

Liabilities and Equity Exercises I

Larry M. Walther; Christopher J. Skousen



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Larry M. Walther & Christopher J. Skousen

Liabilities and Equity Exercises I



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1st edition

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Supporting calculations:

Solution 1

| Liabilities | | | |
|---------------------------------|----|----------------|--------------|
| Current liabilities | | | |
| Accounts payable | \$ | 210,000 | |
| Utilities payable | | 82,500 | |
| Unearned revenue | | 562,500 | |
| Sales tax payable | | 7,500 | |
| Interest payable | | 5,625 | |
| Current portion of loan payable | | <u>750,000</u> | \$ 1,618,125 |

Supporting calculations:

Accounts payable ($\$150,000 + \$975,000 - \$915,000 = \$210,000$)

Interest payable ($\$2,250,000 \times 6\% \times 15/360 = \$5,625$)

Solution 2

a), b), c)

| GENERAL JOURNAL | | | |
|-----------------|---|--------|--------|
| Date | Accounts | Debit | Credit |
| 1-Apr | Equipment | 17,500 | |
| | Cash | | 2,500 |
| | Note Payable | | 15,000 |
| | <i>To record purchase of equipment for cash and 8% note payable</i> | | |
| 31-Dec | Interest Expense | 900 | |
| | Interest Payable | | 900 |
| | <i>To record accrued interest for 9 months (\$15,000 X 8% X 9/12)</i> | | |
| 31-Mar | Interest Expense | 300 | |
| | Interest payable | 900 | |
| | Note Payable | 15,000 | |
| | Cash | | 16,200 |
| | <i>To record repayment of note and interest (\$15,000 X 8%)</i> | | |

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Problem 3

On August 1, 20X7, Desert Water Company purchased a water hauling truck. The sole consideration was a \$150,000 note due in one year. Interest of \$18,000 was included the face amount of the note. If Miller had purchased the truck for cash, the purchase price would have been only \$132,000.

- a) Prepare the appropriate journal entry to record the purchase on August 1, 20X7.
- b) Prepare the appropriate journal entry to record the year-end discount amortization on December 31, 20X7.
- c) Prepare the appropriate journal entry to record the payment of the note on July 31, 20X8.
- d) What was the actual rate of interest on this loan?

Worksheet 3

a), b), c)

| GENERAL JOURNAL | | | |
|-----------------|----------|-------|--------|
| Date | Accounts | Debit | Credit |
| 1-Apr | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| 31-Dec | | | |
| | | | |
| | | | |
| | | | |
| 31-Mar | | | |
| | | | |
| | | | |
| | | | |
| | | | |

d)

Solution 3

a), b), c)

| GENERAL JOURNAL | | | |
|-----------------|--|---------|---------|
| Date | Accounts | Debit | Credit |
| 1-Apr | Equipment | 132,000 | |
| | Discount on Note Payable | 18,000 | |
| | Note Payable | | 150,000 |
| | <i>To record note payable, issued at a discount</i> | | |
| | | | |
| 31-Dec | Interest Expense | 7,500 | |
| | Discount on Note Payable | | 7,500 |
| | <i>To record discount amortization for 5 months</i> | | |
| | | | |
| 31-Mar | Interest Expense | 10,500 | |
| | Note Payable | 150,000 | |
| | Discount on Note Payable | | 10,500 |
| | Cash | | 150,000 |
| | <i>To record discount amortization and repayment of note</i> | | |

d) The actual interest rate is about 13.6% ($\$18,000/\$132,000$).

Problem 4

Northern Freeze Corporation manufactures and sells snow removal machines. These machines include a complex heater module, and about 10% of all units sold require subsequent repair under the warranty. The average repair cost is \$75 per unit.

Northern Freeze began the year with an accrued warranty liability of \$150,000. During the year, 65,000 machines were sold. \$340,000 was expended on warranty services performed during the year.

Prepare Northern's journal entries to accrue additional warranty costs relating to current year sales and account for monies expended on actual warranty work performed during the year. How much will appear as warranty expense in the current year income statement, and how much will appear as the warranty liability on the closing balance sheet?

