CHAPTER 13

CURRENT LIABILITIES AND CONTINGENCIES

MULTIPLE CHOICE—Conceptual

Answer	No.	Description
c	1.	Definition of a liability.
b	2.	Characteristics of current liabilities.
b	3.	Definition of economic obligation.
a	4.	Classification of notes payable.
b	5.	Recognition and accounting for financial liabilities.
d	6.	Zero-interest-bearing notes.
c	7.	Refinancing of long-term debts.
d	8.	Identify item that is not a current liability.
c	9.	Identify the current liability.
d	10.	Classification of stock dividends distributable.
a	11.	Goods and Services Tax.
b	12.	Identify current liability.
c	13.	Accounting for GST.
c	14.	Provincial Sales Tax.
d	15.	Current liabilities in general - determine false statement.
b	16.	Corporation income tax.
c	17.	Determine employer's payroll costs.
d	18.	Accumulating rights to benefits.
c	19.	Accrual of a liability for compensated absences.
b	20.	Non-accumulating rights to benefits.
d	21.	Methods of calculating employee bonuses.
c	22.	Definition of a provision.
a	23.	Recognition of an asset retirement obligation.
c	24.	Recognition of an asset retirement obligation.
a	25.	Recording accretion expense for ARO.
c	26.	Revenue approach for product guarantees.
d	27.	Determine false statement regarding warranties.
b	28.	Accounting for premiums and coupons.
c	29.	Recognition of contingencies (private enterprise standards).
a	30.	Recognition of contingencies (IFRS).
d	31.	Accrual of contingent liability.
c	32.	Proposed amendments regarding provisions and contingencies.
c	33.	Disclosure of commitments.
d	34.	Acid-test ratio elements.
c	35.	Days payable outstanding elements.
d	36.	IFRS re customer loyalty programs.

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MULTIPLE CHOICE—Computational

Answer	No.	Description
b	37.	Adjusting entry for zero-interest-bearing note.
d	38.	Journal entry for payment of interest-bearing note.
b	39.	Determine amount of short-term debt to be reported.
d	40.	Determine amount of short-term debt to be reported.
b	41.	Calculate accounts receivable including sales taxes.
b	42.	Calculate cost of purchase for own use.
c	43.	Adjusting entry for unearned revenue.
a	44.	Calculate payroll tax expense.
d	45.	Payment of GST.
b	46.	Calculate vacation pay expense to be reported.
c	47.	Calculate accrued vacation pay liability.
a	48.	Expense approach to warranty.
c	49.	Adjusting entry for corporate income tax..
d	50.	Entry for asset retirement obligation.
b	51.	Entry for asset retirement obligation accretion.
b	52.	Determine amount to accrue as a loss contingency.
a	53.	Revenue approach to warranty.
c	54.	Calculate warranty liability (expense approach).
d	55.	Determine amount to accrue as a gain contingency.
b	56.	Calculate liability for unredeemed coupons.
c	57.	Calculate quick (acid-test) ratio.
d	58.	Calculate current ratio.
a	59.	Calculate days payables outstanding.
b	60.	Calculate net pay.

MULTIPLE CHOICE—CPA Adapted

Answer	No.	Description
a	61.	Knowledge of accounts payable.
a	62.	Determine amount of short-term debt to be reported.
b	63.	Determine current and long-term portions of debt.
c	64.	Determine accrued interest payable.
a	65.	Calculate accrued salaries payable.
b	66.	Calculate unearned service contract revenue.
c	67.	Calculate liability from unredeemed trading stamps.
b	68.	Accrual of payroll taxes.
d	69.	Determine range of loss accrual.
c	70.	Calculate GST/HST collected.
b	71.	Calculate asset retirement obligation.

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EXERCISES

Item	Description
E13-72	Notes payable.
E13-73	Payroll entries.
E13-74	Compensated absences.
E13-75	Sales taxes.
E13-76	Asset retirement obligation.
E13-77	Contingent liabilities.
E13-78	Premiums.
E13-79	Premiums.

PROBLEMS

Item	Description
P13-80	Accounts and notes payable.
P13-81	Refinancing of short-term debt.
P13-82	Premiums.
P13-83	Warranties.
P13-84	Common types of current liabilities.
P13-85	Employee related liabilities.
P13-86	Asset retirement obligation.
P13-87	Unredeemed coupons.
P13-88	Contingences.

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MULTIPLE CHOICE—Conceptual

1. The IASB current proposed definition of a liability is
   a. an account having a credit balance after closing entries are posted.
   b. a deferred credit that is recognized and measured in conformity with generally accepted accounting principles.
   c. a present economic obligation for which the entity is the obligor.
   d. an obligation to sell shares in the future.

2. According to the IASB current proposed definition, which of the following is NOT an essential characteristic of a liability?
   a. It exists in the present time.
   b. There is certainty about the amount of future outflows.
   c. The obligation is enforceable on the obligor entity.
   d. It represents an economic burden or obligation.

3. An economic obligation is
   a. an unconditional promise to pay money in the future.
   b. an unconditional promise to provide or forego economic resources.
   c. an unconditional promise to provide or forego economic resources only if there is absolute certainty as to the amount.
   d. a conditional obligation which becomes unconditional if an uncertain future event occurs.

4. Among the short-term obligations of Lance Corp, on its most recent balance sheet date, are notes payable totalling $250,000 with the Provincial Bank. These are 90-day notes, renewable for another 90-day period. These notes should be classified on the balance sheet of Lance Corp as
   a. current liabilities.
   b. deferred charges.
   c. long-term liabilities.
   d. shareholders' equity.

5. Which of the following statements is NOT true about recognition and subsequent accounting for financial liabilities?
   a. They are initially recognized at their fair value.
   b. After acquisition, they continue to be accounted for at fair value.
   c. After acquisition, they are generally accounted for at amortized cost.
   d. Short term liabilities, such as accounts payable, are usually recorded at their maturity value.

6. Regarding zero-interest-bearing notes,
   a. they do not have an interest component.
   b. the debtor receives the future value of the note and pays back the present value.
   c. any interest is never recognized until the note is repaid.
   d. the debtor receives the present value of the note and pays back the future value.

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7. Under IFRS, even if the entity plans to refinance long term debt, the current portion must be reported as a current liability UNLESS
   a. long term financing has been completed after the balance sheet date, but before the financial statements are released.
   b. management intends to refinance the debt on a long-term basis.
   c. at balance sheet date, the entity expects to refinance under an existing agreement for at least a year, and the decision is solely at its discretion.
   d. management intends to discharge the debt by issuing shares.

8. Which of the following should NOT be included in the current liabilities section of the balance sheet?
   a. Trade accounts payable.
   b. Short-term zero-interest-bearing notes payable.
   c. A liability due on demand (callable debt).
   d. Current portion of long term debt to be retired by non-current assets.

9. Which of the following is a current liability?
   a. Preferred dividends in arrears.
   b. Stock dividends distributable.
   c. Preferred cash dividends payable.
   d. Stock splits.

10. Stock dividends distributable should be classified on the
    a. income statement as an expense.
    b. balance sheet as an asset.
    c. balance sheet as a liability.
    d. balance sheet as an item of shareholders' equity.

11. Goods and Services Tax (GST)
    a. is a value added tax.
    b. is a sales tax charged by each province on all taxable goods.
    c. in some provinces, is an income tax.
    d. must be collected by all businesses in Canada.

12. Which of the following may be classified as a current liability?
    a. Stock dividends distributable.
    b. Accounts receivable credit balances.
    c. Losses expected to be incurred within the next twelve months in excess of the company's insurance coverage.
    d. Tenant’s rent deposit not returnable until the end of a long-term lease.

13. Accounting for GST includes
    a. crediting GST Payable to record GST paid on inventory for resale.
    b. crediting GST Recoverable to record GST collected from customers.
    c. debiting GST Recoverable to record GST paid to suppliers.
    d. debiting GST Payable to record GST collected from customers.

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14. Regarding Provincial Sales Tax (PST)
    a. All PST paid is recorded in a “PST Expense” account.
    b. All PST paid is recorded in a “PST Recoverable” account.
    c. The purchaser includes any PST paid in the cost of the goods or services.
    d. For balance sheet presentation, a PST registrant “nets” any PST paid against any PST collected from customers.

