Financial & Managerial Accounting for Undergraduates
2nd Edition
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PRACTICE QUIZ

Chapter 10: Accounting for Liabilities

1. An example of a current liability that must be accrued at the end of a fiscal period is:

a. Accounts payable
b. Interest receivable
c. Notes payable
d. Wages payable

2. On October 1, Smith & Sons borrowed $60,000 from Bank of America on a 6 month, 7 percent note. If the company's fiscal year ends on December 31 and no adjusting entries have been made since the initial journal entry on October 1, Smith & Sons should make a year-end adjusting entry involving a debit to:

a. Interest expense for $2,100
b. Interest payable for $2,100
c. Interest expense for $1,050
d. Interest payable for $1,050
e. Interest expense for $700
f. Interest payable for $700

3. A customer has sued Smith & Sons for an injury sustained while shopping at a company outlet. The company's management determined that it is possible that the customer will win the lawsuit and estimated that the possible lawsuit award might be as high as $1,000,000.

Smith & Sons should:

a. Record a liability in the company's financial statements.
b. Record a liability and a loss in the company's financial statements.
c. Do not record a liability in the financial statements but disclose the information in a note to the company's financial statements.
d. Neither record a liability in the company's financial statements, nor disclose the information in a note to its financial statements.

4. Cave Creek Harley Davidson sells motorcycles. During the first year of operations, the company sold 3,000 motorcycles, each with a 3 year warranty. The company estimates that 10 percent of the motorcycles sold will need warranty repair work at an average cost of $600 per motorcycle. In the second year of operations, Cave Creek HD performed warranty work on the motorcycles sold in the first year at a total cost of $30,000.

When Cave Creek HD performs the repairs in the second year, they will debit the Warranty Expense account for:

a. $30,000
b. $50,000
c. $0
d. $20,000

5. Italian Garden Restaurant sold $20,000 of gift cards in May. These gift cards may be used anytime before their expiration on May 31 of the following year. In May, when the gift cards are sold, Italian Garden will credit:

a. Unearned Revenue for $20,000
b. Cash for $20,000
c. Prepaid Revenue for $20,000
d. Accrued Revenue for $20,000

6. General Mills sells cereal and other food items to Safeway. General Mills mails out 1,000,000 coupons to consumers on January 1 for $0.50 off a box of cereal. Based on past experience with this type of coupon, General Mills estimates that five percent of the coupons will be redeemed at Safeway.

How much of a "coupon liability" will General Mills record on January 1 when the coupons are mailed?

a. $500,000
b. $100,000
c. $ 25,000
d. $0

7. Which of the following is *not* considered to be a contingent liability?

a. Environmental clean-up costs
b. Pending lawsuit award
c. Credit guarantee
d. Notes payable

8. Smith & Sons issued $200,000 of 10 year, 12 percent bonds payable on January 1 for $250,000, yielding an effective interest rate of 10 percent. Interest is payable on January 1 and July 1. Calculate the bond interest expense for the first six months using the effective interest amortization.

a. $15,000
b. $12,500
c. $12,000
d. $10,000

9. Smith & Sons reported net income of $15,000, income tax expense of $3,000, and interest expense of $1,000. What is the company's times-interest-earned ratio?

a. 19
b. 18
c. 15
d. 3

10. Smith & Sons reported current assets of $15,000, quick assets of $10,000, and current liabilities of $5,000. What is the company's current ratio?

a. 1/3
b. 1/2
c. 2
d. 3

1. d

2. c
Rationale: ($60,000 x 7% x 3/12)

3. c

4. c
Rationale: The expense will be recorded in the year the motorcycles were sold.

5. a

6. c
Rationale: (1,000,000 coupons x 5% x $0.50)

7. d

8. b
Rationale: ($250,000 x 10% x 6/12 months)

9. a
($15,000 + $3,000 + $1,000)/$1,000

10. d
Rationale: ($15,000/$5,000)