Exercise 9-7A *Effect of warranty obligations and payments on financial statements*

LO 4

The Wolf Appliance Co. provides a 120-day parts-and-labor warranty on all merchandise it sells. Wolf estimates the warranty expense for the current period to be $2,450. During the period a customer returned a product that cost $1,950 to repair.

Required

a. Show the effects of these transactions on the financial statements using a horizontal statements model like the example shown here. Use a + to indicate increase, a − for decrease, and NA for not affected. In the Cash Flow column, indicate whether the item is an operating activity (OA), investing activity (IA), or financing activity (FA).

Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Cash Flow

b. Prepare the journal entry to record the warranty expense for the period.
c. Prepare the journal entry to record payment for the actual repair costs.
d. Discuss the advantage of estimating the amount of warranty expense.

Exercise 9-8A *Current liabilities*

LO 1, 2, 4

The following transactions apply to Midsouth Equipment Sales Corp. for 2013:

1. The business was started when Midsouth received $60,000 from the issue of common stock.
2. Purchased $160,000 of merchandise on account.
3. Sold merchandise for $220,000 cash (not including sales tax). Sales tax of 8 percent is collected when the merchandise is sold. The merchandise had a cost of $140,000.
4. Provided a six-month warranty on the merchandise sold. Based on industry estimates, the warranty claims would amount to 4 percent of merchandise sales.
5. Paid the sales tax to the state agency on $180,000 of the sales.
6. On September 1, 2013, borrowed $40,000 from the local bank. The note had a 6 percent interest rate and matures on March 1, 2014.
7. Paid $6,600 for warranty repairs during the year.
8. Paid operating expenses of $61,000 for the year.
9. Paid $145,000 of accounts payable.
10. Recorded accrued interest at the end of the year.

Required

a. Show the effect of these transactions on the financial statements using a horizontal statements model like the one shown here. Use a + to indicate increase, a − for decrease, and NA for not affected. In the Cash Flow column, indicate whether the item is an operating activity (OA), investing activity (IA), or financing activity (FA). The first transaction is recorded as an example.

Assets	=	Liabilities	+	Equity	Rev.	−	Exp.	=	Net Inc.	Cash Flow
+		NA		+	NA		NA		NA	+ FA

b. Prepare the journal entries for the above transactions and post them to the appropriate T-accounts.
c. Prepare the income statement, balance sheet, and statement of cash flows for 2013.
d. What is the total amount of current liabilities at December 31, 2013?

LO 5

Exercise 9-9A *Calculating payroll*

Herring Enterprises has two hourly employees, Emily and Jash. Both employees earn overtime at the rate of 1½ times the hourly rate for hours worked in excess of 40 per week. Assume the Social Security tax rate is 6 percent on the first $110,000 of wages and the Medicare tax rate is 1.5 percent on all earnings. Federal income tax withheld for Emily and Jash was $280 and $250 respectively. The following information is for the first week in January 2013:

Employee	Hours Worked	Wage Rate per Hour
Emily	54	$25
Jash	48	$35

Required

a. Calculate the gross pay for each employee for the week.
b. Calculate the net pay for each employee for the week.
c. Prepare the general journal entry to record payment of the wages.

LO 5

Exercise 9-10A *Calculating payroll*

Book Mart has two employees in 2013. Jessica earns $4,500 per month and Moses, the manager, earns $11,000 per month. Neither is paid extra if they work overtime. Assume the Social Security tax rate is 6 percent on the first $110,000 of earnings and the Medicare tax rate is 1.5 percent on all earnings. The federal income tax withholding is 15 percent of gross earnings for Jessica and 20 percent for Moses. Both Jessica and Moses have been employed all year.

Required

a. Calculate the net pay for both Jessica and Moses for March.
b. Calculate the net pay for both Jessica and Moses for December.
c. Is the net pay the same in March as December for both employees? Why or why not?
d. What amounts will Book Mart report on the 2013 W-2s for each employee?

