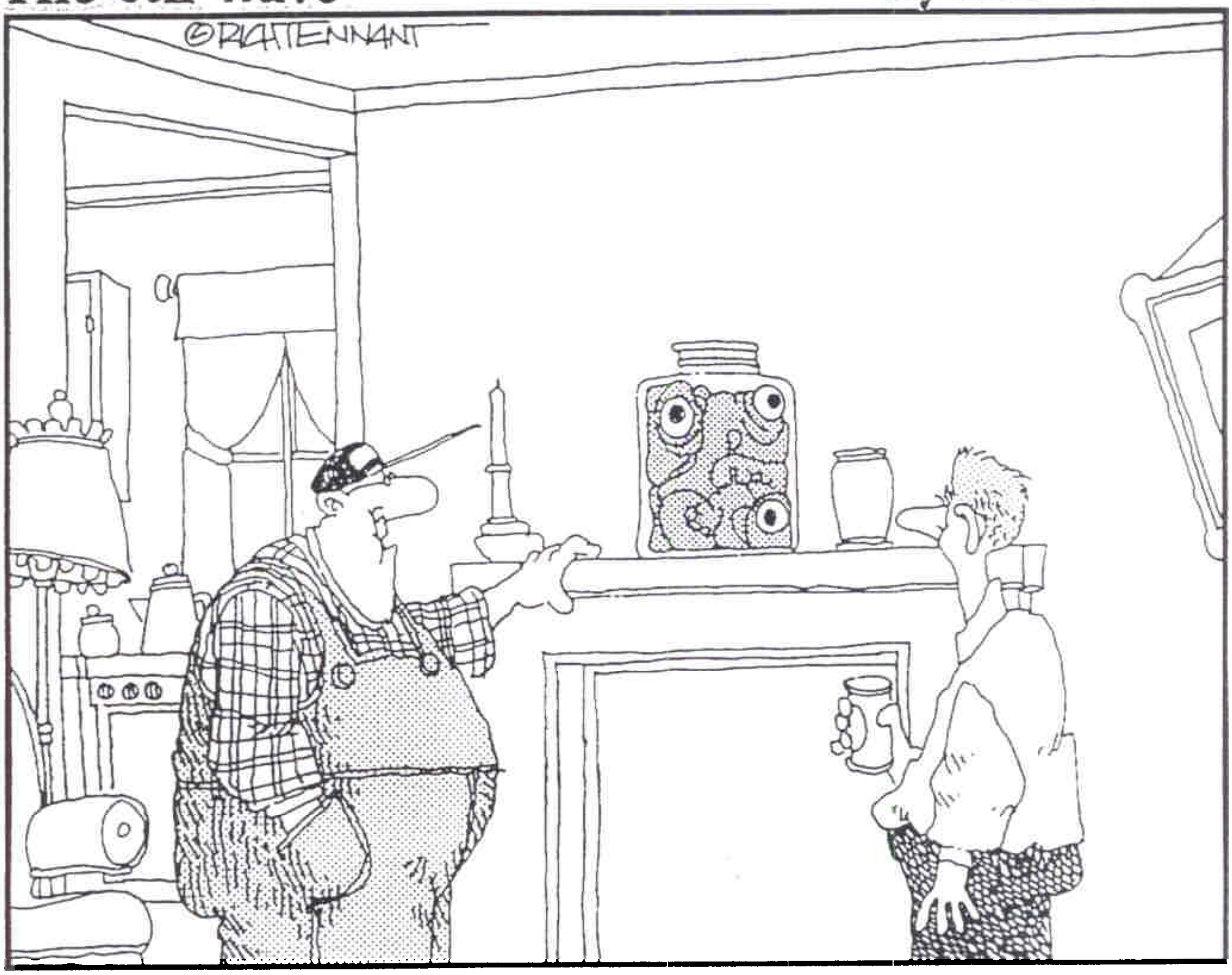
The 5th Wave By Rich Tennant



"We were told to put our money into something that got more interest, so we started sticking it into this mason jar that's got some dang thing in it we bought from a traveling freak show."

