# CHAPTER 8

## DISCUSSION QUESTIONS

**1.** The accounting for payroll-related liabilities is more complicated than for other current liabilities because employers are required to withhold various taxes and other amounts from employees’ salaries and remit these amounts to the proper authorities. The accounting for all these withholdings requires recognizing several liability and expense accounts.

**2.** If the payroll period does not coincide with the last day of a company’s reporting year, the company must prepare an adjusting entry for salaries and wages expense and for the salaries and wages payable for the amount earned after the end of the last payroll period up to the close of the reporting year. In other words, if employees were paid through Friday, December 26, but work on Monday, Tuesday, and Wednesday (December 29 through 31) without being paid until Friday, January 2, then the wage and salary expense and the wage and salary liability must be included in an adjusting entry on December 31 in order to have these amounts reflected in the company’s financial statements for the calendar year ended December 31.

**3.** Certain fringe benefits that accrue over an employee’s term of employment allowing the employee to take time off with pay are called compensated absences; included are vacation pay, sick pay, early retirement benefits, and compensated time off (i.e., instead of overtime pay, the employee is allowed to take additional vacation).

**4**. Such a bonus plan increases the manager’s incentive to manipulate reported earnings.

**5.** Expenses are recognized when incurred. The event that creates a severance benefit is the termination of employees. Although this item relates to future payouts, it is estimated and recognized as an expense in the current period.

**6.** In a defined contribution plan, the amount of money set aside to pay benefits is fixed, and the benefits that will be paid are uncertain. They depend on the earnings of the contributions, the age of retirement, and so forth. With a defined benefit plan, the pension benefits that will be paid are fixed, meaning retired workers will get a pension benefit that is based on factors such as the number of years worked.

**7.** Many plans associated with post-retirement benefits other than pensions are informal. As such, some companies do not view them as legally binding obligations. In addition, these plans are often not backed by an asset fund. In contrast, U.S. companies are required by law to maintain a pension fund to back up promises to make defined benefit pension payments.

**8.** A year-end adjusting entry is often necessary in connection with property taxes owed to city or county governments because the property tax assessment year of the governmental unit frequently does not coincide with the paying company’s financial reporting year. When the assessment year and the reporting year do not coincide, the company being assessed must report a property tax liability on its end-of-year balance sheet for taxes owed for the first portion of the assessment year that need not be paid until some date after the close of the financial reporting year.

**9.** The primary objective of determining pretax accounting income is to provide investors and creditors with a relevant measure of operating results and management’s performance. This measure should not be affected by the tax regulations that are not controllable by management. Therefore, the pretax accounting income is reported in the financial statements, and income tax expense is based on this pretax accounting income. The objectives of determining taxable income, on the other hand, include social equity, ease of administration, political considerations, and ensuring that individuals and corporations are taxed when they have the ability to pay.

**10.** A company reports the amount owed to the government for income taxes for a given year by preparing an adjusting entry at year-end. The adjusting entry is composed of a debit to *Income Tax Expense* and a credit to *Income Taxes Payable* in the amount of the company’s reported income before income taxes times the company’s effective tax rate. The income tax expense is subtracted from income before income taxes on the statement of comprehensive income to arrive at net income. The income taxes payable account is shown on the year-end balance sheet as a current liability.

**11.** With a contingent liability, there is a *potential* liability to pay cash, perform a service, or ship a product; with an actual liability, there is a *definite* obligation to pay cash, perform a service, or ship a product. Actual liabilities are recognized on the balance sheet; contingent liabilities may be included with liabilities on the balance sheet, described in the notes, or not mentioned at all, depending on their likelihood of occurrence.

**12.** According to IAS 38, expenditure on research (or on the research phase of an internal project) shall be recognized as an

expense when it is incurred. As for expenditure on development (or from the development phase of an internal project) shall be

capitalized if, and only if, an entity can

meet all of the following criteria, or else it shall be recognized as an expense:

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale.

