

# Intermediate Accounting I

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Subject	Course Level	Title	Grade	Credit Hours	Quality R. Points
ACC 203	UG	Introduction to Accounting I	A	3.000	12.00
ECO 231	UG	Principles of Macroeconomics	B	3.000	9.00

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# Intermediary Accounting.

God please give me the strength + determination to get through this accounting course stress free and triumph. I wanna make Gilmore proud. And more importantly you + myself. I know you wouldn't put me in anything I can't handle so I pray that you keep me encouraged + that I don't become discouraged.

Accounting - A special language used to communicate financial info. about a business to those who wish to use the info to make decisions.

OLD: The recording, + analyzing, ~~press~~ business transactions

Financial Accounting - For external users like investors + creditors. Focus on providing relevant financial info. to various external users.

Managerial Accounting: Deals with concept + methods used to provide info. to an organizations internal users (It's managers)

Financial Reporting: The process of providing this info. to external users  
mechanism that exists

Capital Markets (Economics) <sup>VTO</sup> allocate resources to ~~privately owned companies~~ + to privately owned

enterprises that ensures or tries to ensure that resources are going to those companies that will utilize them the most efficiently.

- The mechanism that foster this efficient allocation of resources are **CAPITAL MARKETS**: composite (many parts) of investors + creditors

Secondary Market: The transfer of stocks + bonds among ~~the~~ individuals + institutions. Because the corp. receives no cash from these transactions.

Primary Market Transactions - Transactions in which the shares or bonds are sold by the corp. to initial owners.

INVESTMENT/Credit Decision cash flow perspective

Rate of Return =

$$\frac{\text{DIV} + \text{share Price Appreciation}}{\text{Initial Investment}}$$

Adjusting Entries - ~~Transfer~~ for the most part, conversions from cash basis to ~~accrual~~ accrual basis.

Prepayments + ~~accruals~~ occur when cash flow precedes or follows expense or revenue recogn.

## New Notes Needed Chp 2

Step 6 In accounting Process

Adjusting Entry: Are only for accounts that effect the internal events on accounting equation

- meaning ones that dont involve any external factors such as another entity

- These entries are required to implement the <sup>①</sup>accrual accounting model.

② Satisfy realization principle

③ Matching Principle

\* Helps to ensure that all revenues earned in a period are recognized in that period, regardless to when cash is received

Also when all expenses are incurred during a period regardless of when a cash payment is made.

\* Adjusting entries necessary for 3 situation

① • Prepayments

② • Accruals

③ • Estimates (Depr.)

Prepayments - Occur when cash flow precedes either expense or revenue recognition

Prepaid Expenses - Are the costs of assets acquired in one period and expensed in a future period. If only ~~the~~ benefits ~~to~~ any future periods

Unearned Revenues - Are created when a comp. receives cash from a cust. for one period for goods or services that are to be provided in a future period.

Accrued Liabilities - Expense incurred but not yet paid

- The adjusting entry for accrued liab. always includes a debit to an expense + a credit to a liability

Accrued Receivables - Involve the recognition of revenue earned before cash is received.

## Chp 7

Net Operating Cashflow - Included in Cash Basis Accounting.

- Measure is difference between cash receipts and cash disbursements during a reporting period from transactions related to providing goods + services to customers.

## Chap 3 - Mcgean Online - 2/5

### Current Assets

Cash Equivalents: Includes commercial paper, money, market funds, + U.S Treasury Bills.

- Cash that is restricted for special purposes is not classified as current Asset ~~but~~ but as Investments

- Investments with maturity dates of 3 months or less classified as cash equivalents

Short-term Investments - Liquid Investments not classified as cash equivalents. (temporary investment or short-term marketable securities)

- Investments in Stocks, + debt securities of other corp, if comp, plans to sell them in 1 year or 1 operating cycle whichever longer

Accounts Receivable - Results from a sale of goods or service on credit. usually due 30-60 days

Notes Receivable - When receivables are ~~reported~~ supported by a formal agreement or note that specifies payment terms

- Any Receivable regardless of the source not expected to be collected within one year or the operating cycle is classified as Investments (noncurrent assets)

Inventories - Include goods awaiting sale (finished goods), goods in the course of production (WIP), and goods to be consumed directly or indirectly in production (Raw Materials)



Prepaid Expenses - Represents an asset recorded when an expense is paid in advance, creating benefits beyond the current period.

- if prepayment is for more than year a portion is considered other or noncurrent asset.

Other Current Assets Include:

Nontrade Receivables

Noncurrent Assets - Investments - Assets that company acquires that are not used directly in the operations of the corp.

- Include:

- Investment in debt + equity securities of other corp.

- Land held for speculation

- Noncurrent receivables

- Cash set aside for special purposes

Property, Plant, + Equipment - Tangible, long lived, and used in operation of the business

- Land, buildings, equipment, machinery, and natural resources such as mineral mines, timber tracts, and oil wells.

Intangible Assets - Assets used in operations of a business have no physical substance. Generally these represent the ownership of an exclusive right to something such as a product, a process, or a name.

↳ - Patents, copyrights, + franchises

Other Assets - a catch-all classification of noncurrent assets

- Includes ~~to~~ long-term prepaid exp. called deferred charges, and any noncurrent asset not falling in any other classification

Liabilities - Represent obligations to other entities

Current Liabilities - Are those obligations that are expected to be satisfied through ~~those~~ the use of current assets or the creation of other current liab.

- expected to be paid within 1 year or an operating cycle whichever is longer.

- Accounts Payable - Obligations to suppliers of merchandise or of services purchased on open acct, with payment usually due in 30-60 days

Notes Payable - Are written promises to pay cash at a future date

- Notes maturing in the next year or operating cycle whichever longer will classify as C.L.

Unearned Revenues (Deferred Revenue) - Represent cash received from a customer for goods or services to be provided in a future period.

Accrued Liabilities -

M-123

DM - 80,000

OL - 40,000

FOH = (2 × 40,000) = 80,000

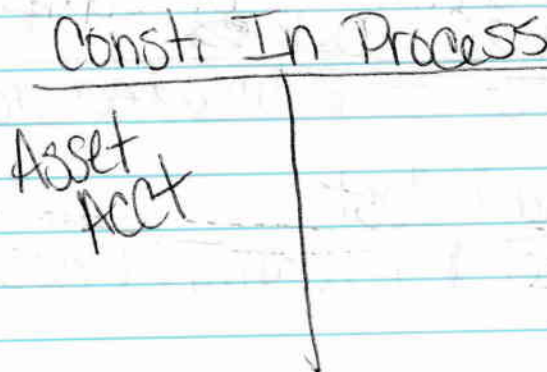
$$\frac{200,000}{2,000} = \$100 \text{ per unit}$$

Consignment Sales - meaning the retailer does NOT have to invest in inventory. The cosignor holds the title and there is no journal entry to show the transfer of the title to the goods. When goods are sold the cosignee gets the amount he charged the cosignor to sell it.

Completed Contract Meth - Revenue is recognized when the contract is completed.

Percentage of degree of completion Method - Revenue is recognized as a percentage of the job is completed.

Construction in Process (WIP) - All construction cost will be debited to CIP.



As you put in DM, DL, + FOH into the account it gives account value.

Const In Process		Billing On Contr	
1,500,000		1,200,000	
1,000,000		2,000,000	
1,600,000		1,800,000	
<hr/>		<hr/>	
4,100,000		5,000,000	

$\swarrow$  Total Cost                       $\swarrow$  Total Revenue

A/R		Cash	
1,200,000	100,000,000	1,000,000	
8,000,000	1,400,000		
1,800,000	2,600,000	2,600,000	
<hr/>		<hr/>	

$\$1,000,000$  profit

0  $\Rightarrow$  should have 0 balance

Whenever you debit A/R you credit Billing on construction

~~Recognize~~  
 Percentage of job is based on the actual cost incurred plus the estimated cost to complete will determine % of completion  

$$\frac{\text{actual cost}}{\text{add actual cost} + \text{estimated cost}}$$

$$\% \text{ complete} = \frac{\text{Actual Cost}}{\text{estimated} + \text{actual cost}}$$

## Chap. 5

### Revenue ~~Recog~~ Recognition

Matching Principle - ~~Report~~ Expenses should be recognized in the period in which the related revenues are recognized.

Realization Principle - Requires that 2 criteria be satisfied, before revenue can be recognized (recorded)

1. The earnings process is judged to be complete or virtually complete to what company uses to generate revenue.

2. There is a reasonable certainty as to the collectibility of the asset to be received.

\* SEC issued Staff Accounting Bulletin (SAB) No. 101<sup>5</sup>  
Additional Criteria for Revenue Recognition

1. Persuasive evidence of an arrangement ~~exists~~ exists.

2. Delivery has occurred or services <sup>have been</sup> rendered

3. The seller's price to the buyer is fixed or determinable

4. Collectibility is reasonably assured.

### 3 Revenue Recognition Methods

#### Revenue Recognition @ delivery -

\* Revenue actually is earned throughout the earnings process. The critical event is when the realization principle is ~~recognized~~ <sup>satisfied</sup>

The product delivery date occurs when legal title to the goods passes from sellers to buyers, depending on terms of sales agreement -

F.o.b (free on board) <sup>(Free for person that shipped)</sup> shipping point Criteria:

- Legal title to the goods changes hands at the point of shipment. (when seller delivers goods to common carrier)

- The purchaser is responsible for shipping costs & transit insurance

f.o.b. Destination - <sup>(Free to the destination)</sup>

- Seller responsible for shipping

- Legal title does not pass until the goods arrive at the customer's location.

Service Revenue - Recognized at a point in time if there is one final activity that is deemed critical to the earnings process. (Revenue is deferred until final activity is complete)

Cash  
1.0 / 1.5

A/R  
1.2 / 1.0

CIP  
1.5

BOC  
1.2

~~Jan~~

2) To Record progress Billings

A/Receivable -

Billings on Construction -

3) To Record cash collections

Cash -

A/Receivable -

\* If at end of year the balance of CIP (after billings on constr. is closed into it) is a debit bal. its an asset. If a credit bal. its a liability. (~~incur a loss~~)

### Journal Entries For Profit Recognition

Completed Contract Method -

CIP (gross profit) -

(COGS) Cost of Construction -

Revenue from long term

Contracts

(To record gross profit)

### % of Completion

The same  $\$$  but every year (or period) that cost are incurred, and the gross profit is recognized.

Formula: To get gross profit recognized during a period

$$\text{GP Recognized During This Period} = \left( \frac{\text{Tot. est. GP}}{\text{Tot. Rev.} - \text{Tot. Cost est.}} \times \% \text{ completed to date} \right) - \text{GP recogn. in prior periods}$$

$$\begin{aligned} \text{Tot. Rev.} &= \swarrow \\ - \text{Tot. Cost est.} & \end{aligned}$$

Actual Cost to Date

Tot. Est. Cost +  
Tot. Act. Cost for project

OR \* Calculate Gross Profit with Revenue Recognition

$$\text{Gross Profit} = \left( \% \text{ of Comp.} \times \text{Contract Price} \right) - \text{Rev. Recogn. Prior Periods} - \text{Cost of Construction}$$

\* Balance Sheet \*

CIP > Billings on Constr. = Asset (Receivable)

Billings > CIP = Liability (Unearned Revenue)

% of Completion

Current Assets

Accts Receivable

Costs & Profit

Current Liabilities

Billings in Excess of Cost & Profit



### ③ Cost Recovery Method -

$$\text{COST} = 60,000$$

$$\text{payment} = 20,000$$

$$\text{Profit} = 40,000$$

	Payment	Cost Recov.	Profit
①	20,000	20,000	-0-
②	20,000	20,000	-0-
③	20,000	20,000	-0-
④	20,000	-0-	20,000
⑤	20,000	-0-	20,000
		<del>60,000</del>	40,000

Right of Return - Because of this revenue recognition is deferred until after special criteria is met. Normally after point of delivery.

Consignment Sales - When a company arranges for another company to sell its product. Cosignor physically transfers the goods to the other comp. & consignee. Cosignor retains title of the goods and doesn't recognize revenue until the consignee sells goods & title is passed to the eventual customer.

## Revenue Recognition Prior to Delivery

Percentage of Completion Method - Recognize Revs + Exp over time by allocating a share of the project's expected revenues + expenses to EACH PERIOD in which the earnings process occurs. (The contract period)

Completed Contract Method - Realization of Recognition criteria suggest that revenue be recognized when a long-term project is finished. Earnings process virtually complete.

Both Need These Accounts:

Construction In Process

Billings on Construction Contract

Debit Bal.

Credit

CIP - Used as a WIP

Contains Cost + GP.

~~Because~~  $Cost + GP = SP + Billings$

Billings on Construction Contract - Increased any time a customer is billed (representing a A/R)

~~Contra~~ Contra Acct to CIP. Credit

When debit A/R (Reduces CIP)

$CIP\ Bal = 0$

3 Journal entries to record ~~with~~ Construction Cost

1) CIP -

Cash, Materials etc. -

(To Recd Construction Cost)

## Revenue Recognition After Delivery

- Installment Sales Method - Recognize

revenue and costs only when cash payments are received

★ - Each payment has 2 components → ★

① A partial recovery of ~~costs~~ the cost of the ~~item~~ item sold +

② A gross profit component,

Applied using gross profit %:  $\left( \frac{\text{Gross Profit}}{\text{Sales Price}} \right)$

Deferred Gross  
Profit

30%

60,000 profit

140,000 cost

CRONTA

acct to

Installment

Receivable

credit Bal

## Journal Entries to Record an Installment

Sale and payments

Make Installment sale: (Record)

Installment Reciev — debit

Inventory — credit

deferred Gross Profit — credit

Cash — debit

Install/Rec — credit

Deferred Gross Profit - debit <sup>(for amount of gross profit earned)</sup>

→ Realized GP - credit

closed into R. Earnings with closing entries into income summary. Reported on Income Statement

Installment receivables - are classified as current assets if they will be collected within one year (or within company's operating cycle; if longer)

Cost Recovery Method - Method defers all gross profit recognition until the cost of the item sold has been recovered.

pg. 243 Concept Review Exercise

① Point of Delivery Method

A/R - 100,000

Sales Rev - 100,000

COGS - 60,000

Inventory 60,000

② Installment Sales Meth.  $\frac{40,000}{100,000} = 40\%$

2011 ① Payment 20,000      ~~Receiv~~ COST 60% GP (40%) 100,000

② 20,000      12,000      8,000

③ 20,000      12,000      8,000

④ 20,000      12,000      8,000

⑤ 20,000      12,000      8,000

12,000      8,000

} 40,000

bookwork from Lecture 1

Revenue Recognition - When the seller has fulfilled all obligations and delivered ~~product~~ (Point of Sale) product

Product Services FOB Shipping - if goods are shipped the buyer pays the transportation cost and as soon as you put goods on truck the title is turned over to the buyer

FOB destination - Don't recognize revenue until the goods are delivered

Service Revenue - Revenue is earned when the service is provided  
- Magazine subscriptions

Installment Sales - Revenue is recognized as the cash is recognized - The criteria is when cash is collected.

pg 270  
Pg 273 BE 51

3000000  
1200000

8.1 - 1,800,000 2011 → Because we recognize revenue at point of sale when its delivered.  
2012  
Installment

# Installment method

5-2)	3,000,000	1,200,000	180,000
	2015	20	20
	150,000	60,000	90,000 (2011)
			90,000 (2012)

Cost Recovery - Rev is earned when all cost has been recovered. 1st get what you spent back then add profit.  
pg 242

	Cash Recd	Cost	Recogn. Profit
1	150,000	150,000	
2	150,000	150,000	
3	150,000	150,000	
4	150,000	150,000	
5	150,000	150,000	
6	150,000	150,000	
7	150,000	150,000	
8	150,000	150,000	
9	150,000	150,000	
	3,000,000	1,200,000	1,800,000

51 Installment Sale Receivable 3,000,000  
 Inventory 1,200,000  
 Cash - 150,000  
 Install Recier - 150,000

Chap. 6

Interest Earned on our investment

Interest - Taking a present value & converting it to a future value

Simple Interest

$$\frac{\text{Int}}{\text{P.V.} \times \text{6\%}} = \text{F.V.} \quad 1,000 \times 1.06 = 1060$$

$n=1$      50

Present Value - Is taking a future & converting it to a PV.

