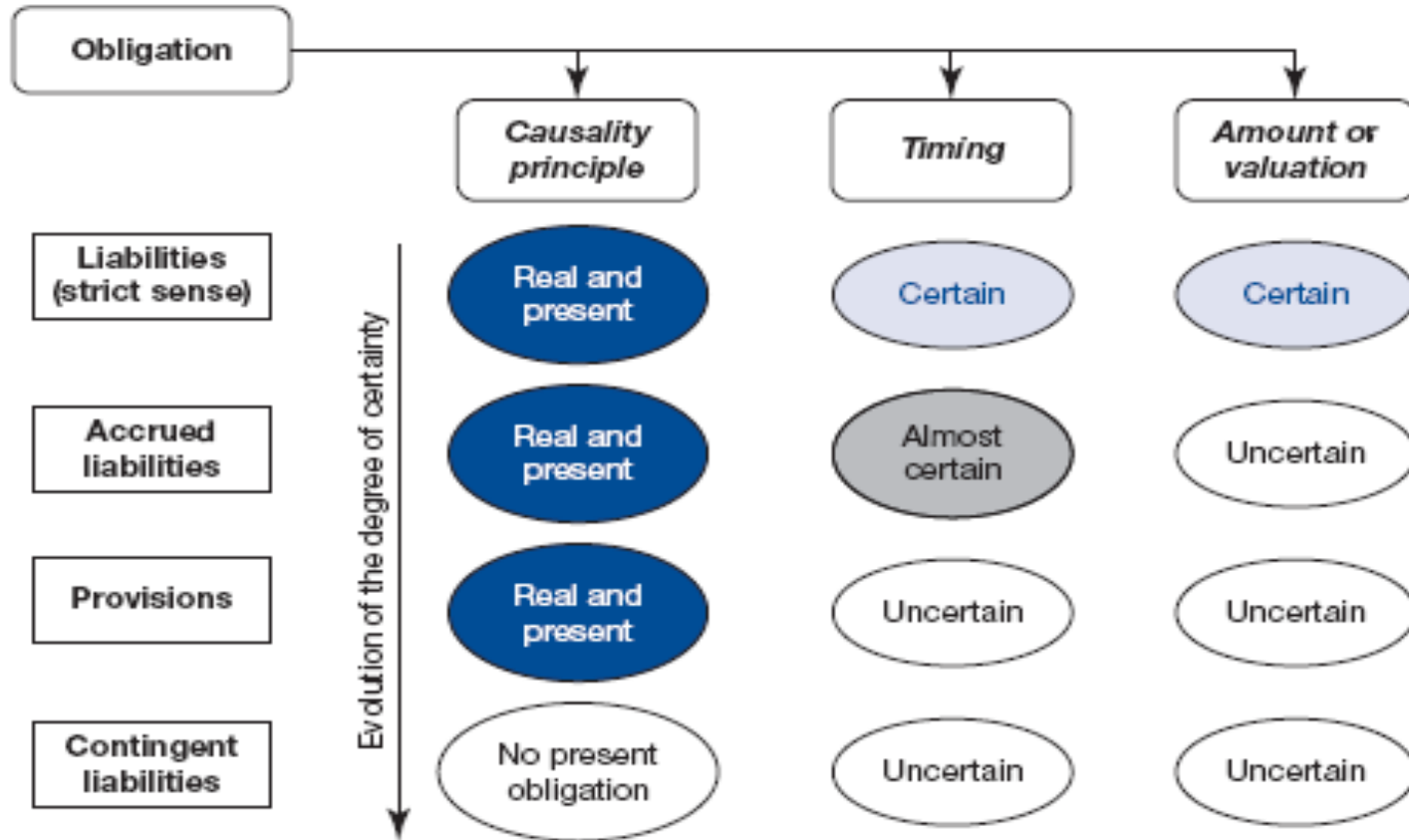


MBA in Food & Agribusiness

Financial Management

Current Liabilities

Liabilities and related concepts (IAS 37)



