APPENDIX H

Other Significant Liabilities

ASSIGNMENT CLASSIFICATION TABLE

Learning Objectives	Questions	Brief Exercises	Exercises	A Problems	B Problems
1. Describe the accounting and disclosure requirements for provisions and contingent liabilities.	1, 2	1	1, 2	1A	1B
2. Contrast the accounting for operating and finance leases.	3, 4, 5	2	3	2A	2B
3. Identify additional fringe benefits associated with employee compensation.	6, 7, 8, 9, 10	3	4		

ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
H-1A	Prepare current liability entries, adjusting entries, and current liabilities section.	Moderate	30–40
H-2A	Analyze three different lease situations and prepare journal entries.	Moderate	20–30
H-1B	Prepare current liability entries, adjusting entries, and current liabilities section.	Moderate	30–40
H-2B	Analyze three different lease situations and prepare journal entries.	Moderate	20–30

ANSWERS TO QUESTIONS

1. A provision is a liability of uncertain timing or amount. Provisions are only recorded in the accounts if they are probable and the amount can be reasonably estimated. Warranty costs are a provision usually recorded in the accounts since they are both probable and can be reasonably estimated.

2. If the contingency is only reasonably possible, then only note disclosure is required. If the possibility of a contingent liability occurring is only remote, then neither recording in the accounts nor note disclosure is required.

3. (a) A lease agreement is a contract in which the lessor gives the lessee the right to use an asset for a specified period in return for one or more periodic rental payments. The lessor is the owner of the property and the lessee is the renter or tenant.
(b) The two most common types of leases are operating leases and finance leases.
(c) In an operating lease the property is rented by the lessee and the lessor retains all ownership risks and responsibilities. A finance lease transfers substantially all the benefits and risks of ownership from the lessor to the lessee, so that the lease is in effect a purchase of the property.

4. This lease would be reported as an operating lease. In an operating lease each payment is debited to Rent Expense. Neither a leased asset nor a lease liability is recorded.

5. In a finance lease agreement the lessee records the present value of the lease payments as an asset and a liability. Therefore, Palmer SA would debit Leased Asset—Equipment for €186,300 and credit Lease Liability for the same amount.

6. Three additional types of fringe benefits are:
(1) Paid absences—vacation pay, sick pay, and paid holidays.
(2) Postretirement health-care and life insurance benefits.
(3) Pension plan benefits.

7. Paid absences refer to compensation paid by employers to employees for vacations, sick pay benefits, and paid holidays. When the payment for such absences is probable and the amount can be reasonably estimated, a liability should be accrued for paid future absences. When this amount cannot be reasonably estimated, the potential liability should be disclosed.

8. Two types of postretirement benefits are: (1) postretirement health-care and life insurance benefits and (2) pension plan benefits. The IASB advocates expensing the cost of these postretirement benefits during the working years of the employees rather than the retirement years of the employees.

Questions Appendix H (Continued)

9. The three parties in a pension plan are generally: (1) the employer, (2) the plan administrator, and (3) the pension recipient. The employer sponsors and makes contributions to the plan. The plan administrator invests the pension assets and makes the benefit payments to the pension recipients. The recipients are retired employees who receive the benefit payments.

10. In a defined-contribution pension plan the employer agrees to contribute a certain sum each period based on a formula. In contrast, a defined-benefit plan defines the benefits that the employee will receive at the time of retirement.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE H-1

Dec. 31	Warranty Expense	27,200	
	Warranty Liability [(1,000 X 4%) X HK$680]		27,200

BRIEF EXERCISE H-2

1.	Rent Expense	68,000	
	Cash		68,000
2.	Leased Asset—Building	900,000	
	Lease Liability		900,000

BRIEF EXERCISE H-3

Jan. 31	Vacation Benefits Expense	5,250	
	Vacation Benefits Payable (35 X €150)		5,250

SOLUTIONS TO EXERCISES

EXERCISE H-1

(a) Estimated warranties outstanding:

Month	Estimate	Units Defective	Outstanding
November	840	620	220
December	990	500	490
Total	1,830	1,200	710

Estimated warranty liability—710 X £15 = £10,650.

		Debit	Credit
(b)	Warranty Expense (1,830 X £15)	27,450	
	Warranty Liability		27,450
	Warranty Liability	16,800	
	Repair Parts		16,800
(c)	Warranty Liability (500 X £15)	7,500	
	Repair Parts		7,500

EXERCISE H-2

(a)

KESETE ONLINE AG
Partial Statement of Financial Position

Current liabilities	
Accounts payable	€ 63,000
Long-term debt due within one year	40,000
Unearned ticket revenue	21,000
Warranty liability	18,000
Sales taxes payable	10,000
Interest payable	8,000
Total current liabilities	€160,000

EXERCISE H-2 (Continued)

