CH 13 CURRENT LIABILITIES & CONTINGENCIES SELF-STUDY QUESTIONS

(note from Dr. N: I have deleted questions for you to omit, but did not renumber the remaining questions)

1. A zero-interest bearing note is recorded at its present value.
   A. True
   B. False

3. Which of the following is not an example of a current liability?
   A. Dividends Payable.
   B. Preferred dividends in arrears.
   C. Unearned Revenue.
   D. Sales Taxes Payable.

4. Which of the following is not true about the discount on short-term notes payable?
   A. The Discount on Notes Payable account has a debit balance.
   B. The Discount on Notes Payable account should be reported as an asset on the balance sheet.
   C. When there is a discount on a note payable, the effective interest rate is higher than the stated discount rate.
   D. The amortization of Discount on Notes Payable increases interest expense.

5. Liabilities are
   A. any accounts having credit balances after closing entries are made.
   B. deferred credits that are recognized and measured in conformity with generally accepted accounting principles.
   C. obligations to transfer ownership shares to other entities in the future.
   D. obligations arising from past transactions and payable in assets or services in the future.

6. Which of the following statements is false?
   A. A company may exclude a short-term obligation from current liabilities if the firm intends to refinance the obligation on a long-term basis and demonstrates an ability to complete the refinancing.
   B. Cash dividends should be recorded as a liability when they are declared by the board of directors.
   C. Unearned revenues represent advance payments for goods or services from customers.
   D. Stock dividends are a reported as a liability until paid.

7. Long-term debts maturing currently should be included as a current liability if they are or will be:
   A. converted into capital stock.
   B. due on demand.
   C. refinanced with the proceeds of a new debt issue.
   D. retired by use of noncurrent assets.

8. Current liabilities are defined as obligations whose liquidation is reasonably expected to:
   A. be paid within a year.
   B. require use of current assets.
   C. require use of current assets or creation of other current liabilities.
   D. require the distribution of cash.
9. All of the following are typically classified as current liabilities except:
   A. current maturities of long-term debt.
   B. returnable deposits.
   C. unearned revenues.
   D. stock dividends distributable.

10. When a zero-interest-bearing note is issued, the borrower receives the:
    A. face value of the note.
    B. maturity value of the note.
    C. present value of the note.
    D. None of these.

12. On December 31, 2011, Bollinger Co. has $3,000,000 of short-term notes payable due on February 14, 2012. On January 10, 2012, Bollinger arranged a line of credit with Compass Bank which allows Bollinger to borrow up to $1,500,000 at one percent above the prime rate for three years. On February 3, 2012, Bollinger borrowed $1,800,000 from Compass Bank and used $800,000 additional cash to liquidate $2,600,000 of the short-term notes payable. The amount of the short-term notes payable that should be reported as a current liability on the December 31, 2011 balance sheet which is issued on March 2, 2012 is
    A. $0.
    B. $400,000.
    C. $800,000.
    D. $1,200,000.

13. A company can exclude a short-term obligation from current liabilities if it:
    A. intends to refinance the obligation on a long-term basis.
    B. demonstrates an ability to consummate the refinancing.
    C. pays off the obligation after the balance sheet date and subsequently replaces it with long-term debt before the balance sheet is issued.
    D. intends to refinance the obligation on a long-term basis and demonstrates an ability to consummate the refinancing.

15. Short-term obligations expected to be refinanced are not classified as current liabilities because
    A. they will be paid by the balance sheet date.
    B. the obligations will be satisfied before the financial statements are issued.
    C. their satisfaction will not require the use of assets classified as current as of the balance sheet date.
    D. None of these.

16. State and federal unemployment taxes are imposed on both employers and employees.
    A. True
    B. False

20. Which of the following statements is false?
    A. Vested rights exist when an employer has an obligation to make payment to an employee.
    B. Unemployment taxes are paid by the employer.
    C. Profit-Sharing Bonus Payable is usually recognized as a long-term liability.
    D. The liability for compensated absences should be recognized in the year earned.
21. Sales taxes collected from customers are reported by retailers as:
   A. liabilities.
   B. revenues.
   C. unearned revenues.
   D. receivables.

22. Most corporations make quarterly tax payments based on:
   A. actual taxable income for the quarter.
   B. estimated taxable income for the quarter.
   C. estimated total annual tax liability.
   D. actual annual tax liability.

23. Employer payroll taxes include all of the following except:
   A. federal unemployment taxes.
   B. federal income taxes.
   C. FICA taxes.
   D. state unemployment taxes.

24. A liability for compensated absences is:
   A. accrued under all conditions.
   B. disclosed in a note only.
   C. accrued only if specific conditions are met.
   D. never accrued but may be disclosed if desired.

Additional Self-Study Questions

1. Which of the following is included in employer payroll taxes?
   A. F.I.C.A. taxes.
   B. Federal unemployment taxes.
   C. State unemployment taxes.
   D. All of the above.

2. Which of the following is not one of the requirements for accruing the cost of compensated absences?
   A. The employee's services must have already been rendered.
   B. The obligation relates to rights that vest or accumulate.
   C. Payment of the compensation is possible.
   D. The amount can be reasonably estimated.

