Ch8

Student: ____

1. Delta, Northwest, and United Airlines have all, at one time, filed for bankruptcy.

   True False

2. In a classified balance sheet, we categorize all liabilities as current.

   True False

3. Commonly, current liabilities are payable within one year, and long-term liabilities are payable more than one year from now.

   True False

4. Given a choice, most companies would prefer to report a liability as current rather than long-term, because doing so may cause the firm to appear less risky.

   True False

5. When a company borrows cash from a bank promising to repay the amount borrowed plus interest, the borrower reports its liability as notes payable.

   True False

6. Interest is stated in terms of a percentage rate to be applied to the face value of the loan.

   True False

7. We record interest expense in the period in which we pay it, rather than in the period we incur it.

   True False

8. A line of credit is an informal agreement that permits a company to borrow up to a prearranged limit without having to follow formal loan procedures and paperwork.

   True False

9. If a company borrows from another company rather than from a bank, the note is referred to as commercial paper.

   True False

10. Accounts payable are amounts the company owes to suppliers of merchandise or services that it has bought on credit.

    True False

11. Deductions from employee salaries in determining the amount of payroll checks include withholdings for federal and state income taxes, FICA taxes, and the employee portion of insurance and retirement contributions.

    True False

12. All states impose a state income tax.

    True False

13. Companies are required by law to withhold federal and state income taxes from employees' paychecks and remit these taxes to the government.

    True False

14. The employer records amounts deducted from employee payroll as liabilities until it pays them to the appropriate organizations.

    True False

15. FICA taxes are paid only by the employee.

    True False

16. The employer is required to match the amount of FICA taxes withheld for each employee, effectively doubling the amount paid into Social Security.

    True False

17. Additional employee benefits paid for by the employer are often referred to as fringe benefits.

    True False

18. When a company receives cash in advance, it debits Cash and credits a revenue account called Unearned Revenue.

    True False

19. Airlines do not record revenue when a ticket is sold, but wait to record revenue until the actual flight occurs.

    True False

20. All states impose a general state sales tax, and many areas include an additional local sales tax.

    True False

21. Companies selling products subject to sales taxes are responsible for collecting the sales tax directly from customers and periodically remitting the sales taxes collected to the state and local governments.

    True False

22. When a company collects sales taxes, the debit is to Cash and the credit is to Sales Tax Payable.

    True False

23. Sales taxes collected from customers by the seller are not an expense, instead they represent current liabilities payable to the government.

    True False

24. Long-term obligations such as notes, mortgages, and bonds are reported as long-term liabilities when they become payable within the upcoming year.

    True False

25. Net income in the income statement is the same amount as taxable income reported to the Internal Revenue Service (IRS).

    True False

26. Differences between financial accounting and tax accounting result in a company being permitted to defer paying some of its income tax expense, in which case it will report a deferred tax liability.

    True False

27. A contingent liability is an existing, uncertain situation that might result in a loss.

    True False

28. We record a contingent liability when the likelihood of the loss occurring is reasonably possible and the amount can be reasonably estimated.

    True False

29. The journal entry to record a contingent liability requires a debit to a loss (or expense) account and a credit to a liability.

    True False

30. Regarding a contingent liability, when no amount within a range of potential losses appears more likely than others, we record the maximum amount in the range.

    True False

31. If the likelihood of a loss is reasonably possible rather than probable, we record no entry, but make full disclosure in a footnote to the financial statements to describe the contingency.

    True False

32. If the likelihood of loss is remote, disclosure usually is not required.

    True False

33. A contingent liability is recorded only if a loss is at least reasonably possible and the amount can be reasonably estimated.

    True False

34. The balance in the Warranty Liability account is always equal to Warranty Expense.

True False

35. A gain contingency is an existing uncertain situation that might result in a gain, which often is the flip side of loss contingencies.

True False

36. We record gain contingencies when the gain is probable and can be reasonably estimated.

True False

37. A company is said to be liquid if it has sufficient cash to pay currently maturing debts.

True False

38. The current ratio is calculated by dividing current liabilities by current assets.

True False

39. The acid-test ratio, or quick ratio, is similar to the current ratio but is based on a more conservative measure of current assets available to pay current liabilities.

True False

40. Quick assets include only cash, short-term investments, and accounts receivable.

True False

41. A lower current ratio or acid-test ratio generally indicates a greater ability to pay current liabilities on a timely basis.

True False

42. Which of the following is *not* a reason why a company might prefer to report a liability as long-term rather than current?

A. It may cause the firm to appear less risky to investors and creditors.
B. It may increase interest rates on borrowing.
C. It may cause the company to appear more stable commanding a higher stock price for new stock listings.
D. It may reduce interest rates on borrowing.

43. Given a choice, most companies would prefer to report a liability as long-term rather than current because:

A. It may cause the firm to appear less risky to investors and creditors.
B. It may reduce interest rates on borrowing.
C. It may cause the company to appear more stable commanding a higher stock price for new stock listings.
D. All of the other answers are true.

44. Which of the following is not a current liability?

A. Accounts payable.
B. A note payable due in 2 years.
C. Current portion of long-term debt.
D. Sales tax payable.

45. Which of the following is not a characteristic of a liability?

A. It represents a probable, future sacrifice of economic benefits.
B. It must be payable in cash.
C. It arises from present obligations to other entities.
D. It results from past transactions or events.

46. Which of the following is not a liability?

A. Notes payable.
B. Current portion of long-term debt.
C. An unused line of credit.
D. Unearned revenue.

47. Liabilities are defined as:

a. Resources owed by an entity as a result of past transactions.
b. Resources owned by an entity as a result of past transactions.
c. Selling products and services to customers in the current period.
d. Costs of running the business in the current period.

A. Option a
B. Option b
C. Option c
D. Option d

48. Brian Inc. borrowed $8,000 from First Bank and signed a promissory note. What entry should Brian Inc. record?

a. Debit Cash, $8,000; Credit Notes Receivable, $8,000.
b. Debit Notes Receivable, $8,000; Credit Cash, $8,000.
c. Debit Cash, $8,000; Credit Notes Payable, $8,000.
d. Debit Notes Payable, $8,000; Credit Cash, $8,000.

A. Option a
B. Option b
C. Option c
D. Option d

49. Brian Inc. borrowed $8,000 from First Bank and signed a promissory note. What entry should First Bank record?

a. Debit Cash, $8,000; Credit Notes Receivable, $8,000.
b. Debit Notes Receivable, $8,000; Credit Cash, $8,000.
c. Debit Cash, $8,000; Credit Notes Payable, $8,000.
d. Debit Notes Payable, $8,000; Credit Cash, $8,000.

