GAAP: Balance Sheet Part 3

Course #2103B

Accounting

2 Credit Hours

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GAAP: BALANCE SHEET PART 3

This course covers a variety of issues related to GAAP with a focus on balance sheets. Much of the course is in a Question & Answer format.

LEARNING ASSIGNMENTS AND OBJECTIVES

As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.

SUBJECTS

GAAP Q & A: Balance Sheet

Study the course materials from pages 1 to 38

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

Objectives:

- To identify the accounting for environmental contamination costs
- To identify examples of costs associated with exit activities

NOTICE

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EXAM OUTLINE

- **TEST FORMAT:** The final exam for this course consists of 10 multiple-choice questions and is based specifically on the information covered in the course materials.

- **ACCESS FINAL EXAM:** Log in to your account and click Take Exam. A copy of the final exam is provided at the end of these course materials for your convenience, however you must submit your answers online to receive credit for the course.

- **LICENSE RENEWAL INFORMATION:** This course qualifies for **2** CPE hours.

- **PROCESSING:** You will receive the score for your final exam immediately after it is submitted. A score of 70% or better is required to pass.

- **CERTIFICATE OF COMPLETION:** Will be available in your account to view online or print. If you do not pass an exam, it can be retaken free of charge.

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GAAP Q & A

H. CURRENT LIABILITIES

1. Accrual for Employer Co-Insurance Arrangements

Question: A company has a self-insured medical insurance program with a “stop-gap” insurance policy covering medical expenses in excess of $10,000 per employee. What amount should the company accrue to cover its liability?

Response: Although ASC 450, *Contingencies*, excludes employment-related costs, that statement guidance may be appropriate for this situation. In accordance with ASC 450, a liability should be accrued if the loss is probable and the amount can be estimated. <u>*The company should record a liability for medical expenses incurred by the employees during the year yet not paid at year end*</u>, including expenses incurred during the reporting period but submitted subsequent to the balance sheet date. Any liability will be reduced by any excess over $10,000 which will be covered by the insurance policy.

2. Accrual for Sick Pay

Question: A company is concerned that its employees will vote for a union. In order to safeguard against this, they institute several benefits including a sick or personal days option. Under this policy, employees earn one personal day each quarter that they work. At the end of the year, the employees can take any unused personal days in the form of cash paid out in January of the following year. In January 20X1, the company paid $76,000 for personal days earned but not taken in 20X0. Should the $76,000 be recorded as a liability as of December 31, 20X0?

Response: Yes. ASC 710-10, *Compensation-General*, requires a company to record a liability for any compensated absence (vacation, holiday or sick pay) if <u>*four criteria*</u> are met:

- The compensation has been earned.
- It vests or accumulates.
- It is probable that it will be paid.
- The amount can be estimated.

Based on the above information, the <u>*four criteria*</u> have been met and the liability should be accrued. Although in this example, sick pay is accrued, usually, sick pay does not satisfy the four criteria and is therefore not usually accrued.

3. Accrual for Sabbatical Leave and Other Similar Benefits

Question: A company offers its employees sabbatical leave under which its employees are entitled to paid time off after working for the company for 10 years During the sabbatical leave, the individual is still a compensated employee of the company and is not required to perform any duties for the company.

Should the employer record an accrual for the liability for the sabbatical leave similar to an accrual for vacation pay?

Response: An entity may provide its employees with a benefit in the form of a compensated absence known as a sabbatical leave under which the employee is entitled to paid time off after working for an entity for a specified period of time. During the sabbatical leave, the individual continues to be a compensated employee and is not required to perform any duties for the entity.

Historically, companies have followed the guidance of ASC 710-10, *Compensation-General*, in determining whether the cost of a sabbatical or other arrangement should be accrued.

ASC 710-10 states that an employer shall accrue a liability for employees' compensation for future absences if four criteria are met:

1. The compensation has been earned.
2. The obligation relates to rights that vest or accumulate.
3. Payment of the compensation is probable.
4. The amount can be reasonably estimated.

Vested rights are those for which the employer has an obligation to make payment, even if an employee terminates, and are not contingent on an employee's future service. Rights *accumulate* if rights have been earned but unused rights may be carried forward to future periods, even if there may be a limit to the amount that can be carried forward.

ASC Subtopic 710-10-25, *Sabbatical Leave Benefits*, provides further guidance by stating:

> *"An employee's right to a compensated absence under a sabbatical or other similar benefit arrangement a) that requires the completion of a minimum service period, and b) in which the benefit does not increase with additional years of service, accumulates under ASC 710-10 (e.g., the second criterion is met) as long as the employee":*
>
> 1) Continues to be a compensated individual, and
> 2) Is not required to perform duties for the entity during the absence.

That is, the third criterion for accrual (the obligation relates to rights that vest or accumulate) is satisfied if the above-noted guidance is satisfied.

Therefore, assuming the other three requirements for accrual are also met (e.g., compensation is earned, payment is probable, and amount can be reasonably estimated), the compensation cost associated with a sabbatical or other similar benefit arrangement should be accrued over the requisite service period to earn the sabbatical leave. For example, if an employee must work 10 years to earn a thirty-day sabbatical leave with pay, that thirty days of sabbatical leave pay should be accrued during the 10 years over which the employee earns the sabbatical pay.

Arrangements in which employees are required to engage in research or public service to enhance the reputation of or otherwise benefit the employer are not within the scope of ASC 710-10.

4. Environmental Liabilities

Question: A company must remove underground storage tanks and remediate the soil in accordance with the environmental laws. The costs will be approximately $100,000.

Should the cost be expensed or capitalized?

Response: ASC 410, *Asset Retirement and Environmental Obligations*, provides guidance.

General Rule: Environmental contamination treatment costs should be charged to expense.

However the ASC provides exceptions which the entity may elect (but is not required) to capitalize the expenditure if any one of the following criteria is met:

a. The costs extend the life, increase the capacity, or improve the safety or efficiency of property owned by the company.

   Note: For purposes of this criterion, the condition of the property after the costs are incurred must be improved as compared with the condition when originally constructed or acquired, if later.

b. The costs mitigate or prevent environmental contamination that has yet to occur and that may result from future operations or activities, of property owned by the company.

   Note: As with condition a) the costs must improve the property compared with its condition when constructed or acquired.

c. The costs are incurred in preparing the property for sale.

Note

ASC 410-30 states that the costs incurred for removal of asbestos may be capitalized as the removal improves the safety and efficiency of the property.

In this example, the costs to remove the tanks and remediate the soil should be expensed since the activity does not satisfy any of the three (3) exceptions noted previously.

Change the facts: Not only are the old tanks removed for $100,000, but the company also spends $200,000 to install new tanks.

Response: The $100,000 expenditure to remove the tanks should be expensed. However, the $200,000 to install new tanks should be capitalized as a fixed asset addition.