1 year want 1,000

$$\$943.40 \leftarrow \text{PV} \xrightarrow{n=1} \text{FV } 1000$$

~~0.94340~~ 6%

$$0.94340 \times 1000$$

Compounding - Is when you pay interest upon interest.

$$\textcircled{1} 100 \xrightarrow[6\%]{1 \text{ year}} 106 \quad \textcircled{2} 106 \xrightarrow[6\%]{} 112.36$$

PV     FV

$$\textcircled{3} 112.36 \xrightarrow[6\%]{} 119.10 \quad \textcircled{4} 119.10 \xrightarrow[6\%]{} 126.25$$

\* 2 classes for this

Chp. 7

Solve on

Refers to any company that sells stock  
- V Law that was

passed that requires businesses to file accurate financial statements started because banks + investor use your Financial Statements to determine rather or not to <sup>let</sup> borrow or invest

Internal Control - Procedures put into place by business to protect assets of business from customers, + employees (regulations on who does what) most difficult to ~~control~~ protect cash.

Primary Protection for cash is Bank Account

- Businesses try to get cash out of business and into BA asap.

Cash Register - ~~is~~ control procedure over cash because it prints receipts

Bank Statement - <sup>acct FOR BANK</sup> Credit for Bank (my Money) B. balance, deposits, checks,



debit transactions, and fees.  
A detailed statement of  
all your transactions during  
a period.

pg 332 7-3A

Bank Reconciliation = Proves  
accuracy of Bank Balance/Statement  
forces you to find any errors  
that have occurred during  
period

Book Bal.

Bank Reconciliation

Bank Bal. ← ① → Book Bal.

\* ending balance  
showed on Bank S  
19,340

company records  
Bank Chrg (50)  
6,480

Deposit In Transit - 2,500

When proven their equal  
is called proven accuracy of  
cash

somebody owe you in  
Bank collects it. notes possible

Bank Service Charge - When receive bank statement - the bank has took bank fees from Bank (deduct from book balance)

Deposit In Transit - A ~~check~~ deposit made into BA and not yet posted. (add to Bank Balance)

A note collected by the bank is when the bank is for you

by owner

Outstanding Check - Check written but not received by bank yet. so it's not been cashed

- Every adjustment to the Book Balance must be journalized in journal

Petty Cash fund - Small cash fund used to pay expenditures that you don't want to write checks for. Usually 1 person in office responsible for petty cash

Dont ever debit/credit petty cash anymore after its established unless you wanna increase/decrease the fund.

-anytime I go to ~~draw~~ check draw should have Begining amount of cash or cash receipts for the ~~the~~ the balance.

\* Fund exalted at <sup>some</sup> point and needs to be replenished to original balance.  
Put enough to bring it back

\* If short debit balance  
\* If over is a credit balance

\* if over would subtract

Sup - 120	
Cash - <del>140</del>	+ 120
MIS - 75	+ 75
305	195
-5	-5
<u>300</u>	<del>190</del> 190

Sup Exp - 120

MISC - 75

Cash Short & Over - 5

Cash - 5

Change Fund - a fund a business uses to give change to establish a change fund

Change Fund - 500

Cash ————— 500

- When cashout draw at end of day you always leave \$500 in draw. Ⓞ
- Change Fund NEVER deposit into bank
- Always 500<sup>same</sup> no more/less
- Always record sales as the amount shown on cash registers tape

08/26/10

## Class Notes

~~Recognize~~ Means to show income as earned in Income Statement & it is deferred on the Balance sheet

Deferral - Is the postponement of the recognition (won't be in Inc. State.) of Rev. received + not earned or the expenses that have been paid but not incurred.

Balance Sheet - Assets, Liabilities  
& Stoc. Equity: 2 parts  
① R. Earnings  
② Paid in Capital

Liabilities - Assets will be used to pay liabilities. (Obligations we must pay)

Expenses - Involves services + assets obtain

Gain + Losses - Are only recognized when we sell something we use in our operations & not sold in normal business operations

## Economic Entity Assumptions -

When an entity is ~~spe~~ separate from all others + separate from its owners.

Going Concern - We prepare financial statements under the assumption that the business will continue to operate + not liquidate.

Historical Cost - We use historical cost because it can be verified. Book Value

\*Diff between liquidated firm will be stated at market value because you are trying to sell the assets

Periodic Assumption - that we will prepare financial statements at least ~~one~~ once a year.

Cost Principle - The amt you must pay to purchase the asset + get it up + running for its proper ~~the~~ use.

Realize Principle - The Point of sale is a realization principle. Once merchandise is delivered to customer revenue is recognized. ~~ass~~ soon as you fulfill obligations

to customer.

Matching Concept - ~~is~~ In Income Statement where you show revenue earned for that period with expenses incurred in that period.

Disclosure - Making it available to the public. Things that will affect the decision of investor should be disclosed

Acquisition - taking over another company

\* In Notes

Income Statement BE 1-1	
Revenue	— \$400,000
Rent Exp <del>①</del>	— 20,000
Sal Exp	— 120,000
Utility Exp	— 52,000
N. I	— 208,000

BE 1-2 ① Liabilities Bal. Sheet

② Asset Bal. Sheet

③ Rev. Income Statement

④ Peripheral or incidental - Sale of equipment or Resource not sold in normal business operations

Adjusting Entries are made because some accounts are overstated + some understated + we make the entries to fix those

<u>Prepaid Rent</u>		<u>Rent Exp</u>
40000	20000	
20000		20000
<hr/>		
20000		

- BE 1-3)
- ① Periodicity Principle
  - ② Economic Entity Concept
  - ③ Realization Principle
  - ④ Matching Concept

- BE 1-4)
- ① Matching Principle
  - ② Historical Cost
  - ③ Business Entity Concept

- BE 1-5)
- ① ~~Not~~ Violated Full disclosure
  - ② Yes Periodic Concept
  - ③ Violated matching concept
  - ④ Realization Principle (yes)



## Monetary Unit Assumption -

We use the American dollar to value our assets

Journalizing - The process of analyzing Business transactions and allocating them into ~~the~~ their correct debit + credit accounts

Debit - Left Side

pg. 95

ex 2-4) ① Cash - 500,000

Com. Stock - 500,000

② Furniture - 100,000

N/P - 60,000

Cash - 40,000

③ M. Inventory - 200,000

A/P - 200,000

Perpetual - (no COGS)

④ A/R - 280,000

Sales - 280,000

COGS - 140,000

M. I. 140,000

⑤ Rent Exp — 6000  
Cash — 6000

⑥ Prepaid Ins. — 3,000  
Cash — 3000

⑦ A/P — 120,000  
Cash — 120,000

⑧ Cash — 55,000  
A/R — 55000

⑨ ~~DIV Cash DIV~~ 3 Journal Entries  
Cash DIV — 5000  
Cash DIV Pay — 5000

Cash DIV Pay — 5000  
Cash — 5000

⑩ Depre. Expense — 2000  
Accumulated Depr — 2000

⑪ Ins. Exp — 250  
Prep. Insur. — 250

Adjusting Entries - To correct accounts that are over + understated. Every adjusting will have at least (1) Bal Sheet acct and ~~Ex 2-8~~ (1) Income Statement (1 of each)

ex 2-8) ① Use a picture

<u>Ins Exp</u>	<u>Prep Ins.</u>
12000   10000	12000   10000
2000	2000

$$\frac{12,000}{36}$$

$$= 333.333$$

$$\text{/month}$$

July 1 - Dec 31 = 6 months

333.33
X 6
2000

Prepaid Insu. — 10,000  
                   — Insur Exp — 10,000

Deferral - Is the deferment of expense paid but not incurred

② Deprec. Exp — 15,000  
                   Accumulated Depr. — 15,000  
                   Equip

\* Will never have cash in adjusting entry

③ 2 methods for writing/off bad debt

Direct W/O = Bad Debt Exp

Allowance Method = Allowance from Bad Debt Account

Rule says - <sup>when</sup> Estimate is based on A/R must take into consideration any balance found in allowance account

③ Est. 6500

Allow. 2000

Adjust Entry - 4500

Bad Debt Exp - 4500

Allowance - 4500  
for Doubtful Accts

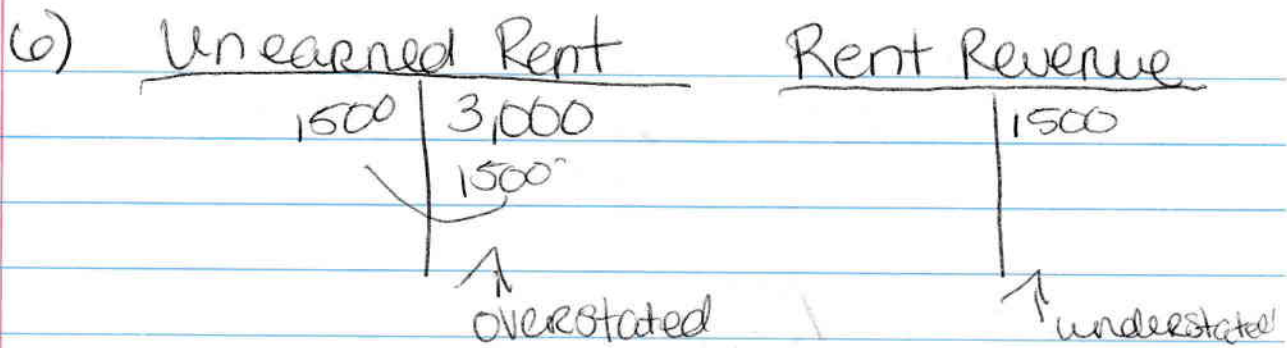
\* When you finish want allowance acct to equal the estimate.

4) Salary Exp - 18,000

Sal Pay - 18000

5) Interest Exp - 4,000

Intrest Pay - 4000



Unearned Rent - 1,500  
 Rent Inc - 1500

✶ Reversal entry

$$60 = 12,000 \times 6\% \times \frac{1}{2} \text{ Dec 1}$$

N/R - 12,000  
 Cash - 12,000

Dec 31 Int. Rec - 60  
 Int Rev - 60

Int Rev. - 60  
 Int Rec - 60

Int Rev
60

Int Rev
0
60

After closing entry

When pays

$$12000 \times .06 \times \frac{90}{360} = 180$$

Cash — 12180

N/R — 12000

Interest Inc — 180



60 earned  
in previous  
~~entry~~ period  
so reversing  
entry causes acct  
to balance out

If no reversing entry

Cash — 12180

N/R — 12000

Int. Rec — 60

IA Rl — 120

# Test Last Question

NI accrual basis

Add Cash Basis ————— 313,000  
A/R Incr. ————— 10,000  
Inc Sup ————— 3,000  
Bal Pay ————— 3,3000

Less Depr- Exp. ————— (55,000)  
Dec, Prep. Rent ————— (10,000)  
Inc. Int Pay ————— (1,500)  
NI ————— 270,800

9/14/10

Balance Sheet is considered a physician statement. Lets you know the position of the business on that particular day.

- Does not display Market value
- Doesn't show Market val. and use historical cost (book value) because it's verifiable

Some businesses have many operating cycles within one year

Business Cycle — Helps us to determine what assets should be considered current

## Long term Sovereignty -

Assets (Current) ~~the~~ Come from activities we perform.

## Liabilities

Cash + Cash Equivalence - Any bank bank will except as cash are cash equivalence

Short Term Investment - Items business tend to liquidate as cash is needed (sell them)

A/R - generated from sales of product  
N/R - usually 30-90 days  
CURRENT ASSET

Inventories: 3 for manufacturing comp.  
(current assets)

Retail - 1 inventory call Merch. Inv  
Current Assets



Investments - under this heading considered Long Term and aren't sold when cash is needed

Property, Plant & Equip. - Use for operations (production) not for sale in regular business operation

Land and Equip that are not being used aren't considered PP+E goes under other assets

Any current portion of LTL must be present under current Liab. So you break it up.

pg. 144 <sup>BE</sup> 3-1 Current vs Noncurrent

(a) Current

(b) Current

3-2 Trial Balance

Cash	16,000	Tot. Current = 52,000
AR	11,000	
Inv	25,000	
Equip		
Net		

Current Liab.

A/P	14000
Wag/pay	9000
Int/Pay	1000
Current Liab. 24000	

3-3. Asset - Liab = Stock

~~52000~~  
 $132000 - 54000 - 50000 = R.E.$   
 $R.E. = 28000$

Usually current

Equity

Classified Bal. Sheet

Current Assets		C.L	
Cash	16000	A/P	14000
A/R	11000	Wag Pay	9000
Inv.	25000	Int/Pay	1000
Tot. C.A	52000	LT Liab	
P.P. + E		N/P	30000
Equip	140000	Tot. Liab.	54000
Acc Depr.	60000	80,000	
Tot. Assets	132000	Equity	
		R.E.	28000
		PIC	50000
		Total	78000

total liabilities & stock equity 132000

9/16/10

Chp-3

Pg, 125

Full Disclosure

Fifo - Based on new dollars

Lifo - Based on Old dollars

Full disclosure - Tell everything that will affect an investors or creditors decision

Subsequent Events -

↳ If anything happens to company between now & before the financial statements are approved.