(b) its intention to complete the intangible asset and use or sell it.

(c) its ability to use or sell the intangible asset.

(d) how the intangible asset will generate probable future economic benefits. Among other things, the entity

can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself

or, if it is to be used internally, the usefulness of the intangible asset.

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.

(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

**13.** With respect to advertising, the general presumption is that advertising expenditures are to be expensed because of the uncertainty around any future benefit. However, for some types of targeting advertising, where the advertising is directed at customers who have purchased in the past, the advertising cost should be initially capitalized as an asset because the future benefit is both probable and estimable.

**14.** Other revenues and expenses are those items incurred or earned from activities outside of, or peripheral to, the normal operations of a firm. For general industry, examples of items included would be dividend income, interest revenue, and interest expense.

**15.** Investors and creditors are generally interested in being able to assess a company’s profitability, liquidity, and solvency. The earnings per share number provides a quick summary of a company’s profitability that is normalized (for the number of shares of stock outstanding), thus allowing for comparison among firms. A company may have very high earnings, but if it has twice as many shares of stock outstanding as another company, its earnings per share may not be as high as the other company’s and, thus, not deemed as profitable by investors.

## PRACTICE EXERCISES

### PE 8–1 (LO1) Salaries Expense Calculation

Income tax withholding payable $ 2,750

Labor insurance withholding payable 1,045

Health insurance withholding payable 810

Salaries payable 50,395

Total salaries expense $55,000

### PE 8–2 (LO1) Salaries Expense Journal Entry

Salaries Expense 55,000

Income Tax Withholding Payable 2,750

Labor Insurance Withholding Payable 1,045

Health Insurance Withholding Payable 810

Salaries Payable 50,395

### PE 8–3 (LO1) Insurance Expense Calculation

Labor insurance payable $3,658

Health insurance payable 2,755

Total insurance expense $6,413

### PE 8–4 (LO1) Insurance Expense Journal Entry

Insurance Expense 6,413

Labor insurance payable 3,658

Health insurance payable 2,755

### PE 8–5 (LO1) Salaries and Insurance Payments

Income Tax Withholding Payable 2,750

Labor Insurance Withholding Payable 1,045

Health Insurance Withholding Payable 810

Cash 4,605

Labor insurance payable 3,658

Health insurance payable 2,755

Cash 6,413

Salaries Payable 50,395

Cash 50,395

### PE 8–6 (LO1) Accruing Compensated Absences

Salaries Expense 1,350

Sick Leaves Payable 1,350

3 months in the quarter × $450 = $1,350

### PE 8–7 (LO1) Using Compensated Absences

Sick Leaves Payable 900

Cash 900

### PE 8–8 (LO1) Post-employment Benefits

Salaries Expense 2,400,000

Benefits Payable ($12,000 × 200) 2,400,000

### PE 8–9 (LO1) Defined Contribution Plan

Pension Expense 250,000

Cash 250,000

### PE 8–10 (LO1) Defined Benefit Plan

Pension Expense 200,000

Cash 160,000

Pension Liability Payable 40,000

### PE 8–11 (LO1) Defined Benefit Plan

Pension Expense 80,000

Cash 80,000

PE 8–12 (LO2) Sales Tax

Cash 552.5

Sales Revenue 520

Sales Tax Payable ($520 × 6.25%) 32.5

### PE 8–13 (LO2) Property Taxes

1. September 24

Prepaid Property Taxes 10,800

Cash 10,800

2. December 31

Property Tax Expense 2,700

Prepaid Property Taxes 2,700

$10,800/12 months = $900 per month; 3 months × $900 per month = $2,700

### PE 8–14 (LO2) Income Tax Expense

The correct answer is D.

### PE 8–15 (LO3) Provisions and Contingent Liabilities

The correct answer is E. “Probable” means the future event is likely to occur, and the amount can be measured reliably so that the entity can make an   
appropriate journal entry. According to IAS 37 paragraph 14, an entity must recognize a provision if, and only if (1) a present obligation (legal or constructive) has arisen as a result of a past event (the obligating event), (2) payment is probable ('more likely than not'), and (3) the amount can be estimated reliably.