Worksheet 4

| GENERAL JOURNAL | | | |
|-----------------|----------|-------|--------|
| Date | Accounts | Debit | Credit |
| | | | |
| | | | |
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Solution 4

| GENERAL JOURNAL | | | |
|-----------------|--|---------|---------|
| Date | Accounts | Debit | Credit |
| | Warranty Expense | 487,500 | |
| | Warranty Liability | | 487,500 |
| | <i>To accrue additional warranty costs (65,000 units X 10% X \$75)</i> | | |
| | | | |
| | Warranty Liability | 340,000 | |
| | Cash | | 340,000 |
| | <i>To record actual warranty expenditures</i> | | |

The warranty expense in the income statement is \$487,500, and the closing warranty liability balance is \$297,500 (\$150,000 beginning balance + \$487,500 additional accrual – \$340,000 work performed).

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Problem 5

Following are selected transactions or events of Alpine Company relating to its first month of operation.

- 01-Jun Alpine borrowed \$75,000 via a note payable bearing interest at 1% per month. This note and all accrued interest is due at the end of July.
- 10-Jun Purchased \$15,000 of inventory, terms 2/10,n/30. The purchase was initially recorded at the net amount. The obligation was not paid during June.
- 15-Jun The company adopted an employee health insurance plan. The total estimated cost is \$75 per day. None of this cost was funded during June.
- 20-Jun Sold goods for \$65,000 cash. Alpine offers a warranty on the goods, and anticipates that total warranty cost will be 2% of sales.
- 25-Jun One of Alpine's vehicles was involved in an accident. Alpine expects to be held responsible for an estimated \$7,500 in damages.
- 30-Jun At month end, it was estimated that employees are owed for \$11,500 in accrued wages. In addition, \$275 was spent on warranty service work.

- a) Prepare any initial journal entries necessary to record the above transactions or events.
- b) Prepare month-end adjusting journal entries that are deemed appropriate related to the above transactions or events.
- c) Prepare the current liability section of the company's balance sheet as of the end of the month. The only obligations are those related to the above transactions or events.

Solution 5

a)

| GENERAL JOURNAL | | | |
|-----------------|--|--------|--------|
| Date | Accounts | Debit | Credit |
| 1-Jun | Cash | 75,000 | |
| | Note Payable | | 75,000 |
| | <i>Record note payable</i> | | |
| 10-Jun | Purchases (or Inventory) | 14,700 | |
| | Accounts Payable | | 14,700 |
| | <i>Record purchase, net of discount</i> | | |
| 20-Jun | Cash | 65,000 | |
| | Warranty Expense | 1,300 | |
| | Sales | | 65,000 |
| | Warranty Obligation | | 1,300 |
| | <i>Record sale and warranty cost</i> | | |
| 25-Jun | Loss | 7,500 | |
| | Estimated Liability for Accident | | 7,500 |
| | <i>Record estimated cost of accident</i> | | |

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b)

| GENERAL JOURNAL | | | |
|-----------------|---|--------|--------|
| Date | Accounts | Debit | Credit |
| 30-Jun | Wages Expense | 11,500 | |
| | Wages Payable | | 11,500 |
| | <i>Record accrued wages</i> | | |
| 30-Jun | Warranty Obligation | 275 | |
| | Cash | | 275 |
| | <i>Record warranty work performed</i> | | |
| 30-Jun | Interest Expense | 750 | |
| | Interest Payable | | 750 |
| | <i>Accrue 1% interest on note</i> | | |
| 30-Jun | Discount Lost (or Inventory) | 300 | |
| | Accounts Payable | | 300 |
| | <i>Lapse of available discount</i> | | |
| 30-Jun | Employee Insurance Expense | 1,125 | |
| | Insurance Liability | | 1,125 |
| | <i>Accrue 15 days of insurance cost</i> | | |

c)

| Liabilities | | | |
|-------------------------------------|--|----|--------------|
| Current liabilities | | | |
| Notes payable | | \$ | 75,000 |
| Accounts payable | | | 15,000 |
| Interest payable | | | 750 |
| Wages payable | | | 11,500 |
| Employee health insurance liability | | | 1,125 |
| Warranty obligation | | | 1,025 |
| Estimated liability for accident | | | 7,500 |
| | | | <u>7,500</u> |
| | | \$ | 111,900 |

Problem 6

Following are selected borrowing transactions by University Life Housing Corporation.

