Exam

Name________________________________

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

1) Conceptually, liabilities constitute a present obligation as a result of a past event and entail an expected future sacrifice of assets or services. 1) _______

2) Under ASPE, only legal obligations are recognized. 2) _______

3) A reasonable expectation on the part of a company's stakeholders arising from a company's past practices or behaviour may constitute a constructive obligation in certain instances. 3) _______

4) A contingency may become a provision if the likelihood of the contingent event greatly increases. 4) _______

5) Under IFRS, most financial liabilities are valued at Fair Value. 5) _______

6) An improvement to a company's credit rating under IFRS will lead to a reduction in the carrying amount of any financial liabilities and a gain being reported in OCI. 6) _______

7) Loan guarantees are only recorded if they are likely to be paid. 7) _______

8) Accrued liabilities made due to routine operating expenses are not normally discounted. 8) _______

9) For a small population, the best estimate for the amount of a provision that must be recognized is the expected value of the possible outcomes. 9) _______

10) Under IFRS, provisions are always recorded at their expected value. 10) _______

11) For a large population, the best estimate for the amount of a provision that must be recognized is the most likely outcome with respect to the expected value and cumulative probabilities. 11) _______

12) Under ASPE, contingent liabilities which are more likely than not, are accrued at the lowest end of the range. 12) _______

13) Contingent assets may be recorded under ASPE but not under IFRS. 13) _______

14) Executory contracts seldom require a journal entry, while onerous contracts do. 14) _______

15) Discounting is not required when the time value of money is immaterial or if the amount and timing of cash flows is highly uncertain. 15) _______

16) Financial liabilities are initially recognized at fair value and at cost, amortized cost or fair value post-acquisition. 16) ______

17) A company decides to relocate a group from a discontinued business segment to a division with ongoing operations. The expenses incurred in doing so would qualify as a restructuring charge. 17) ______

18) Under the warranty expense approach, there should be no income statement effects for warranty repairs performed after the year of sale (assuming that accrued warranty expenses and expenditures equal one another). 18) ______

19) Under the warranty revenue approach, there should be no income statement effects for warranty repairs performed after the year of sale (assuming that accrued warranty expenses and expenditures equal one another). 19) ______

20) An onerous contract is one where the unavoidable costs of meeting the contract may or may not exceed the benefits derived from the contract. 20) ______

21) A lawsuit in progress wherein the defendant will probably be found guilty would likely be accounted for as a provision. 21) ______

22) Warranties provisions may arise from legal or constructive obligations. 22) ______

23) Once a company has formally decided to restructure its operations, a provision must be made for the restructuring. 23) ______

24) Loyalty points are provided (accrued) for and reversed once the points are redeemed. 24) ______

25) Self-insurance costs for expected losses must never be provided for. 25) ______

26) Current liabilities are usually discounted. 26) ______

27) A decline in value of a company's reporting currency relative to the foreign currency in which it has payables will result in a foreign exchange gain on the reporting company's books. 27) ______

28) Adjustments to fair value relating to FVTPL liabilities will always flow through earnings. 28) ______

29) Loan guarantees must be provided for; the amount of the provision is the probability of payout multiplied by the fair value of the loan guarantee. 29) ______

30) A company may reclassify a current financial liability to a long-term one only if there is a contractual agreement in place by the reporting date to replace the financing. 30) ______

31) Debt issue costs may be expensed or included in the cost of the debt. 31) ______

32) Normal business risks that are insured must be provided for. 32) ______

33) An administrative fee pertaining to an unsuccessful loan application is to be immediately expensed. 33) ______

34) Capitalization of borrowing costs on qualifying assets will continue even if work on the asset has temporarily ceased. 34) ______

35) Accounts payable should include only obligations directly related to the primary and continuing operations of an entity. 35) ______

36) Capitalization of borrowing costs on qualifying assets is mandatory under both IFRS and ASPE. 36) ______

37) Under IFRS, a loss contingency must be credited to a liability account only if the occurrence of the contingent event is probable and if the amount of loss can be reasonably estimated. 37) ______

