Financial Accounting for Executives & MBAs, 3rd Edition by Simko, Ferris & Wallace

Practice Quiz

Chapter 10 – Commitments and Contingent Liabilities, Deferred Tax Liabilities, and Retirement Obligations

Multiple Choice Questions. Identify the answer that BEST completes the statement or answers the question.

1. ToysRUs is a distributor of children's toys. Because of a recently proven health hazard in one of its toys, the government has indicated its intention of having the company recall those toys sold during the last six months. The management of the company estimates that the recall will cost $15,000,000.

What accounting recognition, if any, will this situation warrant?

a. No recognition necessary
b. Note disclosure only
c. Operating expense and a liability of $15,000,000 and note disclosure
d. Statement of comprehensive income amount totaling $15,000,000 and note disclosure

2. How should a gain contingency that is probable for which the amount of the gain can be reasonably estimated be accounted for?

a. Report in the income statement and disclose in a footnote to the financial statements
b. Report as part of comprehensive income
c. Disclose in a footnote, with no recognition in the income statement
d. Neither recognize in the income statement nor disclose in a footnote

3. Why should executory contracts be disclosed to financial statement users?

a. They call for some form of future performance, which creates an obligation for the reporting company
b. They create an obligation contingent upon the occurrence of a past event
c. They represent a possible inflow of economic resources
d. They create current income tax obligations

4. Deferred income taxes:

a. Result from permanent differences between GAAP net income and taxable income
b. Result from timing differences between GAAP net income and taxable income
c. Are only reported on the income statement
d. Can basically be ignored because the amount actually paid as taxes is all that really is important for financial statement users

5. Presented below is a condensed income statement for Smith & Sons for its first year of operations:

Revenues	$800,000
Expenses	440,000
Income before taxes	$360,000

The expenses include an accrual for bad debt expense of $9,900 in Year 1 and $9,300 during Year 2. Actual write offs occur in the year following the accrual. The company's effective income tax rate is 34%.

How much is the company's income tax payable at the end of Year 1?

a. $ 57,766
b. $ 54,400
c. $ 51,034
d. $125,766

6. Presented below is a condensed income statement for Smith & Sons for its first year of business:

Revenues	$800,000
Expenses	440,000
Income before taxes	$360,000

The expenses include an accrual for bad debt expense of $9,900 in Year 1 and $9,300 during Year 2. Actual write offs occur in the year after the accrual. The company's effective income tax rate is 34%.

How much will be reported as deferred income taxes at the end of Year 1?

a. $204 as Deferred tax liability
b. $204 as Deferred tax asset
c. $3,366 as Deferred tax liability
d. $3,366 as Deferred tax asset

7. Pomona Contractors uses the percentage-of-completion method to recognize revenue for financial reporting purposes and the completed contract method to recognize revenue for income tax purposes. The company's income before taxes for financial reporting purposes was $860,000 including $320,000 of profit recognized under percentage-of-completion for a job that would be completed next year. The company's income tax rate is 38%.

How much is reported as a deferred tax liability at the end of the current year?

a. $326,800
b. $205,200
c. $121,600
d. $448,400

8. One of McBurger's employees invented a revolutionary coffee lid that cools coffee as you drink it in order to prevent burns. Two customers ordered coffee and burned their mouths after failing to properly secure the lids. The customers sued McBurger's. Lawyers believe that it is highly probable that judgment will be rendered against McBurger's, and it is likely a payment in excess of $2 million will be incurred.

The proper accounting treatment of the lawsuit will:

a. Decrease total liabilities
b. Increase total liabilities
c. Increase the current ratio
d. Require accountants to wait until the suit is settled to account for the event

9. If it is reasonably possible, but not highly probable, a contingency will result in a loss and the amount can be reasonably estimated:

a. A liability will be reported on the balance sheet
b. Footnote disclosure is required
c. No liability or footnote disclosure is required because the contingency may be resolved favorably
d. An asset should be recorded to make it look like being sued is a good thing for the company

10. An increase in the deferred income tax liability account is recognized when:

a. The tax accountant erroneously excluded taxable revenue from the tax returns.
b. The amount of tax paid to the government is more than that calculated by a tax accountant on the firm's tax return.
c. Net income measured under GAAP is greater than taxable income on tax returns because of temporary timing differences.
d. As a result of a tax audit by the IRS, the government respectfully requests an additional payment.