- 01-Jun University Life Housing purchased new furniture in exchange for a \$250,000 promissory note. The note was due in 6 months and bears interest at 10% per annum.
- 01-Jul Borrowed cash of \$45,000, giving a \$50,000 one-year note. The interest is implicit in the difference between the cash borrowed and the note's \$50,000 maturity value.
- 01-Oct University Life Housing was experiencing a temporary cash flow crunch. The company issued a \$20,000 one-year note in settlement of an outstanding account payable. The note bears interest at 6% per annum. The agreement with the creditor was that University Life Housing would repay the note as soon as possible, and the total interest would be allocated to each month based on the "rule of 78."
- 31-Oct University Life Housing paid the note and accrued interest resulting from the October 1 transaction.
- 01-Nov Borrowed \$50,000 cash from a local bank by issuing a 2-year, 8% promissory note. The interest is to be calculated based on actual days, using a 365-day year assumption.
- 01-Dec University Life Housing paid the note and accrued interest resulting from the June 1 transaction.
- Prepare journal entries necessary to record the above transactions.
 - Prepare year-end adjusting journal entries pertinent to the above borrowing transactions.

b)

| GENERAL JOURNAL | | | |
|-----------------|----------|-------|--------|
| Date | Accounts | Debit | Credit |
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Solution 6

a)

| GENERAL JOURNAL | | | |
|-----------------|---|---------|---------|
| Date | Accounts | Debit | Credit |
| 1-Jun | Furniture | 250,000 | |
| | Note Payable | | 250,000 |
| | <i>Record note payable, 10%</i> | | |
| 1-Jul | Cash | 45,000 | |
| | Discount on Note Payable | 5,000 | |
| | Note Payable | | 50,000 |
| | <i>Record one-year note payable</i> | | |
| 1-Oct | Accounts Payable | 20,000 | |
| | Note Payable | | 20,000 |
| | <i>Record note payable, 6%</i> | | |
| 31-Oct | Note Payable | 20,000 | |
| | Interest Expense | 185 | |
| | Cash | | 20,185 |
| | <i>Record note payoff (\$20,000 X 6% X 12/78 = \$185)</i> | | |
| 1-Nov | Cash | 50,000 | |
| | Note Payable | | 50,000 |
| | <i>Record 8% note payable</i> | | |
| 1-Dec | Note Payable | 250,000 | |
| | Interest Expense | 12,500 | |
| | Cash | | 262,500 |
| | <i>Record note payoff (\$250,000 X 10% X 6/12 = \$20,000)</i> | | |

b)

| GENERAL JOURNAL | | | |
|-----------------|--|-------|--------|
| Date | Accounts | Debit | Credit |
| 31-Dec | Interest Expense | 2,500 | |
| | Discount on Note Payable | | 2,500 |
| | <i>To amortize discount on note</i> | | |
| 31-Dec | Interest Expense | 668 | |
| | Interest Payable | | 668 |
| | <i>To accrue interest</i> <i>(\$50,000 X 8% X 61/365 = \$668)</i> | | |

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Problem 7

ABC Corporation has 8 employees. Information about the October payroll follows:

| Name | Hours Worked | Pay Rate | Federal Income Tax Withheld |
|-------------|--------------|--------------------|-----------------------------|
| Ahn, M. | 190 | \$12 per hour | \$450 |
| Bhushan, F. | n/a | \$2,500 per month | \$638 |
| Child, G. | 60 | \$13 per hour | \$167 |
| Edwards, J. | n/a | \$6,700 per month | \$1,200 |
| Hall, J. | n/a | \$10,200 per month | \$2,681 |
| Wong, I. | 150 | \$11 per hour | \$360 |
| Wu, C. | 148 | \$12 per hour | \$400 |
| ZoBell, D. | n/a | \$12,200 per month | \$3,000 |

Additional information is as follows:

ABC is in a state without an income tax. Employees' federal income tax withholdings depend on various factors, and the amounts are as indicated in the above table.

No employees worked overtime, with the exception of Meeyeon Wong, who worked 30 hours of overtime. Overtime is paid at 150% of the normal hourly rate.

Assume that gross pay is subject to social security taxes at a 6.5% rate, on an annual base of \$100,000. Assume that Medicare/Medicaid taxes are 1.5% of gross earnings. These taxes are matched by the employer. Only James Hall had earned more than \$90,000 during the months leading up to October. He had earned \$91,800 during that time period.

ABC has 100% participation in a \$15 per month employee charitable contribution program. These contributions are withheld from monthly pay.

ABC pays for workers' compensation insurance at a 2% of gross pay rate. None of this cost is paid by the employee.