SOME
ADJUSTING
ENTRIES

&

FIXED
ASSET
ACCOUNTING

ADJUSTING ENTRIES

- **End-of-period entries initiated by the accountant, NOT a transaction** {because there is no source source document per se}

- **Make adjustments for the differences in the timing of revenues and expenses** *

- **Yield more realistic financial statements for the period**

* The "problem" is that, in accrual accounting, cash inflows and outflows do not necessarily correspond to the flow of revenues and expenses.

COMMON TYPES
of
TIMING DIFFERENCES

(page 140)

	REVENUE	EXPENSE
Cash flow occurs **BEFORE** revenue/ expense is to be recognized	Unearned Revenue (Liability)	Prepaid Expense * (Asset)
Cash flow occurs AFTER revenue/ expense is to be recognized	Accrued Receivable Account Receivable (Asset)	Accrued Liability Account Payable (Liability)

* Note - Text states "Prepaid Asset," which is correct, but "Prepaid Expense" is more commonly used.

CLASSIC EXAMPLES

A firm pays 12 months of property insurance coverage on January 1, leading to the entries:

Dr: PREPAID INSURANCE
  Cr: CASH

Adjusting entries at the end of January:

Dr: INSURANCE EXPENSE (1/12)
  Cr: PREPAID INSURANCE (1/12)

A firm loans money on January 1, to be repaid in two semiannual payments, each including principle and interest, leading to the entries:

Dr: NOTES RECEIVABLE
  Cr: CASH

Adjusting entries at the end of January:

Dr: INTEREST RECEIVABLE (for January)
  Cr: INTEREST EARNED (for January)

TYPICAL ADJUSTMENTS due to OPERATIONS*

WARRANTIES:

Dr: Warranty Expense

Cr: Warranty Reserve
(Liability account)

EMPLOYEE VACATION EARNED

Dr: Vacation Expense

Cr: Accrued Vacation Payable
(Liability account)

*Liabilities recognized as claims against current period income but not yet paid. These adjustments are frequently estimates to force recognition of potential future liabilities.

COST OF GOODS SOLD

Perpetual Inventory System

- accounts for each individual inventory transaction
- point-of-sale systems

Periodic Inventory System

- tracks inventory <u>purchases</u> but not inventory <u>sold</u>
- physical inventory count at end of period
- estimated cost of goods sold <u>derived</u>

PERIODIC INVENTORY SYSTEM
COST OF GOODS SOLD
(Retail Organization)

Beginning Inventory
plus: Purchases
less: Purchase Returns
less: Ending Inventory
EQUALS: Cost of Goods Sold

Adjusting Entries:

Dr: Cost of Goods Sold
Dr: Purchase Returns
    Cr: Purchases
Dr: Inventory (Ending)
    Cr: Inventory (Beginning)

FIXED ASSET ACCOUNTING

Assets with useful life > 1 year

Use in conduct of business; not for resale

Capitalized, not expensed

Depreciation accounting consists of allocating, over the useful life of the asset, the difference between acquisition cost and estimated disposition value

DEPRECIATION METHODS

Based on Initial Cost, Useful Life, Salvage Value

Numerous methods, including:

- **Straight Line**
- **Sum-of-the-years Digits**
- **Declining Balance**
- **MACRS**

Different methods allowed <u>for the same asset</u> for financial accounting purposes and for income tax accounting purposes

DEPRECIATION METHODS

STRAIGHT-LINE SCHEDULE - ILLUSTRATION

Annual depreciation expense is allocated in accord with:

(First cost - Estimated salvage) / Useful life

FOR EXAMPLE, LET:

Initial cost = \$ 1,000
Salvage = \$ 200
Useful life = 4 years

Then,

(1,000 - 200) / 4

= \$200 annual depreciation expense allocation

JOURNAL ENTRY EACH YEAR:

Dr: Depreciation Expense	**\$ 200**	
Cr: Allowance for Depreciation		**\$ 200**

ADJUSTING ENTRY
ALLOWANCE FOR DEPRECIATION
"Contra Account"

Rather than decreasing the value of the asset, the original value of the asset is retained, and the depreciation expense is accumulated in a separate account

Dr: Depreciation Expense
Cr: Allowance for Depreciation

"Contra account" - The balance "contradicts" the established Long-Lived Asset account

