rather than buy it and issue long term bonds?

Leasing might be preferred by a company because it eases up the cash flow of the company that can be directed to other operating activities. It also takes a shorter time compared to purchasing which involves a long and tedious procurement process. With leasing, the costs are spread over a long time and can thus be matched to the company's income. The interest rates are agreed upon beforehand hence it's easier to forecast company's cash flow and budget. When leasing, the company can also get repaired and maintenance of the asset as part of the deal and is likely to get high quality assets, unlike buying which means the company has to do its own repair and maintenance. Leasing is more convenient than issuing bonds as it does not dilute ownership of the company and the financial risk is lower (Weil, Schip & Francis, 2014).

#### References

Weil, R. L., Schipper, K., & Francis, J. (2014). Financial accounting: An introduction to concepts, methods, and uses. Mason, OH: South-Western, Cengage Learning.