A. Option a
B. Option b
C. Option c
D. Option d

50. On November 1, 2012, The Bagel Factory signed a $100,000, 6%, six-month note payable with the amount borrowed plus accrued interest due six months later on May 1, 2013. The Bagel Factory should report interest payable at December 31, 2012, in the amount of:

A. $0.
B. $1,000.
C. $2,000.
D. $3,000.

51. On November 1, 2012, The Bagel Factory signed a $100,000, 6%, six-month note payable with the amount borrowed plus accrued interest due six months later on May 1, 2013. The Bagel Factory records the appropriate adjusting entry for the note on December 31, 2012. In recording the payment of the note plus accrued interest at maturity on May 1, 2013, The Bagel Factory would

A. Debit Interest Expense, $2,000.
B. Debit Interest Expense, $1,000.
C. Debit Interest Payable, $2,000.
D. Debit Interest Expense, $3,000.

52. On September 1, 2012, Daylight Donuts signed a $100,000, 9%, six-month note payable with the amount borrowed plus accrued interest due six months later on March 1, 2013. Daylight Donuts should report interest payable at December 31, 2012, in the amount of:

A. $0.
B. $1,500.
C. $3,000.
D. $4,500.

53. On September 1, 2012, Daylight Donuts signed a $100,000, 9%, six-month note payable with the amount borrowed plus accrued interest due six months later on March 1, 2013. Daylight Donuts records the appropriate adjusting entry for the note on December 31, 2012. In recording the payment of the note plus accrued interest at maturity on March 1, 2013, Daylight Donuts would

A. Debit Interest Expense, $3,000.
B. Debit Interest Expense, $1,500.
C. Debit Interest Payable, $1,500.
D. Debit Interest Expense, $4,500.

54. On December 1, 2012, Old World Deli signed a $300,000, 5%, six-month note payable with the amount borrowed plus accrued interest due six months later on June 1, 2013. Old World Deli should record which of the following adjusting entries at December 31, 2012?

A. Debit Interest Expense and credit Interest Payable, $7,500.
B. Debit Interest Expense and credit Cash, $7,500.
C. Debit Interest Expense and credit Interest Payable, $1,250.
D. Debit Interest Expense and credit Cash, $1,250.

55. On December 1, 2012, Old World Deli signed a $300,000, 5%, six-month note payable with the amount borrowed plus accrued interest due six months later on June 1, 2013. Old World Deli records the appropriate adjusting entry for the note on December 31, 2012. What amount of cash will be needed to pay back the note payable plus any accrued interest on June 1, 2013?

A. $300,000.
B. $301,250.
C. $306,250.
D. $307,500.

56. On November 1, 2012, New Morning Bakery signed a $200,000, 6%, six-month note payable with the amount borrowed plus accrued interest due six months later on May 1, 2013. New Morning Bakery should record which of the following adjusting entries at December 31, 2012?

A. Debit Interest Expense and credit Interest Payable, $2,000.
B. Debit Interest Expense and credit Cash, $2,000.
C. Debit Interest Expense and credit Interest Payable, $6,000.
D. Debit Interest Expense and credit Cash, $6,000.

57. On November 1, 2012, New Morning Bakery signed a $200,000, 6%, six-month note payable with the amount borrowed plus accrued interest due six months later on May 1, 2013. New Morning Bakery records the appropriate adjusting entry for the note on December 31, 2012. What amount of cash will be needed to pay back the note payable plus any accrued interest on May 1, 2013?

A. $200,000.
B. $202,000.
C. $204,000.
D. $206,000.

58. The Pita Pit borrowed $100,000 on November 1, 2012, and signed a six-month note bearing interest at 12%. Principal and interest are payable in full at maturity on May 1, 2013. In connection with this note, The Pita Pit should report interest expense at December 31, 2012, in the amount of:

A. $0.
B. $1,000.
C. $2,000.
D. $6,000.

59. The Pita Pit borrowed $100,000 on November 1, 2012, and signed a six-month note bearing interest at 12%. Principal and interest are payable in full at maturity on May 1, 2013. In connection with this note, The Pita Pit should report interest expense in 2013 for the amount of:

A. $0.
B. $4,000.
C. $2,000.
D. $6,000.

60. Universal Travel, Inc. borrowed $500,000 on November 1, 2012, and signed a twelve-month note bearing interest at 6%. Principal and interest are payable in full at maturity on October 31, 2013. In connection with this note, Universal Travel, Inc. should report interest payable at December 31, 2012, in the amount of:

A. $8,000.
B. $30,000.
C. $5,000.
D. $25,000.

61. Universal Travel, Inc. borrowed $500,000 on November 1, 2012, and signed a twelve-month note bearing interest at 6%. Principal and interest are payable in full at maturity on October 31, 2013. In connection with this note, Universal Travel, Inc. should record interest expense in 2013 in the amount of:

A. $8,000.
B. $30,000.
C. $5,000.
D. $25,000.

62. Large, highly-rated firms sometimes sell commercial paper

A. To borrow funds at a lower rate than through a bank.
B. To borrow funds when they cannot obtain a loan from a bank.
C. Because they can't borrow anywhere else.
D. To improve their credit rating.

63. Which of the following is not an employer payroll cost?

A. FICA taxes.
B. Federal and state unemployment taxes.
C. Federal and state income taxes.
D. Employer contributions to a retirement plan.

64. Which of the following is not withheld from an employee's salary?

A. FICA taxes.
B. Federal and state unemployment taxes.
C. Federal and state income taxes.
D. Employee portion of health insurance.

65. Which of the following is true regarding FICA taxes?

A. FICA taxes are paid only by the employee.
B. FICA taxes are paid only by the employer.
C. FICA taxes are paid in equal amounts by the employee and the employer.
D. FICA taxes are paid in different amounts by the employee and the employer.

66. Which of the following are not included in an employer's payroll tax expense?

A. Employer portion of FICA taxes.
B. Federal unemployment taxes.
C. State unemployment taxes.
D. State income taxes.

67. Which of the following are included in an employer's payroll tax expense?

A. Employer portion of FICA taxes.
B. Federal unemployment taxes.
C. State unemployment taxes.
D. All of the other answers are correct

68. Mike Gundy is a college football coach making a salary of $2,400,000 a year ($200,000 per month). Employers are required to withhold a 6.2% Social Security tax up to a maximum base amount and a 1.45% Medicare tax with no maximum. Assuming the FICA maximum base amount is $106,800, how much will be withheld during the year for the coach's Social Security and Medicare.

A. $34,800.
B. $41,422.
C. $183,600.
D. None of these amounts is correct

69. Mike Gundy is a college football coach making a salary of $2,400,000 a year ($200,000 per month). Employers are required to withhold a 6.2% Social Security tax up to a maximum base amount and a 1.45% Medicare tax with no maximum. Assuming the FICA maximum base amount is $106,800, through what month will Social Security be withheld?