38) A gain contingency will usually not be recorded in the accounts and reported in the financial statements even though its occurrence is probable. 38) ______

39) Under ASPE, disclosure in the footnotes to the financial statements is the only way to properly report contingent losses. 39) ______

40) Under IFRS, a continuity schedule must be provided for both provisions and contingencies. 40) ______

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

41) A brewing company operating in an Ontario city experiencing water shortages received its water bill for December 2013, on December 31, 2013. The bill ($8,000) represents the cost of water used in December to make its product. The company will not publish the 2013 financial statements until February 2014. Therefore, the adjusting entry as of December 31, 2013 includes which of the following? 41) ______

A) cr. utilities expense $8,000
B) cr. utilities payable $8,000
C) cr. cash $8,000
D) no adjusting entry needed because the bill will not be paid until January 2014

42) A short-term note payable may include all of the following except: 42) ______

A) Non trade notes payable.
B) Unearned revenue.
C) Trade notes payable.
D) A current portion of a long-term liability.

43) Which of the following statements is correct? 43) ______

A) A contingency is more likely to require an accrual than a provision.
B) Under IFRS, content gains should be recognized if they are reasonably certain to occur.
C) Litigation for which the company will probably be found guilty would normally be accrued as a provision.
D) Under IFRS, contingencies may be accrued, but not under ASPE.

44) A firm sold $100,000 worth of goods during 2014. The firm extends warranty coverage on these goods. Historically, warranty costs have averaged 2% of total sales. During 2014, the firm incurred $1,000 to service goods sold in 2013 and $200 to service goods sold in 2014. What is warranty expense for 2014? 44) ______

A) $3,200 B) $1,200 C) $200 D) $2,000

45) You are an investor and have just purchased a bond on July 1 which pays interest every March 1 and September 1. When you receive your first interest cheque, you will receive and have earned how many months interest? 45) ______

	Received	Earned
1	6	6
2	6	2
3	2	2
4	4	4
5	6	4

A) Choice 1 B) Choice 2 C) Choice 3 D) Choice 4 E) Choice 5

46) On November 7, 2014 local residents sued Brimley Corporation for excess chemical emissions that caused some of them to seek medical attention. The total lawsuit is $8,000,000. Brimley Corporation's lawyers believe that the lawsuit will be successful and that the amount to be paid to the residents will be $4,000,000. On its December 31, 2014 financial statements Brimley should: 46) ______

A) Simply disclose the details regarding the lawsuit in a note.
B) Accrue a provision loss of $4,000,000 and note disclose.
C) Do nothing as the lawsuit has not yet ended.
D) Accrue a provision loss of $8,000,000 with no financial statement disclosure necessary.

47) ABC Inc. has 50 pending lawsuits for which it may be found liable. The expected value (sum of the probabilities of the outcomes multiplied by their respective payouts) amounts to $100,000. However, the company's controller believes that the most likely outcome will be a payout of $120,000. Which of the following statements pertaining to the accrual of the provision is correct? 47) ______

A) There is a small population of lawsuits, so a provision of $100,000 must be accrued.
B) There is a large population of lawsuits, so a provision of $100,000 must be accrued.
C) There is a large population of lawsuits, so a provision of $120,000 must be accrued.
D) There is a small population of lawsuits, so a provision of $120,000 must be accrued.

48) Which one of the following items is not a liability? 48) ______

A) Advances from customers on contracts
B) Accrued estimated warranty costs
C) The portion of long-term debt due within one year
D) Dividends payable in shares

49) A company has commenced work on a non-cancellable fixed price construction contract in the amount of $6 million. Costs of $4 million have been incurred to date, and it is expected that $3.2 million in additional costs will have to be incurred to complete the contract. The company adheres to IFRS. Which of the following statements with respect to the contract are correct? 49) ______

A) This is an onerous contract, so the company must accrue a loss of $1.2 million plus any previously recognized profit.
B) The company has a constructive obligation to accrue a loss of $1.2 million plus any previously recognized profit.
C) There is a constructive obligation to finish the contract.
D) The company will have recognized $3 million in profit on the contract to date.

