Chapter 13: Current Liabilities and Contingencies

Defined by SFAC No. 6 as:
Probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

Liabilities

Liabilities Definite in Amount
- Record liability at face amount (理論上所有負債不論長期短期均應以現值評價)
- Classify as short- or long-term based on when debt will be repaid (到期日之長短)
- Short-term debt to be refinanced can be classified as long-term if:
  - management intends to refinance on a long-term basis.
  - management can demonstrate an ability to refinance.

What is a Current Liability?

Probable future sacrifices or economic benefits... Arising from present obligations to other entities...
...Resulting from past transactions or events.

Current Liabilities
- Expected to be satisfied with current assets or by the creation of other current liabilities.
- Usually recorded at maturity amounts.

Long-term Liabilities

Current liability
- Obligations whose maturity is within one year or the operating cycle whichever is longer
- whose liquidation is reasonably expected to require the use of existing resources classified as current assets, or the creation of other current liabilities.
- 一：30. 經營週期長於一年者，得改以一個營業週期作爲劃分流動及非流動之標準...

Operating Cycle

1. 負債之確列（發現其存在及確認記錄之時點）。
2. 負債及相關資產或費用之衡量及存在期間之評價。
3. 負債在財務報表及其附註中之表達。
Current Liabilities

Current liabilities are:
- obligations whose liquidation is reasonably expected to require the use of current assets or the creation of other current liabilities
- The following slides discuss select current liabilities

2. Notes Payable

- Notes payable may be interest-bearing or non-interest-bearing
- For non-interest-bearing notes, the difference between the present value of the note and the face value of the note represents the discount on the note payable.
- The discount is the interest expense chargeable to future periods

Current Liabilities

Valuation in Theory
- Interest element of the time value of money should theoretically be taken out of the amount due
- Amount should be recorded at the present value of the assets or services that must be given up to satisfy the obligation

Valuation in Practice
- Interest element is generally immaterial & ignored
- Value at the amount of future payments
- Exception: firms with long operating cycles

Categories of Current Liabilities

Determinable current liabilities
- Known to exist with certainty, or can be reasonable estimated

Current liabilities that are dependent on operating results
- Cannot be known with certainty until the end of the accounting period

Contingencies
- Uncertain existing conditions, situations, etc. will be resolved by future events

1. Accounts Payable

- Obligations arising from the company's ongoing operations
  - includes the acquisition of inventory, supplies, materials and services.
- Commonly called trade payables
- Other current payables should be reported separately.

Current Liabilities Having A Contractual Amount

Trishan Corporation uses a perpetual inventory system and purchases merchandise for $7,000 on September 1, 2001 by issuing a $7,000, 12%, 30-day note to the supplier.

September 1, 2001
Inventory 7,000
Notes Payable 7,000

October 1, 2001
Interest Expense ($7,000 x 0.12 x 30/360) 70
Notes Payable 7,000
Cash 7,070

Continued

Current Liabilities Having A Contractual Amount

On December 1, 2000, the Trolleringwood Corporation borrows money at First National Bank by issuing a $10,000, 90 -day, non-interest-bearing note that is discounted on a 12% basis.

December 1, 2000
Cash 9,700
Discount on Notes Payable 300
Notes Payable 10,000

Current Liabilities Having A Contractual Amount

December 31, 2000
Interest Expense 100
Discount on Notes Payable 100

March 1, 2001
Interest Expense 200
Discount on Notes Payable 200
Notes Payable 10,000
Cash 10,000
Short-Term Notes Payable

Interest-Bearing

• The rate of interest is specified and is called the stated rate.
• The debtor (or borrower) receives cash, other assets, or services.
• The debtor repays the face amount of the note plus interest at the stated rate.

Example

On May 1, 19X9, Batter-Up, Inc. issued a one-year, noninterest-bearing note with a face amount of $10,000 in exchange for equipment valued at $9,434.

What is the implicit interest rate on the note?

From the Present Value table, we find that a PV factor of .9434 for 1 period represents an interest rate of 6%.

Interest-Bearing Notes

Example

On September 1, Eagle Boats borrows $80,000 from Cooke Bank. The note is due in 180 days and has a stated interest rate of 9%. Record the borrowing on September 1.

General Journal

Date Description PR Debit Credit
1-Sep Cash 80,000 Notes Payable 80,000
to record receipt of short-term loan proceeds from Cooke Bank

Current Maturities of Long Term Debt

The portion of long term debt maturing within the next fiscal year is reported as a current liability. Long-term debts should not be reported as current liabilities if:

• they are retired by assets not classified as current assets,
• they are refinanced by new issues of debt,
• they are converted into capital stock.