A. Social Security will be withheld only in January.
B. Social Security will be withheld through the entire year.
C. Social Security will be withheld through the month of March.
D. Social Security will be withheld through the month of June.

70. Action Travel has 10 employees each working 40 hours per week and earning $20 an hour. Federal income taxes are withheld at 15% and state income taxes at 6%. FICA taxes are 7.65% and unemployment taxes are 3.8% of the first $7,000 earned per employee. What is the actual direct deposit of payroll for the first week of January?

A. $5,404.
B. $5,708.
C. $4,792.
D. $8,000.

71. Action Travel has 10 employees each working 40 hours per week and earning $20 an hour. Federal income taxes are withheld at 15% and state income taxes at 6%. FICA taxes are 7.65% and unemployment taxes are 3.8% of the first $7,000 earned per employee. What is the total payroll tax expense for the first week of January?

A. $612.
B. $1,224.
C. $916.
D. $304.

72. In December, 2011, Quebecor Printing received magazine subscriptions for 2012 from a customer, who paid $500 in cash. What would be the appropriate journal entry for this event?

a. Debit Cash, $500; credit Subscription Revenue, $500.
b. Debit Cash, $500; credit Unearned Revenue, $500.
c. Debit Subscription Revenue, $200; credit Cash, $200.
d. No journal entry is necessary.

A. Option a
B. Option b
C. Option c
D. Option d

73. At times, businesses require advance payments from customers that will be applied to the purchase price when goods are delivered or services provided. These customer advances represent:

A. Liabilities until the product or service is provided.
B. A component of stockholders' equity.
C. Long-term assets until the product or service is provided.
D. Revenue upon receipt of the advance payment.

74. The sale of gift cards by a company is a direct example of:

A. Unearned revenues.
B. Sales tax payable.
C. Current portion of long-term debt.
D. Deferred taxes.

75. When a company delivers a product or service for which a customer has previously paid, the company records the following:

A. A debit to a revenue account and a credit to a liability account.
B. A debit to a revenue account and a credit to an asset account.
C. A debit to an asset account and a credit to a revenue account.
D. A debit to a liability account and a credit to a revenue account.

76. Sales taxes collected by a company on behalf of the state and local government are recorded by:

A. A debit to an expense account.
B. A credit to a revenue account.
C. A debit to a revenue account.
D. A credit to a liability account.

77. When a company collects sales tax from a customer, the event is recorded by:

A. A debit to Sales Tax Expense and a credit to Sales Tax Payable.
B. A debit to Cash and a credit to Sales Tax Payable.
C. A debit to Sales Tax Payable and a credit to Sales Tax Expense.
D. A debit to Sales Tax Payable and a credit to Cash.

78. Suppose you buy lunch for $8.39 that includes a 5% sales tax. How much did the restaurant charge you for the lunch (excluding any tax) and how much do they owe for sales tax?

A. $8.39 for lunch and $0.42 for sales tax.
B. $8.39 for lunch and no sales tax.
C. $8.81 for lunch and $0.42 for sales tax.
D. $7.99 for lunch and $0.40 for sales tax.

79. Union Apparel has sales including sales taxes for the month of $551,200. If the sales tax rate is 6%, what are Union Apparel's sales for the month?

A. $500,000.
B. $518,128.
C. $520,000.
D. $551,200.

80. The current portion of long-term debt should be

A. Reported as a current liability on the balance sheet.
B. Reported as a long-term liability on the balance sheet.
C. Combined with the rest of the long-term debt on the balance sheet.
D. Paid immediately.

81. Region Jet has a $50 million liability at December 31, 2012, of which $10 million is payable in 2013. In its December 31, 2012 balance sheet, the company reports the $50 million debt as

A. A $50 million current liability on the balance sheet.
B. A $50 million long-term liability on the balance sheet.
C. A $10 million current liability and a $40 million long-term liability on the balance sheet.
D. A $40 million current liability and a $10 million long-term liability on the balance sheet.

82. United Supply has a $5 million liability at December 31, 2012, of which $1 million is payable in each of the next five years. United Supply reports the liability on the balance sheet as:

A. a $5 million current liability.
B. a $5 million long-term liability.
C. a $1 million current liability and a $4 million long-term liability.
D. a $4 million current liability and a $1 million long-term liability.

83. Which of the following is true regarding the relationship between net income reported in the income statement and taxable income reported to the Internal Revenue Service (IRS)?

A. Net income and taxable income are always the same amount.
B. Net income and taxable income are rarely the same amount.
C. Net income is always larger than taxable income.
D. Taxable income is always larger than net income.

84. If management can estimate the amount of loss that will occur due to litigation against the company, and the likelihood of the loss is *reasonably possible*, a contingent liability should be

A. Disclosed, but not reported as a liability.
B. Disclosed and reported as a liability.
C. Neither disclosed nor reported as a liability.
D. Reported as a liability, but not disclosed.

85. If management can estimate the amount of loss that will occur due to litigation against the company, and the likelihood of the loss is *probable*, a contingent liability should be

A. Disclosed, but not reported as a liability.
B. Disclosed and reported as a liability.
C. Neither disclosed nor reported as a liability.
D. Reported as a liability, but not disclosed.

86. Reeves Co. filed suit against Higgins, Inc., seeking damages for copyright violations. Higgins' legal counsel believes it is probable that Higgins will settle the lawsuit for an estimated amount in the range of $100,000 to $200,000, with all amounts in the range considered equally likely. How should Higgins report this litigation?

A. As a liability for $100,000 with disclosure of the range.
B. As a liability for $150,000 with disclosure of the range.
C. As a liability for $200,000 with disclosure of the range.
D. As a disclosure only. No liability is reported.

87. Away Travel filed suit against West Coast Travel seeking damages for copyright violations. West Coast Travel's legal counsel believes it is reasonably possible that West Coast Travel will settle the lawsuit for an estimated amount in the range of $100,000 to $200,000, with all amounts in the range considered equally likely. How should West Coast Travel report this litigation?

A. As a liability for $100,000 with disclosure of the range.
B. As a liability for $150,000 with disclosure of the range.
C. As a liability for $200,000 with disclosure of the range.
D. As a disclosure only. No liability is reported.

88. Away Travel filed suit against West Coast Travel seeking damages for copyright violations. Away Travel's legal counsel believes it is probable (but not certain) that Away Travel will win the lawsuit for an estimated amount in the range of $100,000 to $200,000, with all amounts in the range considered equally likely. How should Away Travel report this litigation?