### PE 8–16 (LO4) Capitalize versus Expense

The correct answer is B.

### PE 8–17 (LO5) Statement of Comprehensive Income Classification

Gross sales $230,000

Less: Sales returns (5,000)

Less: Sales discounts (8,000)

Net sales $217,000

Cost of goods sold 95,000

Gross margin $122,000

Operating expenses:

Salaries expense $ 11,000

Advertising expense 3,500

Rent expense 4,400

Total operating expenses 18,900

Operating income $103,100

Other revenues and expenses:

Dividend revenue $ 2,000

Gain on sale of equipment 1,500

Interest expense (5,000)

Net other revenues and expenses (1,500)

Income from operations before income taxes $ 101,600

Income taxes on operations (20%) 20,320

Net income $ 81,280

Other comprehensive income 0

Comprehensive income $ 81,280

### PE 8–18 (LO5) Earnings per Share

1. Basic EPS: $1,360,000/650,000 shares = $2.09 per share

2. Diluted EPS: $1,360,000/(650,000 shares + 80,000 potential shares) = $1.86 per share

## EXERCISES

### E 8–1 (LO1) Bonus Computation and Journal Entry

1. The bonuses are calculated as follows:

Chris George

Net income $745,000 $745,000

Bonus threshold 325,000 325,000

Income subject to bonus $420,000 $420,000

Bonus package × 0.05 × 0.04

Bonus (before any tax considerations) $ 21,000 $ 16,800

2. Salaries Expense ($21,000 + $16,800) 37,800

Various Taxes Payable ($8,400 + $6,720) 15,120

Bonus Payable ($12,600 + $10,080) 22,680

*To record bonuses earned by the president and*

*vice president.*

Various Taxes Payable 15,120

Bonus Payable 22,680

Cash 37,800

*To record the payment of bonuses.*

### E 8–2 (LO1) Computing Pension Expense and Payments

Dec. 31 Pension Expense 250,000

Pension Liability Payable 250,000

Jan. 5 Pension Liability Payable 250,000

Cash 250,000

### E 8–3 (LO2) Accounting for Property Taxes

1. Aug. 1 Prepaid Property Tax 27,550

Cash 27,550

*Paid property taxes for the period July 1,*

*2017, through June 30, 2018.*

2. Dec. 31 Property Tax Expense 13,775

Prepaid Property Tax 13,775

*To record (accrue) property tax expense*

*for the period July 1, 2017 through*

*December 31, 2017.*

### E 8-4(LO1) Journalize Sales and Related Taxes

Kelly Inc.

Apr. 10 Cash  37,450

Sales Revenue  35,000

Sales Taxes Payable  2,450

Jordon Inc.

Apr. 15 Cash  21,600

Sales Revenue ($21,600 ÷ 1.08)  20,000

Sales Taxes Payable

  ($20,000 X .08) 1,600

### E 8–5 (LO3) Provisions and Contingent Liabilities

The objective of this exercise is to illustrate the difficulty involved in applying the contingency standards. While the accounting standard uses terms such as *probable* and *possible*, matching these terms with probabilities is difficult. Studies show that there is little consensus on the probabilities associated with the terms *probable*, *possible*, and *remote*. While there are no exact answers to the scenarios given, students should recognize the judgment involved in making the classification decision. The following are provided as possible (or probable) answers.

a. A 40% probability of occurrence would most likely fall between remote and probable. If Rayn Company determined this contingency was reasonably possible, then note disclosure would be appropriate.

b. If the probability of incurring fines levied by the government is less than 10%, most would classify this event as remote and provide no information (or only a brief mention, with no details) in the notes to the financial statements.

c. A probability of 90% is likely to be interpreted as probable. If management determines the likelihood of losing the gender discrimination lawsuit as being probable, the liability (and associated loss) would be formally recognized in the accounting records.