Current Maturities of Long Term Debt

(一年內到期之長期負債)

• The portion of long-term debt that matures within the next fiscal year is reported as a current liability, unless
  – it is retired by assets that properly have been shown as noncurrent assets,
  – it is to be refinanced by a new long-term debt or by conversion into stock.

Short Term Obligations Expected to be Refinanced

Short term debt must be excluded from current liabilities if:

• it is to be refinanced on a long term basis, and
• the entity demonstrates the ability to complete the refinancing.

If the entity has the ability to refinance if:

• the debt is actually refinanced before issue of the financial statements, or
• the entity enters into a refinancing agreement.
Short-Term Debt Expected to be Refinanced

When a company relies on a financing agreement to demonstrate the ability to refinance, the amount of the short-term debt that it excludes from current liabilities is reduced to an amount that is the lesser of...

Refinancing Agreement Criteria

SFAS No. 6 requires:
The agreement must be noncancelable by all parties and must extend beyond one year.

• The company must not be in violation of the agreement on the balance sheet or the issue date.
• The lender must be financially capable of honoring the agreement.

Dividend Payable (應付股利)

• At the date of declaration of a cash dividend, the corporation assumes a liability.
• Accumulated but undeclared dividends on cumulative preferred stock are not a liability.
• Stock dividends are part of stockholders’ equity, not a liability.

Determinable Current Liabilities

• Customer Prepayments and Deposits
  – Prepayments
    • Recorded as unearned revenue (liability) until the goods or services have been transferred to the buyer
  – Deposits
    • Treated as liabilities until the goods are returned
    • If it is determined that the goods will not be returned, record as revenue

Advances recorded as unearned revenue, recognized when goods or services are provided

When earned

Unearned Revenue

Revenue

Deposits recorded as liabilities, liability removed if deposit forfeited

When forfeited

Cash, Etc.
Sales and Use Taxes

The Sales Tax is Included in the Price Charged to the Customer

Cash 53,000
Sales 53,000

At the end of January the Sales account is adjusted to record the tax on all goods sold \([53,000 - (53,000 \div 1.06)] = 3,000\).

Sales 3,000
Sales Taxes Payable 3,000

Sales and Use Taxes

Typical Situation

Selleroy Company sells merchandise for cash with a retail sales price of $50,000 on which a sales tax of 6% is levied. The company collects $53,000.

Cash 53,000
Sales 50,000
Sales Taxes Payable 3,000

Property Taxes

Ezzell Company closes its books annually each December 31. The fiscal year for the town and county in which the firm is located ends on June 30. The estimated property taxes for the period July 1, 2001 to June 30, 2002 are $7,200. The tax bill is mailed in October with a requirement that the tax be paid before December 31, 2001. The tax bill reported an actual tax of $7,290, and the corporation pays this amount on October 31, 2001.
9. Property Taxes

Three Monthly Entries July 31-September 30, 2001

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Property Tax Expense</td>
<td>600</td>
</tr>
<tr>
<td>Property Taxes Payable</td>
<td>600</td>
</tr>
</tbody>
</table>

October 31, 2001: Payment of Property Taxes

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Property Tax Payable</td>
<td>7,200</td>
</tr>
<tr>
<td>Cash</td>
<td>7,290</td>
</tr>
</tbody>
</table>

Three Monthly Entries: October 31-December 30, 2001

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Property Tax Expense</td>
<td>610</td>
</tr>
<tr>
<td>Prepaid Property Taxes</td>
<td>610</td>
</tr>
</tbody>
</table>

10. Current Liabilities Dependent on Operating Results

- Income Taxes Payable
  - Usually paid in advance in quarterly installments
  - Any deficiency in the total estimated payments at the end of the year is recorded as a current liability

Employee Payroll Deductions

- Payroll deductions are taxes and miscellaneous deductions
  - Taxes are:
    - Social security tax (6.2% on a maximum of $76,200 of wages)
    - Medicare tax (1.45% on all wages)
    - Income tax withholding at a predetermined rate
  - Miscellaneous (employee) deductions are:
    - Insurance, union dues, and other discretionary deductions

Employee Payroll Taxes

- Employer payroll taxes are (matching) FICA tax and unemployment tax
- Employer matches each employee’s FICA tax (social security and medicare taxes)
- Employer also pays unemployment tax (FUTA) at 6.2% on the first $7,000 of wages of each employee.

