

EXPANDED MATERIAL**LO 6 Understand the computational details of labor insurance and health insurance premiums.**

- The labor insurance program in Taiwan includes labor insurance and employment insurance. Labor insurance covers general accident benefits and occupational injury payment. The insurance rate for general accident benefits is fixed at 8.5%, with the payment by employers, employees, and the government according to the 7:2:1 ratio.
- Occupational injury payments are in general solely paid by the employers with the insurance rate varying with the industry.
- The insurance rate for the employment insurance is 1% of the salary and the premium is paid by employers, employees, and the government following the 7:2:1 ratio.
- The National Health Insurance (NHI) premiums for employees working at private companies are determined by (1) the employee's insured salary, (2) the insurance premium rate—4.91%, (3) the employee's contribution ratio—30%, and (4) the number of dependents enrolled under the employee's name.
- The NHI premiums for the private companies are determined by (1) the employee's insured salary, (2) the insurance premium rate—4.91%, (3) the employer's contribution ratio—60%, and (4) the average number of dependents enrolled under the employee's name.

Key Terms & Concepts

- basic earnings per share, 334
- bonus, 321
- contingent liabilities, 327
- defined benefit plan, 322
- defined contribution plan, 322
- diluted earnings per share, 334
- earnings per share (EPS), 333
- other revenues and expenses, 332
- pension, 322
- post-employment benefits, 321
- provisions, 327
- sales tax payable, 324

Review Problem**The Statement of Comprehensive Income**

From the following information, prepare a statement of comprehensive income for Southern Corporation for the year ended December 31, 2018. Assume that there are 200,000 shares of stock outstanding.

Sales Returns	\$ 50,000
Sales Discounts	70,000
Gross Sales Revenue	9,000,000
Income Taxes	500,000
Administrative Salaries Expense	360,000
Sales Salaries Expense	800,000
Rent Expense (general and administrative).	32,000
Utilities Expense (general and administrative).	4,000
Supplies Expense (general and administrative).	16,000
Delivery Expense (selling).	6,300
Payroll Tax Expense (selling).	6,000
Automobile Expense (general and administrative).	3,800
Insurance Expense (general and administrative).	34,000
Advertising Expense (selling)	398,000
Interest Revenue	6,000
Interest Expense	92,000
Insurance Expense (selling)	7,000
Entertainment Expense (selling)	7,200
Miscellaneous Selling Expenses	15,000
Miscellaneous General and Administrative Expenses	10,800
Cost of Goods Sold	5,950,000

Solution:

The first step in preparing a statement of comprehensive income is classifying items, as follows:

Revenue Accounts	
Sales Returns	\$ 50,000
Sales Discounts	70,000
Gross Sales Revenue	9,000,000

Cost of Goods Sold Accounts	
Cost of Goods Sold	\$5,950,000

Selling Expense Accounts	
Sales Salaries Expense	\$800,000
Delivery Expense	6,300
Payroll Tax Expense	6,000
Advertising Expense	398,000
Insurance Expense	7,000
Entertainment Expense	7,200
Miscellaneous Selling Expenses	15,000

General and Administrative Expense Accounts	
Administrative Salaries Expense	\$360,000
Rent Expense	32,000
Utilities Expense	4,000
Supplies Expense	16,000
Automobile Expense	3,800
Insurance Expense	34,000
Miscellaneous General and Administrative Expenses	10,800

Other Revenue and Expense Accounts	
Interest Revenue	\$ 6,000
Interest Expense	92,000

Miscellaneous Accounts	
Income Taxes	\$500,000

Once the accounts are classified, the statement of comprehensive income is prepared by including the accounts in the following format:

	Net Sales Revenue (Gross Sales Revenue – Sales Returns – Sales Discounts)
–	Cost of Goods Sold
=	Gross Margin
–	Selling Expenses
–	General and Administrative Expenses
=	Operating Income
+/-	Other Revenues and Expenses (add Net Revenues, subtract Net Expenses)
=	Income before Income Taxes
–	Income Taxes
=	Net Income

After net income has been computed, earnings per share is calculated and added to the bottom of the statement. It is important that the proper heading be included.