A. As a receivable for $100,000 with disclosure of the range.
B. As a receivable for $150,000 with disclosure of the range.
C. As a receivable for $200,000 with disclosure of the range.
D. As a disclosure only. No receivable is reported.

89. Young Company is involved in a lawsuit. The liability which could arise as a result of this lawsuit should be recorded on the books if the probability of Young owing money as a result of the lawsuit is:

a. Remote and the amount can be reasonably estimated.
b. Probable and the amount can be reasonably estimated.
c. Reasonably possible and the amount can be reasonably estimated.
d. Probable and the amount cannot be reasonably estimated.

A. Option a
B. Option b
C. Option c
D. Option d

90. Ogden Motors, Inc. is involved in a lawsuit. It is reasonably possible that the jury will find in favor of the plaintiff and Ogden will owe ten million dollars. What is the appropriate reporting of this lawsuit and what is the effect on the balance sheet?

a. Record; decrease stockholders' equity and increase liabilities.
b. Record; increase stockholders' equity and decrease liabilities.
c. Disclose; no effect on the balance sheet.
d. Disclose; decrease stockholders' equity and decrease liabilities.

A. Option a
B. Option b
C. Option c
D. Option d

91. Amplify, Inc. was sued by Sound City for $50,000. Sound City feels very confident that it will win the case and will be awarded the full amount. Amplify, Inc. feels it is probable that it will lose the case and pay Sound City the full amount. Which of the following is correct?

a. Amplify, Inc. would record a loss and contingent liability for $50,000.
b. Sound City would record a gain and lawsuit receivable for $50,000.
c. Sound City would record nothing.
d. Both a. and c. are correct.

A. Option a
B. Option b
C. Option c
D. Option d

92. At the beginning of 2012, Angel Corporation began offering a 1-year warranty on its products. The warranty program was expected to cost Angel 4% of net sales. Net sales made under warranty in 2012 were $180 million. Five percent of the units sold were returned in 2012 and repaired or replaced at a cost of $5.3 million. The amount of warranty expense on Angel's 2012 income statement is:

A. $5.3 million.
B. $7.2 million.
C. $9.0 million.
D. $27.0 million.

93. Strikers, Inc. sells soccer goals to customers over the Internet. History has shown that 2% of Strikers' goals are faulty and will need repair under the warranty program. For the year, Strikers has sold 4,000 goals and 45 have been repaired. If the estimated cost to repair a goal is $200, what would be the Warranty Liability at the end of the year?

a. $0.
b. $16,000.
c. $7,000.
d. $6,750.

A. Option a
B. Option b
C. Option c
D. Option d

94. Bears Inc. sells football helmets to local schools and warrants all of its products for one year. While no helmets sold in 2012 have been returned to them yet, based upon previous years, Bears Inc. estimates that 3% of its products will need repairs or be replaced within the next year. What effect would this warranty have on assets, liabilities, and stockholders' equity in 2012?

a. A decrease in assets and decrease in stockholders' equity.
b. No journal entry is necessary until products under warranty are returned.
c. An increase in stockholders' equity and a decrease in liabilities.
d. A decrease in stockholders' equity and an increase in liabilities.

A. Option a
B. Option b
C. Option c
D. Option d

95. Talks-A-Lot, Inc. sells cell phones to customers and expects that 10% of phones sold will be returned for repair under its warranty program. The average repair cost is $75 per phone. For 2012, Talks-A-Lot has sold 750 cell phones and has repaired 30 of them as of December 31, 2012. What amount of warranty liability should be reported at December 31, 2012?

a. $2,250.
b. $3,375.
c. $5,625.
d. None, all expected returns from warranties have been received.

A. Option a
B. Option b
C. Option c
D. Option d

96. Carpenter Inc. estimates warranty expense at 2% of sales. Sales during the year were $4 million and warranty expenditures were $44,000. What was the balance in the Warranty Liability account at the end of the year?

A. $44,000.
B. $80,000.
C. $36,000.
D. $480,000.

97. Footnote disclosure is required for material potential losses when the loss is at least reasonably possible:

A. Only if the amount is known.
B. Only if the amount is known or reasonably estimable.
C. Unless the amount is not reasonably estimable.
D. Even if the amount is not reasonably estimable.

98. Gain contingencies usually are recognized in a company's income statement when:

A. The gain is certain.
B. The amount can be reasonably estimated.
C. The gain is reasonably possible and the amount can be reasonable estimated.
D. The gain is probable and the amount can be reasonably estimated.

99. A contingent liability should be accrued on a company's financial statements only if the likelihood of a loss occurring is:

A. At least remotely possible and the amount of the loss is known.
B. At least reasonably possible and the amount of the loss is known.
C. At least reasonably possible and the amount of the loss can be reasonably estimated.
D. Probable and the amount of the loss can be reasonably estimated.

100. When a gain contingency is probable and the amount of gain can be reasonably estimated, the gain should be:

A. Reported in the income statement and disclosed.
B. Offset against stockholders' equity.
C. Disclosed, but not recognized in the income statement.
D. Reported in the income statement, but not disclosed.

101. A contingent liability should be disclosed in a note to the financial statements rather than being recorded if:

A. The likelihood of a loss is remote.
B. The incurrence of a loss is reasonably possible.
C. The incurrence of a loss is probable.
D. The likelihood of a loss is eighty percent.

102. Volt Electronics sells equipment that includes a three-year warranty. Repairs under the warranty are performed by an independent service company under a contract with Volt. Based on prior experience, warranty costs are estimated to be $25 per item sold. Volt should recognize these warranty costs:

A. When the equipment is sold.
B. When the repairs are performed.
C. When payments are made to the service firm.
D. Evenly over the life of the warranty.

103. Which of the following is a contingency that should be recorded?

A. The company is being sued and a loss is reasonably possible and reasonably estimable.
B. The company deducts life insurance premiums from employees' paychecks.
C. The company offers a two-year warranty and the expenses can be reasonably estimated.
D. It is probable that the company will receive $100,000 in settlement of a lawsuit.

104. Skypt Co. is involved in a lawsuit and sued by Quart Co. for $500,000. Skypt feels it is probable that it will lose the lawsuit. What should Skypt Co. and Quart Co. record or disclose concerning the lawsuit?

a. Skypt Co. should record a $500,000 contingent liability; Quart Co. should record a $500,000 contingent gain.
b. Skypt Co. should record a $500,000 contingent liability; Quart Co. should not record or disclose a contingent gain.
c. Skypt Co. should disclose a $500,000 contingent liability; Quart Co. should disclose a $500,000 contingent gain.
d. Skypt Co. should not record or disclose a contingent liability; Quart Co. should record a $500,000 contingent gain.

