

Chapter 9: Liabilities

Accounting for Current & Contingent Liabilities

- Current liabilities:
 - Known amounts
 - Estimated amounts

Liabilities if Known Amount

- Are:
 - Accounts payable
 - Short term notes payable
 - Sales tax payable
 - Accrued liabilities
 - Payroll liability
 - Unearned revenue
 - Current portion of long term debt
- Accounts payable - amounts owed for products/ services purchased on account
- Accounts payable turnover - number of times a year a company is able to pay its accounts payable
 - Turnover = cost of goods sold / average accounts payable
 - Turnover in days = 365/ TO
 - High turnover rate (short period of days) is better than low turnover ratios
 - Shorter payment periods have better credit
 - Some with strong credit withhold payments to conserve cash
- Short term notes payable - due in 1 year
- Sales tax payable - retailers collect tax then pay the government

Cash ($\$200,000 \times 1.05$)	210,000	
Sales Revenue		200,000
Sales Tax Payable ($\$200,000 \times 0.05$)		10,000
<i>To record cash sales and the related sales tax.</i>		

- Accrued liability - expense not yet paid
 - Wages/ salaries payable, interest payable, income tax payable
- Payroll liabilities
 - Salary - stated at monthly/ yearly expense
 - Wage - pay stated at hourly rate
 - Bonus - amount over regular compensation

Salary Expense	10,000	
Employee Income Tax Payable		1,200
FICA Tax Payable		800
Salary Payable to Employees (take-home pay)		8,000
<i>To record salary expense.</i>		

- Salary expense is gross pay (pay before subtractions_
- Salary expense creates payroll liabilities
 - Employee income tax payable- income tax withheld from paychecks
 - FICA tax payable - social security & medicare
 - Salary payable - take home pay
 - Maybe: employer payroll taxes for employee benefits
- Unearned revenue - revenue collected in advance

2012			
Dec 15	Cash	300	
	Air traffic liability		300
	<i>Received cash in advance for ticket sales.</i>		

2012			
Dec 28	Air traffic liability	150	
	Ticket Revenue (\$300 × 1/2)		150
	<i>Earned revenue that was collected in advance.</i>		

2013			
Jan 4	Air traffic liability	150	
	Ticket Revenue (\$300 × 1/2)		150
	<i>Earned revenue that was collected in advance.</i>		

- Current portion of long term debt - amount of principal due in year

Current Liabilities that must be estimated

- Estimated warranty payable
 - Expense recognition says record warranty expense in same period that business records sales revenue

	Warranty Expense	3,000	
	Estimated Warranty Payable		3,000
	<i>To accrue warranty expense.</i>		

	Estimated Warranty Payable	2,800	
	Inventory		2,800
	<i>To replace defective products sold under warranty.</i>		

Estimated Warranty Payable	
2,800	3,000
	Bal 200

- Estimated warranty payable of 200 will be a current liability

Contingent Liabilities

- **Contingent liability** - potential liability that depend on future outcome of past event
 - Future obligations because of lawsuits, tax disputes, violations of environmental protection laws
- Ways to account for contingent liabilities
 - Accrue (in journal entry) if its probable that loss will occur and amount can be reasonably estimated
 - Disclose in financial statement if its possible (less likely) loss will occur
 - Ex: lawsuit in progress
- No need to report contingent loss that is not likely to occur

Are all Liabilities reported on Balance sheet?

- If you fail to accrue interest on liability, you overstate net income

Accounting, Inc. Balance Sheet December 31, 2012			
Assets		Liabilities	
Current Assets:		Current liabilities:	
Cash		Accounts payable	
Short-term investments		Salary payable*	
Etc.		Interest payable*	
		Income tax payable*	
Property, plant, and equipment:		Unearned revenue	
Land		Estimated warranty payable*	
Etc.		Notes payable, short-term	
		Current portion of long-term debt	
Other assets		Total current liabilities	
		Long-term liabilities	
		Stockholders' Equity	
		Common stock	
		Retained earnings	
		Total liabilities and	
Total assets	\$XXX	stockholders' equity	\$XXX

Account for Bonds Payable, Notes Payable, & Interest Expense.

- Bonds payable - groups of notes payable issued to multiple lenders (bondholders)

Bonds

- Bonds payable are debts to issuing company
- Certificate states
 - Principal/ par value / face value
 - Interest rates
 - Dates of interest payments
- Types of bonds
 - Term bond - bonds mature at same time
 - Serial bond - pay installments over period of time
 - Debentures - unsecured bonds; backed only by faith of borrower
 - Higher interest rate; riskier
- Bond price
 - Quotes at percentage of maturity value
 - \$1000 at 100 is bought/sold at \$1000
 - \$1,000 quotes at 101.5 has price of \$1,015
- Bond premium & bond discount
 - **Premium** - bond issues at price above face value
 - Has credit balance
 - **Discount** - bond issued at price below face value
 - Has debit balance
 - Bond discount is a contra liability account