Southern Corporation Statement of Comprehensive Income For the Year Ended December 31, 2018			
Revenues:			
Gross sales revenue		\$9,000,000	
Less: Sales returns		(50,000)	
Less: Sales discounts		<u>(70,000)</u>	
Net sales revenue			\$8,880,000
Cost of goods sold			<u>5,950,000</u>
Gross margin			\$2,930,000
Operating expenses:			
Selling expenses:			
Sales salaries expense	\$800,000		
Delivery expense	6,300		
Payroll tax expense	6,000		
Advertising expense	398,000		
Insurance expense	7,000		
Entertainment expense	7,200		
Miscellaneous expenses	<u>15,000</u>		
Total selling expenses		\$1,239,500	
General and administrative expenses:			
Administrative salaries expense	\$360,000		
Rent expense	32,000		
Utilities expense	4,000		
Supplies expense	16,000		
Automobile expense	3,800		
Insurance expense	34,000		
Miscellaneous expenses	<u>10,800</u>		
Total general and administrative expenses		<u>460,600</u>	
Total operating expenses			<u>1,700,100</u>
Operating income			\$1,229,900
Other revenues and expenses:			
Interest revenue		\$ 6,000	
Interest expense		<u>(92,000)</u>	
Net other revenues and expenses			<u>(86,000)</u>
Income from operations before income taxes			\$1,143,900
Income taxes			<u>500,000</u>
Net income			\$643,900
Other comprehensive income			<u>0</u>
Total comprehensive income			<u>\$643,900</u>
Earnings per share:	\$ 3.22	(net income \$643,900 ÷ 200,000 shares)	

Put it on Paper**DISCUSSION QUESTIONS**

1. Why is the accounting for payroll-related liabilities more complicated than the accounting for other current liabilities?
2. If the period of time covered by a company's payroll does not coincide with the last day of the year for financial reporting, how is accounting for the payroll affected by this situation?
3. What is a compensated absence?
4. What danger is there in basing a manager's bonus on reported net income?
5. Severance benefits resulting from a company restructuring are reported as an expense in the period that the employees are terminated rather than when the benefits are actually paid. Why?
6. What is the difference between a defined contribution pension plan and a defined benefit pension plan?
7. In what ways do post-retirement health care and life insurance benefit plans differ from post-retirement pension plans?
8. Why is an end-of-year adjusting entry for property taxes often necessary?
9. In your opinion, what is the primary objective of determining pretax financial accounting income? How does this objective differ from the objectives of determining taxable income as defined by the IRS?
10. When and how does a company record the amount owed to the government for income taxes for a given year?
11. What is the difference between a "contingent liability" and a "liability"?
12. Many companies spend a tremendous amount of money on research and development costs to continuously develop new products. How are such R&D costs accounted for?
13. XYZ Corporation pays for advertising costs all the time. Sometimes the company records these payments as assets, and sometimes it records them as expenses. Why would XYZ use different accounting treatments?
14. What types of items would be included on a statement of comprehensive income as "other revenues and expenses"?
15. More than ever before, tremendous attention is being paid to a company's earnings per share number. Why do you think investors and creditors pay so much attention to earnings per share?

PRACTICE EXERCISES**PE 8-1****Salaries Expense Calculation****LO 1**

Using the following data, compute salaries expense.

Income tax withholding payable	\$ 2,750
Labor insurance withholding payable	1,045
Labor insurance payable	3,658
Health insurance payable	2,755
Health insurance withholding payable	810
Salaries payable	50,395

PE 8-2**Salaries Expense Journal Entry****LO 1**

Refer to the data in PE 8-1. Make the journal entry necessary to record salaries expense for the period.

- PE 8-3 Insurance Expense Calculation**
LO 1 Refer to the data in PE 8-1. Compute insurance expense.
-
- PE 8-4 Insurance Expense Journal Entry**
LO 1 Refer to the data in PE 8-1. Make the journal entry necessary to record insurance expense for the period.
-
- PE 8-5 Salaries and Insurance Payments**
LO 1 Refer to the data in PE 8-1. Make the journal entries necessary to record the payment of the payable accounts related to salaries expense and insurance expense.
-
- PE 8-6 Accruing Compensated Absences**
LO 1 Assume an employee earns \$450 per day and accrues one sick leave each month. Make the journal entry necessary at the end of the quarter to record the accrual of the sick leaves during the quarter.
-
- PE 8-7 Using Compensated Absences**
LO 1 The employee mentioned in PE 8-6 used two sick leaves. Make the journal entry necessary to record the use of the sick leaves.
-
- PE 8-8 Post-employment Benefits**
LO 1 Because of a drop in demand for its products, Company A found it necessary to lay off 200 employees. The employment contract grants termination benefits worth an estimated \$12,000 to each employee. Make the journal entry necessary to record the termination of the employees.
-
- PE 8-9 Defined Contribution Plan**
LO 1 Gordon Inc. adopts a defined contribution pension plan, which requires Gordon Inc. to contribute NT\$250,000 for February 2018. Prepare a journal entry for the payment.
-
- PE 8-10 Defined Benefit Plan**
LO 1 Joyce Company adopts a defined benefit plan for its employees as a post-retirement benefit. According to the plan and the actuarial assumptions, the pension expense is NT\$200,000, and Joyce only contributes NT\$116,000 to the pension fund. Prepare a journal entry.
-
- PE 8-11 Defined Benefit Plan**
LO 1 Dickhaut Inc. adopts a defined benefit pension plan, and makes the following journal entry:
- | | | |
|-------------------------------------|---------|--------|
| Pension Expense | 150,000 | |
| Cash | | 80,000 |
| Pension Liability Payable | | 70,000 |
- What journal entries should be prepared if Dickhaut Inc. adopts a defined contribution plan that requires contributing NT\$80,000 to the pension fund?
-
- PE 8-12 Sales Tax**
LO 2 Delan Company sold merchandise for \$520; this price does *not* include sales tax. The state sales tax rate is 6.25%. Make the journal entry necessary to record this transaction.
-
- PE 8-13 Property Taxes**
LO 2 Azure Company paid \$10,800 in advance for one year of property taxes on September 24. The property taxes are for the one-year period beginning October 1. Make the journal entries necessary to record (1) the payment of the property taxes and (2) the year-end adjusting entry on December 31.