LO 5

Exercise 9-11A *Calculating employee and employer payroll taxes*

Panola Co. employed Jan Rao in 2013. Jan earned $5,200 per month and worked the entire year. Assume the Social Security tax rate is 6 percent on the first $110,000 of earnings and the Medicare tax rate is 1.5 percent. Jan's federal income tax withholding amount is $800 per month. Use 6.2 percent for the unemployment tax rate for the first $7,000 of earnings per employee.

Required

a. Answer the following questions:
   (1) What is Jan's net pay per month?
   (2) What amount does Jan pay monthly in FICA payroll taxes?
   (3) What is the total payroll tax expense for Panola Co. for January 2013? February 2013? March 2013? December 2013?
b. Assume that instead of $5,200 per month Jan earned $10,000 per month. Answer the questions in Requirement *a*.

LO 5

Exercise 9-12A *Fringe benefits and payroll expense*

Watson Co. provides various fringe benefits for its three employees. It provides vacation and personal leave at the rate of one day for each month worked. Its employees earn a combined total of approximately $500 per day. In addition, Watson Co. pays $780 per month in medical insurance premiums for its employees. Watson also contributes $400 per month into a retirement plan for the employees. Assume the Social Security tax rate is 6% of the first $110,000 of salaries and the Medicare tax rate is 1.5%. The unemployment tax rate is 5.2% on the first $7,000 of earnings per employee.

Required

a. Prepare the monthly journal entry for the accrued fringe benefits.

Exercise 10-2A *Amortization schedule for an installment note*

LO 1

On January 1, 2013, Hatch Co. borrowed $100,000 cash from First Bank by issuing a four-year, 6 percent note. The principal and interest are to be paid by making annual payments in the amount of $28,859. Payments are to be made December 31 of each year, beginning December 31, 2013.

Required

Prepare an amortization schedule for the interest and principal payments for the four-year period.

Exercise 10-3A *Financial statement effects of an installment note*

LO 1

Jay Mills started a business by issuing a $60,000 face value note to State National Bank on January 1, 2013. The note had a 6 percent annual rate of interest and a 10-year term. Payments of $8,152 are to be made each December 31 for 10 years.

Required

a. What portion of the December 31, 2013, payment is applied to
   (1) Interest expense?
   (2) Principal?
b. What is the principal balance on January 1, 2014?
c. What portion of the December 31, 2014, payment is applied to
   (1) Interest expense?
   (2) Principal?

Exercise 10-4A *Financial statement effects of an installment note*

LO 1

A partial amortization schedule for a five-year note payable that Holly Co. issued on January 1, 2013, is shown here:

Accounting Period	Principal Balance January 1	Cash Payment	Applied to Interest	Applied to Principal
2013	$50,000	$11,549	$2,500	$8,959
2014	41,041	11,549	2,052	9,497

Required

a. What rate of interest is Holly Co. paying on the note?
b. Using a financial statements model like the one shown below, record the appropriate amounts for the following two events:
   (1) January 1, 2013, issue of the note payable.
   (2) December 31, 2014, payment on the note payable.

Event No.	Assets	=	Liab.	+	Equity	Rev.	−	Exp.	=	Net Inc.	Cash Flow
1											

c. If the company earned $60,000 cash revenue and paid $30,000 in cash expenses in addition to the interest in 2013, what is the amount of each of the following?
   (1) Net income for 2013.
   (2) Cash flow from operating activities for 2013.
   (3) Cash flow from financing activities for 2013.
d. What is the amount of interest expense on this loan for 2015?

LO 2

Exercise 10-5A *Journal entries for a line of credit*

Martin Company has a line of credit with Federal Bank. Martin can borrow up to $600,000 at any time over the course of the 2013 calendar year. The following table shows the prime rate expressed as an annual percentage along with the amounts borrowed and repaid during the first four months of 2013. Martin agreed to pay interest at an annual rate equal to 2 percent above the bank's prime rate. Funds are borrowed or repaid on the first day of each month. Interest is payable in cash on the last day of the month. The interest rate is applied to the outstanding monthly balance. For example, Martin pays 5 percent (3 percent + 2 percent) annual interest on $90,000 for the month of January.