↳ About your business & the way you value inventory etc

- Auditor - Job is to verify the accuracy of info.

- Compensation of Top Managers

Stock Options - Stock you can ~~buy~~ buy at a discount

Backdated Stock options - At what date do you have an option to ~~buy~~ buy

Risk Analysis - ~~the~~ Financial statement should be comparable that's why you need to have a consistent application of GAAP guidelines

Industry Average - Whenever you compute ratio (any) must compare to industry average to be important

Group 4 Income Statement - Flotation  
 gives us info about flotation  
 will contain all items (inflow from revenues)  
 outflow for exp

Equipment - 15,000

$$(15,000 \times 120 / 360 \times .08)$$

Income from Continuing Operation - Income generated from one primary source of operations. The inflow and outflow resources related to sales

Gain + Losses - from sale of equip (things you sell that are not part of regular business activities)

We separate these types of info, so we can have a predictive value

2 Types of Income Statement

- ① Multi Step
- ② 1 Step - All income goes at top of statement

Income Taxes - The business will have income tax expense.

Interperiod Tax Allocation The taxes should follow the source of the income. Various income statement tax related to various

Chap. 4 Income Statement - Flow statement gives us info about a specific period of time. will contain all flows (inflow from Revenue) outflow for Exp.

Income from Continuing Operation - Income generated from our primary source of operation. The ~~at~~ inflow and outflow Resources related to sales.

Gain & Losses - From sale of equip (things you sale that are not ~~your~~ sold in regular business activities.

We seperate these types of info, so we can have a predictive value.

## 2 Types of Income Statement

① Multi Step

② 1 Step - all income goes at top of statement

Income Taxes - The business will have income tax expense.

Intra-period Tax Allocated The taxes should follow the source of the income. Show in income statement the tax related to various

items in income statement

(in millions)

Extraordinary Items are showed net from taxes. They are infrequent & unusual. We show them net of taxes

Don't show Interest income/expense in operating section because it's financing

Earnings Quality - The reliability of the income we report on Income Statement. Because some people recognize income before it is accrued, violating the accrual method

Income Smoothing

Restructuring Cost - Legitimate exp.

When start closing plants + consolidating dept. These cost should be expensed in the period it took place, and allocated over the years until you let them go.

NI	381
Inc Tax Exp	11928
Int	35
Admin + General	100
Depreciation	1910
Exp + Loss	1940
NI	381

transfere amo... ni emoti

(In millions)

### BE 4-3) Income Statement (Multi-Step)

Sales Revenue:	2,106	
COGS	1,240	
Gross Margin	866	
Operating Exp:		
Selling	126	
General + Admin	105	
Tot. Operating Exp	231	
Operating Income	635	
Other Income + Exp		
Gain of Sale of Investments	45	
Int Exp	(35)	10
Income 4 Con'td Operations before taxes	645	
Tx	645 (.40)	258
N.I.		387

### + Single Step Income Statement

Sales	2,106	
Gain on Inv.	45	
Tot. Rev	2,151	
Exp + losses		
COGS	1,240	
Selling	126	
Admin + General	105	
Int	35	
Inc. Tax Exp		258
NI		387



BE 4-4)

Sales ————— 3000000

GOC<sub>5</sub> ————— 1600000

Gross Margin ————— 1400000

Operating Exps:

General + Admin ————— 400000

Selling ————— 25,000

Reconstructing ————— 50000

Tot. operating exps ————— 115000

Operating Inc. ————— 25000

OTHER Inc. + Exp

Int. Inc. ————— 4000

Loss on sale of Investments (22,000) 18000

~~Tx. (7000 x .40) N.I.B4 Taxes + Extra Items~~ 7000

Tx (7000 x .40) ————— 28000

Net Inc. from Extraordinary Items -4200

Extra Loss + ————— (30,000)

Net of taxes ————— 20000

Net loss ————— 25800

10/5/10

# Cash Flow Statement - Attempt to

R ~~convert~~ Income statement from  
(E) accrual to cash basis.  
N.I

3 sections

Cash Flow from Operations

- Investment (selling property + equipment)
- Finance (stocks + bonds)

Expenses that don't require use of any cash

Amortization

Depreciation

Amortizing Patent (amortize intangibles)

A/R

<u>Beg</u>	<u>End</u>	<u>Increase</u>	During the year our cust. purchased more on credit than they paid. (deduct)
10000	15000	5000	

Prepaid Ins.

<u>Beg</u>	<u>End</u>	<u>Decrease</u>	During the year expensed more than I paid (add)
8000	6000	2000	

1/18/11

# Chapter 9 Inventories

## Evaluating Ending Inventory

### Inventory Methods

FIFO

LIFO

Average Cost

Gross Profit ✓

Retail Method ✓

LCM (Lower cost or market method) ✓

Market - Is Replacement cost (not what you paid for it) Not what you can get on the market

Item	Cost	MRK	LCM	LCM
1 (10)	3 30	10 100	3	30
2 (20)	5 100	2 40	2	40
3 (30)	7 210	8 240	7	210
	#15 340	#20 380	#7 By Item	280 By item

By Group

2 ways to cal.  
 LCM ① By Item  
 ② By Group

LCM By Group - 15

## Gross Profit Method

### Income statement

Sales		<u>2,000,000</u>
COGS		
Add Beg Inve	600,000	
Add Purchase	1,500,000	
Goods avail for Sale	2,100,000	
- End.	900,000	
- COGS	1,200,000	
Gross Margin		<u>800,000</u>

Purchases + Sales + B.I. should be given  
 Gross-Margin %

Class Notes 1/20/11  
 (NRV) Net Realizable Value - Selling Price - cost to dispose.



NRV - % Gross Profit

Item	Cost	Replace Cost (MV)	SP	Est disposal	NRV
A	\$50	\$55	\$100	\$15	\$85
B	100	90	120	20	100
C	80	70	85	20	65
D	90	37	100	24	76
E	95	92	110	24	86

Gross P. = 20% of Sale Price

Gross Profit

NRV - GP

		20	65
		24	76
DMV	55, 65, 85	17	48
65	76, 90, 100	20	56
90	48, 65, 70	22	64
65	37, 56, 76		
56	64, 86, 92		
86			

# PRODUCT LINE

Item	COST	Q	LCM	DMV	Cost	DMV	By Individ Items
A	50	1000	50	65	50000	65K	50K
B	100	1000	90	90	100K	90K	90K
C	80	1000	65	65	80K	65K	65K
D	90	1000	37	56	90K	56K	<del>56K</del>
E	95	1000	86	86	95K	86K	86K
					362,000	415,000	347,000

Decrease (Depress if) ending inventory will increase Cost of Good Sold & decrease reported N.I.

asked  
 Answer if ~~the~~ value of E. Inventory using LCM by individual items.

2 ways

- Do by item
- Do by individual items

By Total  $\rightarrow$  Add Cost Column + DMV Column  
Inventory and take lowest of 2

By Product  
Line

150,000

362,000

(When you have diff. Product lines, clothing, food etc.)

If inventory mark down regularly

COGS xxx

Inventory xxx

if something unusual and infrequent happens:

~~COGS~~

Loss on M/d

Inventory

# Valuing Inventory Methods

- ① Gross Margin  $\rightarrow$  estimates without counting  
② Retail Method

\* Because of GAAP you must do a physical count of ending inventory @ end of year (NOT ESTIMATE!)

Retail Method - For own info, when doing financial statements  
Retail - what you plan to sell it for.

B. inventory	Cost	Retail
	\$100k	\$100k
Add Purch.	\$287,200	460,000
Goods Avail & Sale $\rightarrow$	347,200	560,000

STOP @ Goods avail.  $\rightarrow$  calculate Cost-to-Retail Ratio  
~~Cost to Retail~~ Cost to Retail ~~Ratio~~ Ratio

$$\frac{347,200}{560,000} = 62\%$$

Less Sales - (400,000)  
(from Retail)

Ending Inv. @ Retail 160,000

Ending Inv. @ Cost ( $160k \times .62$ ) 99,200  
COGS  $(99,200 - 347,200)$  248,000

HOMEWORK pg 481 E 9-3, 9-5, 9-8, 9-9

## Chp 9 Self Notes Inventories

### Methods to Determine the cost of inventory

@ the end of a period & the corresponding ~~COGS~~ COGS.

① Lower of Cost or Market (LCM): Approach to valuing inventory was developed to avoid reporting inventory at an amount greater than the benefits it can provide.  
 - Causes losses to be recognized in the period the value of the inventory declines below its cost, rather than in the period they are ultimately sold \*

✓ Market Value - For LCM purpose is the inventory's current replacement cost (by purchase or by reproduction)  
 → how much it will cost you to replace this item or reproduce it

(NRV) Net Realizable Value: Represents the ceiling (upper limit)

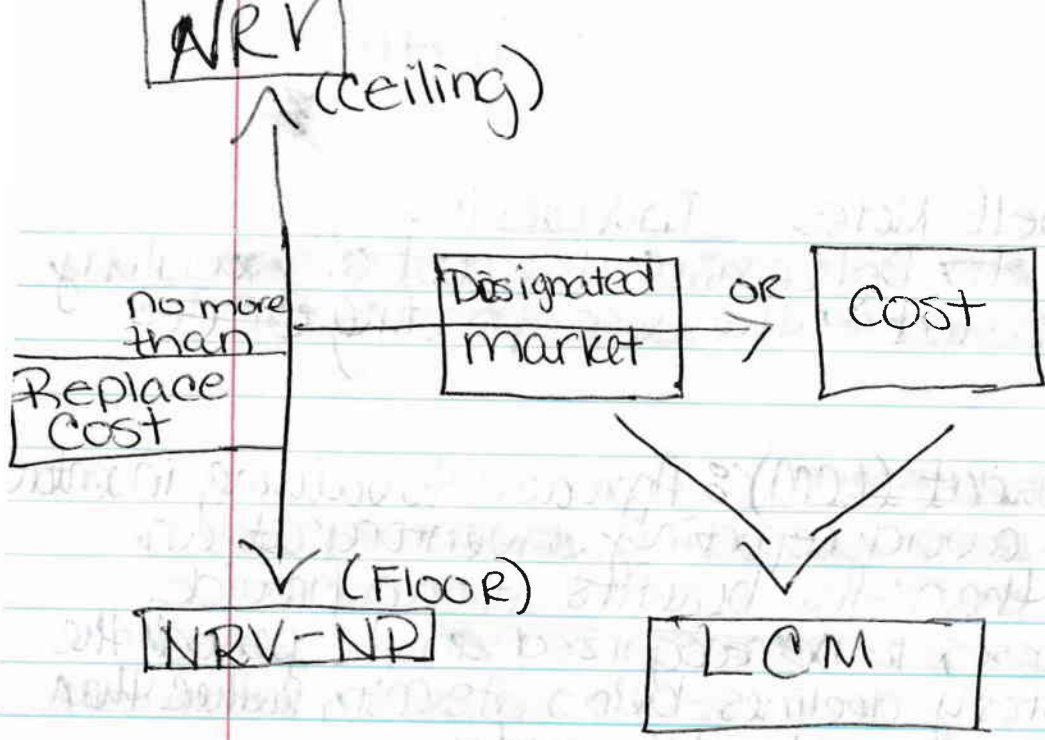
(NRV-NP) Net realizable value - A normal profit margin provides the floor (lower limit)  
 The lowest you should go!

Replacement Cost (RC) - If between the floor & ceiling the (RC) represents market  
 - if below the floor, or higher than the ceiling the ceiling or the floor becomes market.

### Applying Lower of Cost or Market

- 1) Individual Inventory Item
- 2) Logical categories of inventory (major product line)
- 3) The entire inventory

\* For TAX purposes LCM must be applied on individual item basis \*



$$\text{Selling Price} - \text{Disposal Cost} = \text{NRV}$$

$$\text{NRV} - \text{Normal (gross) profit} = \text{NRV-NP}$$
  
 (NRV-NP)  $\rightarrow$  (Selling price  $\times$  cost to retail ratio)

### Steps Valuing Inventory (LCM)

- ① Get all needed info.
- ② Get NRV by  $g \cdot SP - \text{Disposal Cost}$
- ③ Get gross profit % of each item, multiply gross profit % by Selling Price (get NP)
- ④ NRV-NP
- ~~⑤ Get DM~~
- ⑤ Get designated market value by taking Replacement Cost, NRV, and NRV-NP
  - arrange them in descending order
  - The middle value is the DMV of each product

\* If doing by <sup>individual</sup> item or product line add steps  
 ① add the logical inventory categories (product line)



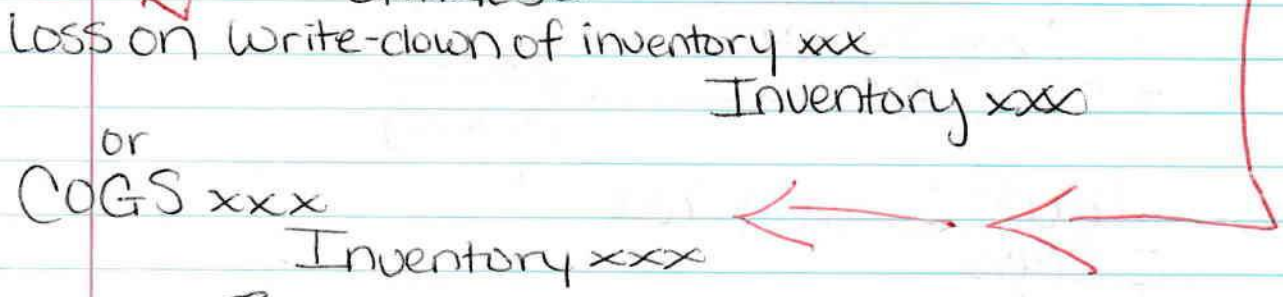
together (display total)

- ② Get the LCM by item (the less between cost + DMV)
- ③ Get LCM by product lines individually
- ④ Get the totals by
  - individual items
  - By Product line
  - By total inventory
- ⑤ To get amt of loss to report (see next pg.)