PE 8-14

Income Tax Expense

LO (2)

Which one of the following statements correctly describes income tax expense?

- The amount of cash paid for income taxes during the year
- The amount of income tax owed as of the end of the year
- The amount of cash that will be paid for income taxes next year
- The amount of income taxes attributable to the income earned during the year

PE 8-15

Provisions and Contingent Liabilities

LO (3)

Which one of the following correctly describes the circumstances in which an obligation should be recognized as a liability in the financial statements?

- The chance of the future event occurring is remote.
- The chance of the future event occurring is possible.
- The chance of the future event occurring is probable, but the amount is not estimable.
- The chance of the future event occurring is slight.
- The chance of the future event occurring is more likely than not, and the amount can be measured reliably.

PE 8-16

Capitalize versus Expense

LO (4)

Which one of the following statements is correct?

- When there is significant uncertainty about whether an expenditure should be capitalized or expensed, capitalize it.
- When there is significant uncertainty about whether an expenditure should be capitalized or expensed, expense it.
- Generally, advertising costs are capitalized because it is easy for firms to trace advertising dollars spent to revenue generated from such advertisements.
- Expenditures made for equipment and buildings should be expensed in the period of the purchase.
- Research and development expenditures are typically capitalized in the period in which they are incurred.

PE 8-17

Statement of Comprehensive Income Classification

LO (5)

Using the following data, prepare a classified statement of comprehensive income. The income tax rate on all items is 20%.

Advertising expense	\$ 3,500
Sales returns	5,000
Cost of goods sold	95,000
Dividend revenue	2,000
Gain on sale of equipment	1,500
Interest expense	5,000
Rent expense	4,400
Sales discounts	8,000
Salaries expense	11,000
Gross sales	230,000

PE 8-18

Earnings per Share

LO (5)

Saratoga Company had 650,000 shares of stock outstanding throughout the year. In addition, as of January 1 the company had issued stock options that allowed employees to receive 80,000 shares of stock for free at a time of their choosing in the future. As of the end of the year, none of the options had been exercised. Net income for the year was \$1,360,000. Compute (1) basic earnings per share and (2) diluted earnings per share.

EXERCISES

E 8-1**LO 1****Bonus Computation and Journal Entry**

Chris Anger is the president of Anger Company, and his brother, George Anger, is the vice president. Their compensation package includes bonuses of 5% for Chris Anger and 4% for George Anger of net income that exceeds \$325,000. Net income for the year 2018 has just been computed to be \$745,000.

1. Compute the amount of bonuses to be paid to Chris and George Anger.
2. Prepare the journal entries to record the accrual and payment of the bonuses. Summarize all withholding taxes related to the bonuses in an account called Various Taxes Payable. Taxes payable on the bonuses total \$8,400 for Chris and \$6,720 for George.

E 8-2**LO 1****Computing Pension Expense and Payments**

Banquak Co. maintains a defined contribution pension plan for its employees. The plan requires quarterly installments to be paid to the pension funds. Assume that the pension cost is \$250,000 for the quarter ended December 31. Prepare the journal entries to record the accrued pension liability on December 31 and the payment to the pension funds on January 5.

E 8-3**LO 2****Accounting for Property Taxes**

In June 2017, Distancia Company received a bill from the county government for property taxes on its land and buildings for the period July 1, 2017, through June 30, 2018. The amount of the tax bill is \$27,550, and payment is due July 1, 2017. Distancia Company uses the calendar year for financial reporting purposes.