Recording Notes Payable

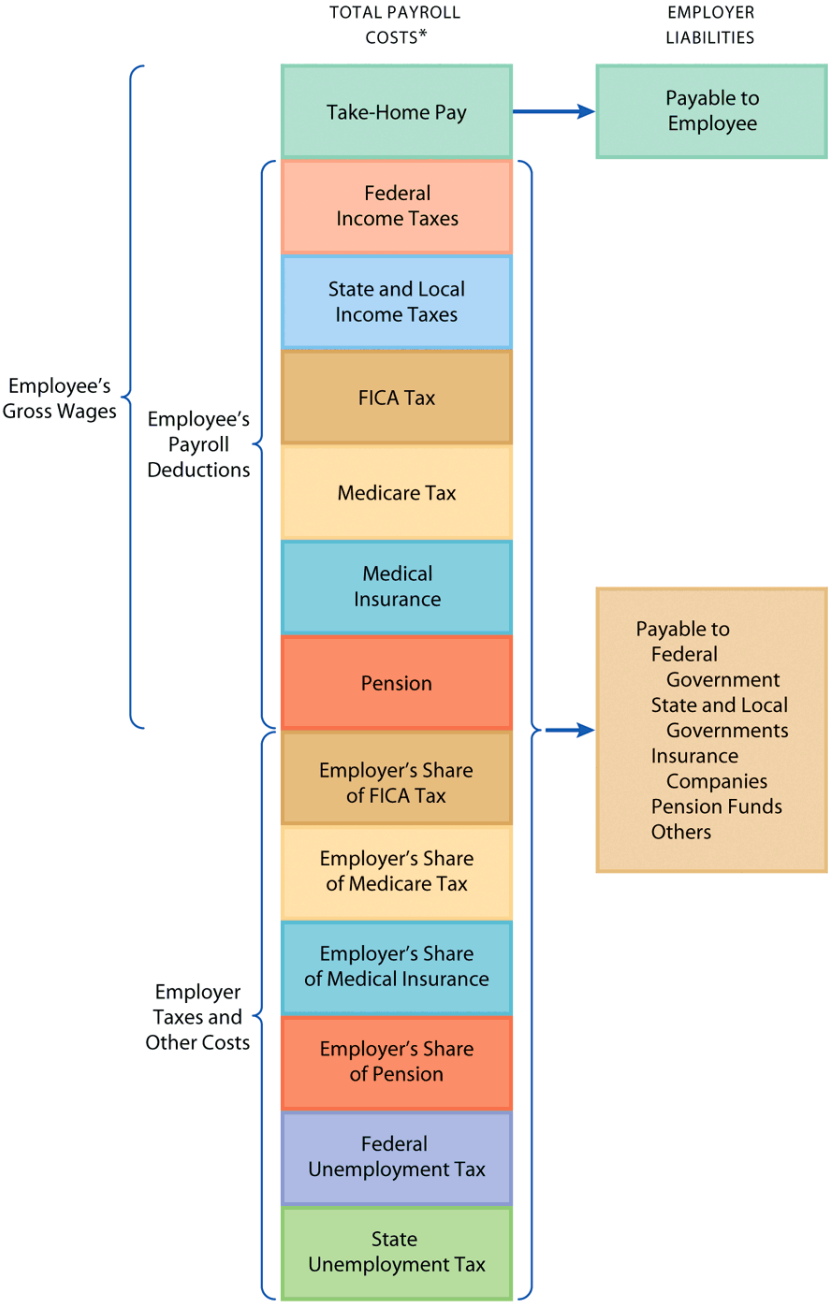
Issuance of 60-day, 12 percent promissory note on August 31

Aug. 31	Cash	5,000	
	Notes Payable		5,000
	Issued 60-day, 12 percent promissory note		

Payment of note

Oct. 30	Notes Payable	5,000.00	
	Interest Expense	98.63	
	Cash		5,098.63
	Payment of promissory note with \$100 interest		
		$\$5,000 \times .12 \times \frac{60}{365} = \98.63	

Payroll Costs



*Boxes are not proportional to amounts.

Recording Payroll

Feb. 15: Record payroll, total employee wages, \$32,500

Feb.15	Wages Expense	32,500	
	Employees' Federal Income Taxes Payable		5,400
	Employees' State Income Taxes Payable		1,200
	Social Security Tax Payable		2,015
	Medicare Tax Payable		471
	Medical Insurance Premiums Payable		900
	Pension Contributions Payable		1,300
	Wages Payable		21,214
	To record payroll		

Note that employees earned \$32,500 but their take home pay was only \$21,214

Recording Payroll

Feb. 15: Record payroll taxes and benefit costs

Feb.15	Payroll Taxes and Benefits Expense	9,401	
	Social Security Tax Payable		2,015
	Medicare Tax Payable		471
	Medical Insurance Premiums Payable		3,600
	Pension Contributions Payable		1,300
	Federal Unemployment Tax Payable		260
	State Unemployment Tax Payable		1,755
	To record payroll taxes and other costs		

Payroll taxes and benefits increase the total cost of payroll to \$41,901

Notes Payable and Wages Payable

P 2. **Part A:** Alhara Corporation, whose fiscal year ended June 30, 20xx, completed the following transactions involving notes payable:

- | | |
|---------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| May 21 | Obtained a 60-day extension on a \$36,000 trade account payable owed to a supplier by signing a 60-day, \$36,000 note. Interest is in addition to the face value, at the rate of 14 percent. |
| June 30 | Made the end-of-year adjusting entry to accrue interest expense. |
| July 20 | Paid off the note plus interest due the supplier. |

Required

1. Prepare journal entries for the notes payable transactions.
2. When notes payable appears on the balance sheet, what other current liability would you look for to be associated with the notes? What would it mean if this other current liability did not appear?