(b) **Kesete Online AG's working capital is €140,000 (€300,000 − €160,000) and its current ratio is 1.88:1 (€300,000 ÷ €160,000). Although a current ratio of 2:1 has been considered the standard for a good credit rating, many companies operate successfully with a current ratio below 2:1.**

EXERCISE H-3

(a)		**Rent Expense**	**720**	
		Cash..		**720**
(b)	**Jan. 1**	**Leased Asset—Equipment**	**103,084**	
		Lease Liability.................................		**103,084**

EXERCISE H-4

Mar. 31	**Vacation Benefits Expense**	**1,920**	
	Vacation Benefits Payable (10 X 2 X €96)..................................		**1,920**
31	**Pension Expense (€30,000 X 8%)**	**2,400**	
	Pension Liability		**2,400**

SOLUTIONS TO PROBLEMS

PROBLEM H-1A

(a)	Jan. 1		Cash	15,000	
			Notes Payable		15,000
	5		Cash	9,752	
			Sales Revenue (€9,752 ÷ 106%)		9,200
			Sales Taxes Payable (€9,752 – €9,200)		552
	12		Unearned Service Revenue	9,000	
			Service Revenue		9,000
	14		Sales Taxes Payable	5,800	
			Cash		5,800
	20		Accounts Receivable	38,584	
			Sales Revenue		36,400
			Sales Taxes Payable (700 X €52 X 6%)		2,184
	25		Cash	13,144	
			Sales Revenue (€13,144 ÷ 106%)		12,400
			Sales Taxes Payable (€13,144 – €12,400)		744
(b)	(1)	Jan. 31	Interest Expense	100	
			Interest Payable (€15,000 X 8% X 1/12)		100
	(2)	Jan. 31	Warranty Expense	1,456	
			Warranty Liability (€36,400 X 4%)		1,456

PROBLEM H-1A (Continued)

(c) Current liabilities

Notes payable	**€15,000**
Accounts payable	**42,500**
Unearned service revenue (€15,000 – €9,000)	**6,000**
Sales taxes payable (€552 + €2,184 + €744)	**3,480**
Warranty liability	**1,456**
Interest payable	**100**
Total current liabilities	**€68,536**

PROBLEM H-2A

(a) **Amsrud Enterprises should record the Haber Co. lease as a finance lease because the lease term is about 86% of the estimated economic life of the second property.**

Both the Lennon Ltd. and Schell Ltd. leases should be reported as operating leases because neither meets any of the four conditions that would require treatment as a finance lease.

(b) **The Haber Co. lease is a finance lease. The entry to record the finance lease on January 1, 2017, therefore is as follows:**

Leased Asset—Equipment	**62,000**	
Lease Liability		**62,000**

(c) **The Lennon Ltd. lease is an operating lease. The entry to record the lease payment in 2017, therefore is as follows:**

Rent Expense	**4,800**	
Cash		**4,800**

PROBLEM H-1B

(a)	Jan. 5	Cash	17,496	
		Sales Revenue (£17,496 ÷ 108%)		16,200
		Sales Taxes Payable (£17,496 – £16,200)		1,296
	12	Unearned Service Revenue	10,000	
		Service Revenue		10,000
	14	Sales Taxes Payable	7,700	
		Cash		7,700
	20	Accounts Receivable	34,992	
		Sales Revenue		32,400
		Sales Taxes Payable (600 X £54 X 8%)		2,592
	21	Cash	18,000	
		Notes Payable		18,000
	25	Cash	12,420	
		Sales Revenue (£12,420 ÷ 108%)		11,500
		Sales Taxes Payable (£12,420 – £11,500)		920

(b)	(1) Jan. 31	Interest Expense	30	
		Interest Payable		30
		(£18,000 X 6% X 1/12 = £90; £90 X 1/3)		
	(2) Jan. 31	Warranty Expense	1,620	
		Warranty Liability (£32,400 X 5%)		1,620

PROBLEM H-1B (Continued)

(c) Current liabilities

Notes payable	£18,000
Accounts payable	52,000
Unearned service revenue (£16,000 – £10,000)	6,000
Sales taxes payable (£1,296 + £2,592 + £920)	4,808
Warranty liability	1,620
Interest payable	30
Total current liabilities	£82,458

PROBLEM H-2B

(a) McKay A/S should record the Block Delivery lease as a finance lease because: (1) the lease term is about 86% of the estimated economic life of the leased property and (2) the present value of the lease payments is 90% of the fair value of the computer.

Both the Dunbar Co. and Jens Auto leases should be reported as operating leases because none of the four conditions is met to require treatment as a finance lease.

(b) The Dunbar Co. lease is an operating lease. The entry to record the lease payment in 2017 therefore is as follows:

Rent Expense..	**4,200**	
Cash..		**4,200**

(c) The Block Delivery lease is a finance lease. The entry to record the finance lease on January 1, 2017, therefore is as follows:

Leased Asset—Equipment..................................	**38,000**	
Lease Liability...		**38,000**