Month	Amount Borrowed or (Repaid)	Prime Rate for the Month
January	$90,000	3.0%
February	50,000	3.5
March	(30,000)	4.0
April	20,000	4.5

Required

Provide all journal entries pertaining to Martin's line of credit for the first four months of 2013.

LO 3

Exercise 10-6A *Two accounting cycles for bonds issued at face value*

Chapman Company issued $400,000 of 20-year, 6 percent bonds on January 1, 2013. The bonds were issued at face value. Interest is payable in cash on December 31 of each year. Chapman immediately invested the proceeds from the bond issue in land. The land was leased for an annual $60,000 of cash revenue, which was collected on December 31 of each year, beginning December 31, 2013.

Required

a. Prepare the journal entries for these events, and post them to T-accounts for 2013 and 2014.
b. Prepare the income statement, balance sheet, and statement of cash flows for 2013 and 2014.

LO 3

Exercise 10-7A *Two accounting cycles for bonds issued at face value*

On January 1, 2013, Chavez Corp. issued $200,000 of 10-year, 6 percent bonds at their face value. Interest is payable on December 31 of each year with the first payment due December 31, 2013.

Required

Prepare all the general journal entries related to these bonds for 2013 and 2014.

LO 3

Exercise 10-8A *Journal entries for callable bonds*

Truax Co. issued $250,000 of 6 percent, 10-year, callable bonds on January 1, 2013, at their face value. The call premium was 2 percent (bonds are callable at 102). Interest was payable annually on December 31. The bonds were called on December 31, 2016.

Required

Prepare the journal entries to record the bond issue on January 1, 2013, and the bond redemption on December 31, 2016. Assume that all entries to accrue and pay interest were recorded correctly.

LO 3

Exercise 10-9A *Annual versus semiannual interest for bonds issued at face value*

Ellis Co. issued bonds with a face value of $150,000 on January 1, 2013. The bonds had a 6 percent stated rate of interest and a five-year term. The bonds were issued at face value.

b. What item(s) in the table would appear on the 2014 balance sheet?
c. What item(s) in the table would appear on the 2014 income statement?
d. What item(s) in the table would appear on the 2014 statement of cash flows?

LO 6

Exercise 10-22A *Determining the effects of financing alternatives on ratios*

Husky Industries has the following account balances:

Current assets	$ 20,000	Current liabilities	$10,000
Noncurrent assets	80,000	Noncurrent liabilities	50,000
		Stockholders' equity	40,000

The company wishes to raise $40,000 in cash, and is considering two financing options. Either it can sell $40,000 of bonds payable, or it can issue additional common stock for $40,000. To help in the decision process, Husky's management wants to determine the effects of each alternative on its current ratio and debt to assets ratio.

Required

a. Help Husky's management by completing the following chart:

Ratio	Currently	If Bonds Are Issued	If Stock Is Issued
Current ratio			
Debt to asset ratio			

b. Assume that after the funds are invested, EBIT amounts to $12,000. Also assume the company pays $4,000 in dividends or $4,000 in interest depending on which source of financing is used. Based on a 30 percent tax rate, determine the amount of the increase in retained earnings that would result under each financing option.

LO 5

Exercise 10-23A *Effective interest amortization of a bond premium*

On January 1, 2013, Janus Company issued bonds with a face value of $200,000, a stated rate of interest of 6 percent, and a 10-year term to maturity. Interest is payable in cash on December 31 of each year. The effective rate of interest was 5 percent at the time the bonds were issued. The bonds sold for $215,443. White used the effective interest rate method to amortize bond discount.

Required

a. Determine the amount of the premium on the day of issue.
b. Determine the amount of interest expense recognized on December 31, 2013.
c. Determine the carrying value of the bond liability on December 31, 2013.
d. Provide the general journal entry necessary to record the December 31, 2013, interest expense.

LO 5

Exercise 10-24A *Effective interest amortization for a bond premium*

On January 1, 2013, Pitre Incorporated issued bonds with a face value of $120,000, a stated rate of interest of 8 percent, and a five-year term to maturity. Interest is payable in cash on December 31 of each year. The effective rate of interest was 7 percent at the time the bonds were issued. The bonds sold for $124,920. Pitre used the effective interest rate method to amortize bond discount.