

Chapter 5

Warranty claims

A trading company's balance sheet at January 01 is as follows:

Fixed assets	400	Equity	500
Inventory	300	Long term loan (6%)	400
Receivables	200	Payables	100
Bank	100		
Total	1,000	Total	1,000

The company's CFO states that currently the balance sheet does not reflect that the company is liable to warranty claims by customers. He estimates that the current warranty claims might amount to €75. He wishes to have this potential claim shown on the balance sheet.

- Show the changes on the balance sheet following the CFO's policy.

The CFO also estimates, that 2% of sales results in warranty claims. Starting this year, this 2% will be taken as a cost at time of sale.

Additional Information upcoming year

- Total sales will be €10,800.
 - Credit term on sales is 1.5 months.
 - The purchase price is 70% of the sales price.
 - Total purchases were €7,440.
 - Credit term on purchases is one month.
 - Total paid warranty claims amounted to €275.
 - Depreciation on fixed assets is €50.
 - Total other overhead costs are €2,700. These will be paid in full.
 - At year end, stock holders receive a dividend of €100.
- Give income statement, cash flow statement and final balance sheet.

Solutions Warranty Claims

A provision will be created by debiting equity

Equity – 75

Provision + 75

Income Statement

Sales		10,800
COS	$0.7 * 10,800$	(7,560)
Warranty	$0.02 * 10,800$	(216)
Overheads		(2,750)
EBIT		274
Interest		(24)
Earnings		250
Dividend		100
Retain		150

Cash Flow Statement

Receive from clients	$200 + 10,800 * 10.5 / 12$	9,650
Payment for Purchases	$100 + 7,440 * 11 / 12$	(6,920)
Warranty		(275)
Overhead		(2,700)
Dividend		(100)
Interest		(24)
Net Cash Flow		(369)

Final Balance Sheet

Fixed assets	$400 - 50$	350
Inventory	$300 + 7,440 - 7,560$	180
Receivables	$10,800 / 12 * 1.5$	1,350
Total Assets		1,880
Equity	$425 + 150$	575
Loan		400
Provision	$75 + 216 - 275$	16
Payables	$7,440 / 12$	620
Bank	$100 - 369$	269
Total Sources		1,880