1. Prepare the journal entries to record payment of the property taxes on July 1, 2017.
2. Prepare the adjusting entry for property taxes on December 31, 2017.

E 8-4**LO 1****Journalizing Sales and Related Taxes**

In providing accounting services to small businesses, you encounter the following situations pertaining to cash sales.

1. Kelly Inc. enters sales and sales taxes separately on its cash register. On April 10, the register totals are sales \$35,000 and sales taxes \$2,450.
2. Jordon Inc. does not segregate sales and sales taxes. Its register total for April 15 is \$21,600, which includes a 8% sales tax.

Required:

Prepare the entry to record the sales transactions and related taxes for each client.

E 8-5**LO 3****Provisions and Contingent Liabilities**

Rayn Company is involved in the following legal matters:

- a. A customer is suing Rayn for allegedly selling a faulty and dangerous product. Rayn's attorneys believe that there is a 40% chance of Rayn's losing the suit.
- b. A federal agency has accused Rayn of violating numerous employee safety laws. The company faces significant fines if found guilty. Rayn's attorneys feel that the company has complied with all applicable laws, and they therefore place the probability of incurring the fines at less than 10%.
- c. Rayn has been named in a gender discrimination lawsuit. In the past, Rayn has systematically promoted its male employees at a faster rate than it has promoted its female employees. Rayn's attorneys judge the probability that Rayn will lose this lawsuit at more than 90%. For each item, determine the appropriate accounting treatment.

E 8-6

LO 3

Warranty

Quick Manufacturing Co. warrants its products for one year. The estimated product warranty is 10% of sales. The sales were NT\$770,000 for April. In September, the actual warranty repair costs were NT\$45,000.

1. Prepare the entry to record the accrued product warranty at April 30.
2. Journalize the entry to record the warranty cost in September.

E 8-7

LO 3

Computing Warranty Expense

ASEN Computer Co. warrants its products for one year. The estimated product warranty is 5% of sales. Assume that the sales were NT\$1,000,000 for January. On February 5, a customer received warranty repairs requiring NT\$4,250 of parts and of NT\$2,750 of labor.

1. Prepare the adjusting entry required at January 31 to record the accrued product warranty.
2. Prepare the journal entries to record the warranty work provided in February.

E 8-8

LO 4

Classifying Expenditures as Assets or Expenses

Determining whether an expenditure should be expensed or capitalized is often difficult. Consider each of the following independent situations and indicate whether you would recommend that the cost be expensed or capitalized as an asset. Explain your answer.

1. Splash.com has spent \$1.5 million for a 30-second advertisement to be aired during the Super Bowl. The ad introduces the company's new Web-based product, and the company expects the ad to increase sales for at least 18 months.
2. GenChrome has spent \$8 million on research related to genetic diseases. The company expects this research to lead to substantial revenues, beginning in the next year.
3. All Choices is an online catalog sales company. All Choices has just spent \$5 million designing a targeted advertising campaign that will encourage regular customers of the company's online catalog service to buy new products.
4. Stock Up is an online seller of groceries. The company just spent \$4 million building a new warehouse. The warehouse is expected to be useful for the next 15 years.

E 8-9

LO 5

Preparing a Statement of Comprehensive Income

Ragnarok Company is preparing financial statements for the calendar year 2018. The following totals for each account have been verified as correct:



Office Supplies on Hand	\$ 820
Insurance Expense	540
Gross Sales Revenue	39,850
Cost of Goods Sold	21,500
Sales Returns	1,200
Interest Expense	410
Accounts Payable	600
Accounts Receivable	1,000
Selling Expenses	970
Office Supplies Used	200
Cash	850
Revenue from Investments	250
Number of shares of capital stock	900

Prepare a statement of comprehensive income. Assume a 30% income tax rate on income from operations. Include EPS numbers.

E 8-10

LO 5

Unifying Concepts: The Statement of Comprehensive Income

Use the following information to prepare a statement of comprehensive income for Fairchild Corporation for the year ended December 31, 2018. You should show separate classifications for revenues, cost of goods sold, gross margin, selling expenses, general and administrative expenses, operating income, other revenues and expenses, income before income taxes, income taxes, and net income. (*Hint:* Net income is \$27,276.)