DISPOSITION OF LONG-LIVED ASSETS

Book Value =
Initial Cost - Accumulated Depreciation

Capital Gain (Loss) =
Sales Amount - Book Value

For Capital Gain:
- Dr: CASH
- Dr: ALLOWANCE FOR DEPRECIATION
  - Cr: GAIN ON DISPOSITION OF ASSET *
  - Cr: ASSET

For Capital Loss:
- Dr: CASH
- Dr: ALLOWANCE FOR DEPRECIATION
- Dr: LOSS ON DISPOSITION OF ASSET *
  - Cr: ASSET

Often ONE T-ACCOUNT:

Disposition of Asset

Debit	Credit
enter losses	enter gains

DISPOSITION OF LONG-LIVED ASSETS

Alternative Entries For Capital Gain/Loss

Dr: Cash
  Cr: Capital gain/loss; Fixed assets

Dr: Allowance for depreciation
  Cr: Capital gain/loss; Fixed assets

Dr: Capital gain/loss; Fixed assets
  Cr: Fixed assets

Asset Accounts:
  Cash
  Fixed Assets (i.e., Long-Lived Assets)
Income Account (nonoperating):
  Capital [gain/loss]
Contra Account:
  Allowance for depreciation

INCOME TAX ISSUES

Capital gains may not be fully taxed
Capital losses may not be fully deductible

When depreciation methods for financial and income tax reporting purposes are different:

- **Income taxes calculated using both depreciation methods**
- **Difference between income taxes is in Deferred Income Taxes account OR additional income taxes are paid**

page 151, #7.16, part a: **Select those debit and credit entries that you think best record the end-of-period entry described.**

Singh Restaurant is planning to rent a billboard next to the highway to try to attract tourist business. Singh paid $3,575 last month to the leasing company and charged $3,575 to Promotion Expense. The accountant notes that the $3,575 rental is for a full year, commencing next month. In order to correct the records, Singh's accountant must make which of the following entries:

1	**Dr:**	**Loss/Gain account**	**$3,575**	
2	**Dr:**	**Promotion expense**	**$3,575**	
3	**Dr:**	**Accounts payable**	**$3,575**	
4	***Dr:***	***Prepaid promotion expense***	***$3,575***	
5	**Cr:**	**Loss/Gain account**		**$3,575**
6	***Cr:***	***Promotion expense***		***$3,575***
7	**Cr:**	**Accrued promotion expense payable**		**$3,575**
8	**Cr:**	**Prepaid promotion expense**		**$3,575**

<u>page 154, #7.3, parts a, b, c</u>: Marones, Inc. is a manufacturer of specialized heavy equipment. When an order for a piece of equipment is placed, Marones requires a nonrefundable 20 percent down payment with the balance of the sale price payable upon delivery.

a) **Al Smith placed in June an order for a $25,000 piece of equipment, with a $5,000 down payment. How should this payment be recorded by Marones?**

Dr: Cash	*$5,000*	
Cr: Customer down payments		*$5,000*

Customer down payments is a Liability for Marones. Note that, even though the down payment is non-refundable, the realization concept requires that the full value of the sale only be recognized at the time of shipment.

b) **Two months later, Smith receives the new piece of equipment and pays off the $20,000 balance of his order. How should these transactions be recorded by Marones, Inc.?**

Dr: Customer down payments	*$ 5,000*	
Dr: Cash	*$20,000*	
Cr: Sales		*$25,000*

page 154, #7.3, parts a, b, c: Marones, Inc. is a manufacturer of specialized heavy equipment. When an order for a piece of equipment is placed, Marones requires a nonrefundable 20 percent down payment with the balance of the sale price payable upon delivery.

c) How is this accounting different from the one that an auto dealer would follow in connection with selling a car with a $4,000 down payment and $10,000 to be paid in monthly installments over 60 months?

Dr: Cash	*$4,000*	
Dr: Installment contract receivable	*$6,000*	
Cr: Sales		*$10,000*

Note that in this case, the customer's down payment does not arrive in advance, but rather simply serves to offset the amount that the customer is borrowing on installment credit.

page 156, #7.13: The Electronics Outlet, a television and electronics appliance store, starts the month with $137,000 in inventory. The following transactions take place during the month:

a) Receives $21,230 worth of stereo equipment on account

INCREASES INVENTORY

b) Returns a $300 television to a supplier because it did not work

DECREASES INVENTORY

c) Purchases $130 in promotional materials for the store

NOT PERTINENT TO INVENTORY

d) Acquires (and receives) three used television sets for $90 per unit or a total of $270