15. Which of the following statements is FALSE?
    a. A company may exclude a short-term obligation from current liabilities if, at balance sheet date, the entity expects to refinance under an existing agreement for at least a year, and the decision is solely at its discretion.
    b. Cash dividends should be recorded as a liability when they are declared by the board of directors.
    c. Under the cash basis method, warranty costs are charged to expense as they are paid.
    d. Federal income taxes withheld from employees' payroll cheques should never be recorded as a liability.

16. Corporation income taxes payable
    a. must always be approved by an external auditor.
    b. are reviewed and approved by Canada Revenue Agency (CRA).
    c. also apply to proprietorships and partnerships.
    d. are always the same under GAAP and Canadian tax laws.

17. Which of the following are included in an employer's payroll costs?
    a. Employee income tax deducted, CPP/QPP and EI contributions.
    b. CPP/QPP and EI contributions, union dues.
    c. CPP/QPP and EI contributions only.
    d. EI contributions, union dues, and employee income tax deducted.

18. Accumulating rights to benefits (for employees)
    a. Are often mandated by provincial labour law.
    b. Include vested rights that do not depend on the employee’s continued service.
    c. Are rights that accrue with employee service.
    d. All of these statements are correct.

19. A liability for compensated absences such as vacations, for which it is expected that employees will be paid, should
    a. be accrued during the period when the compensated time is expected to be used by employees.
    b. be accrued during the period following vesting.
    c. be accrued during the period when earned.
    d. not be accrued unless a written contractual obligation exists.

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20. Non-accumulating rights to benefits, such as parental leave, are generally accounted for by
    a. The full accrual method.
    b. The event accrual method.
    c. The cash method.
    d. Financial statement note disclosure only.

21. Which of the following may be used as a basis for calculating bonuses or profit sharing amounts?
    a. a percentage of the employees' regular pay rates.
    b. the company's annual profit.
    c. productivity increases.
    d. all of the above may be used.

22. Under IFRS, a provision is
    a. a special fund set aside to pay long-term debt.
    b. unearned revenue.
    c. a liability of uncertain timing or amount.
    d. an allowance for future dividends to be paid.

23. At the time of recognition of an asset retirement obligation, the present value should be
    a. added to the related asset cost and recorded as an asset retirement obligation.
    b. expensed and recorded as an asset retirement obligation.
    c. expensed to "Asset Retirement Expense" in the period actually paid.
    d. recorded as a separate long-term asset and as an asset retirement obligation.

24. An asset retirement obligation should be recognized when
    a. an asset is impaired and is available for sale.
    b. operation of an asset has resulted in an additional obligation such as the cost of cleaning up an oil spill.
    c. there is a legal obligation to restore the site of the asset at the end of its useful life.
    d. the company has an obligation to purchase a long-lived asset.

25. Which of the following statements is INCORRECT regarding the recording of the related increase or accretion in the carrying amount of an asset retirement obligation (ARO)?
    a. Under private enterprise standards, it is recognized as interest expense.
    b. Under private enterprise standards, it is recognized as an operating expense (but not as interest expense).
    c. Under IFRS, it is recognized as a borrowing cost.
    d. The amount should be calculated using the same discount (interest rate) as was used to calculate the initial present value of the ARO.

26. Using the revenue approach to account for product guarantees and warranty obligations
    a. the liability is measured at the estimated cost of meeting the obligation.
    b. there is no effect on future income.
    c. the liability is measured at the value of the services to be provided.
    d. the liability is measured at the value of the services to be provided but there is no effect on future income.

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27. Which of the following statements is INCORRECT concerning warranties?
    a. Using the expense approach, the warranty is provided with the product or service for free.
    b. Where warranty costs are immaterial or when the warranty period is quite short, the warranty costs may be accounted for using the cash basis.
    c. Using the revenue approach, the warranty is a separate deliverable from the related product or service.
    d. The revenue approach must be used for income tax purposes.

28. The current (commonly used) accounting treatment for premiums and coupons requires that the costs should
    a. be recorded at the maximum possible redemption cost in the year of the related sales.
    b. be recorded at the total estimated redemption cost in the year of the related sales.
    c. be recorded in the year(s) that the redemption is expected to occur.
    d. not be recorded at all.

29. Under private enterprise standards, a contingent liability is recognized if
    a. it is certain that funds are available to settle the contingency.
    b. an asset may have been impaired.
    c. the amount of the loss can be reasonably estimated and it is likely that an asset has been impaired or a liability incurred as of the financial statement date.
    d. it is likely that an asset has been impaired or a liability incurred even though the amount of the loss cannot be reasonably estimated.

30. Under current IFRS requirements, a contingent liability is recognized if
    a. the amount of the loss can be reliably estimated and it is probable that an asset has been impaired or a liability incurred as of the financial statement date.
    b. the amount of the loss cannot be measured reliably but it is probable that an asset has been impaired or a liability incurred as of the financial statement date.
    c. it relates to a lawsuit commenced after the balance sheet date, the outcome of which can be reliably measured.
    d. it relates to an asset recognized as impaired after the balance sheet date.

31. Which of the following may be accrued as a contingent liability?
    a. Threat of expropriation of assets.
    b. Pending or threatened litigation.
    c. Guarantees of indebtedness of others.
    d. All of the above.

32. According to the *Exposure Draft of Proposed Amendments to IAS 37, Provisions, Contingent Liabilities and Contingent Assets*
    a. Only conditional obligations are recorded.
    b. Liabilities must have measurement certainty.
    c. The term “contingent liabilities” is eliminated.
    d. A conditional obligation related to an unconditional obligation is not recognized.

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33. Which of the following commitments would NOT require disclosure in the financial statement notes?
    a. Major property, plant and equipment expenditures.
    b. Payments under non-cancellable operating leases.
    c. Large purchases of materials in the normal course of business.
    d. Commitments involving significant risk.

34. The numerator of the acid-test ratio consists of
    a. total current assets.
    b. cash and marketable securities.
    c. cash and net receivables.
    d. cash, marketable securities, and net receivables.

35. The denominator of the days payable outstanding ratio consists of
    a. average daily sales.
    b. average trade accounts payable.
    c. average daily cost of goods sold.
    d. average trade accounts receivable.

36. What are the current International Financial Reporting Standards regarding customer loyalty programs (such as frequent flyer points)?
    a. They are recognized only in the financial statement notes.
    b. They are recognized only when customers redeem their points.
    c. They are not explicitly addressed.
    d. The current proceeds are to be split between the original transaction and the award credits (as unearned revenue).

Multiple Choice Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	c	7.	c	13.	c	19.	c	25.	a	31.	d
2.	b	8.	d	14.	c	20.	b	26.	c	32.	c
3.	b	9.	c	15.	d	21.	d	27.	d	33.	c
4.	a	10.	d	16.	b	22.	c	28.	b	34.	d
5.	b	11.	a	17.	c	23.	a	29.	c	35.	c
6.	d	12.	b	18.	d	24.	c	30.	a	36.	d

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MULTIPLE CHOICE—Computational

37. Binnie Corp. signed a three-month, zero-interest-bearing note on November 1, 2011 for the purchase of $40,000 of inventory. The maturity value of the note was $40,600, based on the bank's discount rate of 6%. The adjusting entry prepared on December 31, 2011 in connection with this note will include a
    a. debit to Note Payable for $400.
    b. credit to Note Payable for $400.
    c. debit to Interest Expense for $600.
    d. credit to Interest Expense for $400.

38. Carter Ltd borrowed $90,000 from their bank on December 1, 2011, by signing a four-month, 7% interest bearing note. Assuming the company has a December 31 year end and does not use reversing entries, the journal entry to record payment of this note on April 1, 2012 will include a
    a. credit to Note Payable of $90,000.
    b. debit to Interest Expense of $2,100.
    c. debit to Interest Payable of $1,575.
    d. debit to Interest Payable of $525.

