CONCEPT: ESTIMATED LIABILITIES – WARRANTIES

● Companies often offer a ***warranty*** along with the sale of their product.

□ A ***warranty*** guarantees that the product will function properly for a set period of time (90-day, one-year, etc)

- Warranties increase sales revenue because they increase consumer confidence in the product
- However, if a customer uses the warranty, it is going to cost the company money!

□ Warranties are an example of an estimated or ____________ liability

- At the time of sale, we can't be sure if the customer will use the warranty
- The added cost associated with fulfilling warranty costs is an expense

> Estimating warranty expenses is an example of the ________________ principle

Year 1: Dell sells $100,000 of laptops with a 2-year warranty	Year 2: Some customers use warranties costing Dell $5,000.
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● Estimated Warranty Payable is similar to the _________________ method for the AR Allowance for Bad Debts.

Drones International sells drones with a one-year warranty. Based on past experience, Drones expects warranty costs to equal approximately 4% of sales. During December, Drones International had $2,000,000 in sales.

Journal Entry:

Assets	=	Liabilities	+	Equity

In January, customers exercised warranties for replacement products at a cost to Drones International of $6,000.

Journal Entry:

PRACTICE: ECB Company recently released a new product to compete with the product of TLR Company. ECB's product carries a two-year warranty against any manufacturing defects. Based on previous market experience, ECB estimates warranty costs to equal 2% of sales. At the end of the first year on the market, total sales equaled $15 million and actual warranty costs totaled $100,000. What amount (if any) should ECB report as a liability related to this data at year-end?

a) $0
b) $100,000
c) $200,000
d) $300,000
e) $400,000

PRACTICE: The American Tire Company provides a warranty for its tire sales that cover manufacturing defects for three years or 50,000 miles, whichever comes first. ATC estimates that warranty costs during the warranty period will equal 5% of sales. During the current year, ATC made sales of $337,000. ATC received cash equal to 35% of sales and accounts receivable for the remainder. Payments to satisfy warranty claims during the year totaled $9,700. If the beginning balance in estimated warranty payable was $7,000, what would be the final balance in the estimated warranty payable?

a) $5,898
b) $9,700
c) $14,150
d) $16,700
e) $16,850