Employer and Employee Payroll liabilities: Example

- Given:
  - Employee’s gross earnings: $10,000
  - FICA Tax (7.65%): $765
  - Income Tax withheld: $1,320
  - FUTA (state): 5.4% on $7,000: $378
  - FUTA (federal): 0.8% on $7,000: $56

- Provide journal entries for employee’s payroll deductions and for employer’s payroll tax expense

Employee Related Liabilities

- Employee-related liabilities are the following:
  - Salaries or wages owed to employees at end of the accounting period
  - Payroll deductions
  - Compensated absences
  - Bonuses

- Employee’s payroll deductions:
  - Wages and salaries expense: $10,000
  - FICA Payable: $765
  - FIT Payable: $1,320
  - Cash: $7,915

- Employee’s payroll tax expense:
  - Payroll tax expense: $1,199
  - FICA Payable (matching): $765
  - FUTA Payable (federal): $56
  - FUTA Payable (state): $378
**Payroll Taxes - Employee Example**

Batter-Up, Inc. has 5 employees. Each employee receives a salary of $1,000 per week. The Federal Insurance Contributions Act (FICA, i.e., social security tax) rate is 7.65% and income tax is withheld at the rate of 20%.

Prepare the journal entry to record the payroll for Batter-Up for the week ending June 14, 19X9.

**GENERAL JOURNAL**

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>PR Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>14-Jun</td>
<td>Salary Expense</td>
<td>5,000.00</td>
<td></td>
</tr>
<tr>
<td></td>
<td>FIT Withholding Payable</td>
<td>1,000.00</td>
<td></td>
</tr>
<tr>
<td></td>
<td>FICA Tax Payable</td>
<td>382.50</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>3,617.50</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** The expense to the company is $5,000 while the actual payment to the employees is $3,617.50.

**Payroll Taxes - Employee Example**

Prepare Batter-Up’s journal entry for all of their taxes related to the June 16 payroll.

**GENERAL JOURNAL**

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>PR Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>14-Jun</td>
<td>Payroll Tax Expense</td>
<td>632.50</td>
<td></td>
</tr>
<tr>
<td></td>
<td>FUTA Payable</td>
<td>50.00</td>
<td></td>
</tr>
<tr>
<td></td>
<td>SUTA Payable</td>
<td>200.00</td>
<td></td>
</tr>
<tr>
<td></td>
<td>FICA Payable, employer</td>
<td>382.50</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** The employer matches the FICA that was withheld from the employees’ paychecks. In effect, the total FICA tax rate is 15.3%; half is paid by the employee (7.65%) and half is paid by the employer (7.65%).

**Determinable Current Liabilities**

- Accrued Liabilities: obligations that have been incurred but not paid
  - Rent payable
  - Salaries and wages payable
  - Payroll taxes payable
    - Employer’s share of FICA
    - Unemployment taxes (FUTA and SUTA)
    - Compensated employee absences
    - Property taxes

**Employee Compensated Absences**

Compensated absences are absences from employment for which employees are paid.

- A liability for such absences must be accrued if:
  - the employer’s liability relates to services already rendered by employees,
  - the liability relates to employee’s vested or accumulated rights of employee,
  - payment of the compensation is probable, and
  - the amount can be reasonably estimated.

- The liability is recognized in the year earned by employees.
Compensated Absences

Occurs when unused vacation time is carried over to future years. Employer must accrue a liability when all 4 conditions are met; disclose if only the first 3 conditions are met:
- Obligation is attributable to services already rendered by employees
- Obligation relates to rights that either:
  - Vest (payment is not contingent on future service), or
  - Accumulate (unused rights can be carried to future periods)
- Payment is probable
- The amount of compensation is reasonable estimable

Compensation assumptions

For 1997
10 new employees paid $100 per day
Each employee earns 2 weeks of vacation after first full year
Each employee earns 5 vested sick days beginning after first full year
For 1998
Rate changes to $120 per day
All ten employees take 2-week vacations
30 sick days used

Compensated absences entries

December 31, 1997
Wage & Salary Expense 15,000
  Vacation Pay Payable 10,000
  Sick Pay Payable 5,000
During year 1998
Vacation Pay Payable 10,000
Sick Pay Payable 3,000
Wage & Salary Expense 2,600
Cash, Etc. 15,600

Compensated absences entries

December 31, 1998
Wage & Salary Expense 18,000
  Vacation Pay Payable 12,000
  Sick Pay Payable 6,000

Compensated Absences

Milton Company has 100 employees who are paid an average of $100 per day. Company policy allows each employee 12 days of paid vacation per year. Assume no vacation days were taken.