Sales Returns	\$ 4,280
Income Taxes	26,000
Interest Revenue	2,400
Office Supplies Expense (general and administrative)	400
Utilities Expense (general and administrative)	3,980
Office Salaries Expense (general and administrative)	12,064
Miscellaneous Selling Expenses	460
Insurance Expense (selling)	1,160
Advertising Expense	6,922
Sales Salaries Expense	40,088
Sales Discounts	3,644
Interest Expense	1,170
Miscellaneous General and Administrative Expenses	620
Insurance Expense (general and administrative)	600
Payroll Tax Expense (general and administrative)	3,600
Store Supplies Expense (selling)	800
Delivery Expense (selling)	2,198
Inventory, January 1, 2018	79,400
Sales Revenue	395,472
Cost of Goods Sold	262,610
Purchases	230,560
Purchases Discounts	3,050
Inventory, December 31, 2018	44,300
Average number of shares of stock outstanding	10,000

PROBLEMS

P 8-1

LO 1

Payroll Accounting

Innovation company has three employees, Makoto Hinata, Kosuke Sawaki, and Miwa Yoshida. Summaries of their salaries and withholdings in December are as follows:

Employee	Gross salaries	Income taxes withheld	Labor insurance taxes withheld	Health insurance withheld
Makoto Hinata	NT\$48,000	NT\$2,400	NT\$ 912	NT\$ 707
Kosuke Sawaki	76,000	2,570	1,444	2,239
Miwa Yoshida	35,000	1,750	665	516

Required:

1. Prepare the journal entry to record salaries payable for the month of December.
2. Prepare the journal entry to record payment of the December salaries to employees.

P 8-2

LO (1)

LO (6)

Payroll Accounting

Swordstone Market, Inc., has three employees, Kindal Boyd, Brent Debenham, and Cesar Gaona. Summaries of their salaries and withholdings are as follows:

Employee	Gross salaries	Income taxes withheld	Labor insurance taxes withheld	Health insurance withheld
Kindal Boyd.	\$64,000	(a)	\$1,216	\$943
Brent Debenham.	57,000	\$2,850	(b)	840
Cesar Gaona.	90,000	4,500	1,710	(c)

5% of the salary is withheld for income tax. The insurance rate for accident is 8.5% of the salary and the employment insurance rate is 1% of the salary, and the employee is responsible for the payments of 20% of insurance. The National Health insurance premium rate is 4.91% of the salary, and the employee is responsible for the payments of 30%.

1. Use the rate given to count the missing data.
2. Prepare the journal entry to record salaries payable for the month of December.
3. **Interpretive Question:** What other types of items are frequently withheld from employees' paychecks in addition to income taxes and insurance?

P 8-3

LO (1)

Determining Payroll Costs

Parley Pharmaceuticals pays its salespeople a base salary of \$25,000 per month plus a commission. Each salesperson starts with a commission of 1.5% of total gross sales for the month. The commission is increased thereafter according to seniority and productivity, up to a maximum of 5%. Parley has five salespeople with gross sales for the month of July and commission rates as follows:

	Commission Rate	Gross Sales
Jordan.	3.0%	\$140,000
Alisa.	4.5	200,000
Kasey.	1.5	110,000
Trevor.	5.0	180,000
Chad.	2.5	90,000

The income tax of 5% is withheld from each employee. In addition, the total labor and health insurance withheld is \$5,137.

Required:

1. Compute Parley's total payroll expense (base salary plus commissions) for the month.
2. Compute the total amount of cash paid to employees for compensation for the month.
3. **Interpretive Question:** Briefly outline the advantages and disadvantages of having no income taxes withheld, but instead relying on individual taxpayers to pay the entire amount of their income tax at the end of the year when they file their tax return.

P 8-4

LO (1)

Recording Accrual of Compensated Absences

John Ackley and Susan Baldwin are employees of Clarion Company. Both John and Susan work 8 hours a day and are paid monthly on the last day of the month. John is paid at a rate of \$15 per hour and Susan is paid \$12 per hour. John and Susan accrue compensated absences throughout the year at a rate of 1.5 days per month. In March, John missed three days of work due to illness and Susan missed one day of work. Both John and Susan have payroll withholdings of 25%.

Required:

1. Prepare the journal entries to record the monthly accrual of compensated absences on January 31 and February 28.
2. Prepare the journal entries for March 31 to record the accrual of compensated absences and the use of John and Susan's accrued compensated absences. Use the account Various Taxes Payable for the payroll withholdings.

P 8-5

LO 4

Preparing Entry for Research and Development Costs

Newell Industries spent \$260,000 on research and \$700,000 on development of a new product. Of the \$700,000 in development costs, \$450,000 was incurred prior to technological feasibility and \$250,000 after technological feasibility had been demonstrated.

Required:

Prepare the journal entry to record research and development costs.