39. On February 10, 2011, after issuance of its financial statements for calendar 2010, Hull Corp entered into a financing agreement with Gigantic Bank, allowing Hull Corp to borrow up to $6,000,000 at any time through 2013. Amounts borrowed under the agreement bear interest at 2% above the bank's prime interest rate and mature two years from the date of loan. Hull presently has $2,250,000 of notes payable with Provincial Bank maturing March 15, 2011. The company intends to borrow $3,750,000 under the agreement with Gigantic and pay off the notes payable to Provincial. The agreement with Gigantic also requires Hull to maintain a working capital level of $9,000,000 and prohibits the payment of dividends on common shares without prior approval by Gigantic. From the above information only, the total short-term debt of Hull Corp as of the December 31, 2010 balance sheet date is
    a. $0.
    b. $2,250,000.
    c. $3,000,000.
    d. $6,000,000.

40. On December 31, 2010, Street Ltd. has $4,000,000 of short-term notes payable due on February 14, 2011. On January 10, 2011, they arranged a line of credit with Regal Bank, which allows Street to borrow up to $3,000,000 at 1% above the prime rate for three years. On February 2, 2011, Street borrowed $2,400,000 from Regal Bank and used $1,000,000 additional cash to liquidate $3,400,000 of the short-term notes payable. The amount of the short-term notes payable that should be reported as current liabilities on Street's December 31, 2010 balance sheet (to be issued on March 5, 2011) is
    a. $0.
    b. $600,000.
    c. $2,400,000.
    d. $4,000,000.

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41. Diamond Co. is a retail store operating in a province with a 6% retail sales tax. The store must also collect 5% GST on all sales. For the month of May, Diamond Co. sold $45,000 worth of goods to customers, 60% of which were cash sales and the balance being on account. Based on the above information, what is the total debit to Accounts Receivable for the month of May?
a. $29,970.
b. $19,980.
c. $18,900.
d. $18,000.

42. Emerald Ltd, a GST registrant, buys $3,700 worth of Office Supplies for its own use. The purchase is subject to 8% provincial tax and 5% GST. What amount will be debited to the Office Supplies account as a result of this transaction?
a. $4,181.
b. $3,996.
c. $3,885.
d. $3,700.

43. On Dec 12, 2010, Pearl Gold, CGA, received $1,000 from a customer as an advance payment for accounting work to be done. The payment was credited to Accounting Revenue. Thirty percent of the work was performed in December 2010, with the rest to be done in January 2011, at which time the customer will be billed. The required adjusting entry at December 31, 2010 (year end) is
a. Dr Unearned Revenue $300, Cr Accounting Revenue $300.
b. Dr Accounting Revenue $300, Cr Unearned Revenue $300.
c. Dr Accounting Revenue $700, Cr Unearned Revenue $700
d. Dr Unearned Revenue $700, Cr Accounting Revenue $700.

44. The total payroll of Angela Company for the month of October was $240,000, subject to CPP/QPP contributions of 4.95% and employment insurance contributions of 1.73%. As well, $60,000 in federal income taxes and $6,000 of union dues were withheld. What amount should Angela record as employer payroll tax expense for October?
a. $17,692.80.
b. $23,692.80.
c. $16,032.00.
d. $76,032.00.

45. At December 31, 2011, Roger's records show the following balances, all of which are normal: PST Payable, $625; GST Payable, $600; GST Recoverable, $488. In January 2012, Roger pays the Federal Government the net amount owing regarding GST owing from December. The journal entry to record this payment will include a
a. debit to GST Payable of $112.
b. credit to Cash of $600.
c. credit to GST Payable of $600.
d. credit to GST Recoverable of $488.

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Use the following information for questions 46 and 47.

Oliver Company has 35 employees who work 8-hour days and are paid hourly. On January 1, 2010, the company began a program of granting its employees 10 days paid vacation each year. Vacation days earned in 2010 may be taken starting on January 1, 2011. Information relative to these employees is as follows:

Year	Hourly Wages	Vacation Days Earned by Each Employee	Vacation Days Used by Each Employee
2010	$12.90	10	0
2011	13.50	10	8
2012	14.25	10	10

Oliver has chosen to accrue the liability for compensated absences (vacation pay) at the current rates of pay in effect when the vacation pay is earned.

46. What is the amount of vacation pay expense that should be reported on Oliver's income statement for 2010?
    a. $37,800.
    b. $36,120.
    c. $34,440.
    d. $ 0.

47. What is the amount of the Vacation Wages Payable that should be reported at December 31, 2012?
    a. $39,900.
    b. $45,360.
    c. $47,460.
    d. $47,880.

48. William Corp uses the expense approach to account for warranties. They sell a used car for $15,000 on Oct 25, 2011, with a one year warranty covering parts and labour. Warranty expense is estimated at 2% of the selling price, and the appropriate adjusting entry is recorded at Dec 31, 2011. On March 12, 2012, the car is returned for warranty repairs. This cost William $100 in parts and $60 in labour. When recording the March 12, 2012 transaction, William would debit Warranty Expense with
    a. Zero.
    b. $ 60.
    c. $100.
    d. $160.

49. Luke Machinery Ltd has made a total of $46,500 in instalments for corporate income tax for 2011, which have been debited to Current Income Tax Expense. At year end, Dec 31, 2011, the accountant has calculated that the corporation's actual tax liability is only $43,000. What is the correct adjusting entry to reflect this fact?
    a. Dr Current Income Tax Expense $3,500, Cr Income Taxes Payable $3,500.
    b. Dr Income Taxes Payable, $3,500, Cr Current Income Tax Expense $3,500.
    c. Dr Income Taxes Receivable $3,500, Cr Current Income Tax Expense $3,500.
    d. Dr Current Income Tax Expense $43,000, Cr Income Taxes Payable $43,000.

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Use the following information for questions 50 and 51.

Arabella Inc. has developed a new gold mine in 2010 and is required by provincial law to reclaim the site once mining operations are completed. The company estimates that the mine will close in 20 years and that the mine reclamation will cost $5,000,000. Arabella uses a 6% discount rate.

50. The entry to record the asset retirement obligation is

a. Reclamation Expense	93,541	
Asset Retirement Obligation		93,541
b. Reclamation Expense	250,000	
Asset Retirement Obligation		250,000
c. Gold Mine	5,000,000	
Asset Retirement Obligation		5,000,000
d. Gold Mine	1,559,024	
Asset Retirement Obligation		1,559,024

51. The entry to record accretion at the end of one year is

a. Accretion Expense	250,000	
Asset Retirement Obligation		250,000
b. Accretion Expense	93,541	
Asset Retirement Obligation		93,541
c. Gold Mine	93,541	
Asset Retirement Obligation		93,541
d. Interest Expense	93,541	
Asset Retirement Obligation		93,541

52. Wendy Corp. is being sued for illness caused to local residents as a result of negligence on the company's part in permitting the local residents to be exposed to highly toxic chemicals. Wendy's lawyer states that it is likely that Wendy will lose the suit and be found liable for a judgement costing Wendy anywhere from $600,000 to $3,000,000. However, the lawyer states that the most likely cost is $1,800,000. As a result of the above facts, Wendy should accrue
    a. a loss contingency of $600,000 and disclose an additional contingency of up to $2,400,000.
    b. a loss contingency of $1,800,000 and disclose an additional contingency of up to $1,200,000.
    c. a loss contingency of $1,800,000 but not disclose any additional contingency.
    d. no loss contingency but disclose a contingency of $600,000 to $3,000,000.

53. Peterboro Corp uses the revenue approach to account for warranties. During 2010, the company sold $500,000 worth of products, all of which carried a two year warranty (included in the price). It was estimated that 2% of the selling price represented the warranty portion, and that 60% of this related to 2010, and 40% to 2011. Assuming that Peterboro incurred costs of $3,700 to service the contract in 2011, what is the net warranty revenue (revenue minus servicing costs) for 2011?
    a. $300.
    b. $1,300.
    c. $3,700.
    d. $4,000.