### E 8–6 (LO3) Warranty

**1.**

Apr. 30 Product Warranty Expense 77,000

Product Warranty Provision 77,000

2.

Sep. Product Warranty Provision 45,000

Supplies (Cash or Wages Payable)\* 45,000

\*Depends on what resources Quick Manufacturing Co. uses for repair.

### E 8–7 (LO3) Computing Warranty Expense

1.

Jan. 31 Product Warranty Expense 50,000

Product Warranty Provision 50,000

2.

Feb. 5 Product Warranty Provision 7,000

Supplies 4,250

Wages Payable 2,750

### E 8–8 (LO4) Classifying Expenditures as Assets or Expenses

1. This amount should be expensed. Although the company expects the ad to increase sales over the next 18 months, the product is new and the advertising is not directed at specific past customers. Significant uncertainty exists regarding the actual amount of increased sales in the future.

2. The entire amount should be expensed. Although the company feels that the research costs will be beneficial in the future, significant uncertainty still   
exists. It may take years before any actual sales are generated from the research, or there may be no sales at all.

3. The cost of this targeted advertising should be capitalized and then recognized as an expense over the expected beneficial life of the advertising   
campaign.

4. This one is easy—the cost of the warehouse should be capitalized.

### E 8–9 (LO5) Preparing a Statement of Comprehensive Income

Ragnarok Company

Statement of Comprehensive Income

For the Year Ended December 31, 2018

Revenues:

Gross sales revenue $39,850

Less: Sales returns 1,200

Net sales revenue $38,650

Cost of goods sold 21,500

Gross margin $17,150

Operating expenses:

Selling expenses $ 970

General and administrative expenses:

Office supplies expense $200

Insurance expense 540

Total general and administrative expenses 740

Total operating expenses 1,710

Operating income $15,440

Other revenues and expenses:

Revenue from investments $ 250

Interest expense (410)

Net other revenues and expenses (160)

Income from operations before income taxes $15,280

Income taxes on operations (30%) 4,584

Net income $10,696

Other comprehensive income 0

Comprehensive income $ 10,696

Earnings per share:

Net income ($10,696/900) $ 11.88

### E 8–10 (LO5) Unifying Concepts: The Statement of Comprehensive Income

Fairchild Corporation

Statement of Comprehensive Income

For the Year Ended December 31, 2018

Revenues:

Gross sales revenue $395,472

Less: Sales returns $ 4,280

Less: Sales discounts 3,644 7,924

Net sales revenue $387,548

Cost of goods sold:

Inventory, January 1, 2018 $ 79,400

Purchases $230,560

Less: Purchases discounts 3,050

Net purchases 227,510

Cost of goods available for sale $306,910

Less: Inventory, December 31, 2018 44,300

Total cost of goods sold 262,610

Gross margin $124,938

Operating expenses:

Selling expenses:

Sales salaries expense $ 40,088

Advertising expense 6,922

Delivery expense 2,198

Insurance expense 1,160

Store supplies expense 800

Miscellaneous expenses 460

Total selling expenses $ 51,628

General and administrative expenses:

Office salaries expense $ 12,064

Utilities expense 3,980

Payroll tax expense 3,600

Miscellaneous expenses 620

Insurance expense 600

Office supplies expense 400

Total general and administrative

expenses 21,264

Total operating expenses 72,892

Operating income $ 52,046

Other revenues and expenses:

Interest revenue $ 2,400

Interest expense (1,170) 1,230

Income before income taxes $ 53,276

Income taxes 26,000

Net income $ 27,276

Other comprehensive income 0

Comprehensive income $ 27,276

Earnings per share ($27,276 ÷ 10,000 shares) $ 2.73

## PROBLEMS

### P 8–1 (LO1) Payroll Accounting

1. Salaries Expense 159,000

Income Tax Withholding Payable 6,720

Labor Insurance Withholding Payable 3,021

Health Insurance Withholding Payable 3,462

Salaries Payable 145,797

*To record salaries for the month of December.*

2. Salaries Payable 145,797

Cash 145,797

*Paid salaries for the month of December.*

### P 8–2 (LO1,LO6) Payroll Accounting

1. (1) $64,000\*5%=$3,200

5% of the salary is withheld for income tax.