50) Constructive obligations may arise from: 50) ______

A) Accrued Liabilities resulting from operations.
B) Notes Payable.
C) Unearned Revenues.
D) Warranty obligations.

51) Jake Co. includes three coupons in each bag of dog food it sells. In return for fifteen coupons, customers receive a dog leash. The leashes cost Jones $2.00 each. Jake estimates that 50% of the coupons will be redeemed. Data for 2014 and 2015 are as follows: 51) ______

	2014	**2015**
Bags of dog food sold	200,000	300,000
Leashes purchased	50,000	50,000
Coupons redeemed	100,000	50,000

The estimated liability for premiums for Jake Co. as at December 31, 2015 is:

A) $80,000. B) $160,000. C) $50,000. D) $20,000.

52) Long-term obligations (i.e., debts) that is callable for early payment: 52) ______

A) Must continue to be classified as a long-term liability by the debtor, if a provision of the debt covenant has been violated.
B) Must be reported as current liabilities by the debtor if callable on demand.
C) Must continue to be classified as a long-term liability in all situations.
D) Can be reported as current liabilities by the debtor only if callable because a provision of the debt covenant has been violated.

53) A company had sales of $1 million. Coupons in the amount of $1 per $10 in sales were given to paying customers. History has shown that 50% of all coupons are redeemed. Which of the following statements is correct? 53) ______

A) A provision for $1 million must be recognized.
B) A provision for $50,000 must be recognized.
C) No provision is necessary.
D) A provision for $100,000 must be recognized.

54) By law, a fleet of aircraft must be subject to a major overhaul every 5 years as part of its scheduled maintenance program. Which of the following statements is correct? 54) ______

A) The estimated cost of the overhaul should be disclosed as part of a continuity schedule in the notes to the financial statements.
B) The costs of the overhaul should be expensed as incurred.
C) An accrual should be made in each of the 5 years preceding the overhaul.
D) The cost of the overhaul should be deferred and amortized.

55) Which of the following statements is correct? 55) ______

A) There is no guidance for self-insurance under IFRS.
B) Contingent assets are only recorded when it is reasonably certain that the benefits relating to the contingent assets will be received.
C) Contingent assets are only recorded when it is virtually certain that the benefits relating to the contingent assets will be received.
D) For companies that are self-insured, a provision must be established for events taking place prior to the reporting period if known.

56) Information obtained prior to the issuance of the current period's financial statements of KG Company indicates that it is probable that, at the date of the financial statements, a liability will be incurred for obligations related to product warranties on products sold during the current period. During the past three years, product warranty costs have been approximately 1 1/2 percent of annual sales revenue. An estimated loss contingency should be: 56) ______

A) Accrued in the accounts and reported in the financial statements.
B) Neither accrued nor disclosed in the financial statements.
C) Recognized as an appropriation of retained earnings.
D) Disclosed in the financial statements but not accrued.

57) Contingent liabilities will or will not become actual liabilities depending on: 57) ______

A) Whether they are probable and estimable
B) The degree of uncertainty
C) The outcome of a future event
D) The present condition suggesting a liability

58) Under IFRS, which of the following will only require only a note disclosure as a contingency? 58) ______

A) Loss from an investment in equity securities that is certain
B) Cash discounts given for early payment by customers; almost always taken
C) Probable claim for an income tax refund
D) Remote chance of loss from a lawsuit in process

59) Which of the following contingencies should be accrued in the accounts and reported in the financial statements? 59) ______

A) An accommodation endorsement involving a remote loss.
B) It is probable that the company will receive $50,000 in settlement of a lawsuit.
C) The estimated expenses of a one-year product warranty.
D) The company is forcefully contesting a personal injury suit and a loss is possible and reasonably estimable.