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54. In 2010, Persimmon Corp began selling a new line of products that carry a two-year warranty against defects. Based upon past experience with other products, the estimated warranty costs related to dollar sales are as follows:

First year of warranty	2%
Second year of warranty	5%

Sales and actual warranty expenditures for 2010 and 2011 are presented below:

	2010	2011
Sales	$450,000	$600,000
Actual warranty expenditures	15,000	30,000

Persimmon uses the expense approach to account for warranties. What is the estimated warranty liability at the end of 2011?
a. $73,500.
b. $43,500.
c. $28,500.
d. $12,000.

55. At January 1, 2011, Ball Corp. owned a machine that had cost $100,000. The accumulated depreciation to date was $60,000, estimated residual value was $6,000, and fair value was $160,000. On January 4, 2011, this machine suffered major damage due to Snow Corp's actions and was written off as worthless. In October 2011, a court awarded damages of $160,000 against Snow in favour of Ball. At December 31, 2011, the final outcome of this case was awaiting appeal and was, therefore, uncertain. However, in the opinion of Ball's attorney, Snow's appeal will be denied. At December 31, 2011, what amount should Ball accrue for this gain contingency?
a. $160,000.
b. $130,000.
c. $100,000.
d. $0.

56. Craft Foods distributes coupons to consumers which may be presented (on or before a stated expiry date) to grocery stores for discounts on certain Craft products. The stores are reimbursed when they send the coupons to Craft. In Craft's experience, only about 50% of these coupons are redeemed. During 2011, Craft issued two separate series of coupons as follows:

Issued On	Total Value	Coupon Expiry Date	Amounts Reimbursed as of Dec 31/11
Jan 1/11	$250,000	Jun 30/11	$118,000
Jul 1/11	360,000	Dec 31/11	150,000

Craft's only journal entries for 2011 recorded debits to coupon expense, and credits to cash of $268,000. Their December 31, 2011 balance sheet should include a liability for unredeemed coupons of
a. $0.
b. $30,000.
c. $62,000.
d. $180,000.

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57. Presented below is information available for Lozell Company.

Current Assets	
Cash	$ 4,000
Marketable securities	75,000
Accounts receivable	61,000
Inventories	110,000
Prepaid expenses	30,000
Total current assets	$280,000

Total current liabilities are $80,000. To two decimals, the acid-test ratio for Lozell is
a. 3.50
b. 3.13
c. 1.75
d. .81

58. Park Inc's most recent balance sheet includes

Cash	$7,500
Accounts receivable	10,000
Inventory	13,300
Plant and equipment (net)	73,700
Accounts payable	14,000
Long term bonds payable	50,000
Common shares	20,000
Retained earnings	20,500

To two decimals, Park Inc has a current ratio of
a. .27
b. .48
c. 1.63
d. 2.20

59. Jasminder Corp provides the following information for 2011 and 2012:

	2011	2012
Current assets	$23,000	$27,000
Accounts payable	9,000	10,000
Other current liabilities	5,000	4,000
Non-current liabilities	50,000	62,000
Sales	125,000	135,000
Cost of goods sold	75,000	79,600

To one decimal, Jasminder's days payable outstanding for 2012 is
a. 43.6 days.
b. 46.2 days.
c. 47.2 days.
d. 48.7 days

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60. Information regarding Heather Manufacturing's payroll for the period ending March 22 follows:

Gross salaries and wages	$75,000
CPP rate	4.95%
EI rate	1.73%
Company pension deducted	5% of gross salaries and wages
Union dues (total)	$ 650

Assume 100% of the gross salaries and wages are subject to CPP and EI. Therefore, the NET pay for this period is

a. $61,877.50.
b. $65,590.00.
c. $66,240.00.
d. $69,340.00.

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Multiple Choice Answers—Computational

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
37.	b	41.	b	45.	d	49.	c	53.	a	57.	c
38.	d	42.	b	46.	b	50.	d	54.	c	58.	d
39.	b	43.	c	47.	c	51.	b	55.	d	59.	a
40.	d	44.	a	48.	a	52.	b	56.	b	60.	b

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MULTIPLE CHOICE—CPA Adapted

61. Which of the following is generally associated with current liabilities classified as accounts payable?

	Periodic Payment of Interest	Secured by Collateral
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

62. Included in Lennon Inc's account balances at December 31, 2011, were the following:

4% note payable issued October 1, 2011, maturing September 30, 2012	$250,000
6% note payable issued April 1, 2011, payable in six equal annual instalments of $100,000 beginning April 1, 2012	600,000

Lennon's December 31, 2011 financial statements were to be issued on March 31, 2012. On January 15, 2012, the entire $600,000 balance of the 6% note was refinanced by issuance of a long-term note to be repaid in 2015. In addition, on March 10, 2012, Lennon made arrangements to refinance the 4% note on a long-term basis. On the December 31, 2011 balance sheet, the amount of the notes payable that Lennon should classify as current liabilities is

a. $350,000.
b. $250,000.
c. $100,000.
d. $0.

63. On January 1, 2011, Wick Ltd. leased a building to Candle Corp. for a ten-year term at an annual rental of $90,000. At the inception of the lease, Wick received $360,000 covering the first two years' rent of $180,000 and a security deposit of $180,000. This deposit will not be returned to Candle upon expiration of the lease but will be applied to payment of rent for the last two years of the lease. What portion of the $360,000 should be shown as a current and long-term liability, respectively, in Wick's December 31, 2011 balance sheet?

	Current Liability	Long-term Liability
a.	$ 0	$360,000
b.	$ 90,000	$180,000
c.	$180,000	$180,000
d.	$180,000	$ 90,000

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64. On September 1, 2011, Wells Co. issued a $900,000, 12% note to Fargo Bank, payable in three equal annual principal payments of $300,000. On this date, the bank's prime rate was 11%. The first payment for interest and principal was made on September 1, 2012. At December 31, 2012, Wells should record accrued interest payable of
    a. $36,000.
    b. $33,000.
    c. $24,000.
    d. $22,000.

65. Barrett Company's salaried employees are paid biweekly. Occasionally, advances made to employees are paid back by payroll deductions. Information relating to salaries for the calendar year 2011 is as follows:

Employee advances	$ 12,000
Accrued salaries payable	91,000
Salaries expense during the year	910,000
Salaries paid during the year (gross)	875,000

At December 31, 2011, what amount should Barrett report for accrued salaries payable?
    a. $126,000.
    b. $120,000.
    c. $108,000.
    d. $35,000.

66. Roswell Co. sells major household appliance service contracts for cash. The service contracts are for a one-year, two-year, or three-year period. Cash receipts from contracts are credited to unearned service contract revenues. This account had a balance of $600,000 at December 31, 2010 before year-end adjustment. Service contract costs are charged as incurred to the service contract expense account, which had a balance of $150,000 at December 31, 2010. Outstanding service contracts at December 31, 2010 expire as follows:

During 2011	During 2012	During 2013
$125,000	$200,000	$90,000

What amount should be reported as unearned service contract revenues in Roswell's December 31, 2010 balance sheet?
    a. $450,000.
    b. $415,000.
    c. $300,000.
    d. $275,000.

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67. Josslyn Trading Stamp Co. records trading stamp revenue and provides for the cost of redemptions in the year stamps are sold to licensees. Josslyn's past experience indicates that only 80% of the stamps sold to licensees will be redeemed. Josslyn's liability for stamp redemptions was $6,000,000 at December 31, 2010. Additional information for 2011 is as follows:

Stamp revenue from stamps sold to licensees	$4,000,000
Cost of redemptions	2,700,000

If all the stamps sold in 2011 were presented for redemption in 2012, the redemption cost would be $2,000,000. What amount should Josslyn report as a liability for stamp redemptions at December 31, 2011?

a. $7,300,000.
b. $5,300,000.
c. $4,900,000.
d. $3,300,000.

68. Quinn Corp.'s payroll for the pay period ended October 31, 2011 is summarized as follows:

Department Payroll	Total Wages	Income Tax Withheld	Amount of Wages Subject to Payroll Taxes: CPP/QPP	EI
Factory	$ 75,000	$10,000	$66,000	$22,000
Sales	22,000	3,000	16,000	2,000
Office	18,000	2,000	8,000	—
	$115,000	$15,000	$90,000	$24,000

Assume the following payroll tax rates:

CPP/QPP for employer and employee	4.95% each
Employment Insurance	1.73% for employee
	1.4 times employee premium for employer

To the nearest dollar, what amount should Quinn accrue as its share of payroll taxes in its October 31, 2011 balance sheet?

a. $ 4,870.
b. $ 5,036.
c. $ 6,274.
d. $20,036.