A. Option a
B. Option b
C. Option c
D. Option d

105. Which of the following statements regarding liquidity ratios is false?

A. A high current ratio generally indicates the ability to pay current liabilities on a timely basis.
B. A high acid-test ratio generally indicates the ability to pay current liabilities on a timely basis.
C. All current assets are due within one year and therefore have essentially equal liquidity.
D. As a rule of thumb, a current ratio of 1 or higher often reflects an acceptable level of liquidity.

106. Which of the following statements regarding liquidity ratios is true?

A. A low current ratio generally indicates the ability to pay current liabilities on a timely basis.
B. A low acid-test ratio generally indicates the ability to pay current liabilities on a timely basis.
C. All current assets are due within one year and therefore have essentially equal liquidity.
D. A high working capital generally indicates the ability to pay current liabilities on a timely basis.

107. Which of the following is true regarding the relationship between the current ratio and the acid-test ratio?

A. The current ratio will always be equal to or larger than the acid-test ratio for a specific company.
B. The acid-test ratio will always be equal to or larger than the current ratio for a specific company.
C. Either the current ratio or the acid-test ratio could be larger for a specific company.
D. One ratio will always exceed 1.0, while the other will always be less than 1.0.

108. A company's liquidity refers to its:

a. Ability to collect accounts receivable.
b. Ability to sell inventory efficiently.
c. Ability to generate profits from operations.
d. Ability to pay currently maturing debts.

A. Option a
B. Option b
C. Option c
D. Option d

109. Working capital is

A. Current assets divided by current liabilities.
B. Current assets minus current liabilities.
C. Cash, short-term investments, and accounts receivable divided by current liabilities.
D. Cash, short-term investments, and accounts receivable minus current liabilities.

110. The current ratio is

A. Current assets divided by current liabilities.
B. Cash and short-term investments divided by current liabilities.
C. Cash, short-term investments, and accounts receivable divided by current liabilities.
D. Cash, short-term investments, accounts receivable, and inventory divided by current liabilities.

111. The acid-test ratio is

A. Current assets divided by current liabilities.
B. Cash and short-term investments divided by current liabilities.
C. Cash, short-term investments, and accounts receivable divided by current liabilities.
D. Cash, short-term investments, accounts receivable, and inventory divided by current liabilities.

112. Which of the following measures of liquidity does not control for the relative size of the company?

A. Working capital.
B. Current ratio.
C. Acid-test ratio.
D. They all control for the relative size of the company.

113. Assuming a current ratio of 1.2 and an acid-test ratio of 0.80, how will the purchase of inventory with cash affect each ratio?

A. Increase the current ratio and increase the acid-test ratio.
B. No change to the current ratio and decrease the acid-test ratio.
C. Decrease the current ratio and decrease the acid-test ratio.
D. Decrease the current ratio and increase the acid-test ratio.

114. Assuming a current ratio of 1.0 and an acid-test ratio of 0.80, how will the borrowing of cash by issuing a six-month note payable affect each ratio?

A. Increase the current ratio and increase the acid-test ratio.
B. No change to the current ratio and increase the acid-test ratio.
C. Decrease the current ratio and decrease the acid-test ratio.
D. Decrease the current ratio and increase the acid-test ratio.

115. On November 1, Vacation Desinations borrows $1.5 million and issues a six-month, 8% note payable. Interest is payable at maturity. Record the issuance of the note and the appropriate adjusting entry for interest expense at December 31, the end of the reporting period.

116. On September 1, 2012, Allied Moving Corp. borrows $100,000 cash from First National Bank. Allied signs a six-month, 6% note payable. Interest is payable at maturity. Allied's year-end is December 31.
1. Record the note payable by Allied Moving Corp.
2. Record the appropriate adjusting entry for the note by Allied Moving Corp. on December 31, 2012.
3. Record the payment of the note at maturity.

117. On November 1, 2012, Dual Systems borrows $200,000 to expand operations. Dual Systems signs a six-month, 9% promissory note. Interest is payable at maturity. Dual System's year-end is December 31.
1. Record the issuance of the note by Dual Systems.
2. Record the appropriate adjusting entry for the note by Dual Systems on December 31, 2012.
3. Record the payment of the note by Dual Systems at maturity on April 30, 2013.

118. Assume that on July 1, 2012, Togo's issues a $2 million, one-year note. Interest is payable at maturity. Determine the amount of interest expense that should be recorded in a year-end adjusting entry under each of the following independent assumptions:
Interest Rate Fiscal Year-End
1. 8% December 31
2. 9% September 30
3. 6% October 31
4. 7% January 31

119. The following selected transactions relate to liabilities of Deco Emporium whose fiscal year ends on December 31.
Jan. 26 Negotiated a line of credit with City Bank that can be renewed annually upon bank approval. The amount available under the line of credit is $1 million at the bank's prime rate.
March 1 Arranged a six-month bank loan of $400,000 with City Bank under the line of credit agreement. Interest at the prime rate of 8% is payable at maturity.
September 1Paid the 8% note at maturity.
Record the appropriate entries, if any, on January 26, March 1, and September 1.

120. Mike Smith is a college football coach making a base salary of $960,000 a year ($80,000 per month). Employers are required to withhold a 6.2% Social Security tax up to a maximum base amount and a 1.45% Medicare tax with no maximum. Assuming the FICA base amount is $106,800, compute how much will be withheld during the year for Coach Smith's Social Security and Medicare. Through what month will Social Security be withheld? What additional amount will the employer need to contribute?

Answer:

Total withheld for:			
Social Security	$106,800 x .062	=	6,622
Medicare	$960,000 x .0145	=	13,920
Total			$20,542

Social Security will be withheld through February as $80,000 per month reaches the $106,800 maximum in the second month. The employer will contribute an additional (matching) contribution of $20,542.

121. Accurate Reports has 50 employees each working 40 hours per week and earning $25 an hour. Federal income taxes are withheld at 15% and state income taxes at 6%. FICA taxes are 7.65% of the first $106,800 earned per employee and 1.45% thereafter. Unemployment taxes are 3.8% of the first $7,000 earned per employee.

1. Compute the total salaries expense, the total withholdings from employee salaries, and the actual direct deposit of payroll for the first week of January.
2. Compute the total payroll tax expense Accurate Reports will pay for the first week of January.

122. During January, Deluxe Printing pays employee salaries of $1 million. Withholdings in January are $76,500 for the employee portion of FICA, $210,000 for federal and state income tax, and $40,000 for the employee portion of health insurance (payable to Blue Cross/Blue Shield). The company incurs an additional $38,000 for federal and state unemployment tax and $30,000 for the employer portion of health insurance.

1. Record the employee salary expense, withholdings, and salaries payable.
2. Record the employer-provided fringe benefits.
3. Record the employer payroll taxes.