Part B: The payroll register for Alhara Corporation contained the following totals at the end of July: wages, \$278,250; federal income taxes withheld, \$71,163; state income taxes withheld, \$11,727; social security tax withheld, \$17,253; Medicare tax withheld, \$4,035; medical insurance deductions, \$9,600; and wages subject to unemployment taxes, \$171,720.

Required

Prepare entries to record the (1) monthly payroll and (2) employer payroll expenses, assuming social security and Medicare taxes equal to the amount for employees, a federal unemployment insurance tax of .8 percent, a state unemployment tax of 5.4 percent, and medical insurance premiums for which the employer pays 80 percent of the cost.

Answer

1. Transactions recorded						
20xx						
May	21	Accounts Payable			36.000,00	
		Notes Payable				36.000,00
			60-day, 14% note given to supplier in settlement of trade account payable			
June	30	Interest Expense			552,33	
		Interest Payable				552,33
			To accrue interest expense at end of year			
			$\$36.000 \times 0,14 \times 40 / 365$			
			$= \$552,33$			
July	20	Notes Payable			36.000,00	
		Interest Expense			276,16	
		Interest Payable			552,33	
		Cash				36.828,49
			Paid note plus interest			
			$\$36.000 \times 0,14 \times 20 / 365$			
			$= \$276,16$			

Answer (cont.)

1.	20xx				
	July	31	Wages Expense		278.250,00
			Employees' Federal Income Taxes Payable		71.163,00
			Employees' State Income Taxes Payable		11.727,00
			Social Security Tax Payable		17.253,00
			Medicare Tax Payable		4.035,00
			Medical Insurance Premiums Payable		9.600,00
			Wages Payable		164.472,00
			To record the payroll		

Account payable,
determined by deduction

Answer (cont.)

2.	July	31	Payroll Taxes and Benefits Expense				70.334,64			
				Social Security Tax Payable				17.253,00		
				Medicare Tax Payable				4.035,00		
				Medical Insurance Premiums Payable				38.400,00		
				Federal Unemployment Tax Payable				1.373,76		
				State Unemployment Tax Payable				9.272,88		
				To record payroll expenses						
			Computations:					9,600	20%	
			\$9.600	÷	0,20	=	\$48.000	}	x = 48,000	100%
			\$48.000	œ	\$9.600	=	\$38.400		0.8*48,000 = 38400	
			0,008	x	\$171.720	=	\$1.373,76			
			0,054	x	\$171.720	=	\$9.272,88			

Recording Product Warranty Liabilities

Record warranty expense:

July 31	Product Warranty Expense	1,050	
	Estimated Product Warranty Liability		1,050
	To record estimated product warranty expense		

Record replacement of a defective muffler, which cost \$40, and receipt of \$20 service fee to have it replaced:

Dec. 5	Cash	20	
	Estimated Product Warranty Liability	40	
	Service Revenue		20
	Merchandise Inventory		40
	Replacement of muffler under warranty		

Product Warranty Liability

P 3. Visicorp Company is engaged in the retail sale of high-definition televisions (HDTVs). Each HDTV has a 24-month warranty on parts. If a repair under warranty is required, a charge for the labor is made. Management has found that 20 percent of the HDTVs sold require some work before the warranty expires. Furthermore, the average cost of replacement parts has been \$120 per repair. At the beginning of January, the account for the estimated liability for product warranties had a credit balance of \$28,600. During January, 112 HDTVs were returned under the warranty. The cost of the parts used in repairing the HDTVs was \$17,530, and \$18,884 was collected as service revenue for the labor involved. During January, the month before the Super Bowl, Visicorp Company sold 450 new HDTVs.

Required

1. Prepare entries in journal form to record each of the following: (a) the warranty work completed during the month, including related revenue; (b) the estimated liability for product warranties for HDTVs sold during the month.
2. Compute the balance of the Estimated Product Warranty Liability account at the end of the month.