69. Snow Co. has a likely loss that can only be reasonably estimated within a range of outcomes. No single amount within the range is a better estimate than any other amount. The loss accrual should be

a. zero.
b. the maximum of the range.
c. the mean of the range.
d. the minimum of the range.

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70. Harrison Corp operates in British Columbia, selling a variety of goods. For most of these goods, Harrison must charge Harmonized Sales Tax (HST) of 12%; for some they only have to charge 5% HST; while a very few are tax exempt. During June of this year, the company reported sales of $200,000, on which 70% were charged 12% HST, 25% were charged only 5% HST, and the rest were tax exempt sales.
The total amount of HST collected in June was
a. $13,500.
b. $18,000.
c. $19,300.
d. $22,800.

71. On April 30, 2011, Canadian Oil Corp. purchased an oil tanker depot at a cost of $600,000 cash. The company expects to operate this depot for eight years, at which time they will be legally required to dismantle the structure and remove the underground storage tanks. Canadian Oil estimates this asset retirement obligation (ARO) will cost $100,000. Assuming a 5% discount rate, to the nearest dollar, the amount to be recorded as the ARO is
a. $ 12,500.
b. $ 67,684.
c. $ 75,000.
d. $100,000

Multiple Choice Answers—CPA Adapted

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
61.	a	63.	b	65.	a	67.	c	69.	d	71.	b
62.	a	64.	c	66.	b	68.	b	70.	c		

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DERIVATIONS—Computational

No.	Answer	Derivation
37.	b	$40,000 x 6% x 2/12 = $400.
38.	d	Interest payable recorded Dec 31/11 $90,000 x 7% x 1/12 = $525.
39.	b	$2,250,000 (no agreement in place at year end).
40.	d	$4,000,000 (no agreement in place at year end).
41.	b	$45,000 x 40% x 1.11 = $19,980.
42.	b	$3,700 x 1.08 = $3,996.
43.	c	Remove 70% of revenue and transfer to liability
44.	a	($240,000 × 4.95%) + ($240,000 × 1.73% × 1.4) = $17,692.80.
45.	d	Clear GST Recoverable account.
46.	b	$12.90 × 8 × 10 × 35 = $36,120.
47.	c	($14.25 × 8 × 10 × 35) + ($13.50 × 8 × 2 × 35) = $47,460.
48.	a	Debit is to the liability account.
49.	c	$46,500 - $43,000 = $3,500 overpaid = Income Taxes Receivable.
50.	d	PV of $5,000,000 at 6% for 20 years.
51.	b	$1,559,024 x 6% = $93,541.
52.	b	$1,800,000 and $1,200,000.
53.	a	$500,000 x 2% x 40% = $4,000 - $3,700 costs = $300.
54.	c	[$450,000 + $600,000 × .07] – $45,000 = $28,500.
55.	d	$0, gain contingencies are not accrued.
56.	b	($360,000 × .5) – $150,000 = $30,000.
57.	c	$\frac{\$4,000 + \$75,000 + \$61,000}{\$80,000} = 1.75$

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58. d $\frac{7,500 + 10,000 + 13,300}{14,000} = 2.20$

59. a $\frac{(10,000 + 9,000)/2}{79,600/365} = 43.6$ days

60. b $75,000 – (75,000 x (.0495 + .0173 + .05)) – 650 = $65,590

DERIVATIONS—CPA Adapted

No.	Answer	Derivation
61.	a	Conceptual—accounts payable generally are zero-interest-bearing and unsecured.
62.	a	250,000 + 100,000 = $350,000.
63.	b	$90,000 and $180,000.
64.	c	$\$600,000 \times .12 \times \frac{4}{12} = \$24,000$.
65.	a	$910,000 + $91,000 – $875,000 = $126,000.
66.	b	$125,000 + $200,000 + $90,000 = $415,000.
67.	c	$6,000,000 + ($2,000,000 × .8) – $2,700,000 = $4,900,000.
68.	b	($90,000 × .0495) + ($24,000 × .0173 × 1.4) = $5,036.
69.	d	Conceptual.
70.	c	($200,000 x 12% x 70%) + ($200,000 x 5% x 25%) = $19,300.
71.	b	8 N 5 I/Y 100000 FV CPT PV => 67,684.

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EXERCISES

Ex. 13-72—Notes payable.

On August 31, 2011, Kalamazoo Corp paid the Majestic Bank part of an outstanding $150,000 long term 10% note payable obtained one year ago, by paying $90,000 plus $9,000 interest. In order to do this, Kalamazoo used $26,200 cash and signed a new one-year, zero-interest-bearing $80,000 note discounted at 9% by Majestic (i.e. the bank deducted 9% from the $80,000).

Instructions
(1) Prepare the entry to record the refinancing.
(2) Prepare the adjusting entry at December 31, 2011 in connection with the new zero-interest-bearing note.

Solution 13-72

	Account	Debit	Credit
(1)	Notes Payable	90,000	
	Interest Expense	9,000	
	Notes Payable ($80,000 x 91%)		72,800
	Cash		26,200
(2)	Interest Expense ($72,800 x 9% x 4/12)	2,184	
	Notes Payable		2,184

Ex. 13-73—Payroll entries.

The total payroll of Luton Co. was $460,000. Income taxes withheld were $110,000. The employment insurance is 1.73% for the employee and 1.4 times the employee premium for the employer. The CPP/QPP contributions are 4.95% for both.

Instructions
(a) Prepare the journal entry for the wages and salaries paid.
(b) Prepare the entry to record the employer payroll taxes.

Solution 13-73

	Account	Debit	Credit
(a)	Wages and Salaries Expense	460,000	
	Employee Income Tax Deductions Payable		110,000
	Employment Insurance Payable		7,958*
	CPP/QPP Contributions Payable		22,770*
	Cash		319,272

* ($460,000 × 1.73%) = $7,958; ($460,000 × 4.95%) = $22,770.

	Account	Debit	Credit
(b)	Payroll Tax Expense	33,911	
	Employment Insurance Payable ($7,958 × 1.4)		11,141
	CPP/QPP Contributions Payable		22,770

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Ex. 13-74—Compensated absences.

Spock Ltd. began operations on January 2, 2011. The company employs 15 people who work 8-hour days. Each employee earns 10 paid vacation days annually. Vacation days may be taken after January 10 of the year following the year in which they are earned. The average hourly wage rate was $12.00 in 2011 and $12.75 in 2012. The average vacation days used by each employee in 2012 was 9. Spock accrues the cost of compensated absences at rates of pay in effect when earned.

Instructions

Prepare journal entries to record the transactions related to paid vacation days during 2011 and 2012.

Solution 13-74

		Debit		Credit	
2011	Wages Expense	14,400	(1)		
	Vacation Wages Payable			14,400	
	(1) 15 × 8 × $12.00 = $1,440; $1,440 × 10 = $14,400.				
2012	Wages Expense	810			
	Vacation Wages Payable	12,960	(2)		
	Cash			13,770	(3)
	Wages Expense	15,300	(4)		
	Vacation Wages Payable			15,300	

(2) $1,440 × 9 = $12,960.
(3) 15 × 8 × $12.75 = $1,530; $1,530 × 9= $13,770.
(4) $1,530 × 10 = $15,300.

Ex.13-75—Sales taxes.

For the month of April, Regina Sales Ltd recorded $140,000 in sales, 40% of which were on account (terms N30), and 60% of which were cash sales. The company is required to charge 6% Provincial Sales Tax (PST) and 5% Goods and Services Tax (GST) on all sales.

Instructions

Prepare one journal entry to record the company's sales for April.