2 ways to Adjust Cost to Market

- ① Report loss as a separate item in the income statement
- ② Include the loss as part of COGS

Entries:



\* But if a write-down is made because of something unusual that was substantial occurs this should be reported as a separate item among operating exp. \*

Concept Review Exercise

Product	Cost	Replace cost	Selling Price	Disposal cost	NRV	NP	NRV-NP	DMV <small>By Item</small>
101	80K	85K	160K	30K	130K	40K	90K	85, (90), 130
102	175	160	200	25	175	50	125	125, (160), 175
Tot	255	145	360	55	305		215	LCM = 145
201	160	140	180	50	130	45	85	85, (130), 140
202	45	20	60	22	38	15	23	38, (23), 20
Tot.	<del>205</del> 460	160 305	240	72	168		108	LCM = 160

To get the amt of loss to report by category,  
 individual <sup>item</sup> or entire inventory  
 COST - LCM By category by individual product Total Inventory

Cont'd Self Notes Chp 9

GROSS PROFIT METHOD (Gross Margin Meth) - useful  
 in situations where estimates of inventory are desirable

- E.I. + COGS = Goods avail. for sale

Estimated Gross Profit ~~is~~ is given as a % of sales representing ~~gross profit~~ estimated profit from that amt of sales

$$\begin{array}{r} \text{Net Sales} \quad - \quad xxx \\ \text{Less Est GP\%} \quad - \quad (xxx) \\ \hline = \text{Est. COGS} \quad \quad \quad (xxx) \end{array}$$

$$\begin{array}{r} \text{Goods Avail 4 Sale} \\ - \text{COGS} \\ \hline = \text{E.I.} \end{array}$$

The Retail Inventory Method

Relies on Relationship between cost + SP to est End Inventory & COGS

$$\text{Cost to Retail \%} = \frac{\text{Goods Avail 4 Sale (Cost)}}{\text{Goods Avail. 4 Sale (Retail)}}$$

Steps

1) Esti amt of Ending Inventory (at retail) by subtracting sales (at retail) from Goods Avail. 4 Sale (@ retail)

② Est End Inventory is then converted to cost by multiplying it by the cost to Retail %

### Real Steps

① Gather info to get B.I. + Net Purch @ retail + cost. add both  
- add Both columns to get ~~Cost~~  
Cost to Retail %

Then Prior step ① + ②

④ To get COGS 
$$\begin{array}{r} \text{Goods Avail. \& Sale (cost)} \\ - \text{End Inventory (cost)} \\ \hline \text{COGS} \end{array}$$

### Inventory Errors

- If an inventory error is discovered in the same accounting period it occurred, the original erroneous entry should simply be reversed and the appropriate entry recorded

	<u>COST</u>	<u>Retail</u>
9-13		
BI -	35000	50000
Purch -	19120	31600
Net ↑		1200
Net ↓		(800)
GA4 Sale	54120	82000

$$\frac{54120}{82000} = 66\%$$

Sales -		<u>(32000)</u>
E.I.	33000	50000
COGS	21120	

9-14 Conventional Retail Method - Apply  
 by excluding markdowns from the calculation of the cost to retail % But are still subtracted after % is determined.

	<u>COST</u>	<u>Retail</u>
9-14)		
B.I	190000	280,000
Purch.	600,000	840,000
Frieght In	8000	
Net Mex		20000
	<u>798000</u>	<u>1,140,000</u>
	$\frac{798000}{1,140,000} = .70$	

COG 562800

Markdowns		<u>(4000)</u>
Net Sales		1,136,000
EI	235200	<u>(80000)</u>
		336000

# 9-15) Retail Inventory @ LIFO

① Get Cost to Retail of B.I.

② Get Goods Avail for sale excluding B.I.  
get Cost to Retail % of total

③ Goods avail for sale including B.I.

④ Subtract Net Sales from Retail (GA4S) (all)

⑤ E.I. @ Retail

~~⑥ E.P. (Retail) x Cost/Retail %~~

Take E.I. @ retail multiply an

	<u>Cost</u>	<u>Retail</u>	
B.I	160K	280K	→ $\frac{160}{280} = .57$
Purch	607760	840000	
Mark ↑		20000	
Mark ↓		4000	
GA4 Sale no B.I.	<u>607760</u>	<u>864000</u>	→ = .70
GA4 Sale in B.I.	767760	1,144,000	
Net Sales		<u>(800,000)</u>	
		344,000	
	280000 x .57 = 159,600		
	64000 x .70 = 44,800		
		<del>159,600</del> 159,644	

11/27/11

In Class Homework

Eq-13)	<u>Cost</u>	<u>Retail</u>
B.I	35K	50K
Net Purch	19120	31600
Net Markups		1200
Net Markdowns		<u>800</u>
Net Sales	<u>5412</u>	<u>82000</u>

① Get  $\frac{\text{cost}}{\text{Retail}}$  Ratio

$$\frac{54120}{82000} = 66\%$$

Less Net Sales

9-14)	<u>Cost</u>	<u>Retail</u>
BI	190K	280K
Purch.	600K	840K
Freight In	8K	
Mark ↑		20K
Mark ↓		<u>4K</u>
	<u>798,000</u>	<u>1,136,000</u>

\* Subtract mark ↓

$$\text{Cost to Retail } \frac{798000}{1,136,000} = 70\%$$

Less Net Sales (800,000)

Ending Inv Retail 336,000

Ending Inventory Cost  $336,000 \times .70 = 235,200$   
Costs = ~~562,800~~

9-15	Cost	Retail	
B.I.	160K	280K	$\rightarrow \frac{160}{280} = 57.1\%$
Purch	607,760	840K	
Mark ↑		20K	
Mark ↓		4K	

Goods avail  $\rightarrow$  607,760  $\rightarrow$  856,000  $\rightarrow$   $\frac{607,760}{856,000} = 71\%$   
 4 Sale (excluding B.I.)

Goods Avail 4  $\rightarrow$  767,760  $\rightarrow$  1,136,000  
 Sale Including B.I.

Less Net Sales  $\rightarrow$  (800,000)  
 2.1. @ Retail  $\rightarrow$  336,000

Beg Inventory 280,000  $\times$  57.1% = 160,000 (159,880)  
 56,000  $\times$  71% = 39,760

199,760  
 280,000  
 - 336,000  
 -----  
 56,000

767,760  
 - 199,760  
 -----  
 \*568,000

E 9-19) GO TO OFFICE!

- ① Get Cost to Retail Ratio for B.I. = 54%
- ② Calculate Cost 2 Retail with Goods available for sale (-) B.I. 45%
- ③
- ④ Take price increase + divide by price ~~index~~ index

1/27/11

# Class Notes

## Dollar Value LIFO (Taking out inflation)

From prob 9-15

$$\rightarrow \frac{198,800}{1.10} = 180,000$$

That's ending  
Inv. with inflation



$$\frac{160,000 \times}{200,000 \times}$$

Same as other probs just when value of ending inventory is found take out inflation

if E.I. is 336,000 index is 110%

$$\frac{336,000}{1.10} = 305,455$$

$$\frac{280,000}{25,455} \times 1.10 \times 71\%$$

2nd cost/retail

$$= 19,880$$



New remaining  
amt.:

$$1x + 10\%x = 30$$

$$\frac{1.10x}{1.10} = \frac{30}{1.10} = 27$$

## Inventory Errors

Overstatement of

ending - O U

COGS - U O

N.I. - O ~~U~~

Ending Inventory

Beg O U

COGS O U

NI U O

Purch O U

COGS O U

N.I. U O



# Example

B.1	10	0	15
E.1	5		5
COGS	<u>15</u>		<u>10</u>

## CHP 10 Next Class

Chap 10 PP + E, Intangible assets & Acquisition and Disposition

### Types of Assets

Long-lived Revenue producing Assets and expected to benefit future periods.

### Cost to be added to Cost of Asset

#### Cost to be

Capitalized - Add to cost + add to value of equipment - Taxes, Net purch. price, freight in, Installation, modification to building necessary  
~~Expenses Subtract from value~~ for transportation, testing and trial runs.

#### Land (Not depreciable)

- o Purch Price
- o Real estate Commission
- o Attorney's fees
- o Title Search
- o Title transfer fees
- o Title insurance Premiums
- o Removing old building

(Proceeds from the sale of salvaged materials from old buildings torn down after purchase reduce cost of Land)

#### Land Improvements

Separately identified costs of:

- o Driveways
- o Parking Lots
- o Fencing
- o Landscaping
- o Private Roads

\* These cost are separately identified + capitalized \*

## Buildings

- o Purch. Price
- o Attorneys Fees
- o Commissions
- o Recondition (Refurbished, Remodeled, modified, etc.)

## Natural Resources

- o Acquisition Costs
- o Exploration Costs
- o Development Costs - prep
- o Restoration costs -

Preparing coal for production

Has to restore the land after digging, can't leave land in disarray.

## Intangible Assets - Patents

- Franchises
- Goodwill

### 3 Characteristics

- ① Lack physical substance
- ② Give you exclusive rights

- The initial cost includes the purchase price & all other costs necessary to bring it to condition and location for use. Such as legal and filing fees.

## Asset Retirement Obligation

Natural Resource extraction when the land must be restored to a usable condition.

~~Is to be~~ Restoration cost should be recognized a liability. ~~and account for it~~

③ Benefits are less certain than tangible assets

Patents - Gives you an exclusive right for 20 years (can be bought or

developed internally) <sup>(costs)</sup> only thing you can capitalize is the legal + the filing fees.  
(The Research + Development are instead expensed)

- Holder has right to use, manufacture, or sell the patented product or process without interference or infringement by others

- Research + Development costs that lead to an internally developed patent are expensed in the period incurred

$$\text{Purchase Patent Cost} = \text{Price Paid} + \text{Legal + filing fees}$$

~~Problem~~ Infringement - somebody is trying to produce a product just like yours.  
if you successfully defend a patent the legal expense you incurred will be capitalized and added to cost of patent to be future amortized.

~~Copyright~~ Copyright = a form of protection given by law to authors of literary, musical, artistic, and similar works

- Copyright owners have exclusive rights to print, reprint, copy, sell or distribute, perform and record the work.  
- Generally the legal life of a copyright is the life of author + 70 years

Trademarks = A symbol, design, or logo assoc. with a business.

o if internally developed, trademarks have no recorded asset cost.

o Registered with U.S. Patent Dept. + renewable

indefinitely in 10-year periods

### 3 Assets in Chap 10

Tangible - Depreciated

Intangible - Amortized (except good will +

Natural Resource - depleted

Franchise - A contractual assignment where the franchisor grants the franchisee exclusive rights to use the ~~franchise~~ franchisor's trademark within a certain area for a specified period of time.

Good will - Good location, managing, highly talented employees, good reputations.

- Cannot be good-will separate from company

- Good will is bought with a company

- Occurs when one comp. buys another comp.

- Only purchased good-will is an intangible

asset.

- The amt by which the consideration exchanged exceeds the fair value of net assets acquired

Fair Value of Assets	100,000
FV of Liabilit	(70,000)
FV Net Asset	<u>30,000</u>

Goodwill = difference of what you paid

- FV • Net Asset.

so if Paid 50,000  
(30,000)

Good will = 20,000

## Journal Entries

Goodwill - 20000  
Asset - 100000

Liability - 70,000  
Cash - 50,000

Ⓢ Every ~~year~~ year must do impairment + if less you must show change but not if more.

Lump Sum Purchases - Several assets are acquired for a single price that may be lower than the sum of its Fair Value

Appraisal Value      % of Value × Purch Price = Assign Cost

## Journal Entries

Land xxx

Building xxx

Cash xxx

## Non Cash Acquisitions

- Issuance of equity securities (Com. Stock)
- Deferred Payments
- Donated Assets
- Exchanges

→ Land xxx

Com Stock xxx

→ sold 10,000 share MP = 10.00

Par = 2.00

hand - 10,000

Com Stoc - 2000

PIC excess of Par - 8000

\* If shares are not actively ~~shared~~ traded stock is sold then no MP.\*

Deferred Payments - Note Payable - When you buy something and will pay later.

### 2 Types of Notes

- 1) Interest Bearing
- 2) Non interest Bearing

→ Entries:

100 cost 10% = i

① Equip - 100  
N/P - 100

② Interest Exp - 10  
Cash - 10

③ N/P - 100  
Cash - 100

The Face Value already includes the interest.

get Face amount of note  
must get PV of that amount today

example  
50000 = FV

so P/rof #1  $n = 2$  years  $i = 2\%$

$\frac{.82645}{41,323}$

Equip - 41,323

Dis on N/P - 8677

N/P - 50000

End of year one Entries

Interest Exp (10% 41323) - 4132

Dis on N/P - 4132

✓ Add i expense from last payment to equipment price then multiply by ~~i~~ rate to get new interest exp.

$$\begin{array}{r} 41323 \\ + 4132 \\ \hline \text{\$xxx (10\%)} \end{array}$$

Payment Entry

N/P - 50,000

Cash - 50,000

HOMEWORK E 10-1 - 9 2/1/11

-2

-3

-4

-5

-6

-7

-8

2/3/11

Chap 9  
9-19

10-11

-12

-13

-14 - 18

10-22

10-23

10-24

10-25

## Self Notes

### Cost of Equipment

Equipment - Is a broad term that encompasses machinery used in manufacturing, computers, and other office equipment, vehicles, furniture and fixtures

### Capitalized Cost of Equipment

- o Purch Price
- o Sales Tax (less discount received)
- o Transportation cost paid by buyer to ~~transport~~ transport the asset to location of which it will be used.
- o installation (testing)
- o Legal Fees to establish title

Lump Sum Purchases: If lump sum purchase involves different assets it's necessary to allocate the lump-sum ~~equity~~ acquisition price among the separate items

How?

- Allocation is made in proportion to the individual assets' relative fair values
- Relative fair value %s are multiplied by the lump-sum purch. price to determine the initial valuation of each of the separate assets
- o & use stated Fair values to get %\*

### More Land Cost to Capitalize

- o Back taxes or liens, mortgages or other obligations
- o Expenditures such as clearing, filling, draining and even removing (razing) old buildings



\* Proceeds from sale of salvage materials from old buildings torn down after purch. REDUCE the cost of land.\*

## Capitalized Cost of Natural Resources

- Resources that provide long-term benefits are reported as PPE

Include - Timber tracts

Mineral, oil, and gas deposits

~~Benefit~~ (Benefits are derived from their physical consumption) ~~like equipment~~

- When comp. buys N.R. from another comp, initial valuation is = purch. price + any other cost necessary to bring the asset to the condition + location for use

When Developed N.R. in Company (Self)  
Initial Valuation Includes:

1) Acquisition Cost - Amt paid to acquire the rights to explore for undiscovered natural resources or to extract proven natural resources

2) Exploration Cost - Expenditures such as:  
- drilling a well or excavating a mine, or any other costs of searching for natural resources.

3) Development Costs - Are incurred after resource is discovered but before production begins.  
- Expenditures of tunnels, wells, & shafts.

Went over in class

Home Study

4) Est. Restoration Cost & Cost to restore land or other property to its original condition after extraction of natural resource ends. (Initially represents a liability)

Asset Retirement Obligation - Occurs when a comp. incurs obligations assoc. with the disposition of property, plant, & equipment & natural resources often as a result of ~~acquiring~~ acquiring those assets.