P 8-6

LO 5

**Unifying Concepts: The Statement of Comprehensive Income**

From the following information, prepare a statement of comprehensive income for Moriancumer, Inc., for the year ended December 31, 2018. Assume that there are 37,000 shares of capital stock outstanding.

Gross Sales Revenue	\$4,650,000
Income Taxes	96,500
Cost of Goods Sold	3,205,000
Sales Salaries Expense	450,000
Rent Expense (selling)	16,000
Payroll Tax Expense (selling)	5,200
Entertainment Expense (selling)	1,500
Miscellaneous Selling Expenses	6,300
Miscellaneous General and Administrative Expenses	5,400
Automobile Expense (selling)	4,000
Insurance Expense (general and administrative)	800
Interest Expense	39,900
Interest Revenue	3,000
Sales Returns	8,000
Advertising and Promotion Expense	215,000
Insurance Expense (selling)	17,000
Delivery Expense (selling)	3,100
Office Supplies Expense (general and administrative)	7,200
Utilities Expense (general and administrative)	1,300
Administrative Salaries Expense	200,000

P 8-7

LO 5

**Statement of Comprehensive Income Analysis**

The following table represents portions of the statements of comprehensive income of Brinkerhoff Company for the years 2017–2019:

	2019	2018	2017
Gross sales revenue	\$56,000	\$ (9)	\$47,600
Sales discounts	0	300	200
Sales returns	0	100	400
Net sales revenue	56,000	(10)	(1)
Beginning inventory	(15)	8,700	(2)
Purchases	33,400	(11)	25,000
Purchases discounts	700	400	800
Freight-in	(16)	0	700
Cost of goods available for sale	40,500	37,800	(3)
Ending inventory	6,900	(12)	(4)
Cost of goods sold	(17)	(13)	(5)
Gross margin	(18)	20,400	(6)
Selling expenses	4,500	(14)	(7)
General and administrative expenses	(19)	3,100	2,800
Income before income taxes	14,300	14,000	11,900
Income taxes	4,250	4,200	(8)
Net income	(20)	9,800	8,400

Required:

Fill in the missing numbers. Assume that gross margin is 40% of net sales revenue.

ANALYTICAL ASSIGNMENTS

AA 8-1*Judgment Call***You Decide: Should start-up costs be capitalized or expensed?**

Your wife is setting up a home-based Web design business. Her purpose for setting up the business is to earn some extra income now and, in two to three years, sell the business. She is wondering whether she can capitalize the start-up costs or whether they must be expensed. She has heard from other business owners that in order to minimize taxes, it is a lot better to expense as much as you can. With this end goal in mind, what should your spouse do?

AA 8-2*International***Hutchison Whampoa**

In Hong Kong, Li Ka-shing is known as “Superman.” Li and his family fled from China in 1940 in order to escape the advancing Japanese army. Li dropped out of school at age 13 to support his family by selling plastic trinkets on the streets of Hong Kong. Later, he scraped together enough money to buy a company that produced plastic flowers. His big success came when he bought the real estate surrounding his factory and watched the land skyrocket in value. Today, Li’s personal wealth is estimated to be in excess of \$161 billion. Li continues his simple lifestyle even though the companies he controls comprise over 10% of the value of the Hong Kong stock market. When asked why his sons have much nicer houses and cars than he does, Li responded, “My sons have a rich father; I did not.”

Li is chairman of Hutchison Whampoa Limited. Hutchison has five major business segments: property development, container port operations, retailing, telecommunications, and energy. In 2008, Hutchison Whampoa reported net income of HK\$17.664 billion (equivalent to approximately US\$2.265 billion).

1. Assume that one of Hutchison Whampoa’s overseas subsidiaries earns income of \$1,000. The income tax rate in Hong Kong is 16.5%. When this income of \$1,000 is transferred to the parent company in Hong Kong, it will be taxed, but no income tax is owed until then. What journal entry should Hutchison Whampoa make to record the income tax consequences of this \$1,000 in income?
2. In 2008, Hutchison Whampoa reported earnings per share of HK\$4.14. How many shares were outstanding during the year? (*Note:* See the net income information given above.)
3. Hutchison Whampoa reports that it records as assets the costs it incurs to sign up new subscribers to its cellular phone service network. These sign-up costs are then systematically transferred to expense over the following 12 to 24 months. What is the theoretical justification for this accounting practice?

AA 8-3*Ethics***Twisting the Contingency Rules to Save the Environment**

You are a member of an environmental group that is working to clean up Valley River, which runs through your town. Right now, the group is focusing on forcing Allied Industrial, a manufacturer with a large plant located on the river, to conduct its operations in a more environmentally friendly way.