Solution 13-75

Account	Debit	Credit
Accounts Receivable (140,000 x 1.11 x 40%)	62,160	
Cash (140,000 x 1.11 x 60%)	93,240	
Sales Revenue		140,000
GST Payable (140,000 x 5%)		7,000
PST Payable (140,000 x 6%)		8,400

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Ex.13-76—Asset Retirement Obligation.

Nickel Mines International Ltd discovered a new bauxite deposit, the Flamingo Mine, and began production on January 1, 2011. The province requires mining companies to return the land to its natural state at the end of mining activity. Nickel Mines International Ltd estimates that it will operate the mine for 25 years, at which time it will cost $25,000,000 for the land reclamation project. Nickel Mines International Ltd uses an 8% discount rate.

Instructions

(a) Record any obligation for land reclamation as at January 1, 2011.
(b) Record any entry required related to this obligation at December 31, 2011 .

Solution 13-76

(a) January 1, 2011

	Debit	Credit
Flamingo Mine	3,650,447	
Asset Retirement Obligation		3,650,447

$3,650,447 is the present value of the $25,000,000 estimated cost discounted for 25 years at 8%.

(b) December 31, 2011

	Debit	Credit
Accretion Expense	292,036	
Asset Retirement Obligation		292,036

$292,036 is the increase in the present value that occurs because you are one year closer to the expenditure. Present value of $25,000,000 discounted for 24 years at 8% ($3,942,483) less $3,650,447.

OR 3,650,447 x 8% = 292,036

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Ex. 13-77—Contingent liabilities.

Below are three independent situations.

1. In August, 2011 a worker was injured in the factory in an accident partially the result of his own negligence. The worker has sued his employer, Simon Corp, for $800,000. Simon's legal counsel believes it is possible that the outcome of the suit will be unfavourable and that the settlement would cost the company from $250,000 to $500,000.

2. A suit for breach of contract seeking damages of $1,200,000 was filed by an author against Eller Co. on October 4, 2011. Eller's legal counsel believes that an unfavourable outcome is more likely than not. A reasonable estimate of the award to the plaintiff is between $300,000 and $900,000. No amount within this range is a better estimate of potential damages than any other amount.

3. Pratt is involved in a pending court case. Pratt's lawyers believe it is likely that Pratt will be awarded damages of $1,500,000.

Instructions

Discuss the proper accounting treatment, including any required disclosures, for each situation. Give the rationale for your answers. Assume all companies involved use IFRS.

Solution 13-77

1. Simon Corp. should disclose in the notes to the financial statements the existence of a possible contingent liability related to the law suit. The note should indicate the range of the possible loss. The contingent liability should not be accrued because the loss is only possible, not probable (as required by IFRS).

2. The likely award should be accrued by a charge to an estimated loss and a credit to an estimated liability of $300,000. Eller Co. should disclose the following in the notes to the financial statements: the amount of the suit, the nature of the contingency, the reason for the accrual, and the range of the possible loss.

   The accrual is made because it is more likely than not (probable) that a liability has been incurred and the amount of the loss can be reasonably estimated. The lowest amount of the range of possible losses is used when no amount is a better estimate than any other amount.

3. Pratt should not record the gain contingency until it is realized. Usually, gain contingencies are neither accrued nor disclosed. The $1,500,000 gain contingency should be disclosed only if the likelihood that it will be realized is very high.

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Ex. 13-78—Premiums.

Treble Clef Music gives its customers coupons which are redeemable for a poster plus a Dixie Chicks DVD. One coupon is issued for each dollar of sales. On presentation of 100 coupons and $5.00 cash, the customer receives the poster and DVD. Treble Clef estimates that 80% of the coupons will be presented for redemption. Sales for Year One were $1,050,000, and 510,000 coupons were redeemed. Sales for Year Two were $1,260,000, and 1,275,000 coupons were redeemed. Treble Clef bought 30,000 posters at $2.00 each, and 30,000 DVDs at $5.50 each.

Instructions

Prepare the following entries for both years, assuming all the coupons expected to be redeemed from Year One were redeemed by the end of Year Two.

Entry	Year One	Year Two
(a) To record coupons redeemed		
(b) To record estimated liability		

Solution 13-78

	Entry	Year One		Year Two	
(a)	Estimated Liability for Premiums			8,250	
	Premium Expense [(510,000 ÷ 100) x ($7.50 – $5)]	12,750		*23,625	
	Cash (510,000 ÷ 100) × $5	25,500		**63,750	
	Inventory of Premium Posters and DVDs		38,250		95,625
	*[(1,275,000 ÷ 100) x (7.50 - $5)] – 8,250				
	**(1,275,000 ÷ 100) x $5				
(b)	Premium Expense	*8,250		1,575	
	Estimated Liability for Premiums		8,250		1,575
	*[(1,050,000 x .80) – 510,000] ÷ 100 × $2.50				

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Ex. 13-79—Premiums.

Rover Corp. includes one coupon in each bag of dog food it sells. In return for three coupons, customers receive a dog toy that the company purchases for $1.20 each. Rover's experience indicates that 60% of the coupons will be redeemed. During 2011, 100,000 bags of dog food were sold, 12,000 toys were purchased, and 45,000 coupons were redeemed. During 2012, 120,000 bags of dog food were sold, 16,000 toys were purchased, and 60,000 coupons were redeemed.

Instructions

Determine the premium expense to be reported in the income statement and the estimated liability for premiums on the balance sheet for 2011 and 2012.

Solution 13-79

	2011	2012
Premium expense	$24,000 (1)	$28,800 (3)
Estimated liability for premiums	6,000 (2)	10,800 (4)

(1) 100,000 × .6 = 60,000; 60,000 ÷ 3 = 20,000; 20,000 × $1.20 = $24,000.
(2) 45,000 ÷ 3 = 15,000; 20,000 – 15,000 = 5,000; 5,000 × $1.20 = $6,000.
(3) 120,000 × .6 = 72,000; 72,000 ÷ 3 = 24,000; 24,000 × $1.20 = $28,800.
(4) 60,000 ÷ 3 = 20,000; 5,000 + 24,000 – 20,000 = 9,000; 9,000 × $1.20 = $10,800.

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PROBLEMS

Pr. 13-80—Accounts and Notes Payable.

Below are selected transactions of Canary Co. for 2011:

1. On May 10, the company purchased goods from Jay Corp for $60,000, terms 2/10, n/30. Purchases and accounts payable are recorded at net amounts. The invoice was paid on May 18.
2. On June 1, the company purchased equipment for $180,000 from Woodpecker Ltd, paying $60,000 in cash and giving a one-year, 8% note for the balance.
3. On September 30, the company borrowed $162,000 from the First National Bank by signing a one year, zero-interest-bearing note for $180,000. The bank's discount rate was 10%.

Instructions

(a) Prepare the journal entries necessary to record the transactions above using appropriate dates.

(b) Prepare the adjusting entries necessary at December 31, 2011 in order to properly report interest expense related to the above transactions.

(c) Indicate the manner in which the above transactions should be reflected in the Current Liabilities section Canary Co's December 31, 2011 balance sheet.

Solution 13-80

(a)

	Debit	Credit
<u>May 10, 2011</u>		
Purchases/Inventory ($60,000 x .98)	58,800	
Accounts Payable		58,800
<u>May 18, 2011</u>		
Accounts Payable	58,800	
Cash		58,800
<u>June 1, 2011</u>		
Equipment	180,000	
Cash		60,000
Notes Payable		120,000
<u>September 30, 2011</u>		
Cash	162,000	
Notes Payable		162,000

(b)

	Debit	Credit
Interest Expense	5,600	
Interest Payable ($120,000 × .08 × 7/12)		5,600
Interest Expense	4,050	
Notes Payable ($162,000 x 10% x 3/12)		4,050

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Solution 13-80 (Continued)

(c) Current Liabilities

Interest payable	$ 5,600
Note payable—Woodpecker Ltd	120,000
Note payable—First Provincial Bank (162,000 + 4,050)	166,050
	$291,650

Pr. 13-81—Refinancing of short-term debt.