- Some comp. recognize this obligation over the life of the asset and some not until asset is retired or sold.

Get Present Value of expected Restoration Cost<sup>d</sup> using Credit-Adjusted risk free rate and # of (n) periods in which the restoration cost are to be paid.

### Journal Entries

Coal Mine xxx

Cash xxx

Asset Retirement Liab. xxx

Excavation Equip - xxx

Cash - xxx

\* The cost of heavy equipment & other assets a comp. uses during drilling or excavation usually are NOT considered part of the cost of the natural resource itself \*

But if used specifically for that it's depreciable life is the life of natural ~~the~~ resource.

Intangible Assets: Assets that lack physical substance

Property Plant + Equipment — Land, buildings, equipment, machinery, autos, and ~~trucks~~ trucks. Also included ~~but~~ in class of their own Natural Resources such as oils + gas deposits, timber tracts, and mineral deposits.

## Research & Development Capitalize Cost

GAAP require all research & development costs to be charged to expense when incurred.

- Company undertakes R&D project because it believes the project will eventually provide benefits that ~~exceed~~ exceed the current expenditures.  
⊘ Require Immediate Expensing \*

### R&D cost Includes:

- ① salaries, wages and other labor costs of personnel engaged in R&D activities
  - ② Costs of materials consumed
  - ③ Equipment (specific for R&D purpose or deprec.)
  - ④ facilities used in R&D projects
  - ⑤ Intangibles used for R&D project
  - ⑥ Services performed by others in connection/w R&D
  - ⑦ Reasonable allocated cost (overhead)
  - ⑧ Administrative & General cost (only if directly related to R&D activity)
- (all cost incurred before commercial production) (process)
- Anything after R&D is over and product begins to sale ~~the~~ the cost are no longer considered R&D but regular expenses (COGS)

⊘ GAAP also requires that R&D expense incurred must be ~~is~~ disclosed either as a line item in the income statements or in a disclosure note.

### R&D Performed By Others

- Immediate expensing is not required for companies that perform R&D for other companies under contract

R&D costs are ~~expensed~~ capitalized and inventory and carry over into future years until project is completed.

Start-Up Costs: One-time preopening costs for salaries of employees supervising construction, training, travel, and relocation of employees.

- Anytime a company introduces a new prod. or service, or commences business in a new territory or with a ~~new~~ new customer these cost are incurred.

\* Must expense all startup cost as they are incurred, rather than capitalize those cost as an asset \*

Organization Costs: Related to org. a new entity, such as legal fees + state filing fees to incorporate.

## NonCash Acquisitions

### Exchanges

- When a company acquires an asset in exchange for an asset other than cash.

- The basic principle of these noncash purchases is that the asset is to be valued at fair value (Fair value of assets given/received (plus or minus) any cash exchanged).

\* The gain or loss recognized (and needed to balance the journal entry) is the diff between the fair value and book value of the asset given.

PP+E

Acc Depr

PP+E  
Cash and Gain/L

If Fair Value Not Determinable - The comp. would simply use the book value of asset given up, plus/minus any cash received, to value the assets.

Equipment (BV + cash)  
Acc. Deprec. (acct bal)  
Equipment —  
Cash (paid) —

4/10 gain or loss recognized.

If Exchange lacks Commercial Substance  
If the exchange has no commercial substance (not going to change future cash flows) the asset is to be valued at book value if sold.

\* Fair Value can only be used in gain situations that have commercial substance. \*

Commercial Substance: Nonmonetary exchange is considered to have (CS) if future cash flows will change as a result of the exchange.

(most exchanges are for legitimate business reason, i.e. upgrading equipment)

- Unless there is a loss then it's OK to value asset at fair value.

Has commercial Sub.

pg 521 Equip - 57000 (FV + cash rec)  
Acc. Depr - 45000 (acct Bal.)  
Cash - 40000  
(FV - BV) ← Gain - ~~15000~~ (10000 - 15000) = 2000  
Equip - 60000 (acct Bal.)

if no commercial sub.

Equip - ~~45000~~<sup>55000</sup> (BV + cash rec)  
Acc Depr - 45000 (Bal.)  
Cash - 40000  
Equip - ~~45000~~ (circled)

### Deferred Payments

When a comp. acquires an asset by giving the seller a promise to pay cash in the future ~~thus~~ creating a notes payable.

- if not ~~is~~ issued with a reasonable interest rate or no interest rate, will represent its value at the PV of future payments using Table 2. A discount is then recognized.  
(when use PV of note)

if But if realistic interest rate payment is valued at note face value

→ Asset (PPE)

Discount on N/P (diff)

Notes Payable

The diff. is the portion that will represent interest and recognized as i exp. over the life of the note.

### Entries

Interest Exp. (PV x i) ~~and prior payments~~  
Discount on N/P

Ints Exp (PV \* prior payment x i) -  
Dis. on N/P -

\* if no interest rate is given but an asset has a readily available list price you use that price and discount the difference. \*

- To determine i Rate

(implicit rate of interest)      i Rate =  $\frac{\text{cash Price}}{\text{Face Val. of Note}}$

Assets Acquired in Exchange for Equity

2 Situations

① When common stock is not publically traded and has no fair value the fair value of the assets recieved by the corp. is the better indicator of the transactions exchange value

② With corp who stock is publicly traded, the market value of the shares is the best indication of fair value

Entries  
Land -  
Common Stock -

Donated Assets - When comp. acquires asset through donation, usually an enticement to do something that benefits the donor.

Record donated assets at their fair values based on either an available market price or an apprasial value

~~The offsetting credit~~ GAAP requires that donated assets be recorded as revenue (Rationale is that the comp. receiving the donation is performing a service for the donor in exchange for the asset donated.)



Capital Budgeting Decision that require management to forecast all future ~~cash~~ net cash flows (cash inflows minus cash outflows), generated by the assets.  
(When purchasing PP+E)

Fixed-asset Turnover Ratio = Measures how effectively managers use PP+E. Ratio indicates the level of sales generated by the company's investment in fixed assets

$$\text{Fixed-Assets Turnover Ratio} = \frac{\text{Net Sales}}{\text{Ave. Fixed Assets}}$$

The book value  
(cost less <sup>acc</sup> depreciation  
and depletion)

2 years divided  
by 2 to get  
ave.

\* Dispositions - When selling PP+E for monetary consideration (# or receivable) the seller recognizes a gain or loss for the difference between the consideration received and the book value of the asset sold

entries

Cash (selling price)	
Accum. Deprec. (Bal)	
Loss on disposal (difference)	
	machinery (Bal)

- Retirements (or abandonments) are treated similarly  
- diff: no monetary (#) consideration received  
(Loss is Recorded for the remaining BV of the asset)

- When PPE or an intangible asset is to be disposed of we classify it as "held for sale"

- Report it at the lower of its book value or fair value less any cost to sell.

value - if the FV less cost to sell is below book, we recognize an impairment loss.

### Self Constructed Assets -

~~Interest Capitalization~~ When a company decides to construct an asset for its own use rather than buy an existing one.

### 2 Issues Arise

- 1) Determining the amount of overhead (indirect cost) to be allocated to the construction
- 2) Deciding on the proper treatment of interest (actual or implicit) incurred during construction

→ Overhead Allocation - DM + DL are easily determined and included in cost.

- Full-Cost Approach - All overhead costs are allocated both to regular production + to self constructed assets based on relative amt of a chosen cost driver (DL)

### Interest Capitalization

- All costs during this period, including i., should be capitalized and then allocated as depreciation during later periods when the assets are providing benefits

- Interest Costs incurred during the productive life of the asset are expensed as incurred.

(see pg 522 for Qualifying Assets)

Period of Capitalization: Starts with 1st expenditure (materials, labor, or overhead) and ends when asset is complete or substantially ready for use.

### Ave Accumulated Expenditures

- Interest capitalized is only that portion of interest cost incurred during the construction period that could have been avoided if expenditures for the asset had not been made

To get Ave. Accum. Expenditures:

= if evenly incurred throughout the period you get amt + divide by two to get the average. ~~that's the~~

- if not incurred evenly throughout the period a weighted ave is determined by time weighting individual expenditures or groups of expense by # of months from their incurrence to the end of the construction period.

To determine interest capitalized, then, we simply multiply the construction loan rate of 8% by the ave accum. expenditures  
-  $i$  is added to the cost of the building

~~bring in accumulated~~ ~~at~~  
along with the other accumulated  
expenditures, (Not ave but all)

Exam chp 9+10  
Next Tuesday

Homework

10-1) Capitalized Cost

Purch # = \$60,000  
 Legal Fees # = \$2,000  
 Demolition of building = \$4,000  
 Prop Tax on Land = \$3,000  
 Land = \$69,000  
 Salvage - 2,000  
AG 67,000

Building  
 Architect Fee \$12,000  
 Construction # = 500,000  
 Interest on loan = 5,000  
517,000

only included if owed before you got it.

10-2) Equipment - ~~49,800~~ 48,900 45K  
 NIP - 47,200 2,200  
 Cash - ~~2,600~~ 1,700 700

Prepaid Ins. - 900  
 Cash - 900  
 No insurance included prepaid 900  
1,000  
49,800  
 48,900

10-3) Lump Sum Purch Price = \$4,000,000

After Acquisition NOT included

Title Ins. + \$16,000  
 Legal Fees + 5,000  
 Prop. Taxes + 36,000  
 Stat Transfer fee + 4,000  
4,021,000

Fair Values

Land - 3,300,000  
 Building - 1,100,000  
 Tot. - 4,400,000

Demol. + 250,000  
 75% Salvage - 6,000  
 25% Grading + 86,000  
4,403,000

100% 250  
 ① Building Initial Val = ~~1,087,500~~ 435,500  
 Land Initial Val = ~~3,093,750~~ 3,302,250

② Building Val. = 3,302,250  
 Land Val. = 1,100,750  
 No building account cause they credit Land keeping it

## 10-4) Natural Resource

## ① Cost of Natural Resource

$$\begin{array}{r}
 \text{Purch Price} - \$1,000,000 \\
 \text{Extraction} - \$600,000 \\
 \text{Restoration} - 303,939 \\
 \hline
 \text{Cost of Mine} = 1,903,939
 \end{array}$$

Restoration Calculations

$$1 \text{ } 300\text{K} \times .25 = \text{~~75,000~~ } 75,000$$

$$2 \text{ } 400\text{K} \times .40 = 160,000$$

$$3 \text{ } 600\text{K} \times .35 = 210,000$$

$$\#445,000 \times .68301 = 303,939.45$$

$$\text{PV} = \text{~~10 \times~~ }$$

$$.10 = i \quad n = 4$$

② Coal Mine — ~~1,000,000~~ 1,903,939

Cash — 1,000,000

Asset Retirement liab. — 303,939

Excavation Equip — 120,000

Cash — 120,000

10-5) Purch Price — 20,000

Attorney's Fees — 2,000

Filing Fees — 3,000

original costLook  
into  
this

10-6) \$17,000,000

	<u>Fair Value</u>	
Assets	7,500,000	
	14,000,000	
	<u>1,500,000</u>	
	23,000,000	23,000,000

Liab &	4,000,000
	<u>5,500,000</u>

Goodwill = Purch # - FV of Net Asset

9,500,000	-	9,500,000
		<u>FV of Net Asset 13,500,000</u>

$17,000,000$   
 $- 13,500,000$   
 $3,500,000 = \text{Goodwill}$

10-7) FV

1,000,000  
 9,400,000  
~~2,000,000~~ 1,200,000 + 1,000,000  
2,200,000

BV

1,300,000 7,800,000  
 8,000,000 2,200,000  
 200,000 10,000,000  
10,000,000

10-8) \$ 900,000

Initial Val.  
 Build A = 405,000  
 Build B = 225,000  
 Land = 270,000

Paid - 1,100,000  
FV of net Assets (10,000,000)  
 Goodwill 1,400,000  
 Build - A 450K 45%  
 Build - B 250K 25%  
 Land - 300K 30%  
1,000,000

we are trying to get +10-9) n=3 i=10%

Requirement 3 Liab 25K  
 \* 25000  
 - ~~18783~~ 2273 dis. (6217) → -1878 = 4339  
 - ~~18783~~ 2273  
 18783  
 25000  
 - 4339 (+20000) = 2273  
 ① 20661

Tractor = 25000 5,000 cash down  
 Non interest note

Tractor 25000 (0.75131) = 23783  
 Dis N/P — 6,217

N/P	25000
Cash	5000

~~10-11) Exp → 680,000  
 Cash → 680,000~~

2011 Int. Exp - 1878  
 (PV × i) 18783 × .10 = PV = 25000 (.75131) = 18783  
 + 5000 paid  
 23783

1/4 year 2 - 18783 + 1878 × 10% = 2066.1  
 10-11) MP = 18 5,000 shares

Land - 90,000 5000 × 18  
 Comm. Stoc No par - 90000

Building - 600,000  
 Cash - 400,000  
 Revenue (donation of asset) - 200,000

10-12) Net Sales =  $\frac{36,117}{(4,043 + 4151)/2} = \frac{36,117}{8194/2} = 8.82$

- ① = 8.82
- ② They are able to generate \$8.82 of Revenue for every dollar invested in fixed assets



Step 38

① Close Account  
First, Acc.  
Depr. + Asset

10-13) ① Cash - 3,000  
Loss on Sale - 1,000  
Tractor - 4,000

② Recog.  
Cash Rec/  
or given

② Cash - 10,000  
Gain on Sale - 6,000  
Tractor - 4,000

③ Cal.  
~~Cash~~ Gain  
Rec  
(Cash -  
BV)

① Cash - 3,000  
Accum Depr - 2,000  
Loss on Disposal - 1,000  
Tractor - 30,000

② Cash - 10,000  
Acc. Depr. - 2,000  
Gain on Sale - 6,000  
Tractor - 30,000

10-14) ~~Commercial Substance~~ *with exchanges only (FV = BV - FV)*

pg. 5A

Computer (new) - 260,000  
Accum. Deprec - 220,000  
Computer (old) - 400,000  
Cash - 60,000  
Gain - 20,000 (FV - BV)

10-15) Computer (new) - 230,000  
Accum. Deprec - 220,000  
Computer - 400,000  
Cash - 60,000  
Gain

10-15) Computer <sup>(new)</sup> - 230,000  
 Accum. Depr - 220,000  
 Loss - 10,000  
 Computer (old) - 400,000  
 Cash - 60,000

Always close acct using Full old Bal.