60) KR Corporation was involved in a lawsuit with the Government alleging inadequate air pollution control facilities at its Glowworm plant site during 2013. At December 31, 2016, it appeared probable the Government would settle for approximately $150,000. This event should be recorded (i.e., recognized) in 2016 as a(n): 60) ______

A) Disclosure of contingency loss only in a note.
B) Loss on the lawsuit (operating expense).
C) Prior period adjustment.
D) Unusual loss.
E) Unusual gain.

61) On January 1, 2014, DWW borrowed $400,000 cash and signed a one-year, 12 percent interest-bearing note payable. Assuming a 40 percent average income tax rate for DWW Corporation, the net effective interest rate on this note was: 61) ______

A) 6.0 percent. B) 12.0 percent. C) 4.8 percent. D) 7.2 percent.

62) XYZ borrowed $60,000 for one year and signed an 18 percent, interest-bearing note payable. Assuming XYZ has an income tax rate of 45 percent, the net effective rate was: 62) ______

A) 18 percent. B) 9.9 percent. C) 11.7 percent. D) 8.1 percent.

63) On September 1, 2012, Company B signed a $7,392, two-year non-interest-bearing note payable in full on August 31, 2014. Company B received $6,000 cash. What was the yield or effective rate of interest? 63) ______

A) 23 percent B) 11 percent C) 14 percent D) 18 percent

64) VCR Company owed a $73,311 debt due on January 1, 2012. An agreement was reached to pay it off in three equal annual payments of $30,000 each, starting on December 31, 2012. The interest rate was 11 percent. The balance in the liability account of VCR Company on January 1, 2014 is (round annual payment to nearest $1): 64) ______

A) $73,311 B) $51,875 C) $27,026 D) $90,000

65) XY Company owed a $45,489 due on January 1, 2015. An agreement was reached to pay it off in five equal annual payments, starting on December 31, 2015. The interest rate was 10 percent. The total amount of interest paid under the terms of the agreement was (round annual payment to nearest $1): 65) ______

A) $22,745 B) $6,000 C) $14,511 D) $25,000

66) A firm sells products covered by a three-year warranty. From the past experience of the other firms in the industry, the firm expects to incur warranty costs equal to 1% of sales. Firm sales were $40,000 and $50,000 in 2013 and 2014 respectively. In 2014, the firm spent $200 to repair goods sold in 2013, and $300 to repair goods sold in 2014. The firm received no warranty servicing demands from customers in 2013, the firm's first year of operations. What is the balance in the warranty liability account on January 1, 2014? 66) ______

A) $500 B) $0 C) $400 D) $300

67) On January 1, 2014, JG purchased a machine and gave a $30,000 three-year, 8% note. The market or "going" interest rate was 12%. The annual interest payments are to be paid on each December 31. On January 1, 2014, JG should record the net liability amount determined as follows: 67) ______

A) Compute the present value of its face amount and the three $2,400 interest amounts by using a discount rate of 8%.

B) Use its face amount, $30,000 minus $7,200 interest.

C) Compute the present value of its face amount and the three $2,400 interest amounts by using a discount rate of 12%.

D) Use its face amount, $30,000 plus the $7,200 interest.

68) Ryan Company borrow $45,000 US when the exchange rate for US $1.00 is Cdn. $1.46. When the debt was repaid the exchange rate changes to US $1.00 = Cdn. $1.38. Ryan Company records the amount on the date of exchange as: 68) ______

A) A foreign exchange loss of $62,100.
B) A foreign exchange gain of $62,100.
C) A foreign exchange loss of $3,600.
D) A foreign exchange gain of $3,600.

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

69) A company has been sued for damages as a result of illness caused to local residents due to the emission of highly toxic chemicals from its plant. The company's legal firm advises that it is probable that the company will lose the suit and that it probably will result in a judgment of $2 million to $10 million in damages. However, the legal firm believes that the most probable amount o the loss will be $6 million, and that the suit will be terminated about three years hence. The company has no other lawsuits pending.

