Accounting

ASSIGN BUSTER

Question#1: Reporting of Research and Development costs. Reporting of expenditure which relate to Research and Development (RD) are being done in accordance to Current Generally Accepted Accounting Standards (GAAP). Use of U. S GAAP provisions are made for means of expenses while International Financial Reporting Standards (IFRS) are meant for liabilities. Therefore use of GAAP in Research and Development ensures that all expenditures incurred are charged as expenses whenever they occur. Most costs which are incurred in research and development are much similar with other costs which are incurred in other accounting fields. For example in Research and Development there are cost activities such as start-up cost of the new project, amount incurred in promotion and marketing of the project or services which are being offered and cost of incurring training personnel to acquire new skills (Bielstein, 2004). Such costs are also similar to most other financial costing apart from Research and Development. However, the main use of GAAP is to differentiate costs which are incurred in Research and development activities as its being opposed to other expense which is incurred. Use of International Accounting Standards (IAS) and Financial Accounting Standards (FAS) has similar definition on Research and Development activities although the way in which the standards treat the intangible assets of Research and development is much different. Use of GAAP in Research and Development will charge the following costs as expenses; costs which are incurred for procurement of materials, cost of facilities and equipments which will not be used in future, payments of wages, salary or any other costs incurred in payments of personnel in the project, purchases made of intangible for the use in the project, payments done for ratification of the contract being signed and any other expense

which is incurred for the administration of the project. Finally the expenses incurred are supposed to be disclosed in the financial statements which are done in different financial reporting timeframe of the project quarterly, bi-annually or annually. Question #2: Discuss the fundamental basis for reporting contingent liabilities in financial statements. Recording of contingent liabilities in the accounting records differs with some being recorded in the balance sheet while others are discussed only in the footnotes. Such differences arise due to different types of contingent liabilities. Such liabilities arise either due to possible obligations which is arising due to events which were done in the past, and they are likely to be confirmed once there is an occurrence of the event in future. While, the liability would also arise as a result of present obligation this is being realized due to past events. However, such obligation is not recognized because it is not possible to measure its economic or financial records (Miguel, 2005). Therefore, obligations which are possible to arise are recorded as footnotes while those which were being realized in the financial period under review will be recorded in the balance sheet. Contingent liabilities which arise in the normal course of business are known as liabilities of a standard type and this is the one which is recorded in the balance sheet. Examples of such liabilities are; contingent which would arise as a result of non-insurance, contingent of supply or purchase of goods or services as it is authorized. Merck report on exposure to Vioxx related lawsuitsThe exposure of the Vioxx lawsuits being reported by Merck was as a result of estimations. Initially the company had reported an estimate of $18 billion which was argued as being implicit in the report released in August. However, subsequent reporting on the same estimate was $ 12 Billion which was much less than the initial report. I do

concur with such reporting because the estimates were based on different scenarios which would arise due to the outcome of the litigations which the company is facing (BusinessWeek, 2005). The estimates being done were for contingent liabilities which the company would not be able to provide an accurate financial obligation which the company would incur. Question #3: Differences of Deferred Revenue and Contingent Liabilities. The liabilities estimation for manufacturing companies and those of frequent flyer program for airline industry would differ. As for manufacturing companies it is dealing with products while the airline deals with services. Both liabilities are contingent hence they are liabilities of transactions, incidents or events which the companies will not be certain if there will be any financial implications which would be difficult for the companies to ascertain the actual value of the obligation or even the actual time when the costs would be incurred. Reporting of both company contingent liabilities must be recorded when; there must be an exchange transaction which would have occurred due to a past event. Future outflow or sacrifices of resources which would be done should be taken in to considerations to ascertain how much they would cost. The outflow indentified must be measurable; hence the management would be able to estimate the costs of liabilities to be incurred. The estimated amount must be within the range of estimates and its nature must be disclosed during financial reporting of the period under review. If the three factors above are not met then reporting of such contingent liability should be disclosed at the notes of the financial reports for the period under review. The notes of contingent liability would be an indicator that there are possibilities of an increase in expense of the period being reported (Epstein Et al. 2009). This would either be as an additional expense or loss; the

reporting must be precise by indicating the possible liability and the estimates which are being projected. Manufacturing company accounting for warranties would be much easy to estimate and account for them with higher accuracy though not precise based on earlier trends of failure of goods produced. While services offered by airline companies would be much difficult to estimate them. Therefore, I would include contingent liabilities of the manufacturing company in the balance sheet while for the airline industry in the footnotes. Question#4: The Cash Flow Statement (indirect approach). a) Net accounts receivable increased during the accounting period. Accounts receivable is a current asset account. The reason for adjusting the receivables from the net income is to reduce credit sales from profit and to remove the effect of unpaid credit sales from net income. To get the amount of receivables for the current year subtract the closing balance of accounts receivables from the opening receivables from the balance sheet. An increase in receivables will mean that customers who are debtors have not paid cash to the organization, meaning that there is less cash received within the accounting period. b) Merchandise inventory decreased during the accounting period. Inventory is a current asset. A decrease in inventory will mean that there was more cash that was spent in paying for the inventories within the accounting period. The amount of inventory that is included in net income within the cost of sales is a mixture of opening inventory, closing inventory. If there is a decrease in inventory this will have to be adjusted downwards from net income as it means that some amount of merchandise was sold that exceeded the purchases, meaning that some of the merchandise sold formed part of the previous period closing balance. To adjust this amount the merchandise inventory at

the end of the period is subtracted from the merchandise inventory at the beginning of the period. c) Trade accounts payable increased during the accounting period. An increase in payables means that there is an increase in cash as fewer creditors have been paid. These means that most of the purchases have not been paid for and have been credit sales. An adjustment from the net income to get cash from operations for the accounting period will be required. These will be done by taking the opening credit sales and subtracting the closing credit sales. d) A Parcel of land was sold during the accounting period at a loss. The net income has been reduced by the loss after the sale of the parcel of the land. This loss will be added back in the net income to get the cash from operations. The amount at which the parcel of land was sold will be added at the investing activities section of the cash flow.