Answer

1. Entries prepared in journal form											
a.	Jan.	31	Cash						18.884		
			Estimated Product Warranty Liability						17.530		
			Service Fees Revenue							18.884	
			Merchandise Inventory							17.530	
			To record warranty repairs and related revenue during January								
b.	Jan.	31	Product Warranty Expense						10.800		
			Estimated Product Warranty Liability							10.800	
			To record estimated warranty expense for January, computed as follows:								
			HDTVs sold × percent expected to								
			require repair × average cost of parts								
			450	×	0,20	×	\$120	=	\$10.800		

Answer (cont.)

2. Balance of Estimated Product Warranty Liability account computed	
Beginning balance	\$28.600
Less cost of warranty parts used	(17.530)
Plus estimated liability for HDTVs sold	<u>10.800</u>
Ending balance	<u><u>\$21.870</u></u>

Long-Term Assets (IAS 16)

Acquisition Costs

IAS 16 §16 Includes all expenditures reasonable and necessary to get an asset in place and ready for use:

- **Purchase price** including import duties and deducting trade discounts
- **Directly attributable cost** e.g. delivery, testing, professional fees
- **Dismantling** and removing cost

Determining Cost of Assets

P 2. Oslo Company was formed on January 1, 2007, and began constructing a new plant. At the end of 2007, its auditor discovered that all expenditures involving long-term assets had been debited to an account called Fixed Assets. An analysis of the Fixed Assets account, which had a year-end balance of \$2,644,972, disclosed that it contained the following items:

Cost of land	\$ 316,600
Surveying costs	4,100
Transfer of title and other fees required by the county	920
Broker's fees for land	21,144
Attorney's fees associated with land acquisition	7,048
Cost of removing timber from land	50,400
Cost of grading land	4,200
Cost of digging building foundation	34,600
Architect's fee for building and land improvements (80 percent building)	64,800
Cost of building construction	710,000
Cost of sidewalks	11,400
Cost of parking lots	54,400
Cost of lighting for grounds	80,300
Cost of landscaping	11,800
Cost of machinery	989,000
Shipping cost on machinery	55,300
Cost of installing machinery	176,200
Cost of testing machinery	22,100
Cost of changes in building to comply with safety regulations pertaining to machinery	12,540
Cost of repairing building that was damaged in the installation of machinery	8,900
Cost of medical bill for injury received by employee while installing machinery	2,400
Cost of water damage to building during heavy rains prior to opening the plant for operation	6,820
Account balance	<u><u>\$2,644,972</u></u>

Oslo Company sold the timber it cleared from the land to a firewood dealer for \$5,000. This amount was credited to Miscellaneous Income.

During the construction period, two of Oslo's supervisors devoted full time to the construction project. Their annual salaries were \$48,000 and \$42,000, respectively. They spent two months on the purchase and preparation of the land, six months on the construction of the building (approximately one-sixth of which was devoted to improvements on the grounds), and one month on machinery installation. When the plant began operation on October 1, the supervisors returned to their regular duties. Their salaries were debited to Factory Salaries Expense.

Required

1. Prepare a schedule with the following column headings: Land, Land Improvements, Buildings, Machinery, and Expense. Place each of the above expenditures in the appropriate column. Negative amounts should be shown in parentheses. Total the columns.
2. What impact does the classification of the items among several accounts have on evaluating the profitability performance of the company?

Answer

Oslo Company					
Schedule of Proper Charges to Asset and Expense Accounts					
December 31, 20x7					
	Land	Land Improvements	Buildings	Machinery	Expense
Land	\$316.600				
Surveying costs	4.100				
Transfer of title and other fees	920				
Broker's fees	21.144				
Attorney's fees	7.048				
Timber removal	50.400				
Grading land	4.200				
Foundation preparation			\$ 34.600		
Architect's fee		\$ 12.960	51.840		
Building construction			710.000		
Sidewalks		11.400			
Parking lots		54.400			
Lighting for grounds		80.300			
Landscaping	11.800				
Machinery				\$ 989.000	
Shipping cost				55.300	
Installation				176.200	
Testing				22.100	
Safety adjustments				12.540	
Damage to building					\$ 8.900
Injured employee					2.400
Water damage					6.820
Sale of timber	(5.000)				
Supervisory salaries	15.000	7.500	37.500	7.500	
Totals	<u>\$426.212</u>	<u>\$166.560</u>	<u>\$833.940</u>	<u>\$1.262.640</u>	<u>\$18.120</u>