123. Midwest Shipping pays employees at the end of each month. Payroll information is listed below for January, the first month of the fiscal year. Assume that none of the employees exceeds the Federal unemployment tax maximum salary of $7,000 in January.
Salaries $800,000
Federal and state income taxes withheld 160,000
Federal unemployment tax rate 0.80%
State unemployment tax rate (after FUTA deduction) 3.00%
Social Security (FICA) tax rate 7.65%
Record salaries expense and payroll tax expense for the January pay period.

124. On July 8, Compusoft receives $250,000 from a customer toward a cash sale of $1 million for customized computer equipment to be completed on August 1. The remaining $750,000 payment is received upon delivery of the product on August 1. The equipment had a total production cost of $700,000. What journal entries should Compusoft record on July 8 and August 1? Assume Compusoft uses the perpetual inventory system.

125. T. Boone Pickens football stadium at Oklahoma State University has a seating capacity of about 60,000. Assume the stadium sells out all six home games before the season begins and the athletic department collects $30.6 million in ticket sales.
1. What was the average price per season ticket and average price per individual game ticket sold?
2. Record the advance collection of $30.6 million in ticket sales.
3. Record the revenue earned after the first home game was completed.

126. During November, Wireless, Inc. makes a $1,600 credit sale. The state sales tax rate is 5% and the local sales tax rate is 1.5%. Record sales revenue and sales tax payable.

127. Two competing advertising agencies provide similar services, but record sales using different methods.
1. Diversified Advertising records sales and sales taxes in separate accounts. For the month of March, sales total $10,000 and sales taxes are $600.
2. Centralized Advertising records sales and sales taxes together. For the month of March, sales total $5,300, including a 6% sales tax.
Record sales revenue and the related sales tax payable for (1) Diversified Advertising and (2) Centralized Advertising.

128. On April 1, 2012, the Electronic Superstore borrows $22 million of which $4 million is due in 2013. Show how the company would report the $22 million debt on its December 31, 2012 balance sheet.

129. Consultants notify management of Generic Drug that a prescription medication poses a potential health risk. Legal counsel indicates that a product recall is probable and is estimated to cost the company between $5 and $8 million. How will this affect the company's income statement and balance sheet this period?

130. Decorative Concrete produces a concrete overlay for residential and commercial concrete flooring. Customers have complained that one of the products results in excessive cracking. The likelihood the company will incur a loss on this product is probable and the amount of the loss is estimated to be somewhere between $1.5 and $3 million.
1. Should this contingent liability be reported, disclosed in a note only, or both? Explain.
2. What loss, if any, should Decorative Concrete report in its income statement?
3. What liability, if any, should Decorative Concrete report in its balance sheet?
4. What entry, if any, should be recorded?

131. Panama Shirt Designs is a defendant in litigation involving an employee accident in its manufacturing plant.
For each of the following scenarios, determine the appropriate way to report the situation. Explain your reasoning and record any necessary entry.
1. The likelihood of a loss occurring is probable and the estimated loss is $650,000.
2. The likelihood of a loss occurring is probable and the loss is estimated to be in the range of $500,000 to $800,000.
3. The likelihood of a loss occurring is reasonably possible and the estimated loss is $650,000.
4. The likelihood of a loss occurring is remote, while the estimated potential loss is $650,000.

132. Rotary Tools sells power tools and backs each product it sells with a one-year warranty against defects. Based on previous experience, the company expects warranty costs to be approximately 5% of sales. By the end of the first year, sales and actual warranty expenditures are $800,000 and $13,000, respectively.
1. Does this situation represent a contingent liability? Why or why not?
2. Record warranty expense and warranty liability for the year based on 5% of sales.
3. Record the reduction in warranty liability and the reduction in cash of $13,000 incurred during the year.
4. What is the balance in the Warranty Liability account after the entries in parts 2 and 3?

133. The Copper Grill has the following current assets: cash, $12 million; receivables, $50 million; inventory, $44 million; and other current assets $4 million. The Copper Grill has the following liabilities: accounts payable, $38 million; current portion of long-term debt, $7 million; and long-term debt, $12 million. Based on these amounts, calculate the current ratio and the acid-test ratio for The Copper Grill.

134. Selected financial data regarding current assets and current liabilities for two competing companies, Simon and Garfunkel, are provided as follows:

($ in millions)	Simon	Garfunkel
Current assets		
Cash and cash equivalents	$648	$2,917
Short-term investments	3,676	
Net receivables	991	1,372
Inventory	515	202
Other current assets	334	476
Total current assets	$6,164	$4,967
Current liabilities		
Accounts payable	$7,081	$4,295
Short-term debt	1,239	1,021
Other current liabilities		1,308
Total current liabilities	$8,320	$6,624

1. Calculate the current ratio for Simon. Then calculate the current ratio for Garfunkel. Which of the two companies has the best current ratio?
2. Calculate the acid-test (quick) ratio for Simon. Then calculate the acid-test (quick) ratio for Garfunkel. Which of the two companies has the best acid-test ratio?

135. Why is it important to distinguish between current and long-term liabilities?

136. Explain why we record interest in the period in which we incur it rather than in the period we pay it.

137. Name as many items as you can that are withheld from employee payroll checks. Which employee deductions are required by law and which are voluntary? Name as many items as you can that are employer payroll costs in addition to the employee's salary. Which employer costs are required by law and which are voluntary?

138. Retailers like McDonalds, American Eagle, and Apple Computer sell a large number of gift cards. Explain how these companies account for the sale of gift cards.

139. Define a contingent liability. Provide three common examples. Under what circumstances should a firm report a contingent liability?

140. Match (by letter) the correct reporting method for each of the items listed below.

Answer: Reporting Method

C. Current liability

L. Long-term liability

D. Disclosure note only

N. Not reported

<u>Item</u>

_____ 1. Accounts payable.

_____ 2. A contingent liability that is *probable* of occurring within the next year and can be estimated.

_____ 3. A contingent liability that is *reasonably possible* of occurring within the next year and can be estimated.

_____ 4. Current portion of long-term debt.

_____ 5. Sales tax collected from customers.

Answer: C; C; D; C; C

141. Match (by letter) the correct reporting method for each of the items listed below.

Answer: Reporting Method

C. Current liability

L. Long-term liability

D. Disclosure note only

N. Not reported

<u>Item</u>

_____ 1. Notes payable due in two years.

_____ 2. Customer advances.

_____ 3. Commercial paper.

_____ 4. Unused line of credit.

_____ 5. A contingent liability that is *probable* of occurring within the next year but cannot be estimated.

Answer: L; C; C; D; D

142. Listed below are several terms and phrases associated with current liabilities. Pair each item from List A (by letter) with the item from List B that is most appropriately associated with it.