10-16) ① \$160,000 (FV + cash)

② Equipment - 160,000  
 Gain - 80,000 (BV - FV)  
 Cash - 10,000  
 Land - 120,000

unless Land Record @ BV

10-17) ② Equipment - 150,000  
 Cash - 10,000  
 Land - 120,000  
 Gain -

① ~~140,000~~

Equip -  $(140,000 + 7500 - 10000) = 137,500$   
 Cash - 10,000

$0.0625 = \frac{10,000}{150,000 + 10,000}$   
 $\rightarrow \times 120,000 = 7500$

Equip - ~~131,875~~ 137,500  
 Cash - 10,000  
 Land - 120,000  
 Gain -

~~10-17~~ 10-17)

$$\frac{10000}{150,000 + 10000} =$$

$$\frac{\text{Cash Rec}}{\text{FV + Cash Rec}} = \frac{10000}{150000} = 0.06666$$

6.7% ~~6.7%~~

x gain of 30,000

$$= \del{20100} 2001$$

$$\text{Equip } (140,000 + \del{20,000} - 10,000)$$

Equip - 132,000

Cash - 10,000

~~Loss - 7,999 Land - 150,000~~

Land - 150,000

72,000 + 14,000

10-18) i) FV of new land - 86,000

① Close Acct

② Recog. cash

③ Cal. gain

② Land (new) - 86,000

Land ~~old~~ - 30,000

Gain - 42,000

Cash - 14,000

3) Land (new) - 44,000

Cash - 14,000

Land (old) - 30,000

~~\*~~

~~10-22~~ 10-17)

Equipment — 140,000  
Cash — 10,000

Land — 120,000  
Gain — 30,000

10-22) (Evenly throughout so ave it.)  $\rightarrow 6,000,000 / 2 = 3,000,000$   
 $(1,500,000) \cdot 10 = 150,000$   
 $\rightarrow 1,500,000 \times .1 = 150,000$   
255,000

Constr. loan 10%  $1,500,000 \times .10 = 150,000$

Do weighted ave for other 1.5 mill

LTN — 9%  $2,000,000 = 180,000$

LTN — 6%  $\frac{4,000,000}{6,000,000} = \frac{240,000}{420,000}$

$\frac{420,000}{4,000,000} = 7\%$

E-23

Total 1,350,000

Borrowed 10,000,000 8%

so spent  $1,350,000 \times 8\% = 108,000$

Interest that will be capitalized  $\nearrow$

\* if 10 mill wouldnt have covered then you would take remainder of expenditures + give other loans as prior examples to get ave in rate to use that rate

2/3/11

## Class Note

Accretion Expense = Rate (PV of restoration cost)

~~ARO = Balance~~ ARO = Bal. + increase in bal.

Every Period  
last year Entries

Accretion Exp xxx  
ARO xxx pg 507

pg 515

### ~~Assurance~~ Issurance of Equity Securities

- Asset required - acquired is recorded at the fair value of the asset or the mkt val. of the securities (whichever is more evident)
- If the securities are actively traded, MV can be easily determined
- If not publicly traded asset is appraised for fair market value

Fixed Asset Turnover Ratio - measures how well a company manages its fixed assets to generate revenue

$$\frac{\text{Fixed Asset Turnover Ratio}}{\text{Ratio}} = \frac{\text{Net Sales}}{\text{Ave. fixed assets}}$$

For every \$1 they invested in their

fixed asset they <sup>generating</sup> gained \$\$\$ in net sales.

## Disposition of Assets

3 ways

- 1) discard
- 2) Sell
- 3) Trade / Exchange

depreciation from the books

- update depreciation to date of disposal
- Remove org. cost of asset + accumulated depreciation from the books
- The diff between book value of the asset and the amt received is record as gain or loss

! Recap! Straight Line Depreciation Method

$$SL = \frac{\text{org. cost} - \text{salvage value}}{\text{useful life}}$$

if fully depreciated with no salvage value there is no loss.

Step 1 - Close accts

Step 2 - Recognize gain or loss

exchange Lacles Commer

## Interest Capitalization Begins:

- construction begins
- interest is incurred
- qualifying expenses ~~are~~ are incurred

02/22/11

# Class Note      Chp 11 Class Notes \*

## Cost Allocation

- Matching Principle - Requires that part of the acquisition cost of property, plant, and equipment and intangible assets be expensed in periods when the future revenues are earned.

Depreciation, depletion, amortization are cost allocation processes used to help meet the matching principle requirements

Depreciation is truly a cost allocation process.  
trying to match exp. to revenue generated by  
DPE

### Depreciation Methods:

① Straight Line Method \*      salvage value

$$\frac{\text{org cost} - \text{Residual Value}}{\text{useful years}}$$

\* Depreciation Exp \*  
is the same each  
period with this method

What you expect to get for it when you sale it. ←

example =

$$\frac{1000 - 100}{5 \text{ years}} = \frac{900}{5} = 180$$



# Cost Allocation Overview

PP & E = Depreciation

Natural Resource - Depletion  $\rightarrow$  w/o <sup>direct</sup> asset

Intangible - amortization

Service Life: The estimated use that a asset the company expects to receive from the asset

Allocation Base: The value of the usefulness that is expected to be consumed

Allocation Methods: The pattern in which the usefulness is expected to be consumed.

- Straight Line Methods ~~and~~ Accelerated Methods (SYD)
- ① Sum of years Digits
  - ② Double declining Methods

of all line method assumes that the same amount of revenue will be generated by the asset each year. Because the straight-

example: Cost - \$1000

Salvage Val - \$100

Useful Life - 5 years

1

2

3

4

5

15

use that but if big # use formula 
$$= \frac{n(n+1)}{2}$$

Depreciation Expense goes down.

Allo base  
 $\frac{1}{5} 900 \times \frac{5}{15} = 300$

$\frac{2}{5} 900 \times \frac{4}{15} = 240$

$\frac{3}{5} 900 \times \frac{3}{15} = 180$

$\frac{4}{5} 900 \times \frac{2}{15} = 120$

$\frac{5}{5} 900 \times \frac{1}{15} = 60$

# CHP 11

## Double declining Balance Method

example: Orig Cost - 1000  
 Sal val - 100  
 Useful life - 5 years

\* Don't take \*  
 Salvage value out

~~Formula~~

FORMULA = BV @ Beg of year x Deprec Rate = Depre.

\* To get Rate take  $\frac{100\%}{\text{Useful Life}}$  then multiply by 2 to get double

example 8

1/1	1000	x 40%	= 400
1/2	600	x 40%	= 240
1/3	360	x 40%	= 144
1/4	216	x 40%	= 86.4
1/5	129.6	x 40%	= 51.84

$$\frac{100\%}{5} \times 2 = 40\%$$

\* Don't want to depr. lower than salvage value 80 last year

1 issue

year 5 don't do Rate and can only depr. \$30

Partial Year deprec? if bought asset in the middle of year be careful to only deprec. for the time you used it.

1/2 or if got in may the

Read MORE

to get the correct amount

## Unit of Production Method (Truck)

example 8 TRUCK - \$10000

Salvage - 1000

Useful Life - 5 years - But don't use useful life  
use mileage

Mileage Expected = 100,000 miles

~~FORMULA:  $\frac{\text{Original Cost} - \text{Sal Val}}{\text{Tot. Est. Mileage Cost}}$~~

$$\text{so } \frac{10000 - 1000}{100000} = .09 = 9\text{¢ per mile}$$

so if drove 20,000 miles depre<sup>n</sup> =  $20000 \times .09 = 1800$

$$\frac{1}{2} = 30000 \times .09 = 2700$$

from total

~~Subtract what  
you've already  
accounted for.~~

Cooper Mine = \$100,000 (No Salv on Resources)  
100,000 tons of Copper

$$\frac{\$100,000}{100,000 \text{ tons}} = \$1 \text{ per ton it costs me}$$

HW - 11-2 -12  
-3  
-6  
-10  
-11

Quantity of Resource  
Expected quantity  
to deplet

Depletion of  
Natural Resources

that  
Intangible assets have ~~an~~ indefinite life will not be amortized but impaired.

## Self Notes Chp 11 2/22/11

\* When acquiring PPE ~~and~~ and/or Intangibles you plan to use them to generate revenue. They are not considered an expense when you bought them (check journal entry)

Equipment xxx

Cash xxx

So since it's not expensed @ purchase we are to expense it over the life of its benefits (The time that we use it to generate revenue so that we can match revenue with expenses)

\* Estimate \*

Allocation Base = Total amt of cost to be allocated over an asset's service life.

Org. Cost - Residual (Salvage) Value

Residual or Salvage Value: The amt the comp expects to receive for the asset at the end of its service life less any anticipated disposal cost

Accelerated Methods - Used to more adequately estimate depreciation. Assumption is a asset may generate more revenue in its early years rather than in the later ones. With these methods depreciation is greater in the earlier life of the asset.

## Sum-of-The-Years Digit Method

~~Is~~ (depreciable) base by a fraction that declines each year.

- Denominator of fraction remains constant  
- is the sum of the digits from one to  $n$  (the amt of years)

- Numerator decreases each year until it equals ~~the~~ ~~to~~ 1 in the final year of service life.

## ~~Double~~ Declining Methods

Multiply a constant fraction by a declining balance each year.

$$\text{Constant \% Rate} \times \text{BV (declining)}$$

To get Rate  $\frac{1}{n} = \# \text{ years of service life}$

or common Rates are ~~100~~ 125%, 150%, or 200% of the Rate is used.

- When 200% is used that is the Double Declining Method

## Units of Production Method

- Using <sup>the</sup> measure of output/input to allocate depreciation (activity base)

1) Compute ave depr. Rate per unit by  $\frac{\text{Depre Base}}{\text{units expected}}$

2) Multiply Rate by units produced each period

## Partial Periods

- When ~~acquisition~~ acquisition & disposal occur @ other times (not 1st of year) you must theoretically determine how much depreciation, depletion, and amortization to record for the part of the year that each asset is actually used

\* Only presents a problem when time-based depreciation methods are used \* ~~Not applicable~~

Class Notes

02/24/11

### Partial Depreciation

Cost - 1000  
Sal Val - 100  
Useful life - 5 years

① Calculate for each year the amt ~~with~~ without partial consideration

② Get the amt of months ~~not~~ used and subtract from 12 to get months used

Self Test 7/26/11

Calculate ~~with~~ without partial considerations

Step 1

$$\frac{900}{5} = 180$$

1 = 180
2 = 180

$$\frac{100}{5} \times 2 = 40\%$$

$$\frac{540}{1000} \times \frac{2}{15}$$

$$\frac{1}{2} \times 1000 \times \frac{1}{15}$$

$$\begin{array}{r} 1 \\ 2 \\ 3 \\ 4 \\ 5 \\ \hline 15 \end{array}$$

$$1 = 900 \times .4 = 360$$

$$2 = 540 \times .4 = 216$$

~~DON'T take out sal val~~

# PARTIAL Year Examples

SL

180

180

180

1

2

3

4

5

15

DDB April 1st

$$1000 \times 40\% = 400$$

$$600 \times 40\% = 240$$

$$360 \times 40\% = 144$$

SAYD

$$5/15 = 300$$

$$4/15 = 240$$

$$3/15 = 180$$

$$2/15$$

$$1/15$$

Oct 1

Purchased @ April 1st  
so didn't use Jan, Feb, March  
3 months  
 $12 - 3 = 9$

partial = ~~9/12~~  $\frac{9}{12} \times 180 = 135$  1st year only

2010  $\frac{1}{12}$  DDB  $400 \times \frac{9}{12} = 300$

2011  $\frac{1}{2}$   $400 \times \frac{3}{12} = 100$   
 $240 \times \frac{9}{12} = 180$

$\frac{1}{3}$   $240 \times \frac{3}{12} = 60$   
 $144 \times \frac{9}{12} = 108$

Because you need to depreciate the entire 12 months  
Fiscal year for equip is ~~12~~

SAYD Purchased Oct 1

~~$\frac{1}{12} \times 300 \times \frac{3}{12} = 75$~~   
 ~~$\frac{1}{2} \times 240 \times \frac{9}{12} = 180$~~   
 ~~$\frac{1}{3} \times 180 \times \frac{3}{12} = 45$~~

	JAYD	Purch. Oct
1/1	300	$\frac{1}{1} 300 \times \frac{3}{12} = 75$
1/2	240	$\frac{1}{2} 300 \times \frac{9}{12} = 225$
1/3	180	$240 \times \frac{3}{12} = 60$
		$\frac{1}{3} 240 \times \frac{9}{12} = 180$
		$180 \times \frac{3}{12} = 45$

## Impairment of Value pg 580

Impairment - Value goes down  
 - if historical cost is impaired we have to take that into account on Bal. Sheet

### Test 1 PPE 2 Steps to Calculate Impairment

① Recoverability  
~~BV~~ BV is less than the discounted future cash flows

example  $\rightarrow$  BV = 500

~~BV~~ BV discounted cash flow = 400  
 $\leftarrow$  (PV of Future cash flows)  
 if greater there is an impairment

Test 2

② Measurement of the impairment

BV = 500 FU = 300

~~EDD~~

Impairment cost is difference (200)



# For Indefinite intangibles/without Goodwill

- For indefinite intangibles. (Trademark)

Only 1 step

Test 1

\* Check annually if  $BV \geq FV$

## GOODWILL

### Step 1

check BV of goodwill & the FV. If ~~different~~ there is an impairment loss  $\Rightarrow BV > FV$  of net assets  
 $\rightarrow BV - FV$  Yes!

### Step 2 Measurement of impairment

\* Calculate implied Goodwill = FV of Net Assets with Goodwill

- FV of Net assets without Goodwill

FV of Goodwill  $\leftarrow$  Implied Goodwill

Compare implied goodwill with BV of goodwill

if  $BV$  of goodwill  $>$  implied goodwill = impairment loss

example)  $BV = 440$  mil  $FV = 360$  mil  
yes impairment

Step 1

Step 2 ~~440 mil~~ 360 mil  
~~390~~ 335 mil

25 mil implied goodwill

Step 3 BV of GW = 100 mill  
Implied GW = 25 mill

Impairment loss - 75 mill

Entries  
Loss on Impairment - \$75  
Goodwill - \$75

pg 588 Summary of Asset Impairment Guidelines

Assets Held To be Sold  
BV compared to FV - Cost to sale

if  $BV > FV - \text{Cost to Sale}$   
There is an impairment loss recognized for difference

Change of Estimates pg 576  
- When change the estimates made to calculate depreciation.

examples Cost - 250,000  
Residual - 40,000  
Life - 5 years

$$\frac{250,000 - 40,000}{5} = 42,000 \quad \text{SL}$$

2 years were already deprec. by change

$$42,000 \times 2 = 84,000$$

$$\text{so } 250,000 - 84,000 = 166,000$$

on April 1st

$$\frac{11661000 - 40000}{(8-2)6} = 24000$$

\* You just move Forward

Examples Cost - 250,000

Res. - 30,000

Life - 5y

Switching from DDB to SL

DDB (2 years)

$$\frac{1}{2} 250,000 \times .40 = 100,000$$

$$\frac{1}{2} 150,000 \times .40 = 60,000$$

~~200,000~~

160,000

$$\text{Switch do} \frac{250,000 - 160,000}{3} = \text{~~30,000~~}$$

$$\frac{90,000 - 30,000}{3} = 20,000$$

Repairs Maintenance (Read!)  
- Additions (Capitalize)

- Improvement (Capitalize) 3 ways to

do so

- Rearrangements can cost you money  
only use when amt is material enough

pg 591 Summary

$$\begin{array}{r} \text{HMW} \\ \text{11-4} = 19 \\ \text{-14} = 22 \\ \text{-15} = 25 \\ \text{-18} \end{array}$$

2/22/11

# Homework

## 11-2) Machine

Costs \$115,000

Useful life of 10 years

Residual Value of \$5,000

Expect Production of 220,000 units

### 1) Straight Line

$$\frac{115000 - 5000}{10 \text{ years}} = \frac{110,000}{10} = 11,000$$

Jan 1 Purch

Depr.