(2) $57,000\*(8.5%+1%)\*20%=$1,083

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.

(3) $90,000\*4.91%\*30%=$1,326

The National Health Insurance premium rate is 4.91% of the salary, and the employee is responsible for the payments of 30%.

2. Salaries Expense 211,000

Income Tax Withholding Payable 10,550

Labor Insurance Withholding Payable 4,009

Health Insurance Withholding Payable 3,109

Cash (or Salaries Payable) 193,332

3. In addition to income and insurance, employers often withhold amounts for union dues, charitable contributions, employee savings plans, and retirement benefits.

### P 8–3 (LO1) Determining Payroll Costs

1. Commission Gross

Rate Sales Commission

Jordan 3.0% NT$140,000 NT$ 4,200

Alisa 4.5 200,000 9,000

Kasey 1.5 110,000 1,650

Trevor 5.0 180,000 9,000

Chad 2.5 90,000 2,250

Total commissions NT$26,100

Payroll expense is computed as follows:

Base salaries NT$ 125,000

Commissions 26,100

Payroll expense NT$ 151,100

2. Salary and commission NT$151,100

Income tax withheld(5%) (7,555)

Labor and health Insurance withheld (5,137)

Cash paid to employees .................................................................... NT$138,408

3. The advantage to taxpayers of having no taxes withheld is that taxpayers would get to keep their money longer before sending it in to the government. The taxpayers could earn interest on this money in the interim. The disadvantage to the taxpayers is that many would not have the discipline to set aside money to pay their taxes due at the end of the year. They would then be forced to seek out loans, probably at a premium interest rate, with which to pay their taxes. The advantage to the government of having taxes withheld is that the inflow of tax revenue is steady and more reliable. It is difficult to think of any reason why the government would not want taxes withheld.

### P8-4 (LO1) Recording Accrual of Compensated Absences

a.

Jan. 31 Salaries Expense 324

Sick Days Payable-John(8\*$15\*1.5) 180

Sick Days Payable-Susan(8\*$12\*1.5) 144

Feb. 28 Salaries Expense 324

Sick Days Payable-John 180

Sick Days Payable-Susan 144

b.

Mar. 31 Salaries Expense 324

Sick Days Payable-John 180

Sick Days Payable-Susan 144

Sick Days Payable-John 360

Various Taxes Payable(360\*25%) 90

Cash 270

Sick Days Payable-Susan(8\*$12\*1) 96

Various Taxes Payable(96\*25%) 24

Cash 72

### P8-5 (LO4) Preparing Entry for Research and Development Costs

Research and Development Expense

($260,000 + $450,000) 710,000

Development Costs 250,000

Cash 960,000

### P 8-6 (LO5) Unifying Concepts: The Statement of Comprehensive Income

Moriancumer, Inc.

Statement of Comprehensive Income

For the Year Ended December 31, 2018

Gross sales revenue $4,650,000

Less: Sales returns 8,000

Net sales revenue $4,642,000

Cost of goods sold 3,205,000

Gross margin $ 1,437,000

Operating expenses:

Selling expenses:

Sales salaries expense $450,000

Advertising and promotion expense 215,000

Insurance expense 800

Rent expense 16,000

Miscellaneous expenses 6,300

Payroll tax expense 5,200

Automobile expense 4,000

Delivery expense 3,100

Entertainment expense 1,500 $ 701,900

General and administrative expenses:

Administrative salaries expense $200,000

Office supplies expense 7,200

Miscellaneous expenses 5,400

Utilities expense 1,300

Insurance expense 800 214,700

Total operating expenses 916,600

Operating income $ 520,400

Other revenues and expenses:

Interest revenue $ 3,000

Interest expense (39,900) (36,900)

Income before income taxes $ 483,500

Income taxes 96,500

Net income $ 387,000

Other comprehensive income 0

Comprehensive income $ 387,000

Earnings per share $ 10.46

### P 8–7 (LO5) Statement of Comprehensive Income Analysis

2019 2018 2017

Gross sales revenue $56,000 (9) *$51,400* $47,600

Sales discounts 0 300 200

Sales returns 0 100 400

Net sales revenue 56,000 (10) *51,000* (1) *47,000*

Beginning inventory (15) *7,200* 8,700 (2) *12,000*

Purchases 33,400 (11) *29,500* 25,000

Purchases discounts 700 400 800

Freight-in (16) *600* 0 700

Cost of goods available for sale 40,500 37,800 (3) *36,900*

Ending inventory 6,900 (12) *7,200* (4) *8,700*

Cost of goods sold (17) *33,600* (13) *30,600* (5) *28,200*

Gross margin (40%) (18) *22,400* 20,400 (6) *18,800*

Selling expenses 4,500 (14) *3,300* (7) 4*,100*

General and administrative expenses (19) *3,600* 3,100 2,800

Income before income taxes 14,300 14,000 11,900

Income taxes 4,250 4,200 (8) *3,500*

Net income (20) *10,050* 9,800 8,400

*Calculations (to be made in the following order):*

(1) $47,600 – $200 – $400 = $47,000 (13) $51,000 – $20,400 = $30,600

(8) $11,900 – $8,400 = $3,500 (12) $37,800 – $30,600 = $7,200

(6) 0.40 × $47,000 = $18,800 (14) $20,400 – $3,100 – $14,000 = $3,300

(7) $18,800 – $2,800 – $11,900 = $4,100 (15) From ending inventory, period 2018

(5) $47,000 – $18,800 = $28,200 = $7,200

(4) From beginning inventory, period (16) $40,500 – $7,200 – $33,400 + $700 =

2018 = $8,700 = $600

(3) $28,200 + $8,700 = $36,900 (17) $40,500 – $6,900 = $33,600

(2) $36,900 – $25,000 + $800 – $700 = (18) $56,000 – $33,600 = $22,400

$12,000 (19) $22,400 – $4,500 – $14,300 = $3,600

(10) $20,400 ÷ 0.40 = $51,000 (20) $14,300 – $4,250 = $10,050

(9) $51,000 + $100 + $300 = $51,400

(11) $37,800 – $8,700 + $400 = $29,500

## ANALYTICAL ASSIGNMENTS

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

Judgment Call

Issues to be discussed with this question are:

**1.** According to IAS 38 paragraph 69(a), expenditure on start-up activities (ie start-up costs) is recognized as an expense when it is incurred, unless this expenditure is included in the cost of an item of property, plant and equipment in accordance with IAS 16. Start-up costs may consist of establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or business (ie pre-opening costs) or expenditures for starting new operations or launching new products or processes (ie pre-operating costs).

**2.** It is not necessary that the tax accounting match the financial accounting for many start-up costs.

**3.** If start-up costs are capitalized, then they must be expensed against the future revenues those costs will generate.

AA 8–2 Hutchison Whampoa

International

**1.** Income Tax Expense 165

Deferred Income Taxes Payable 165

*To recognize deferred income tax liability on $1,000 of   
income earned by foreign subsidiary ($1,000 × 0.165).*

The income tax liability is deferred because it won’t have to be paid until the income is transferred to the parent company in Hong Kong. This transfer may not take place for many years. In fact, as far as the Hong Kong government is concerned, there is no tax liability until the transfer takes place.