	List A	List B
_____	1. A written promise to repay the amount borrowed plus interest.	a. Current portion of long-term debt
_____	2. Loss is reasonably possible and can be reasonably estimated.	b. Unearned revenues
_____	3. Debt that will be paid within the next year.	c. Recording a contingent liability
_____	4. Loss is probable and can be reasonably estimated.	d. Disclosure of a contingent liability
_____	5. A liability that requires the sacrifice of something other than cash.	e. Notes payable

Answer: e; d; a; c; b

143. Listed below are several terms and phrases associated with current liabilities. Pair each item from List A (by letter) with the item from List B that is most appropriately associated with it.

	List A	List B
_____	1. Long-term debt maturing within one year.	a. Payroll taxes
_____	2. FICA and FUTA.	b. Line of credit
_____	3. Informal agreement that permits a company to borrow up to a prearranged limit.	c. The riskiness of a business's obligations
_____	4. Classifying liabilities as either current or long-term helps investors and creditors assess this.	d. Interest on debt
_____	5. Amount of note payable x annual interest rate x fraction of the year.	e. Current portion of long-term debt

Answer: e; a; b; c; d

144. Listed below are several terms and phrases associated with current liabilities. Pair each item from List A (by letter) with the item from List B that is most appropriately associated with it.

	List A	List B
_____	1. Cash, short-term investments, and accounts receivable all divided by current liabilities.	a. Recording a contingent liability
_____	2. Loss is probable and can be reasonably estimated.	b. Disclosure of a contingent liability
_____	3. Gift cards.	c. Interest expense
_____	4. Long-term debt maturing within one year.	d. FICA
_____	5. Social Security and Medicare.	e. Commercial paper
_____	6. Interest expense is recorded in the period interest is incurred rather than in the period interest is paid.	f. The riskiness of a business's obligations
_____	7. Loss is reasonably possible and can be reasonably estimated.	g. Current portion of long-term debt
_____	8. Incurred on a notes payable.	h. Unearned revenues
_____	9. Unsecured notes sold in minimum denominations of $25,000 with maturities up to 270 days.	i. Acid-test ratio
_____	10. Classifying liabilities as either current or long-term helps investors and creditors assess this.	j. Accrual accounting

Answer: i; a; h; g; d; j; b; c; e; f;

Ch8 Key

1. TRUE

2. FALSE

3. TRUE

4. FALSE

5. TRUE

6. TRUE

7. FALSE

8. TRUE

9. TRUE

10. TRUE

11. TRUE

12. FALSE

13. TRUE

14. TRUE

15. FALSE

16. TRUE

17. TRUE

18. FALSE

19. TRUE

20. FALSE

21. TRUE

22. TRUE

23. TRUE

24. FALSE

25. FALSE

26. TRUE

27. TRUE

28. FALSE

29. TRUE

30. FALSE

31. TRUE

32. TRUE

33. FALSE
34. FALSE
35. TRUE
36. FALSE
37. TRUE
38. FALSE
39. TRUE
40. TRUE
41. FALSE
42. B
43. D
44. B
45. B
46. C
47. A
48. C
49. B
50. B
51. A
52. C
53. B
54. C
55. D
56. A
57. D
58. C
59. B
60. C
61. D
62. A
63. C
64. B
65. C
66. D
67. D

68. B
69. A
70. B
71. C
72. B
73. A
74. A
75. D
76. D
77. B
78. D
79. C
80. A
81. C
82. C
83. B
84. A
85. B
86. A
87. D
88. D
89. B
90. C
91. D
92. B
93. C
94. D
95. B
96. C
97. D
98. A
99. D
100. C
101. B
102. A

103. C

104. B

105. C

106. D

107. A

108. D

109. B

110. A

111. C

112. A

113. B

114. B

115.

November 1	Debit	Credit
Cash	1,500,000	
Notes Payable		1,500,000
(Issuance of notes payable)		
December 31		
Interest Expense [($1,500,000 x .08) x 2/12]	20,000	
Interest Payable		20,000
(*Interest expense incurred, but not paid*)		

116.

1. September 1, 2012	Debit	Credit
Cash	100,000	
Notes Payable		100,000
(Issuance of notes payable)		

2. December 31, 2012		
Interest Expense [($100,000 x 6%) x 4/12]	2,000	
Interest Payable		2,000
(*Interest expense incurred, but not paid*)		

3. March 1, 2013		
Notes Payable	100,000	
Interest Expense [($100,000 x 6%) x 2/12]	1,000	
Interest Payable [($100,000 x 6%) x 4/12]	2,000	
Cash		103,000
(*Payment of notes payable and interest*)		

1. November 1, 2012

	Debit	Credit
Cash	200,000	
Notes Payable		200,000
(Issuance of notes payable)		

2. December 31, 2012

Interest Expense [($200,000 x 9%) x 2/12]	3,000	
Interest Payable		3,000
(Interest expense incurred, but not paid)		

3. April 30, 2013

Notes Payable	200,000	
Interest Expense ($200,000 x 9% x 4/12)	6,000	
Interest Payable ($200,000 x 9% x 2/12)	3,000	
Cash		209,000
(Payment of notes payable and interest)		

117.

1. $2,000,000 x .08 x 6/12 = $80,000.
2. $2,000,000 x .09 x 3/12 = $45,000.
3. $2,000,000 x .06 x 4/12 = $40,000.
4. $2,000,000 x .07 x 7/12 = $81,667.

118.

January 26	Debit	Credit
No Journal Entry		
March 1		
Cash	400,000	
Notes Payable		400,000
(Issuance of notes payable)		
September 1		
Notes Payable	400,000	
Interest Expense [(400,000 x .08) x 6/12]	16,000	
Cash		416,000
(Payment of notes payable and interest)		

119.

120.

1. Total Salaries Expense	(50 x 40 hours x $25)		$50,000
Less: Withholdings			
Federal Income Taxes	($50,000 x .15)	$7,500	
State Income Taxes	($50,000 x .06)	3,000	
FICA Taxes	($50,000 x .0765)	3,825	
Total Withholdings			14,325
Actual Direct Deposit			$35,675

121.

2. FICA Taxes	($50,000 x .0765)	$3,825
Unemployment Taxes	($50,000 x .038)	1,900
Total Payroll Tax Expense		$5,725

January 31	Debit	Credit
Salaries Expense	1,000,000	
Income Tax Payable		210,000
FICA Tax Payable		76,500
Accounts Payable (Blue Cross/Blue Shield)		40,000
Salaries Payable (to balance)		673,500
(Employee salary expense and withholdings)		

122.