Dec 31<sup>1</sup> → 11,000 → 2011

Dec 31<sup>2</sup> → 11,000 → 2012

### 2) Sum of the years' digits

1	1/55	110K	10/55 = <del>73,333</del>	20000	Residual Value 10 years 10+2
2	2/55	110K	9/55 = 18000	2011	
3	3/55	110K	8/55 = 36,166	2012	

### 3) Double declining Balance

$$\frac{1}{3} \times 2 = 20\%$$

2011	115,000	$\times .67$	= <del>77,050</del>	23,000
2012	37,950	$\times .67$	= <del>25,427</del>	18,400

### 4) 150% Declining method $\frac{1}{3} \times 1.50 = 50\%$

2011	115,000	$\times 50\%$	= <del>57,500</del>	57,500
2012	57,500	$\times 50\%$	= <del>28,750</del>	28,750

## 5) Units of Production

$$\frac{\$110000}{220000 \text{ units}} = .5 \text{ so } 50¢ \text{ per unit}$$

~~$$2011 \quad .5 \times 30000 \text{ units} = 15000$$~~

~~$$2012 \quad .5 \times 25000 \text{ units} = 12500$$~~

## 2011 OCT 11-3) 1) Straight Line Partial Period

NOV 3 months

DEC

$$3/12 = 25\%$$

~~$$2011 \rightarrow 11,000 \times .25 = 2,750$$~~

~~$$2012 \rightarrow 11,000$$~~

## 2) Sum of Years digits

~~$$2011 \quad 20000 \times .25 = 5000$$~~

~~$$2012 \quad 20000 \times .75 = 15000$$~~

~~$$18000 \times .25 = 4500$$~~

## 3) DDB 23000

~~$$2011 - 23000 \times 3/12 = 5750$$~~

~~$$2012 - 23000 \times 9/12 = 17250$$~~

~~$$18400 \times 3/12 = 4600$$~~

## 4) 150% Declining Balance

~~$$2011 \rightarrow 17050 \times 3/12 = 4313$$~~

~~$$2012 \rightarrow 17050 \times 9/12 = 12938$$~~

~~$$14163 \times 3/12 = 3666$$~~

5) UOP

2011 = 10,000 units

2012 = 25,000 units

2011 → .5 × 10,000 = 5,000

2012 → .5 × 25,000 = 12,500

11-6) Cost = \$260,000  
Life = 6 years  
Sal Val = \$20,000

Purch April 29,

$\frac{12}{-4}$   
8 months Part

① Do Regularly

DSL  $\frac{260,000 - 20,000}{6} = 40,000$   $\left\{ \begin{array}{l} 2011 \\ 2012 \end{array} \right.$

Partial  
2011  $40,000 \times \frac{8}{12} = 26,667$   
2012 → 40,000

2) Sum of Years Digits

2011  $\frac{2}{3} \times 240,000 = 160,000$

2012  $\frac{1}{3} \times 240,000 = 80,000$

$\frac{1}{2}$   
 $\frac{2}{3}$

Partial  
2011  $160,000 \times \frac{8}{12} = 106,667$

2012  $160,000 \times \frac{4}{12} = 53,333$   
 $80,000 \times \frac{8}{12} = 53,333$

# Switching Methods

## Double Declining

$$3) \frac{1}{10 \text{ years}} \cdot 16 \times 2.33 \quad 33\%$$

$$2011 \quad 260000 \times .33 = 86666.7$$

$$2012 \quad 173,333 \times .33 = 57,200$$

Partial

$$2011 \quad 86666.7 \times \frac{8}{12} = 57,778$$

$$2012 \quad 86666.7 \times \frac{4}{12} = 28,889$$

$$57200 \times \frac{8}{12} = 38,133$$

11-11-10) Cost = Purch # 154000 Freight + 2000 Install <sup>14000</sup>  
Life - 8 years  
Sal Val - 30625  
Cost = 160,000

## DPB

$$\frac{1}{8} \times 2 = .25$$

$$2011 \Rightarrow 160,000 \times .25 = 40,000$$

$$2012 \quad 120,000 \times .25 = 30,000$$

$$2013 \quad 90,000 \times .25 = 22,500$$

$$2014 \quad 67,500 \times .25 = 16,875$$

$$\underline{109,375}$$

$$St \quad 160000 - 109,375 = 50,625 = BV$$

$$so \quad \frac{50,625 - 30,625}{4} = 5000$$

$$2015 \rightarrow 75000$$

$$2016 \rightarrow 75000$$

$$2017 \rightarrow 75000$$

$$2018 \rightarrow 75000$$

# 11-1) Homework Do over

$$11-3) y_1 = \frac{115000 - 5000}{10} = 11000 \times \frac{3}{12} = 2750$$

11-4) Cost - 5,000,000  
Salvage - 200,000  
Useful life - 30 years

Jan. 1  
2009

$$\frac{5,000,000 - 200,000}{30 \text{ y}} = 160,000$$

Jun. 30  
2011

additions

$$\frac{1,650,000}{27.5 \text{ years}} = 60,000$$

2 1/2 years from useful life

$$60,000 \times \frac{6}{12} = 30,000$$

Do separate depreciation because they have different useful lives. It is capitalized that's why it is depreciate

2011	1,600,000 + 30,000
2012	1,600,000 + 60,000

Depreciate additions separate from PP&E if own useful life



11-11) Cost = 4,500,000  
Expected Extraction - 900,000 tons  
Life - 4 years

$$1) \frac{4,500,000}{900,000} = \$5$$

$$240,000 \times \$5 = 1,200,000$$

~~12~~  
~~11~~  
~~18~~

E 11-14) Patent  
11/109 Cost - 700,000  
Use life - 10 years

Patent - 700,000  
Cash - 700,000

$$\frac{700,000}{10} = 70,000$$

(a) Amortization Exp - 70,000  
Patent - 70,000

(b) Franchise - 500,000  
Cash - 500,000  
10 years useful life

$$\frac{500,000}{10} = 50,000$$

11-15) Patent

1/2/11 Cost \$ 500,000

Legal Life 12 years

Useful life 8 years ← use this

$$\frac{500,000}{8} = 62,500$$

1/13 (2 years)  $62,500 \times 2 = 125,000$  already  
amortize

$$\begin{array}{r} 500,000 \\ - 125,000 \\ \hline 375,000 = \text{BV} \end{array}$$

→ Legal Fees successfully defended so  
you capitalize

$$\text{New BV } 375,000 + 45,000 = 420,000$$

$$6 \text{ years left } \frac{420,000}{6} = \$70,000$$

When depreciating intangibles ~~just~~  
Patents divide by useful life  
Depletions divide by expected extraction  
to get cost per ton.

## Chap. 11 contd Self Notes

Switch From Accelerated To Straight Line  
The year you switch take current BV minus sal. val. and divide by remaining years.

\* Read (See) group depreciation pgs 567  
before test! Very IMPORTANT

### Depletion of Natural Resources

Depletion - allocations of the cost of natural resources.

- UOP method usually used
- Service life is the estimated amt of natural resource to be extracted
- Depletion Base = cost - any Residual Costs

ex) 2,300,000

Paid - 1,000,000  
Cost 2 Explore - 800,000  
Other Cost - 500,000  
2,300,000  
Use life - 1,000,000 tons  
Restoration - 468,360.50

$$\frac{2,768,360}{1,000,000} = 2.76836 \text{ per ton}$$

Depletion  $(2.76836 \times 300,000) = 830,508$   
→ Coal Mine - 830,508

Credited to Asset acct not Acc deprec.

## Amortization of Intangible Assets

Amortization is allocating the cost of intangible assets

$$\frac{\text{Capitalized Cost} - \text{Sal Val}}{\text{Useful ~~Legal~~ life (finite life)}} \rightarrow \text{Usually zero unless being sold directly after use}$$

//  
Sometimes shorter than legal life

\* Credit directly to asset (like depletion), no contra account.

exp) Franchise \$ 200,000  
Leg Life - 10 years

Patent \$ 50,000  
leg life 13 years  
Use life 8 years

↙  
Straight line

$$\frac{200,000}{10} = 20,000$$

↓

$$\frac{50,000}{8} = 6,250$$

Amortization Exp - 20,000  
Franchise - 20,000

Amortization Exp - 6,250  
Patent - 6,250

\* If intangible has an indefinite life it is not to be amortized unless useful life is determined later. \*  
(They have impairment of value)

Investor (Buyer)

Cash - 60,000

Premium - 1420

Int Rev - 58,580

14-12) Partial Payment

20 year  
Semi annual  
40 periods

Issued March 1st

FA - 300,000

Sold 4 - 294,000

Discount - 6000

Stated Rate - 14%  
 $\frac{14\%}{2} = 7\%$

Issuer

Cash - 294,000

Discount on B/P - 6000

Bond/Pay - 300,000

Straight line  
method for  
amortization

$$\frac{\text{Dis/Premium}}{\# \text{ of Periods}} = \frac{6000}{40} = 150$$

Interest Exp  $(300,000 \times .07) = 21,150$

Discount on B/P - 150

Cash - 21,000

Investor

Investment in Bonds - 300,000

Dis on Bd Inv. - 6000

Cash - 294,000

Cash - ~~21,000~~ 21,150

Discount Bd Invest - 150

Int. Rev - 21,000

$$3) \text{ Int Exp} - (4\% \times 21150) = 14100$$

$$\text{Dis on Bd/Pay} (4\% \times 150) = 100$$

$$\text{Interest Payable} (4\% \times 21000) = 14000$$

\* Pay in Feb. But accure on Dec. 31 \*

4) February 28

$$\text{Int Exp} (2\% \times 21150) = 7,050$$

$$\text{Int Pay} = 14000$$

$$\text{Discount on Bd/Pay} = 50$$

$$\text{Cash} (\overset{7\% \times 300,000}{\cancel{21,000}}) = 21000$$

---

Everyone except extended warranty is unearned  
Revenue (loss contingency)  
with Extended Warranty sold as product  
13-18) Prepare for test

---

Chp. Straight Line Method

Amortize

Price of Bond

2 14-2)

Bond Price

+ P Payments PV of Annuity  
+ PV of \$1 of Maturity

Use Market Rate for table

40 periods

20 years semiannual  $\frac{12\%}{2} = 6\%$  Stated Rate

\$1,000,000

use stated rate to find i pay

$1,000,000 \times 6\% = 60,000$  MR  $\frac{10\%}{2} = 5\%$

Sold @ premium

PV #1

$1,000,000 \times .14205 = 142,050$

PV annuity  $60,000 \times 17.15909 = 1,029,545.4$

$= 1,171,595$

Issuer (seller)

~~Cash 1,000,000~~ 1,171,595

Premium on BIP - 171,595 😊

Bond Pay - 1,000,000

Buyer (Investor)

Investment in Bonds - 1,000,000 (FV)

Premium on Bond Invest - 171,595

Cash - 1,171,595

② FV \$ 1,000,000  
 Sold For 900,000 (discount)

Journalize

Issuer (seller)

Cash - \$900,000

Discount on B/P - 100,000

Bonds Payable - ~~1,000,000~~



Buyer (Investor)

Investment in Bonds - 1,000,000

Discount on Bd - 100,000

Cash - 900,000

Investment

Journalize Interest Payment & Premium Amortization  
 1st one

Issuer (seller)

① Interest Exp - ~~50,000~~ 58,580  
 Premium on Bd/Pay - ~~14,200~~

② 58,509  
 1,491

60,000

Cash - 60,000

Use Table

Actual Paid  
 V x Stated Rate  
 credit cash &  
 this amt)  
 50,000  
 60,000

Int Exp  
 outstanding Bal  
 x MR  
 58,580  
 58,509

Premium Amt  
 1,420  
 1,491

carrying Value  
 1,171,595  
 - 1,420  
 1,170,173  
 1,171,664



# Chapter 15

1/17/2012

## LEASES

### Advantages

- Cash flow
- USE VS OWNERSHIP



depreciate      appreciate

- protection against obsolescence
- tax benefits
- better looking financial statement (off-balance sheet financing)

### Two types of Leases

• **Operating Lease** ←  
 a lease does not meet any of the 4 criteria

1. Advanced pmts
2. Leasehold Improvements
3. Rent abatement
4. Lessor Depreciation

• **Capital Lease (FASB #13)**  
 - has to meet 1 of 4 criteria

#### Criteria:

1. Transfer of ownership
2. Bargain purchase option
3. Lease term is 75% of eco. life
4. Present value of pmt is 90% of fair value

815-11

LESSEE (Nath-Langstrom)

LESSOR (Computer World)

Jan. 1, 2011

NO Entry

NO Entry

June 30, 2011

Rent exp 10,000  
 Cash 10,000

Cash 10,000  
 Rent Rev 10,000

Dec 31, 2011

Rent exp 10,000  
 10,000

Cash 10,000  
 Rent Rev 10,000

pmt before use = prepaid rent } pmt @ end = rent exp

DEP exp  $(90,000 \div 6)$  15,000

No Entry (does not own it)

Acc dep \_\_\_\_\_ 15,000

E 15-2 Winn Heat Transfer

Owner

Jan. 1, 2011

1) Prepaid rent 80,000  
Cash 80,000

Cash 80,000  
Unearned Rent Rev 80,000

2) Prepaid rent 96,000  
Cash 96,000

Cash 96,000  
Unearned rent rev 96,000

3) Leasehold improvement 180,000  
Cash 180,000

No Entry

Dec. 31, 2011

1) Rent exp 80,000  
Prepaid rent 80,000

Unearned rent 80,000  
Rent rev 80,000

2) Rent exp 32,000  $(96,000 \div 3)$   
Prepaid rent 32,000

Unearned rent 32,000  
Rent rev 32,000

3) Dep exp 60,000  $(180,000 / 3 \text{ yrs})$   
Acc dep - Leasehold 60,000

Dep exp - bldg \$\$\$  
Acc dep - bldg \$\$\$

\* Capital leases (p. 811)\* → (FASB #13 must meet one of four criteria)

\* IFRS → IAS #17 (can meet one of five criteria)\*

Criteria

#3 Term of lease must cover a "major part" of the economic life of the lease asset.