At their last year end, December 31, 2011, the liabilities outstanding of Diamond Corp included the following:

1. Cash dividends on common shares, $100,000, payable on January 15, 2012.
2. Note payable to Manitoba Bank, $850,000, due January 20, 2012.
3. Serial bonds, $2,000,000, of which $500,000 matures during 2012.
4. Note payable to Victoria Bank, $200,000, due January 27, 2012.

The following transactions occurred early in 2012:

January 15: The cash dividends were paid.

January 20: The note payable to Manitoba Bank was paid.

January 25: Diamond entered into a financing agreement with Saskatchewan Bank, enabling it to borrow up to $1,000,000 at any time through the end of 2014. Amounts borrowed under the agreement would bear interest at 1% above the bank's prime rate and would mature 3 years from the date of the loan. The corporation immediately borrowed $800,000 to replace the cash used in paying its January 20 note to Manitoba Bank.

January 26: 40,000 common shares were issued for $300,000. $200,000 of the proceeds was used to pay off the note payable to Victoria Bank.

February 1: The financial statements for 2011 were issued.

Instructions

Prepare a partial balance sheet for Diamond Corp, showing the manner in which the above liabilities should be presented at December 31, 2011. The liabilities should be properly classified between current and long-term, and any appropriate note disclosure should be included.

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Solution 13-81

Current liabilities:		
Dividends payable on common shares	$ 100,000	
Notes payable—Manitoba Bank	850,000	
Note payable—Victoria Bank—Note 1	200,000	
Currently maturing portion of serial bonds	500,000	
Total current liabilities		$1,650,000
Long-term debt:		
Serial bonds not maturing currently	1,500,000	
Total long-term debt		1,500,000
Total liabilities		$3,150,000

Note 1: On January 26, 2012, the corporation issued 40,000 common shares and received proceeds totalling $300,000, of which $200,000 was used to liquidate a note payable that matured on January 27, 2012.

Pr. 13-82—Premiums.

Creamy Candy Company offers a coffee mug as a premium for every ten 50-cent candy bar wrappers presented by customers together with $1.00. The purchase price of each mug to the company is 90 cents; in addition it costs 60 cents to mail each mug. The results of the premium plan for the years 2011 and 2012 are as follows (assume all purchases and sales are for cash):

	2011	2012
Coffee mugs purchased	480,000	400,000
Candy bars sold	3,750,000	4,500,000
Wrappers redeemed	1,900,000	2,800,000
2011 wrappers expected to be redeemed in 2012	1,300,000	
2012 wrappers expected to be redeemed in 2013		1,800,000

Instructions

(a) Prepare the general journal entries that should be made in 2011 and 2012 related to the above plan by Creamy Candy.

(b) Indicate the account names, amounts, and classifications of the items related to the premium plan that would appear on the balance sheet and income statement at the end of 2011 and 2012.

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Solution 13-82

(a)

2011

Account	Debit	Credit
Inventory of Premium Mugs (480,000 × $.90 = $432,000)............	432,000	
Cash		432,000
Cash	1,875,000	
Sales (3,750,000 × $.50 = $1,875,000)		1,875,000
Cash [1,900,000 ÷ 10 = 190,000 × ($1.00 – $.60) = $76,000].......	76,000	
Premium Expense..	95,000	
Inventory of Premium Mugs (190,000 × $.90 = $171,000)...		171,000
Premium Expense (1,300,000 ÷ 10 = 130,000 × $.50 = $65,000) .	65,000	
Estimated Liability for Premiums		65,000

2012

Account	Debit	Credit
Inventory of Premium Mugs (400,000 × $.90 = $360,000)............	360,000	
Cash		360,000
Cash	2,250,000	
Sales (4,500,000 × $.50 = $2,250,000)		2,250,000
Cash [2,800,000 ÷ 10 = 280,000 × ($1.00 – $.60) = $112,000].....	112,000	
Estimated Liability for Premiums	65,000	
Premium Expense	75,000	
Inventory of Premium Mugs (280,000 × $.90 = $252,000)...		252,000
Premium Expense	90,000	
Estimated Liability for Premiums		90,000
(1,800,000 ÷ 10 = 180,000 × $.50 = $90,000)		

(b) Balance Sheet

Name	Classification	2011	2012
Inventory of Premium Mugs	Current Asset	$261,000	$369,000
Estimated Liability for Premiums	Current Liability	65,000	90,000

Income Statement

Name	Classification	2011	2012
Premium Expense	Operating Expense	160,000	165,000

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Pr. 13-83—Warranties.

Canada Computer Company sells computers for $2,000 each which includes a 3-year warranty that requires the company to perform periodic services and to replace defective parts. During 2011, the company sold 500 computers. Based on past experience, the company has estimated the total 3-year warranty costs as $40 for parts and $80 for labour. (Assume sales all occur at December 31, 2011.)

In 2012, Canada Computer Company incurred actual warranty costs relative to 2011 computer sales of $5,000 for parts and $12,000 for labour.

Instructions

(a) Using the expense warranty approach, prepare the entries to reflect the above transactions (accrual method) for 2011 and 2012.
(b) Using the cash basis method, what are the Warranty Expense balances for 2011 and 2012?
(c) The transactions of part (a) create what balance under current liabilities in the 2011 balance sheet?

Solution 13-83

(a)

2011		
Accounts Receivable	1,000,000	
Sales		1,000,000
Warranty Expense	60,000	
Estimated Liability Under Warranties		60,000
2012		
Estimated Liability Under Warranties	17,000	
Inventory		5,000
Accrued Payroll		12,000

(b) 2011 $0.
2012 $17,000.

(c) 2011 Current Liabilities—Estimated Liability Under Warranties $20,000.
(The remainder of the $60,000 liability is a long-term liability.)

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Pr 13-84—Common types of current liabilities.

Define and identify common types of current liabilities and how they are valued.

Solution 13-84

Current liabilities are obligations due within one year or the operating cycle where this is longer than one year from the balance sheet date. The liquidation of a current liability is reasonably expected to require the use of current assets or the creation of other current liabilities. Theoretically, liabilities should be measured at the present value of the future outlay of cash required to liquidate them. In practice, current liabilities other than borrowings are usually recorded in accounting records and reported in financial statements at their full maturity value. There are several types of current liabilities, the most common being accounts and notes payable, sales taxes payable, and payroll related obligations.

Pr. 13-85—Employee related liabilities.

Identify and account for the major types of employee-related liabilities

Solution 13-85

Employee related liabilities include (1) payroll deductions, (2) compensated absences and (3) bonus agreements. Payroll deductions are amounts withheld from employees along with the employer's required contributions that have not yet been remitted to the government. Compensated absences earned by employees are company obligations that should be recognized as the employees earn the entitlement to them, provided they can be reasonably measured. Bonuses based on income should be accrued as an expense and liability as the income is earned.

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Pr. 13-86—Asset Retirement Obligation.

Extraction Friendly Ltd. specializes in extracting ore. It prides itself for following high environmental standards in the extraction process. On January 1, 2006, Extraction Friendly purchased the rights to use a parcel of land from the province of Quebec. The rights cost $15,000,000 and allowed the company to extract ore for five years. The company expects to extract the ore evenly over the contract period. At the end of the contract the firm has one year to clean up and restore the land. Extraction Friendly estimates this cost to be $2,000,000 and expects to incur it evenly over the restoration period.

The firm uses a discounted cash flow method to calculate the fair value of this obligation and believes that 8% is the appropriate discount rate. The company uses the calendar year as its fiscal year.

As a helpful suggestion, students may want to draw a timeline of events before solving the questions given below.

Required:

a) Prepare the journal entry(ies) to be recorded on January 1, 2006.
b) Prepare the journal entry(ies) to be recorded on December 31, 2006. Show the amounts and accounts reported on the classified balance sheet at December 31, 2006.
c) Prepare the journal entry(ies) to be recorded during 2010. Show the amounts and accounts reported on the classified balance sheet at December 31, 2010.
d) After 2010, Extraction Friendly was supposed to clean up and restore the land. Even though the company spent a considerable amount of money on restoration, it was sued by the province of Quebec for not following the contract's requirements. On February 3, 2013, judgment was rendered against Extraction Friendly in the amount of $3,000,000. The company claims that because the language in the contract was misleading regarding the restoration costs, it plans to appeal the judgment and expects the ruling to be reduced to anywhere between $1,000,000 and $2,000,000 with $1,500,000 being the probable amount. The company has not yet released its 2012 financial statements. Discuss how Extraction Friendly should report this matter on its financial statements for the year ended December 31, 2012.