(a) Should the company disclose this event in the year the suit was filed? (check one) ________ No; ________ Note only; ________ A loss in the income statement.
(b) If a loss should be reported, give the journal entry required:

70) On January 1, 2012, a company purchased a machine that had a list price of $23,500. The purchase terms agreed upon were: cash down payment $12,000 plus a 15% note payable of $9,132 (its present value). The note is payable in three equal annual instalments (interest plus principal) on each December 31. Round to the nearest dollar.

Required:

(a) Give the entry to record the acquisition of the machine.
(b) Give the adjusting entry required on September 30, 2013, for interest assuming this is the end of the accounting period.

71) On January 1, 2000, a corporation purchased a machine (10 year estimated useful life; no residual value; straight-line method) by paying cash $1,500 and signing a note payable with a face amount of $4,500, 8% interest payable each December 31. The maturity date is December 31, 2002. The going market rate of interest was 10%. Give all required entry (entries) at each of the following dates:

January 1, 2000:
December 31, 2000:

72) On September 1, 2020, a company purchased a machine and paid for it by signing a two-year noninterest-bearing note, face $4,000. The note is payable August 31, 2022. The going rate of interes was 18% per year. The accounting period ends December 31.

(a) Compute the cost of the machine.
(b) Give all appropriate entries throughout the term of the note.

Use the net method.

73) On September 1, 2020, a company signed a $6,540, one-year, non-interest-bearing note payable and received $6,000 cash.

(a) What was the imputed rate of interest? ________%.
(b) Give the entry required at September 1, 2020, to record the receipt of the cash (record on net basis).
(c) Give the adjusting entry required at the end of the accounting year, December 31, 2020.
(d) Give the entry required on the due date, August 31, 2021, assuming no reversing entries were made.

74) Quality 9000 International Inc., which began operations in 1996, sells 20,000 units of its product each year under the following warranty: defective units will be fixed free of charge during the calendar year of purchase and the next two calendar years. (This means it is best to buy from this company early in the year.) Only 1% of units sold have required warranty service in the past. The average cost has been $200 per unit for servicing. Units require service only once and the likelihood of a unit requiring service is the same during each year in the warranty period. What is the balance in the warranty liability account at December 31, 1999?

75) A firm sells a remarkable product, which serves many household purposes. The firm is confident about its product and is so anxious to sell a large number of units that it grants a 3-year warranty. The warranty agreement specifies that any malfunction or other problem will be fixed at no cost to the customer, unless the customer has abused the product. Based on experience with other household products it has sold in the past, 3% of total units sold will require service over the warranty period at an average cost of $200 per unit. The following information relates to the first two years of the product's life:

	Year 1	**Year 2**
Unit sales	$20,000	$5,000
Actual warranty costs incurred	35,000	80,000

What is the balance of the warranty liability account at January 1, Year 3? Assume that the company did not revise its estimate of future warranty claims frequency.

76) At December 31, 2015, ABC Company has the following three separate lawsuits pending against it: Suit A-Plaintiffs seek damages of $40,000; Suit B-Plaintiff seeks damages of $200,000; and Suit C-Plaintiff seeks damages of $20,000.
ABC management and legal counsel have made the assessments indicated below. For each suit, taking into account the assessment, you are to (a) give the accrual entry if it is required (if not, state why) and (b) indicate whether a disclosure note is required and explain the reason.

CASE A-Remote that ABC will lose the suit.

(a) Accrual entry:
(b) Disclosure note: ________ Yes ________No. Explanation:

CASE B-Reasonably possible that ABC will lose; reasonable estimate of damages $4,000.

(a) Accrual entry:
(b) Disclosure note: ________ Yes ________ No. Explanation:

CASE C-Probable that ABC will lose; reasonable estimate of damages $10,000.

(a) Accrual entry:
(b) Disclosure note: ________ Yes ________ No. Explanation:

77) BRIEFLY explain how the treatment of contingencies differs under IFRS and ASPE.