The leader of your group, Frank Bowers, is a political science major at the local university. Frank discovers that Allied Industrial is involved in ongoing litigation with respect to toxic waste cleanup at 13 factory sites in other states. Frank is shocked to learn that Allied itself estimates that the total cost to clean up the toxic waste at these 13 sites could be as much as \$140 million yet has not reported any liability on its balance sheet. Frank is convinced that he has found a public relations tool that can be used to force Allied Industrial to clean up Valley River. He has called a press conference and plans to accuse Allied of covering up its \$140 million obligation to clean up the toxic waste at the 13 sites. His primary piece of evidence is the fact that the \$140 million obligation is not mentioned anywhere in Allied’s primary financial statements, but instead is buried in the notes.

You look at Allied's annual report and see that it does give complete disclosure about the possible obligation although it does not report the \$140 million as a liability. The report also states that, in the opinion of its legal counsel, it is possible but not probable that Allied will be found liable for the \$140 million toxic waste cleanup cost.

The press conference is scheduled for 3 p.m. What should you do?

EXPANDED MATERIAL

PRACTICE EXERCISES

PE 8-19

LO 6

Insurance Payment Calculation

Mei-Hui works in a local bank and earns NT\$55,000 per month. The insurance rate for general accident benefit is 8.5% of the salary, and the employment insurance rate is 1% of the salary. The insurance premium is payable by the employer, the employee, and the government following the 7:2:1 ratio. Meanwhile, the rate of occupational injury payment is 0.09% for Mei-Hui.

Compute the payment of the labor insurance paid by the employer and by Mei-Hui.

PE 8-20

LO 6

Insurance Payment Calculation

Refer to PE 8-19. The National Health Insurance premium rate is 4.91%, and the premium is payable by the employer, the employee, and the government following the 6:3:1 ratio. The average number of dependents is defined as 0.7. Assume that Mei-Hui has no dependent.

Compute the payment of NHI premium paid by the employer and by Mei-Hui.

PE 8-21

LO 6

Salaries Expense Journal Entry

Refer to PE 8-19. Of the salary, 5% is withheld for income tax. Make the journal entry necessary to record salaries payable for a month.

PE 8-22

LO 6

Insurance Expense Journal Entry

Refer to PE 8-19. Make the journal entry necessary to record the bank's share of insurance premiums relating to Mei-Hui's employment for a month.

PE 8-23

LO 6

Salaries and Insurance Payments

Refer to PE 8-19. Make the journal entry necessary to record the payment of the payable accounts related to salaries expense and insurance expense for a month.

EXERCISES

E 8-11

LO 6

Payroll Accounting

Golden Bookstore has two employees, Wu and Lee. Their monthly salaries are NT\$35,000 and NT\$42,000, respectively. Of the salary 5% is withheld for income tax. The insurance rate for general accident benefit is 8.5% of the salary and the employment insurance rate is 1% of the salary, and the employee is responsible for the payments of 20% of insurance. The NHI premium rate is 4.91% of the salary, and the employee is responsible for the payments of 30%. Assume that both Wu and Lee have no dependents.

Prepare the summary entry for salaries paid to the employees for the year of 2018.

PROBLEMS

P 8-8**LO 6****Payroll Accounting**

Goodrich Bank has three employees, Albert Myers, Juan Moreno, and Michi Endo. During January 2018, these three employees earned NT\$60,000, NT\$42,000, and NT\$40,000, respectively. The income tax withheld was 5% of the gross pay. As of 2018, the labor insurance rate is fixed at 8.5%. In addition, the employment insurance premium is 1% of the insured salary and is split 7:2:1, payable by employers, employees, and the government, respectively. Meanwhile, the rate of occupational injury payment is 0.1%.

As for health insurance, the National Health Insurance premium rate is 4.91% of the employee's insured salary. The premiums are split between employer (60%), employee (30%), and government (10%). The following are formulas used to calculate premiums for employees and employer.

Employee: $\text{Income Basis} \times \text{Premium Rate} \times \text{Contribution Ratio} \times (1 + \text{Number of Dependents})$

Employer: $\text{Income Basis} \times \text{Premium Rate} \times \text{Contribution Ratio} \times (1 + \text{Average Number of Dependents})$

The average number of dependents is defined as 0.7. Assume Albert has one dependent. Both Juan and Michi have no dependents.

Prepare the summary entries for salaries in 2018.

Comprehensive Problem Chapters 6–8

Fray Enterprises is a small business that purchases electronic personal information managers (PIM) from manufacturers and sells them to consumers. These PIMs keep track of appointments, phone numbers, to-do lists, and the like. Fray conducts business via the Internet and, at this point, carries only one model of PIM, the ZL-420. Fray provides the following trial balance as of January 1, 2018.