January 31		
Salaries Expense (fringe benefits)	30,000	
Accounts Payable (Blue Cross/Blue Shield)		30,000
(Employer-provided fringe benefits)		

January 31		
Payroll Tax Expense (total)	114,500	
FICA Tax Payable		76,500
Unemployment Tax Payable		38,000
(Employer payroll taxes)		

January 31	Debit	Credit
Salaries Expense	800,000	
Income Tax Payable		160,000
FICA Tax Payable ($800,000 x .0765)		61,200
Salaries Payable (to balance)		578,800
(Employee salary expense)		
January 31		
Payroll Tax Expense (total)	91,600	
FICA Tax Payable ($800,000 x .0765)		61,200
Unemployment Tax Payable ($800,000 x .038)		30,400
(Employer payroll tax expense)		

123.

July 8	Debit	Credit
Cash	250,000	
Unearned Revenue		250,000
(to record advance receipt of cash)		

124.

August 1		
Cash	750,000	
Unearned Revenue	250,000	
Sales Revenue		1,000,000
Cost of Goods Sold	700,000	
Inventory		700,000
(to complete the sale)		

1. $\frac{\$30{,}600{,}000}{60{,}000} =$ $510 per season ticket

$\frac{\$510}{6 \text{ games}} =$ $85 per individual game ticket

125.

2.

Cash	30,600,000	
Unearned Revenue		30,600,000
(Advance collection of ticket sales)		

3.

Unearned Revenue	5,100,000	
Sales Revenue ($30,600,000 / 6)		5,100,000
(Revenue earned after first home game)		

	Debit	Credit
Accounts Receivable	1,704	
Sales Revenue		1,600
Sales Tax Payable (.065 x $1,600)		104
(Record sales and sales tax)		

126.

1.

March 31	Debit	Credit
Cash	10,600	
Sales Revenue		10,000
Sales Tax Payable		600
(Record sales and sales tax)		

127.

2.

March 31		
Cash	5,300	
Sales Revenue ($5,300 / 1.06)		5,000
Sales Tax Payable		300
(Record sales and sales tax)		

Electronic Superstore
Partial Balance Sheet
December 31, 2012

Current Liabilities:	
Current portion of long-term debt	$4,000,000
Long-Term Liabilities:	
Notes payable	$18,000,000
Total Liabilities	$22,000,000

128.

129. The contingent liability is probable and reasonably estimable, so a loss and a liability for the minimum amount of the range ($5 million) must be recorded. The entry will reduce income before taxes on the income statement and increase total liabilities on the balance sheet by $5 million.

130. 1. The contingent liability is probable and reasonably estimable, so it must be reported. The details of the contingent liability should also be provided in a note to the financial statements.

2. When the loss is estimated within a range, the minimum amount of the loss, $1.5 million, should be reported in its 2012 income statement.

3. Similarly, a $1.5 million liability should be reported in its 2012 balance sheet.

4. The journal entry is as follows:

Loss 1,500,000

Contingent Liability 1,500,000

(*Record a contingent liability)*

131. 1. The contingent liability is probable and reasonably estimable, so it must be recorded as follows:

Loss 650,000; Contingent Liability 650,000

(Entry to record the contingent liability)

2. Panama Shirt Designs should record a loss and a liability for the minimum amount ($500,000)

and disclose the range between $500,000 and $800,000 in the footnotes to the financial statements. The journal entry is as follows:

Loss 500,000Contingent Liability 500,000

(Entry to record the contingent liability)
3. If the likelihood of loss is reasonably possible rather than probable, we record no entry, but

make full disclosure in a footnote to the financial statements to describe the contingency.

4. If the likelihood of loss is remote, disclosure is usually not required.

132. 1. Yes, it's probable that costs for warranties will be incurred and based on previous experience the company can reasonably estimate the amount.

2. Warranty Expense ($800,000 x 5%) 40,000

Warranty Liability 40,000

(Record liability for warranties)
3. Warranty Liability 13,000

Cash 13,000

(Record actual warranty expenditures)

4. **Warranty Liability**

Payment $13,000	$40,000 Expense
	$27,000 Balance

133. ($in millions)

Current Assets	÷	Current Liabilities	=	**Current Ratio**
($12 + 50 + 44 + 4)	÷	($38 + 7)	=	2.44

Quick Assets	÷	Current Liabilities	=	**Acid-Test Ratio**
($12 + 50)	÷	($38 + 7)	=	1.38

134. 1. Garfunkel has a slightly better current ratio.

($ in millions)	Total Current Assets	÷	Total Current Liabilities	=	**Current Ratio**
Simon	$6,164	÷	$8,320	=	0.74
Garfunkel	$4,967	÷	$6,624	=	0.75

2. Garfunkel also has a slightly better acid-test ratio.

($ in millions)	Quick Assets	÷	Total Current Liabilities	=	**Acid-Test Ratio**
Simon	$5,315 (a)	÷	$8,320	=	0.64
Garfunkel	$4,289 (b)	÷	$6,624	=	0.65

135. Distinguishing between current and long-term liabilities is important in helping investors and creditors assess the riskiness of a business' obligations. Given a choice, most companies would prefer to report a liability as long-term rather than current because it may cause the firm to appear less risky. In turn, less risky firms may enjoy lower interest rates on borrowing and command higher stock prices for new stock listings.

136. Accrual-basis accounting requires expenses to be recorded when incurred; cash-basis requires expenses to be recorded when the cash is paid. Generally Accepted Accounting Principles (GAAP) requires the use of accrual-basis accounting in preparing financial statements because it best reflects the timing of the expense, consistent with the matching principle.

137. Items commonly withheld from employee payroll checks include federal and state income taxes, Social Security and Medicare, health, dental, disability, and life insurance premiums, and *employee* investments to retirement or savings plans. Federal and state income taxes, Social Security and Medicare are required by law. The rest are voluntary.

Common employer payroll costs, in additional to the employee's salary, include federal and state unemployment taxes, the employer portion of Social Security and Medicare, employer contributions for health, dental, disability, and life insurance, and *employer* contributions to retirement or savings plans. Federal and state unemployment taxes and the employer portion of Social Security and Medicare are required by law. The rest are voluntary benefits paid by a company on behalf of its employees.

138. When a company receives cash in advance through the sale of gift cards, it debits Cash and credits a current liability account called Unearned Revenue. When it earns the revenue through the sale of goods or services, the company debits Unearned Revenue and credits Sales Revenue.

139. A contingent liability is an existing, uncertain situation that might result in a loss. Examples include lawsuits, product warranties, environmental problems, and premium offers. A contingent liability is recorded only if a loss is probable and the amount can be reasonably estimated.

140.

141.

142.

143.

144.

Ch8 Summary

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Learning Objective: 08-02 Account for notes payable and interest expense.	32
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