Case 8-3 joan holtz

Joan Holtz (D)* 1. 2010 late-night talk show indicated the existence of an unclaimed municipal bond issued in 1883 by a town in Missouri. The bond was $100 with an interest rate on 10%. At a compound interest, what would be the bonds value in 2010. 2. (a) Joan read that a company issued eight-year, zero-coupon bonds at a price of 327 per 1, 000 par value. The question asked, was the yield on these bonds 15 percent, as Joan had calculated. Yes! (b) Assuming that bond discount amortization is tax deductible by the issuing corporation that has a . 0 percent income tax rate, using a straight-line amortization of original discount is permissible. What is the effective or " true" after –tax interest rate to the issuer? * Corporate Bonds- have no tax-free provisions on Zero Coupon Bonds. * Zero coupon bonds are sold at a deep discount and pay no annual interest. The full face value is paid at maturity. However, the IRS computes the implied annual interest and you are liable for that amount even though you do not actually receive it until the bond matures.) Instead of issuing these zero-coupon bonds, the company issued 15 percent coupon bonds with issue proceed of $1000. 00 per bond (i. e. , par value), what would the issuer's effective after-tax interest rate have been on these alternative bonds? The same 40% rate, regular bonds are taxed the same as zero coupons. The only difference is that the holder of a zero-coupon bond does not receive cash payment until maturity. In any case, every year the issuer will send a statement telling you how much interest accrued to the bond that year.

In the case, the bond is amortized semiannually, accruing interest and taxes each year. 3. A- The company uses an investment banker as an intermediary to issue shares on the open market because bonds can only be issued to the public through the intermediary of an investment banker, insurance company or other financial institution. B- The gain on the debt-for-equity swap is required to be recorded as income for financial reporting purposes. 4. Upgrades and free travel coupons are a liability to airlines because customers that use them displace paying customers.

The amount should be determined by the market value of the rewards that the miles could be redeemed for. The offsetting debt could be handled by selling the mileage program, or moving it “ off balance sheet”. If the frequent flyer program is a separate company, or something that resembles a separate company, then the price that frequent flyer program is paying an airline for seats is presumably the real market price and actual cost it’s incurring. There is no need for accountants to make up a hypothetical cost to value mileage liability. They can use actual cost figures. . The key issue is whether the purchase of the electronics product and the extended warranty contract should be viewed as one transaction or two, and which alternative represents the best matching of revenues and expenses. * If viewed as two distinct transactions, then Alternative A represents the best matching. Alternative A is the most conservative as it defers the recognition of the most revenue; none of the warranty revenue is recognized at the date of the sale of the product. It is recognized over the life of the extended warranty contract. If viewed as a single transaction, then Alternative B represents the best matching. Alternative B recognizes all of the warranty revenue on the date the product is sold. * Alternative C recognizes some of the warranty on the date the product is sold. If deferring all extended warranty contract revenue does not seem necessary, then Alternative C may appear most appropriate. The three alternatives will have different effects on the financial statements. * Alternative B will produce the highest revenue and net income, as all extended warranty revenue and profit are recognized immediately.

The balance sheet will also show the largest retained earnings and there will be no deferred revenue liability. * Alternative C will show the second highest revenue and net income. Some of the revenue and most of the income from the extended warranty contract will be recognized immediately. * The balance sheet for alternative C will show the second highest retained earnings. Some of the revenue and most of the income from the extended warranty contract will be recognized immediately. There will be a deferred revenue liability that will increase each year because we have assumed steadily growing sales. Alternative A will show the lowest revenue and the lowest net income. All of the extended warranty revenues and the associated high warranty profits are deferred. * On the balance sheet, Alternative A will show the smallest retained earnings and the largest deferred revenue liability. * The net effect on the cash flow statement is the same for each of the three alternatives. * A lower net income will be adjusted by a higher deferred revenue to reveal the same impact on cash. Which alternative provided the most appropriate representation of the profitability of extended warranties?

To account for the combined purchase of the projection TV and a three-year warranty, Joan Holz introduced three alternatives to claim extended warranty revenue. They are as follows: * Alternative A utilized the full deferral method. In doing so, the purchase of the projection TV and the purchase of the warranty contract were to be treated completely separate. This would involve recording the profit on the item at the time of the sale and the revenue of the warranty contract over the three-year period.

Projection TV Warranty Contract Revenue (over 3 years) Sale $2, 000 Purchase $180 $180/3=$60 (1/3 each year) COGS 1, 840 Associated cost 135 45/3= 15 (1/3 each year) Margin $ 160 $ 45 $75 * Alternative B utilized the full recognition method. This involves recording the full profit of the purchase including the warranty.

Recording the total of the sale creates a profit that would not be there otherwise in the accounting period that the sale is made. Sales $2, 180 COGS 1, 885 Margin $ 295 * Alternative C utilized the partial recognition method. This means that the sale of a portion of the warranty would be recorded at the time of the sale and the remaining would be reported at the end of the warranty period. The proportion to be recognized would depend on the proportion of the costs associated with the projection TV verses the proportion associated with the service contract.

Projection TV $1, 840/$1, 885= 97. 6% would be recognized immediately, that is $2, 180*. 976= $2, 128. Warranty Contract $45/$1, 885= 2. 4% would be deferred and recognized over the three year life of the service contract, that is $2180*. 024=$52. Technically, the best way to account for the revenue from an extended warranty plan is the partial recognition method to record the revenue in equal shares using the number of years for the warranty. The revenue would be recorded as “ Other Income” on the statements.