Interestingly, this is not how Hutchison Whampoa would actually account for these income taxes. According to Hong Kong accounting rules, no deferred income tax liability is required to be recognized if there is no reasonable probability that the income will be transferred and the tax paid in the foreseeable future. In its annual report, Hutchison reports that “it is not anticipated that these amounts will be remitted in the near future.” Thus, since Hutchison does not expect to have to pay the $165 in taxes in the foreseeable future, it would not have to report the deferred tax liability. On the other hand, if Hutchison were using U.S. accounting rules, it would have to report the deferred tax liability whether it anticipated paying the taxes in the foreseeable future or not.

**2.** EPS = Net Income/Shares Outstanding

HK$4.14 = HK$17.664 billion/Shares Outstanding

Shares Outstanding = 4.267 billion

**3.** The costs Hutchison Whampoa incurs in order to sign up new subscribers to its cellular phone service network are assumed to benefit future periods, not just the period when the subscriber is initially signed up. Since Hutchison reports that the costs are expensed over the following 12 to 24 months, it seems that Hutchison has found through experience that, if it can sign up a subscriber, the subscriber is likely to stay with the service an average of 12 to 24 months (or maybe more). Thus, it makes sense to assign the costs of signing up the subscriber to the subsequent periods.

AA 8–3 Twisting the Contingency Rules to Save the Environment

Ethics

Frank is clearly unaware of the accounting rules governing the financial statement reporting of contingent liabilities. From your examination of Allied’s financial statement disclosure, it appears that Allied Industrial has followed the accounting rules exactly—the contingent liability for the $140 million cleanup cost is deemed to be possible but not probable and is therefore disclosed in the notes but is not recognized in the balance sheet. Allied is adhering exactly to the accounting rule for contingencies established by the FASB.

Of course, it may be that Allied has intentionally understated the probability that the contingent liability will materialize. However, even if this is true, the contingent liability is still completely described in the notes to Allied’s financial statements that are available to any member of the public. This can hardly be used as evidence of a cover-up.

You have a responsibility to explain the accounting rules to Frank. You should convince Frank not to misrepresent Allied’s disclosure as evidence of a cover-up. Using this deceptive technique could eventually backfire if Allied is then able to tell the public that your group has maliciously and knowingly twisted its financial statement disclosures. The last thing you want is for the public to start to view Allied Industrial sympathetically as an oppressed organization. A better strategy may be to use the financial statement disclosure in a fair manner. Acknowledge that while Allied Industrial is not currently obligated to pay the $140 million in toxic waste cleanup costs, the fact that Allied is involved in litigation with 13 other sites may demonstrate a pattern of environmental irresponsibility. In this way Frank can still use the information, but he shouldn’t misrepresent it.

## EXPANDED MATERIAL

## PRACTICE EXERCISES

### PE 8–19 (LO6) Insurance Payment Calculation

Payment by the Mei-Hui

NT$55,000 × (8.5% + 1%) × 0.2 =NT$1,045

Payment by the employer

NT$55,000 × (8.5% + 1%) × 0.7= NT$3,658

NT$55,000 × 0.09% × 100% = NT$50

Total:NT$3,708

### PE 8–20 (LO6) Insurance Payment Calculation

Payment by the Mei-Hui

NT$55,000 × 4.91% × 0.3 × 1 =NT$810

Payment by the employer

NT$55,000 × 4.91% × 0.6 × (1 + 0.7) =NT$2,755

### PE 8–21 (LO6) Salaries Expense Journal Entry

Salaries Expense 55,000

Income Tax Withholding Payable 2,750

Labor Insurance Withholding Payable 1,045

Health Insurance Withholding Payable 810

Salaries Payable 50,395

### PE 8–22 (LO6) Insurance Expense Journal Entry

Insurance Expense 6,463

Labor Insurance Payable 3,708

Health Insurance Payable 2,755

### PE 8–23 (LO6) Salaries and Insurance Payments

Salaries Payable 50,395  
 Cash 50,395

**PE 8–23 (LO6) (Continued)**

Income Tax Withholding Payable 2,750

Labor Insurance Withholding Payable 1,045

Health Insurance Withholding Payable 810

Labor Insurance Payable 3,708

Health Insurance Payable 2,755

Cash 11,068

## EXERCISES

### E 8–11 (LO6) Payroll Accounting

Salaries Expense 77,000(1)