ABC provides employees with a group health care plan, however the cost is fully paid by employees. The rate is \$300 per month, per employee.

ABC's payroll is subject to federal (0.5%) and state (1.5%) unemployment taxes on each employee's gross pay, up to \$8,000 per year. All employees had earned in excess of \$8,000 in the months leading up to October, with the exception of Francis Bhushan. Francis was first employed during the month of October.

ABC contributes 5% of gross pay to an employee retirement program. Employees do not contribute to this plan.

- a) Complete the payroll schedule on the accompanying blank worksheet.
- b) Prepare journal entries for ABC's payroll and the related payroll expenses.

Worksheet 7

a)

| Name | Gross Earnings | Deductions | | | | | Net Earnings |
|-------------|----------------|--------------------|---------------------|-------------------|------------|------------------|--------------|
| | | Federal Income Tax | Social Security Tax | Medicare/Medicaid | Charitable | Health Insurance | |
| Ahn, M. | | | | | | | |
| Bhushan, F. | | | | | | | |
| Child, G. | | | | | | | |
| Edwards, J. | | | | | | | |
| Hall, J. | | | | | | | |
| Wong, I. | | | | | | | |
| Wu, C. | | | | | | | |
| ZoBell, D. | | | | | | | |
| Totals | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |

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b)

| GENERAL JOURNAL | | | |
|-----------------|---|-------|--------|
| Date | Accounts | Debit | Credit |
| 31-Oct | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | <i>To record payroll</i> | | |
| | | | |
| 31-Oct | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | <i>To record employer portion of payroll taxes and benefits</i> | | |

Solution 7

a)

| Name | Gross Earnings | Deductions | | | | | Net Earnings |
|-------------|----------------|--------------------|---------------------|-------------------|------------|------------------|--------------|
| | | Federal Income Tax | Social Security Tax | Medicare/Medicaid | Charitable | Health Insurance | |
| Ahn, M. | \$ 2,280.00 | \$ 450.00 | \$ 148.20 | \$ 34.20 | \$ 15.00 | \$ 300.00 | \$ 1,332.60 |
| Bhushan, F. | 2,500.00 | 638.00 | 162.50 | 37.50 | 15.00 | 300.00 | 1,347.00 |
| Child, G. | 780.00 | 167.00 | 50.70 | 11.70 | 15.00 | 300.00 | 235.60 |
| Edwards, J. | 6,700.00 | 1,200.00 | 435.50 | 100.50 | 15.00 | 300.00 | 4,649.00 |
| Hall, J. | 10,200.00 | 2,681.00 | 598.00 | 153.00 | 15.00 | 300.00 | 6,453.00 |
| Wong, I. | 1,650.00 | 360.00 | 107.25 | 24.75 | 15.00 | 300.00 | 843.00 |
| Wu, C. | 1,776.00 | 400.00 | 115.44 | 26.64 | 15.00 | 300.00 | 918.92 |
| ZoBell, D. | 12,200.00 | 3,000.00 | 793.00 | 183.00 | 15.00 | 300.00 | 7,909.00 |
| Totals | \$ 38,086.00 | \$ 8,896.00 | \$ 2,410.59 | \$ 571.29 | \$ 120.00 | \$ 2,400.00 | \$ 23,688.12 |

b)

| GENERAL JOURNAL | | | |
|------------------------|---|--------------|---------------|
| Date | Accounts | Debit | Credit |
| 31-Oct | Wages Expense | 38,086.00 | |
| | Federal Income Tax Payable | | 8,896.00 |
| | Social Security Payable | | 2,410.59 |
| | Medicare/Medicaid Payable | | 571.29 |
| | Charity payable | | 120.00 |
| | Insurance Payable | | 2,400.00 |
| | Cash | | 23,688.12 |
| | <i>To record payroll</i> | | |
| | | | |
| 31-Oct | Payroll Tax Expense | 3,004.68 | |
| | Employee Benefits Expense | 2,666.02 | |
| | Social Security Payable | | 2,410.59 |
| | Medicare/Medicaid Payable | | 571.29 |
| | Workers' Comp Payable (2%) | | 761.72 |
| | FUTA Payable (0.5% X \$1,140) | | 5.70 |
| | SUTA Payable (1.5% X \$1,140) | | 17.10 |
| | Retirement Plan Payable (5%) | | 1,904.30 |
| | <i>To record employer portion of payroll taxes and benefits</i> | | |