

ADM3340M Winter 2013 Student Name _____

Quiz #2 Student ID: _____

Question 1 (2 marks)

BondTerrier Inc. issues 10 year convertible (at the holder's option) bonds with a face value of \$5,000,000 and a coupon rate of 2.00% for \$4,300,000. The company complies with IFRS. Bond interest is paid semi-annually and the company amortizes any bond discount or premium using the straight line method. When the bonds are issued, the prevailing market interest rate (yield or effective interest rate) for similar debt without a conversion option is 4.00%. Similar bonds without a conversion option sell on the open market at 83.64852.

40% of the \$5,000,000 face value bonds are converted after interest is paid at the end of semi-annual period 6 when the fair market value per share is \$65.00. Each \$1,000 face value bond can be converted by the holder into 4 shares.

Instructions

Present the journal entry to record the bond issuance.

Suggested Solution

Intro	INPUT_1	INPUT_2	Text	ISSUANCE	Any_Period	Conversion	Called	Maturity	Amortization	IAS39	IAS32	Flowchart	IRR	OtherApps
A	B	C	D	E	F	G	H	I	J	K				
1	The solution below assumes IFRS [IAS 32 and IAS 39].													
2	Beginning of semi- annual period 1 (date of issuance) using the IAS32_and_IAS39 approach.													
3				Dr		Cr								
4	Cash			4,300,000.00										
5	Bond discount			817,573.35										
6		Contributed capital: common stock conversion rights				117,573.35								
7		Bond liability				5,000,000.00								
8	To record the issuance of 10-year bonds, face value \$5,000,000, stated interest rate 2.00% per year (compounded semi-annually), convertible into 20,000 common shares at the investors' option. Total issuance proceeds = \$4,182,427 + \$117,573 = \$4,300,000 (see below). Bond discount = \$5,000,000 + \$117,573 - \$4,300,000 = \$817,573.													
9		Present value of the bond's 20 x \$50,000 [= \$5,000,000 x 2.000%/2] semi-annual interest payments discounted at 2.000% [=4.000%/2] semi-annually: [\$817,572 = 16.351433 x \$50,000]				817,571.65								
10		Present value of the maturity value of \$5,000,000 at the end of 20 half-years discounted at 2.000% semi-annually: [\$3,364,855 = 0.672971 x \$5,000,000]				3,364,855.00								
11						4,182,426.65								
12		Value of the conversion option.				117,573.35								
13		Total proceeds on issuance (as given in the INPUT screens)				4,300,000.00								

Use Ctrl+ and Ctrl- to zoom in and out.

Not required in your solution.

\$5,000,000
 X
 83.64852% =
 \$4,182,426

= 4,300,000 - 4,182,427
 Given.

Question 2 (2 marks)

Tanggakara Inc reports net income (30% tax rate) of \$1,600,000 for 2013, and an average of 500,000 common shares outstanding during the year. The corporation issued \$2,000,000 par value, 10-year, 9% convertible bonds on January 1, 2011 at a \$18,000 discount. For simplicity, ignore the IFRS requirement to record the debt and equity components of the bonds separately.

The bonds are convertible into 60,000 common shares. Assume Tanggakara Inc uses the straight-line method for amortizing the bond discount.

Instructions

Calculate basic and diluted earnings per share for 2013.

Solution

Basic earnings per share

$$(\$1,600,000 \div 500,000 \text{ shares}) = \underline{\$3.20}$$

Diluted earnings per share

$$\frac{\$1,600,000 + .7(\$180,000 + \$18,000/10)}{500,000 + 60,000} = \underline{\$3.08}$$

Question 3 (1 mark)

Bayern Munich Inc issued Series B preferred shares, annual \$6 cumulative dividend, redeemable at the investor's option for \$110 per share, plus dividends in arrears. Bayern Munich Inc may, at its option, redeem the total obligation for the Series B preferred shares in common shares issued at market values (i.e. the number of common shares to be exchanged for the preferred shares will fluctuate in direct proportion to changes in the market value per common share).

Instructions

Classify, from Bayern Munich Inc's point of view, this financial instrument as debt (financial liability), equity, or hybrid. You must provide an explanation for the basis of your reasoning.

Solution

Debt (financial liability): Bayern Munich Inc extinguishes the principal by (i) issuing cash-equivalent of the total obligation or (ii) paying \$110 per prfd share in cash. Therefore, debt. Any dividends associated with these prfd shares are treated as interest in the financial statements.