INCREASES INVENTORY

e) Discovers that one of the three televisions purchased in (d) is defective and throws it in the trash

DECREASES INVENTORY

f) Merchandise sales during the month total $33,000

NOT PERTINENT TO INVENTORY

g) Determines that the month-end inventory at the store has a value of $132,000

ITEMS REMAINING IN INVENTORY

THE ELECTRONICS OUTLET

Beginning inventory	*$137,000*	*given*
plus: Items received	*21,500*	*a) and d)*
less: Returns to supplier	*(300)*	*b)*
less: Shrinkage	*(90)*	*e)*
less: Ending inventory	*132,000*	*g)*
equals: Cost of goods sold	*$ 26,110*	

Note: Events c) and f) are not pertinent to the determination of Cost of Goods Sold

<u>page 178, #8.13</u>: Why would a country pass tax legislation providing for an investment tax credit?

An investment tax credit provision permits the purchaser of certain types of fixed assets to reduce its income-tax expense by a specified percentage of the initial cost of the assets.

The purpose of the investment tax credit is to influence investment behaviour.

Legislation providing for an investment tax credit generally stimulates capital investment, and typically enhances the country's international competitiveness and/or the growth of the country's economy.

page 179, #8.4: The Leland Company sells for $5,000 cash an asset that had an original cost of $13,500, and accumulated depreciation of $9,300. Account for this transaction in T-account format.

Original cost	*$13,500*
less: Accumulated depreciation	*9,300*
yields: Book value	*$ 4,200*

Selling price	*$ 5,000*
less: Book value	*4,200*
yields: Capital gain (loss)	*$ 800*

Dr: Cash	*$ 5,000*	
Cr: Gain/loss; Fixed asset		*$ 5,000*
Dr: Allowance for depreciation	*$ 9,300*	
Cr: Gain/loss; Fixed asset		*$ 9,300*
Dr: Gain/loss; Fixed asset	*$13,500*	
Cr: Fixed asset		*$ 13,500*

Cash	
$ 5,000	

Fixed Asset	
$ 13,500	*$13,500*

Allowance for Depreciation	
$ 9,300	*$ 9,300*

Capital Gain/Loss Fixed Asset	
$ 13,500	*$ 9,300*
	5,000

<u>pages 180-181, #8.14, parts b, e, g, i</u>: The following transactions and events occurred at the Dym Foundry Corporation in July 1995. During this month, Dym moved from its old facility, to a new plant that was constructed to the company's specifications on a nearby site. The move also signaled a substantial increase in capacity for Dym. Prepare T-account entries to record the events and transactions.

b) Certain equipment used in the old facility, but not appropriate for the new facility, was sold for \$36,000 in cash. This equipment appeared on the company's records at an original cost of \$70,000 less accumulated depreciation of \$31,000.

Original cost	***\$ 70,000***
less: Accumulated depreciation	***<u>31,000</u>***
yields: Book value	***\$ 39,000***

Sales price	***\$ 36,000***
less: Book value	***<u>39,000</u>***
yields: Capital gain (loss)	***\$ (3,000)***

Dr:	***Cash***	***$36,000***	
	Cr: Capital gain/loss; Fixed asset		***$36,000***
Dr:	***Allowance for depreciation***	***$31,000***	
	Cr: Capital gain/loss; Fixed asset		***$31,000***
Dr:	***Capital gain/loss; Fixed asset***	***$70,000***	
	Cr: Fixed asset		***$70,000***

Cash	
$ 36,000	

Allowance for Depreciation	
$ 31,000	***$ 31,000***

Fixed Asset	
$ 70,000	***$ 70,000***

Capital Gain/Loss Fixed Asset	
$ 70,000	***$ 36,000***
	$ 31,000

g) **The landscape contractor with whom Dym contracted for landscaping the new facility at a fixed price of $10,000 offered to accept only $9,200 for the work if Dym agreed to pay at the completion of the work rather than 60 days following completion, as had been specified by the contract. Dym accepted this offer and made the $9,200 cash payment.**

Dr: *Fixed asset (landscaping)*	***$ 9,200***	
Cr: Cash		***$ 9,200***

Cash

$ 9,200	

Fixed Asset
(Landscape)

	$ 9,200