Good income effect essay example

[Business](#), [Marketing](#)

We have determined several accounting issues with regard to the overall operations of Keystone Computers & Networks (KCN). The effects of these issues to the net income are summarized as follows:

- Ringo Company receivable (30, 800)

- Inventory (24, 100)

- “ Bring your daughter to work day” litigation -0-

- Unearned service revenue -0-

- Account receivable from officers -0-

- Prepaid advertising (15, 000)

The detailed examination of these issues are highlighted below:

Issue 1: Ringo Receivable

Proposed Journal Entry

Bad Debt Expense$30, 800

Allowance for Doubtful accounts$30, 800

Computations

We believe that a range of $30, 800 to $38, 500 is accurate. We suggest the use of the minimum amount.

*$77, 000 outstanding receivable x expected loss

The journal entry was made in accordance with general accounting requirements which provide that:

- The accrual of loss when it is probable that the asset has been impaired and can be reasonably estimated at the financial statement date including the collectability of receivables

- The accrual of the minimum amount in case the amount of loss is estimated within a range when every point is not a better estimate than any other amount
- In case the accrued amount of loss is less than the loss that is reasonably possible, the nature of the contingency and additional exposure to loss must be disclosed
- If an amount within a range is a better estimate than point within the range, it shall be the amount accrued.

Issue 2: Inventory

Proposed Journal Entry

Holding Loss from Inventory$24, 100

Allowance to Reduce Inventory to Market$24, 100

Assumption: Computers and parts are treated separately. Otherwise, no journal entry is needed.

Computations

Determination of the lower of cost or market:

*Net Realizable Value = Current Sales Price x Percentage sold in Quarter x Quarter’s Average Price

1st quarter$110, 000 x 35% x 97. 5% = $ 37, 537. 50

2nd quarter$110, 000 x 30% x 92. 5%= 30, 525. 00

3rd quarter$110, 000 x 25% x 87. 5%= 24, 062. 50

4th quarter$110, 000 x 10% x 82. 5%= 9, 075. 00

Net Realizable Value$101, 200. 00

Less: Normal profit margin 25, 300. 00

Net Realizable Value - Normal profit margin $ 75, 900. 00

Assumption: sales occur evenly throughout each quarter.

**If a 50% profit margin is assumed the computation becomes $130, 000 - (. 50 x $130, 000) = $97, 500

The journal entry was made in accordance with general accounting requirements which provide that:

- The use of lower of cost or market with the recognition of loss for impairment, damage, obsolescence, deterioration, price level changes, and other factors in inventory valuation.
- The lower of cost or market may be applied to every item, to the whole inventory, or to the total of the components in every major inventory category.

Issue 3: Bring Your Daughter to Work Litigation

Proposed Solution

The general disclosure of the contingency loss on litigation in KCN's notes to financial statements.

We have taken into account the legal counsel's lack of opinion on the outcome of the case in our solution. We have agreed that it should be not be interpreted as having incurred a probable loss. Thus, the expected future legal costs amounting to $20, 000 will not be accrued.

The solution was made in accordance with general accounting requirements which provide that:

- The accrual of loss when it is probable that the asset has been impaired and can be reasonably estimated at the financial statement date
- The accrual of the minimum amount in case the amount of loss is estimated within a range when every point is not a better estimate than any other amount
- In case the accrued amount of loss is less than the loss that is reasonably possible, the nature of the contingency and additional exposure to loss must be disclosed
- If an amount within a range is a better estimate than point within the range, it shall be the amount accrued.

Issue 4: Unearned Service Revenues

Proposed Solution

Given that the liability associated with the warranty program is reflected on the income statement, a note disclosure in relation to the warranty might have to be made.

Since the expected cost of $300-$400 is less than the $900 annual policy, no adjusting entry is needed.

The solution was made in accordance with general accounting requirements which provide that:

- The revenues from product maintenance contracts and separately priced extended warranty recognized using the straight-line method.
- The recognition of loss in case the expected costs of providing the service contracts are greater than its related unearned revenue.

Issue 5: Accounts Receivables from Officers

Proposed Journal Entry

Accounts receivable$84, 670

This entry is merely for reclassification.

The journal entry was made in accordance with general accounting requirements which provide that:

- The disclosure of related party transactions including borrowings and lendings.

- The disclosures must include the nature of relationship, the description of transactions, the amounts involved for every period presented

- The disclosure should reflect the amount due from or to related parties as of the balance sheet date

- Receivables form unusual transactions not expected to be collected within 12 months must be classified as non-current

Issue 6: Prepaid Advertising

Proposed Journal Entry:

Advertising Expense$15, 000

Prepaid Advertising$15, 000

The journal entry has taken into account that there will be few sales attributed to the advertising.

The journal entry was made in accordance with general accounting requirements which provide that:

- Prepaid expenses are considered as current assets since it requires the use of current assets if not paid in advance within the operating cycle

- The accrual of loss when it is probable that the asset has been impaired and can be reasonably estimated at the financial statement date
- The accrual of the minimum amount in case the amount of loss is estimated within a range when every point is not a better estimate than any other amount
- In case the accrued amount of loss is less than the loss that is reasonably possible, the nature of the contingency and additional exposure to loss must be disclosed
- If an amount within a range is a better estimate than point within the range, it shall be the amount accrued.