Fray Enterprises Trial Balance January 1, 2018		
	Debits	Credits
Cash	\$ 9,200	
Accounts Receivable	26,800	
Allowance for Bad Debts		\$ 804
Inventory	31,650	
Prepaid Rent	1,100	
Office Supplies	900	
Accounts Payable		19,100
Wages Payable		2,800
Taxes Payable		3,400
Common Stock (10,000 shares)		30,000
Retained Earnings		13,546
Totals	<u>\$69,650</u>	<u>\$69,650</u>

Fray uses the periodic FIFO inventory method in accounting for its inventory. The inventory of ZL-420 consists of the following inventory layers:

Layer	Units	Price per Unit	Total Price
1 (oldest purchase)	50	\$120	\$ 6,000
2	80	130	10,400
3	70	135	9,450
4 (most recent purchase)	40	145	5,800
Total	<u>240</u>		<u>\$31,650</u>

Fray provides the following additional relevant information:

- The company uses the percentage of receivables method in estimating bad debts; 2% of the ending receivables balance is deemed to be uncollectible.
- Fray conducts an actual physical count of its inventory and office supplies at the end of each month.
- Fray rents its warehouse, office facilities, and computer equipment. Rent on the computer equipment is paid at the beginning of each month. Rent on the warehouse and office space is paid on the 15th of each month.
- Payroll is paid on the 5th and the 20th (pay periods end on the 15th and the last day of the month).
- Taxes Payable represents payroll taxes that are due by the 5th of the following month.
- All sales and all inventory purchases are on account.

The following transactions occurred for Fray during January of 2018:

- Jan. 1 Paid rent on the computer equipment, \$1,400.
- 5 Recorded sales for the week, 130 units at \$210 per unit. (The company uses a periodic inventory system.)
- 5 Paid wages payable and taxes payable from the prior period.

- 5 Collected \$19,000 from customers on account during the week.
- 8 Purchased office supplies for cash, \$300.
- 10 Received 70 ZL-420s from the manufacturer at a cost of \$145 per unit.
- 11 Paid accounts payable, \$16,900.
- 12 Collected \$22,000 from customers on account during the week.
- 12 Recorded sales for the week, 120 units at \$210 per unit.
- 15 Paid monthly rent for the office and warehouse, \$2,200.
- 15 Received 130 ZL-420s from the manufacturer at a cost of \$150 per unit.
- 18 A customer returned a ZL-420 and requested a refund. A check was immediately mailed to the customer in the amount of \$210.
- 19 Collected \$30,000 from customers on account during the week.
- 19 Recorded sales for the week, 140 units at \$210 per unit.
- 20 Paid the semimonthly payroll for the pay period ending on January 15. Salaries and wages totaled \$4,800 and payroll taxes were as follows: insurance payable \$367; withholding taxes payable, \$310; insurance withholding payable, \$780.
- 22 Received notice that a customer owing Fray \$630 had filed bankruptcy and would be unable to pay.
- 23 Paid the taxes payable from the payroll on January 20.
- 24 Received 180 ZL-420s from the manufacturer at a cost of \$150 per unit.
- 25 Purchased office supplies for cash, \$480.
- 25 Paid accounts payable, \$43,000.
- 26 Collected \$30,500 from customers on account during the week.
- 26 Recorded sales for the week, 135 units at \$220 per unit.
- 29 Customers returned 7 ZL-420s and requested refunds. Checks were immediately mailed to each customer in the amount of \$210 each.
- 30 Received 140 ZL-420s from the manufacturer at a cost of \$145 per unit.
- 31 Collected \$29,900 from customers on account.
- 31 Recorded sales for the partial week, 70 units at \$220 per unit.
- 31 Accrued the semimonthly payroll for the pay period ending on January 31. Salaries and wages totaled \$5,000 and payroll taxes were as follows: insurance payable \$382; insurance withholding payable \$230; withholding taxes payable, \$810.

Required:

1. Provide the required journal entries to record each of the above events.
2. Make the adjusting entries necessary (1) to record bad debt expense for the period and (2) to adjust inventory and office supplies. A count of inventory and office supplies revealed 165 ZL-420s on hand and supplies valued at \$1,000.
3. Prepare a trial balance as of January 31, 2018.
4. Prepare a statement of comprehensive income and a balance sheet for Fray Enterprises.
5. Compute Fray's number of days' sales in inventory, number of days' sales in accounts receivable, and number of days' purchases in accounts payable ratios. What can you conclude about the company's liquidity position based on this analysis?