#4 Present value of the "minimum lease pmt" at inception of the lease is equal to "substantially all" of the fair market value of the leased asset

#5 The lease asset is of a specialized value such that only the lessee can use it without modification.

(Not emphasized by FASB #13)

\* Types of Capital leases \*

1. direct financing lease = lease broken by a fin. co. (ex: bank, fin. institution)
2. sales-type lease = lease broken btw the manufacturer profit on the sale of the asset.

\* Direct Financing Lease (LESSEE)\*

• Min. Lease Pmts = (total rental pmt) + (any resid. value guaranteed by lessee) or (BPO)

• Lease Liability = (PV of rental pmts)

use lessee or lessor borrowing rate (whichever is low)

• Lease Asset = same as lease liability (value of asset is also recorded as liability)

Situation #1 LESSEE (beginning of yr)

E 15-15 4. MLP = \$100,000 (7 yrs) = \$700,000

B.) 5. LA = \$100,000 (5.48592) = \$548,592

6. LL = \$548,592 PV of an. due

Situation #4

B.) 4. MLP = \$100,000 (8 yrs) + \$40,000 = \$840,000 PV of \$1

5. LA = \$100,000 (5.56376) = \$556,376 + (40,000 x 0.40388)

PV of an. due \$556,376 + 16,155.20

\$572,531.20

6. LL = \$572,531.20

E 15-3 ON BACK

MLP = \$15,000 (8 yrs) = \$120,000

LA = \$15,000 (7.47199) = 112,080 2% ; p = 8 yrs

LL = \$112,080 PV of an. due (quarterly)

Proven  $\frac{112,080}{112,080} = 100\%$  or  $\frac{2 \text{ yrs}}{2 \text{ yrs}} = 100\%$

Period #	Rental pmts	int (2%)	Reduce	Pmt
	15,000	(int. acc on a loan over time)		112,080
1	15,000		15,000	97,080
2	15,000	1,942	13,058	84,022
3	15,000	1,680	13,320	70,702
4	15,000	1,414	13,586	57,116
5	15,000	1,142	13,858	43,258
6	15,000	865	14,135	29,123
7	15,000	582	14,418	14,705
8	15,000	294	14,705	0

\* Group 4 (Chapter 19) \* - Print sem. schedule

(Cont. 15-3) → Lessee - Capital Lease Entities

Jan 1, 2011

Lease asset (Equipment) 112,080

Lease liability 112,080

Lease liability 15,000

Cash 15,000

(Liability was reduced = cash was credited)

April 1

Lease Liability 13,058

Int. Expense 1,942

Cash 15,000

July 1

Lease liability 13,320

Interest Expense 1,680

Cash 15,000

Oct 1

Lease liability 13,586

Interest Exp 1,414

Cash 15,000

Dec 31, 2011 (Depreciation)

112,080

2 yrs

Dep. Exp. (LA) 56,040

Acc. Dep (LA) 56,040

Adj. entry (incurred int. in 2011)

Int Exp 1,142

Int Payable 1,142

Jan 1, 2012

Lease liability — 13,858  
 Int. payable — 1,142  
 Cash — 15,000

**\* Lessor \* - Capital lease**

1. direct financing lease - finance Co
2. sales type lease - manuf. of the asset

• **Gross investment = (total rental pmt) + (resid. value - lessor)**  
 or **guaranteed / unguaranteed**  
**(BPO pmt)**

• **Net investment = (PV of lease pmt) + (any direct cost)**  
 → PV of Salv

• **Unearned Int. Rev = (gross inv.) - (net inv.)**

E 15-15

**LESSOR**

A.)	S-1	S-2	S-3	S-4
MLP	\$700,000	\$750,000	\$800,000	\$840,000
G.I.	\$700,000	\$750,000	\$850,000	\$900,000
	(100k x 7yrs)	(100k x 7yr + 50k)	(100k x 8yrs + 50k)	(100k x 8yr + 40k + 60k)
N.I.	\$548,592	\$547,137	\$610,168	\$596,764
	(100k x 5.48592)	(100k x 5.23054)	(100k x 5.86842)	
		(50k x .48166)	(50k x .46651)	
UNE. Int Rev =	151,408	202,863	239,832	303,236

ON NEXT PAGE

Situation 4 (E: 15-15)

Jalisa Butts

$(100,000 \times 5.56376) = \$556,376$

1/24/12

$(40,000 \times .40388) = \$16,155.2$

$(60,000 \times .40388) = \$24,232.8$

\$596,764

Journal Entry (Lessor) Edison Leasing - D7 LEASE

Jan. 1, 2011

LEASE REC \_\_\_\_\_ 112,080

Inv. of equip \_\_\_\_\_ 112,080

Cash \_\_\_\_\_ 15,000

LEASE REC \_\_\_\_\_ 15,000

April 1

Cash \_\_\_\_\_ 15,000

LEASE REC \_\_\_\_\_ 13,058

Int. rev \_\_\_\_\_ 1,942

July 1

Cash \_\_\_\_\_ 15,000

LEASE REC \_\_\_\_\_ 13,320

Int. rev \_\_\_\_\_ 1,680

Oct 1

Cash \_\_\_\_\_ 15,000

LEASE REC \_\_\_\_\_ 13,586

Int. rev \_\_\_\_\_ 1,414

Dec 31, 2011 (# dep. b/c asset transfers to Lessee)

Int. REC \_\_\_\_\_ 1,142

Int. rev \_\_\_\_\_ 1,142

Jan 1, 2012 (has not been recognized) — Revenue —

Cash 15,000  
 Lease rec 13,858  
 Int. rec 1,142

1/26 \*Sales-Type Lease\* p. 823 (ref.)

E 15-5 Net Investment = PV of lease pmt  
 $112,080 = \text{lease pmts} \times \text{PV factor}$   
 $112,080 = \text{lease pmts} \times 7.47199$   
 $\frac{112,080}{7.47199} = \text{lease pmts}$

Lease pmts = 15,000

LESSOR

1/1/11  
 (inception)

Lease rec 112,080  
 Sales Rev 112,080

COGS 85,000  
 Inv. of leased equip 85,000

Cash 15,000  
 Lease rec 15,000

Only difference  
 from DT leasing

4/1/11

Cash 15,000  
 Lease Rec 13,058  
 Int. Rev 1,942

7/1/11

Cash 15,000  
 Lease Rec 13,320  
 Int. Rev 1,680



# Chapter 15 On-line (HW)

$n=4; i=?$   $i=12\%$

#1 implicit rate =  $\frac{\$6,074,700}{2,000,000} = PVOA$   
 $PVOA = 3.03735$

	pmts	$\epsilon.1 (12\%)$	↓ bal.	O.B
2/1/11	2,000,000			6,074,700
4/1/11	2,000,000	928,964	1,271,036	4,803,664
12/31/12	2,000,000	576,439.68	1,423,560.32	3,380,103.68

$n=4; i=11\%$

②  $2,000,000 (3.10245) = \$6,204,900$

#2 5yr. lease x quarterly pmts = 20 periods / int =  $\frac{12\%}{4} i=3\%$

$n=20; i=3\%$   $PVOA = 15.32380$

①  $\$391,548 (15.32380) = \$6,000,003.242$  (Sept. 30, 2011)

	pmt	3%	↓ Bal	O.B
	391,548			6,000,003
9/30/11	391,548		391,548	5,608,455
12/31/11	391,548	168,253.65	223,294.35	5,385,160.65

③

9/30/11	rev (int)	0
12/31/11	int rev.	168,253.65
		168,253.65

④

9/30/11	391,548
12/31/11	223,294
	<u>\$614,842</u>

REV	6,000,003
COGS	(5,000,000)
N.i.	1,000,000
12/31/11 int rev	168,253.65
	<u>1,168,253.65</u>

(A) (LESSOR)

$n=4$   $i=11\%$

Situation 1

2

3

4

#3

MLP  $\$40,000$   $\$44,000$   $\$44,000$   $\$40,000$   
~~(10K x 4yrs)~~ (10K x 4yrs) (10K x 4yrs + 4K) (10K x 4yrs + 4K) (10K x 4yrs)

G. Invest.  $\$40,000$   $\$44,000$   $\$44,000$   $\$44,000$   
 (10K x 4yrs) (10K x 4yrs + 4K) (10K x 4yrs + 4K)  $\rightarrow$  "

N. Invest.  $\$34,437$   $\$37,072.02$   $\$37,072.02$   $\$37,072.02$   
 (10K x 3.44371) (10K x 3.44371) (10K x 3.44371) (10K x 3.44371)  
 (4K x 0.65873) (4K x 0.65873) (4K x 0.65873)

(B) (LESSEE)  $n=4$   $i=11\%$

Situation 1

2

3

4

MLP  $\$40,000$   $\$44,000$   $\$40,000$   $\$40,000$   
 (10,000 x 4yrs) (10K x 4yrs + 4K) " "  $\rightarrow$  " "

L. Asset  $\$34,437.1$   $\$37,072.02$   $\$34,437$   $\$34,437$   
 $\$10K \times (3.44371) \rightarrow$  "10K x" " "  $\rightarrow$  " "  $\rightarrow$  " "  
 (4K x 0.65873)

L. Liab.  $\$34,437$   $\$37,072.02$   $\$34,437$   $\$34,437$

10/1/11 Cash — 15,000  
 Lease Rec — 13,586  
 Int. Rev — 1,414

12/31/11 Int. Rec — 1,142  
 Int. Rev — 1,142

1/1/12 Cash — 15,000  
 Int. Rec — 1,142  
 Lease Rec — 13,858

Residual value

- lessee ignore
- if it goes to lessor, then they consider it

\* If lessee guar. resid. value, when computing MLP it must be included

\* If not guar. then exclude from the lessee MLP

• if lessor resid. value non-guar, then include it in the gross investment of lessor

BPD

- Lessor deduct the BPD when you compute the lease prnts
- Lessee add "~~~~~"
- Compute @ the time the BPD takes effect

E 15-16

Situation 1

fmv	_____	60,000
10k (PV of 1)	_____	
0.56743	_____	(5,674)
		54,326
		54,326

PV of 4.03%  
 ET

## Bluerichnotes.com Key

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@	At	DIV =	Dividend
A/D; Acc Depr =	Accumulated depreciation	DL =	Direct Labor
A/R =	Accounts Receivable	DM =	Direct Materials
Acct =	Account	DMV =	Designated Market Value
Adj =	Adjustment(s) or Adjust	DTA =	Deferred tax asset
Amort =	Amortize or Amortization	DTL =	Deferred tax liability
Amt =	Amount	EFT =	Electronic Funds transfer
AP =	Actual price	El=	Ending Inventory
AQ =	Actual quantity	EL =	Eliminations
Ass =	Assets	Equ =	Equity
Avail =	Available	Equip =	Equipment
Ave =	Average	EST =	Estimate
B / P; Bd / Pay =	Bond Payable	Exp =	Expense
B. Inventory =	Beginning Inventory	Fac =	Factory
BA =	Bank Account	FASB =	Financial Accounting Standards Board
Bal =	Balance	FC =	Fixed Cost
Bd; Bds =	Bond	FICA =	Federal Insurance Contribution Act
Beg =	Beginning	FIFO =	First in First out
BOC =	Billings on Contract	Fin =	Financial
BV =	Book Value	Fin =	Finished
CA =	Current Assets	FMW =	Fair Market Value
Cal; Calc =	Calculated or Calculation	FOH =	Factory Overhead
Cap =	Capital	FV =	Fair Value
Chrg =	Charge	FV =	Face value (in case of investments)
CIP =	Construction in Process	GP =	Gross Profit
CL =	Current Liabilities	i Rate; i =	Implicit Rate of Interest
CM =	Contribution margin	IASB =	International Accounting Standards Board
COG =	Cost of Goods Sold	IDS =	Income distribution schedule
COGM =	Cost of Goods Manufactured	Inc =	Income
COGP =	Cost of goods production	Insur; Insu; Ins =	Insurance
Com =	Common	Int =	Interest
Comp =	Company; Completion	Inv =	Inventory or Investment
Consol =	Consolidation	Invest =	Investment
Const =	Construction	IS =	Intercompany Sale
Contr =	Contract	LCM =	Low Cost Market
Corp =	Corporation	LEV =	Labor efficiency variance
CR =	Contract rate	Liab =	Liability
Cred =	Credit	LIFO =	Last in first out
CV =	Carry Value	LTL =	Long term liability
CVP =	Cost volume profit	Merch =	Merchandise
D =	Distributions	Meth. =	Method
DDB =	Double Declining Balance	MI =	Merchandise Inventory
Deb =	Debit	Misc =	Miscellaneous
Depr =	Depreciation	MR =	Market Rate
Dis; Disc =	Discount	MV =	Market Value

MV =	Maturity value (in case of investments)	Sub =	Subsidiary
N/R =	Notes Receivable	Sum =	Summary
NCI =	Noncontrolling Interest	Sup Exp =	Supply Expense
NI =	Net Income	Tot =	Total
NL =	Net Loss	UOP =	Units of Production
NP =	Normal Profit	Val =	Value or Valuation
NR =	Natural Resources	VC =	Variable Cost
NRV =	Net Realizable Value	VOH =	Variable overhead
NSF =	Nonsufficient funds checks	W/ =	With
OH =	Overhead	WIP =	Work in Process
Org =	Organization; Original	WS =	Worksheet
Pd =	Paid		
PIC =	Paid In Capital		
PP&E =	Property plant & equipment		
Pre =	Premium		
Prep =	Prepaid		
Purch =	Purchase		
PV =	Present Value		
Q =	Quantity		
R&D =	Research & Development		
RC =	Replacement Cost		
RE; R. Earnings =	Retained Earnings		
Rec; Receiv =	Receivable		
Rev =	Revenue		
SAYD =	Sum of the Years Digit Method		
SE =	Simple Equity		
SEC =	Security Exchange Commission		
Sep =	Separate		
Serv =	Service		
SL =	Straight Line Method		
SP =	Sale Price		
Stat =	Statement		
Strd P =	Standard price		