3. Gain contingencies are not recorded.
   A. True
   B. False
4. A loss contingency should be recorded only if it is more likely than not that a liability has been incurred.
   A. True
   B. False

5. Which of the following is the proper way to report a gain contingency?
   A. As an accrued amount.
   B. As deferred revenue.
   C. As an account receivable with additional disclosure explaining the nature of the contingency.
   D. As a disclosure only.

6. A contingent liability
   A. definitely exists as a liability but its amount and due date are indeterminate.
   B. is accrued even though not reasonably estimated.
   C. is not disclosed in the financial statements.
   D. is the result of a loss contingency.

7. Halliburton Co. is being sued by former employees as a result of negligence on the company’s part in permitting them to be exposed to highly toxic chemicals in its plant without providing proper safeguards. Halliburton's lawyers state that it is probable that the company will lose the suit and be found liable for a judgment costing the company anywhere from $10,500,000 to $36,000,000. However, the lawyer states that the most probable cost is $25,500,000. As a result of the above facts, Bailey should accrue
   A. a loss contingency of $10,500,000 and disclose an additional contingency of up to $25,500,000.
   B. a loss contingency of $25,500,000 and disclose an additional contingency of up to $10,500,000.
   C. a loss contingency of $25,500,000 but not disclose any additional contingency.
   D. no loss contingency but disclose a contingency of $10,500,000 to $36,000,000.

8. Gain contingencies include all of the following except:
   A. possible receipts of donations and bonuses.
   B. pending court cases where the probable outcome is favorable.
   C. tax loss carry forwards.
   D. All of the options are gain contingencies.

9. A loss related to general or unspecified business risks is:
   A. always accrued.
   B. not accrued.
   C. sometimes accrued.
   D. usually accrued.

10. Which of the following factors need not be considered in determining whether a liability should be recorded with respect to pending or threatened litigation?
    A. The time period in which the cause of action occurred.
    B. The probability of an unfavorable outcome.
    C. The ability to make a reasonable estimate of the loss.
    D. All of the options must be considered.
11. Premium costs should be charged to expense in the year the product is sold.
   A. True
   B. False

12. Which of the following sets of conditions would give rise to the accrual of a contingency under current generally accepted accounting principles?
   A. Amount of loss is reasonably estimable and event occurs infrequently.
   B. Amount of loss is reasonably estimable and occurrence of event is probable.
   C. Event is unusual in nature and occurrence of event is probable.
   D. Event is unusual in nature and event occurs infrequently.

14. Schoenthaler Co. has a loss contingency to accrue. The loss amount can only be reasonably estimated within a range of outcomes. No single amount within the range is a better estimate than any other amount. The amount of loss accrual should be
   A. zero.
   B. the minimum of the range.
   C. the mean of the range.
   D. the maximum of the range.

15. Jax Company offers a cash rebate of $2 on each $20 package of product sold during 2012. Historically, 25% of customers mail in the rebate form. During 2012, 5,000,000 packages are sold, and 750,000 $2 rebates are mailed to customers. What is the rebate expense and liability, respectively, shown on the 2012 financial statements?
   A. $1,500,000; $1,500,000
   B. $2,500,000; $1,500,000
   C. $1,500,000; $1,000,000
   D. $2,500,000; $1,000,000

16. Gain contingencies are recorded when:
   A. it is probable that a benefit will be received.
   B. the amount of the gain can be reasonably estimated.
   C. Both A and B.
   D. None of the above.

17. In 2011, General Devices Corporation began selling a new line of products that carries a two-year warranty against defects. Based upon past experience with other products, the estimated warranty costs related to dollar sales are as follows: First year of warranty 2%; Second year of warranty 5%. Sales and actual warranty expenditures for 2011 and 2012 are presented below:

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<th>2012</th>
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<tr>
<td>Sales</td>
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<tr>
<td>Actual warranty</td>
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<td>40,000</td>
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<tr>
<td>expenditures</td>
<td></td>
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   What is the estimated warranty liability at the end of 2012?
   A. $38,000.
   B. $58,000.
   C. $98,000.
   D. $16,000.
20. Which of the following is not acceptable treatment for the presentation of current liabilities?
   A. Listing current liabilities in order of maturity.
   B. Listing current liabilities according to amount.
   C. Offsetting current liabilities against assets that are to be applied to their liquidation.
   D. Showing currently maturing long-term debt as part of current liabilities.

21. Current liabilities are usually recorded in the accounting records and reported in financial statements at their:
   A. carrying value.
   B. face value.
   C. maturity value.
   D. present value.

22. Accrued liabilities are disclosed in the financial statements by
   A. a footnote to the statements.
   B. showing the amount among the liabilities but not extending it to the liability total.
   C. an appropriation of retained earnings.
   D. appropriately classifying them as regular liabilities in the balance sheet.

SOLUTIONS

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<th>Additional self-study</th>
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<td>1. A</td>
<td>12. D</td>
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<tr>
<td>4. B</td>
<td>15. C</td>
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11. A
12. B
13. D
14. B
15. D
16. D
17. A
18. C
19. B
20. C
21. C
22. D