0.8*64,800

$(48000+42000)*1/12$

$(48000+42000)*6/12*5/6$

$(48000+42000)*6/12*1/6$

$(48000+42000)*2/12$

Methods of Accounting for Depreciation

Straight-line method	Spreads the depreciable cost evenly over the estimated useful life of the asset
Production method H/W	Based on the assumption that depreciation is solely the result of use and that passage of time plays no role in the depreciation process
Declining-balance method	Accelerated method of depreciation that results in larger amounts of depreciation in earlier years of the asset's life and smaller amounts in later years

Depreciation Schedule, Straight-Line Method

	Cost	Yearly Depreciation	Accumulated Depreciation	Carrying Value
Date of purchase	\$10,000	—	—	\$10,000
End of first year	10,000	\$1,800	\$1,800	8,200
End of second year	10,000	1,800	3,600	6,400
End of third year	10,000	1,800	5,400	4,600
End of fourth year	10,000	1,800	7,200	2,800
End of fifth year	10,000	1,800	9,000	1,000

The amount of depreciation is the same each year

Accumulated depreciation increases uniformly

The carrying value decreases uniformly until it reaches the estimated residual value

Depreciation Schedule, Double-Declining-Balance Method

	Cost	Yearly Depreciation	Accumulated Depreciation	Carrying Value
Date of purchase	\$10,000		—	\$10,000
End of first year	10,000	(40% x \$10,000)	\$4,000	6,000
End of second year	10,000	(40% x \$6,000)	2,400	3,600
End of third year	10,000	(40% x \$3,600)	1,440	2,160
End of fourth year	10,000	(40% x \$2,160)	864	1,296
End of fifth year	10,000		296	1,000

Note that the fixed rate is always applied to the **carrying value at the end of the previous year.**

Depreciation is greatest in the first year and declines each year after that.

The **depreciation in the last year is limited** to the amount necessary to reduce the carrying value to the residual value.
 (\$1,296 - \$1,000 = \$296)

Comparison of Depreciation Methods

P 3. Laughlin Designs, Inc., purchased a computerized blueprint printer that will assist in the design and display of plans for factory layouts. The cost of the printer was \$22,500, and its expected useful life is four years. The company can probably sell the printer for \$2,500 at the end of six years. The printer is expected to last 6,000 hours. It was used 1,200 hours in year 1; 1,800 hours in year 2; 2,400 hours in year 3; and 600 hours in year 4.

Required

1. Compute the annual depreciation and carrying value for the new blueprint printer for each of the four years (round to the nearest dollar where necessary) under each of the following methods: (a) straight-line, (b) production, and (c) double-declining-balance.
2. If the printer is sold for \$12,000 after year 2, what would be the gain or loss under each method?

Answer

Net amount:
22,500 - annual Dep.
exp

Depreciation Table							
	Depreciation Method	Year	Computation			Depreciation	Carrying Value
a.	Straight-line	1	\$20,000*	÷	4	\$5,000	\$17,500
		2	20,000	÷	4	5,000	12,500
		3	20,000	÷	4	5,000	7,500
		4	20,000	÷	4	5,000	2,500
b.	Production	1	\$20,000*	×	$\frac{1,200}{6,000}$	\$4,000	\$18,500
		2	20,000	×	$\frac{1,800}{6,000}$	6,000	12,500
		3	20,000	×	$\frac{2,400}{6,000}$	8,000	4,500
		4	20,000	×	$\frac{600}{6,000}$	2,000	2,500
c.	Double-declining-balance	1	\$22,500	×	50%†	\$11,250	\$11,250
		2	11,250	×	50%	5,625	5,625
		3	5,625	×	50%	2,813	2,812
		4	2,812	—	2,500	312**	2,500
* \$22,500 - \$2,500 = \$20,000							
† 100% ÷ 4 years = 25% × 2 = 50%							
** To reduce to estimated residual value.							

Answer

2. Gain or loss determined

If the printer was sold for \$12,000 after year 2, the gain or loss under each method follows:

a.	a loss of	\$ 500	(\$12,000	-	\$12,500)
b.	a loss of	\$ 500	(\$12,000	-	\$12,500)
c.	a gain of	\$6,375	(\$12,000	-	\$ 5,625)

Answer - Journal entries

a, b	Cash	12,000	
	Accumulated Depreciation, Printer	10,000	
	Loss on Sale of Printer	500	
	Printer		22,500
	Sale of Printer at less than carrying value; loss of \$500 recorded (\$12,000 ÷ \$12,500)		
c	Cash	12,000	
	Accumulated Depreciation, Printer	16,875	
	Gain on Sale of Printer		6,375
	Printer		22,500
	Sale of Printer at more than carrying value; gain of \$6,375 recorded (\$12,000 ÷ \$5,625)		