78) On September 1, 2014, XYZ borrowed $100,000 on a 9%, two-year, note payable. Simple interest is payable on August 31, 2015 and 2016. XYZ's reporting year ends December 31 and the company does not use reversing entries for interest. The required entry on August 31, 2015, is:

1) FALSE
2) FALSE
3) FALSE
4) FALSE
5) FALSE
6) FALSE
7) FALSE
8) FALSE
9) FALSE
10) FALSE
11) FALSE
12) FALSE
13) FALSE
14) FALSE
15) FALSE
16) FALSE
17) FALSE
18) FALSE
19) FALSE
20) FALSE
21) FALSE
22) FALSE
23) FALSE
24) FALSE
25) FALSE
26) FALSE
27) FALSE
28) FALSE
29) FALSE
30) FALSE
31) FALSE
32) FALSE
33) FALSE
34) FALSE
35) FALSE
36) FALSE
37) FALSE
38) FALSE
39) FALSE
40) FALSE
41) B
42) B
43) C
44) D
45) B
46) B
47) C
48) D
49) A
50) D

51) A
52) B
53) B
54) D
55) C
56) A
57) C
58) D
59) C
60) B
61) D
62) B
63) B
64) C
65) C
66) C
67) C
68) D
69) (a) a loss in the income statement.
(b)

Loss-pollution (lawsuit pending)	6,000,000	
Estimated liability pollution lawsuit		6,000,000

70) (a)

Machine	21,132	
Cash		12,000
Note payable		9,132

(b)

Interest expense	731	
Interest payable (975 × 9/12)		731

71) January 1, 2000:

Machine ($1,500 + $4,276)	5,776
Cash (given)	1,500
Note payable (net)*	4,276

*principal $4,500 x (PV1, 10%, 3)(.75131)	3,381	
*interest $360 x (PVA, 10%, 3)(2.48685)	895	
	4,276	
December 31, 2000:		
Depreciation expense ($,5776 / 10 years)	578	
Accumulated depreciation		578
Interest expense ($4,276 x .10)	428	
Cash ($4,500 x .08)		360
Note payable ($428 — 360)		68

72) (a) $4,000 x (PV1, 18%, 2) (.71818) = $2,873
(b) September 1, 2000

Machine	2,873	
Note payable		2,873

December 31, 2020

Interest expense ($2,873 x .18 x 4/12)	172	
Note payable		172

December 31, 2021

Interest expense	548*	
Note payable		548

August 31, 2022

Note payable ($2,873 + $172 + $548)	3,593	
Interest expense ($4,000 - $3,593)	407	
Cash		4,000
*$2,873 x .18 = $517 x 8/12 =		345
Or ($2,873 + $172) x .18		548
($2,873 + $517) x .18 = $610 x 4/12		203

73) (a) $6,540 - $6,000 = $540 $6,000 = 9%
(b) September 1, 2020

Cash	6,000	
Note payable		6,000

(c) December 31, 2020:

Interest expense ($540 x 4/12)	180	
Note payable		180

(d) August 31, 2021:

Note payable	6,000	
Interest expense ($540 x 8/12) Interest payable	360 180	
Cash		6,540

74) As of Dec. 31/99, the warranty for 1996, 1997 units is expired;
Dec. 31/99 liability =

For 1998 sales: 1/3(20,000)($200)(.01)	= $13,333
For 1999 sales: 2/3(20,000)($200)(.01)	= 26,667
Total liability at Dec. 31/1999	$40,000

75) January 1, 20x3 warranty liability balance =
(20,000 + 25,000).03($200) - $35,000 - $80,000 = $155,000

76) **CASE A**

(a) None permitted for remote loss contingencies
(b) No (permissible but not required)

CASE B

(a) None
(b) Yes (required for reasonably possible loss contingencies)

CASE C

(a) Estimated loss-Damages from lawsuit	20,000	
Estimated liability-Damages from lawsuit		20,000

(b) Yes or no (Disclosure often required in addition to the journal entry) for full disclosure.

77) Contingencies may or may not be accrued under ASPE but are never accrued under IFRS. Both IFRS and ASPE require the disclosure of contingencies.

78) Please see the following table:

Interest Expense	6,000	
Interest Payable	3,000	
Cash		9,000