Income Tax Withholding Payable 3,850(2)

Labor Insurance Withholding Payable 1,463(3)

Health Insurance Withholding Payable 1,134(4)

Cash (or Salaries Payable) 70,553

*To record payroll for 2018.*

1. NT$35,000 + NT$42,000 = NT$77,000
2. 5% of the salary is withheld for income tax. (5%\* NT$77,000)
3. 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. (9.5%\* NT$77,000\*0.2)
4. The National Health Insurance premium rate is 4.91% of the salary, and the employee is responsible for the payments of 30%. (NT$77,000\*4.91%\*0.3\*1)

PROBLEMS

### P 8–8 (LO6) Payroll Accounting

Salaries Expense 142,000(1)

Income Tax Withholding Payable 7,100(2)

Labor Insurance Withholding Payable 2,698(3)

Health Insurance Withholding Payable 2,975(4)

Cash (or Salaries Payable) 129,227

*To record payroll for 2018.*

1. NT$60,000 + NT$42,000 + NT$40,000 = NT$142,000
2. 5% of the salary is withheld for income tax. (5%\* NT$142,000)
3. 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. (9.5%\* NT142,000\*0.2)
4. The National Health Insurance premium rate is 4.91% of the salary, and the employee is responsible for the payments of 30%.

(4.91%\*0.3\*(NT$60,000\*2 + NT$42,000\*1 + NT$40,000\*1))

Insurance Expense 16,697

Labor Insurance Payable 9,585(5)

Health Insurance Payable 7,112(6)

1. The insurance rate for accident is 8.5% of the salary and the employment insurance rate is 1% of the salary, and the employer is responsible for the payments of 70% of insurance. The occupational injury payment is 0.1%

(9.5%\* NT142,000\*0.7 + 0.1%\*NT$142,000)

1. The National Health Insurance premium rate is 4.91% of the salary, and the employer is responsible for the payments of 60%.

(NT$142,000\*4.91%\*0.6\*(1 + 0.7))

SOLUTIONS TO “STOP & THINK”

***Stop & Think (p. 327):*** Why might a company hesitate to assess the likelihood of losing an ongoing   
lawsuit as being probable? If you were the attorney for the plaintiff, how could you use the resulting information from the financial statements?

If a company were to consider the likelihood of losing a lawsuit as probable, then the proper accounting treatment would be to recognize the loss on the statement of comprehensive income and to record a liability on the balance sheet. If you were the attorney for the plaintiff in that case, you might use that information to plan your courtroom strategy. After all, if the company thinks it’s going to lose, that would give you a distinct advantage.

***Stop & Think (p. 331):*** Would you expect that a rule requiring all firms to expense R&D outlays would cause R&D expenditures to decrease? Why or why not?

Here are arguments on both sides of the issue:

*Economic Consequences*

While IFRS stipulates that firms capitalize R&D costs incurred after technological feasibility has been established, the U.S. GAAP requires that firms expense all the R&D outlays. From the perspective of a U.S. firm, it will be affected in the following ways:

1. Reported R&D expenses are higher.

2. Reported net income is lower. When a firm’s income is lower, banks are less willing to loan money, and investors are less willing to invest.

3. Shortage of financing causes U.S. firms to cut back their research activities.

4. A slowdown in U.S. research activity puts U.S. firms behind foreign firms in terms of technical advancement.

*Efficient Market*

Bankers and investors, with millions of dollars on the line, do not blindly read financial statements. They are aware of the conservative R&D accounting rule set by the FASB, and they adjust their valuation and forecasting models accordingly when they use the financial statements of companies that perform R&D. Bankers and investors are interested in the economic performance of companies, not in accounting performance. The claim that bankers and investors will reduce financing to firms that report low net income as a result of expensing R&D implies that bankers and investors are completely trusting of whatever numbers the accountants choose to report. This is absurd.