Solution 13-86

a) Extraction Friendly needs to record the purchase of the rights along with the ARO. The journal entry to record the purchase of the rights:

January 1, 2006		
Extraction rights	15,000,000	
Cash		15,000,000

To record the ARO, you need to calculate the PV of the obligation. Because the firm will incur it evenly during 2011, there are a number of alternative calculations.

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Solution 13-86 (cont'd)

1) A reasonable approximation is to assume that the amount will be spent in the middle of the year and therefore discount it over 5.5 years. The discount factor for (5 years, 8%) = 0.68058. To make it a discount factor for 5.5 years, simply divide by 1.04 = 0.6544. The PV of the ARO = $2,000,000 x 0.6544 = $1,308,800. This cost is added to the cost of the underlying asset. Or, with the use of a financial calculator, the obligation equals $1,309,783.

2) An alternative is to first discount the 12 monthly payments and then discount over a 5 year period. Use of a financial calculator yields $1,303,975.

3) Equally acceptable is to simply discount over 5 periods so that the obligation is fully measured by the time clean-up is expected to begin. Usually, periodic cash flows for less than one year are not discounted. Use of a financial calculator yields $1,361,166.

Assuming alternative 1 is chosen (students can opt for the other alternatives, as long as a present value is calculated), the ARO would be recorded as follows:

	Debit	Credit
Extraction rights	1,308,800	
Asset retirement obligation		1,308,800

b) Extraction Friendly needs to depreciate the extraction rights over 5 years and also record accretion (interest) expense on the obligation.

	Debit	Credit	
Depreciation expense	3,261,760		((15,000,000+1,308,800)/5)
Accumulated depreciation		3,261,760	
Accretion expense **	104,704		(1,308,800 x 8%)
Asset retirement obligation		104,704	

** Using IFRS, the debit is to Interest Expense

Balance sheet amounts:

Account	Amount	Classification
Extraction rights net of accumulated depreciation	13,047,040	Long-term assets
Asset retirement obligation	1,413,504	Long-term liabilities

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Solution 13-86 (cont'd)

c) For the depreciation of the extraction rights the journal entry is the same every year.

Depreciation expense	3,261,760		((15,000,000+1,308,800)/5)
Accumulated depreciation		3,261,760	

For the accretion costs first you need to find the carrying value of the obligation as of January 1, 2010 and then to calculate the expense.
The carrying value as of January 1, 2010 is 1,780,608, so the accretion expense is 142,449. ($1,780,608 x 8%)

Accretion expense	142,449	
Asset retirement obligation		142,449

Balance sheet amounts:

Account	Amount	Classification
Extraction rights net of accumulated depreciation	0	
Asset retirement obligation	1,923,057	Current liabilities

Since by the end of 2010 the liability is due within a year, it should be classified as a current liability.

d) This is a somewhat complicated situation. Clearly Extraction Friendly is expecting a contingent loss of anywhere between $1,500,000 and $3,000,000. However, a $3,000,000 judgment has already been rendered against them, while the reduction in the loss is uncertain.
There are two legitimate approaches to this issue. The first approach is to record a loss of $1,500,000 for 2012 (since this amount is deemed probable) and to provide full disclosure in the notes about the ruling and the expected appeal.
The second approach is that the firm has incurred a contingent loss of $3,000,000 and expects a contingent gain of $1,500,000. Because losses are recorded immediately and contingent gains are not, then Extraction Friendly should record a loss of $3,000,000 for 2012 and provide full disclosure on the possible contingent gain.

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Pr. 13-87—Unredeemed coupons.

During 2011 Canadiens Corp. sold 200,000 tickets for hockey games for $60 each under a new sales promotion program. Each ticket contains one coupon. Any person who presents 2 coupons can receive a ticket to a Montreal Allouettes football game for only $2. Canadiens Corp. pays $8.00 per football ticket and at the beginning of the year purchased 80,000 tickets (any tickets not used in 2011 can be used in 2012). The company estimates that 60% of the coupons will be redeemed even though only 50,000 coupons had been processed during 2011.

(a) What amount should Canadiens Corp report as a liability for unredeemed coupons on December 31, 2011?

(b) What amount of expense will Canadiens Corp report on its 2011 income statement as a result of the promotional program?

(c) Prepare any necessary 2011 journal entries related to the promotion program.

(d) Briefly, but clearly, explain how the accounting treatment will change under the international standards.

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Solution 13-87

(a) The number of coupons expected to be processed is 200,000 x 60% = 120,000. In 2011, 50,000 coupons were processed, so 70,000 more are expected to be processed and accordingly 35,000 tickets to be purchased. The additional net cost per ticket is $6 and therefore the liability for unredeemed coupons at December 31, 2011 should be 35,000 x 6 = $210,000.

(b) Promotion expense = $\frac{120{,}000}{2}$ x 6 = 360,000

(c)

	Debit	Credit
Premium Expense	360,000	
Estimated Liability for Premiums		360,000
Cash	12,000,000	
Sales		12,000,000
Inventory of Premiums (80,000 X $8)	640,000	
Cash		640,000
Estimated Liability for Premiums..................................	150,000	
Cash (50,000/2 X $2)	50,000	
Inventory of Premiums (50,000/2 X $8).............		200,000

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Solution 13-87 (cont'd)

(d) Under international standards, this promotion would be considered a multiple deliverables arrangement. Canadiens Corp. is selling two separate products (the hockey tickets and the football tickets), with the selling price of the hockey tickets inflated to encourage the ticket purchasers to also purchase football tickets. Therefore some of the revenue from the sale of each hockey ticket should be deferred and allocated to the delivery of the football tickets. An estimated amount should be deferred to 2012 when the remaining coupons will be redeemed.

Pr. 13-88—Contingencies.

You were hired by Oak Corp. to advise them on how to reflect the events below in their financial statements for the year ended December 31, 2011.

Event 1: The Division A employees union has been negotiating a new contract with Oak Corp. The union is requesting a 5% wage increase retroactive for two years. Oak's management has offered the union a 2% wage increase retroactive for one year. While the negotiations are still ongoing, the company believes that an agreement will soon be reached for a 4% wage increase retroactive for one year, but there is no guarantee that this will be the outcome of the negotiations.

Event 2: The Division B employees union is also negotiating a new contract with Oak Corp. However, these negotiations are proving to be very tough. So far there has not been much progress and management is pessimistic about a quick resolution. The company is concerned that during 2012 the Division B employees will decide to go on strike; in fact, Oak considers it very likely. At this point it is difficult to assess the economic consequences of the potential strike.

Event 3: Towards the end of 2011, a fire destroyed one of Oak's plants. The damage is estimated to be $8,000,000 and the company's insurance policy has maximum coverage of $15,000,000 for this. The deductible on the policy is $300,000. The company is concerned that the insurance premium ($200,000 in 2011) will double in 2012.

Instructions

For each of the above events, state the accounting treatment you believe is most appropriate. Be specific, and give your rationale.

Solution 13-88

Event 1: The event is more likely than not to happen and the cost can be reasonably estimated. Oak Corp should accrue an additional expense for 2011 based on the most likely outcome of a 4% wage increase retroactive for one year. In the notes to the financial statements, they should provide the range for the potential expense (2-5%, 1-2 years).

Event 2: The event is likely to happen but cannot be reasonably estimated. Therefore note disclosure only would be appropriate.

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Pr. 13-88 (cont'd)

Event 3: The $300,000 deductible payment should be accrued in 2011 as a loss from fire. While the premium is likely to increase and can be reasonably measured, the cost relates to future periods and therefore no expense should be accrued for 2011. Full disclosure of the event and of the expected cost increase for next year is appropriate, unless the amount is immaterial
.

Alternatives the company could consider:
1. Shop around for a better deal on insurance.
2. Avoid the potential premium increase by choosing to self-insure.

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