March 31, 2001
Sales Salaries Exp. Compensated Absences 15,000
Office Salaries Exp. Compensated Absences 15,000
Liability for Employees' Compensation for Future Absences (3/12 x $120,000) 30,000

Compensated Absences

The $200,000 April 30, 2001 payroll, including paid vacation time taken by the sales and office staff, is as follows:

Payroll for

<table>
<thead>
<tr>
<th>Time Worked</th>
<th>Vacation Taken</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales staff</td>
<td>$97,000 $3,000</td>
</tr>
<tr>
<td>Office staff</td>
<td>96,500  3,500</td>
</tr>
</tbody>
</table>

Continued

Compensated Absences

April 30, 2001
Sales Salaries Expense 97,000
Office Salaries Expense 96,500
Liability for Employees' Compensation for Future Absences Cash 6,500 200,000

Current Liabilities Dependent on Operating Results

- Bonuses Payable
  - Additional compensation to employees based on the results of operations
  - Can be based on income in several ways
    - Income before bonus expense and before income taxes
    - Income after bonus expense but before taxes
    - Income after income taxes but before deduction of bonus expense
    - Income after bonus expense and after income taxes
  - Complicated by the fact that bonuses are tax deductible
### Bonuses Based on Income

- **Percentage of net income before the bonus**
  - Multiply the net income before the bonus by the bonus percentage.
- **Percentage of net income after the bonus**
  - Algebraically expressed:

  \[
  \text{Bonus} = \% \times (\text{Net Income} - \text{Bonus})
  \]

### Bonus Obligations

- **Method 1**: Bonus computed on income after deducting taxes but before deducting the bonus:
  \[
  \text{B} = 0.10(\$260,000 - \text{T})
  \]
  \[
  \text{T} = 0.30(\$260,000 - \text{B})
  \]
  \[
  \text{B} = 0.10(\$260,000 - 0.30(\$260,000 - \text{B}))
  \]
  \[
  \text{B} = 0.10(\$260,000 - 0.30 \times 0.78000 - 0.030 \times \text{B})
  \]
  \[
  \text{B} = 0.10(\$260,000 - 0.78000 - 0.030 \times \text{B})
  \]
  \[
  0.97B = 0.10(\$260,000 - 0.78000)
  \]
  \[
  B = \frac{0.10(\$260,000 - 0.78000)}{0.97}
  \]
  \[
  B = \$18,763 \text{ (rounded)}
  \]

- **Method 2**: Bonus computed on income after deducting both taxes and the bonus:
  \[
  \text{B} = 0.10(\$260,000 - \text{B} - \text{T})
  \]
  \[
  \text{T} = 0.30(\$260,000 - \text{B})
  \]
  \[
  \text{B} = 0.10(\$260,000 - \text{B} - 0.30(\$260,000 - \text{B}))
  \]
  \[
  \text{B} = 0.10(\$260,000 - \text{B} - 0.30 \times 0.78000 + 0.030 \times \text{B})
  \]
  \[
  \text{B} = 0.10(\$260,000 - \text{B} - 0.78000 + 0.030 \times \text{B})
  \]
  \[
  \text{B} + 0.10\text{B} - 0.030\text{B} = 0.10(\$260,000 - 0.78000)
  \]
  \[
  1.07\text{B} = 0.10(\$260,000 - 0.78000)
  \]
  \[
  \text{B} = \frac{0.10(\$260,000 - 0.78000)}{1.07}
  \]
  \[
  \text{B} = \$17,009 \text{ (rounded)}
  \]

### Bonus and profit sharing plans

- **Bonus accrual entry**
  
  \[
  \begin{align*}
  \text{Bonus Expense} & \quad XXX \\
  \text{Bonus Payable} & \quad XXX
  \end{align*}
  \]

- **Bonus payment entry**
  
  \[
  \begin{align*}
  \text{Bonus Payable} & \quad XXX \\
  \text{Cash} & \quad XXX
  \end{align*}
  \]

### Bonus Obligations Example

Linda Ball, Batter-Up’s CEO, Inc. gets a year-end bonus of 15% of net income after deducting her bonus. 19X9 Net income is $250,000. Compute Linda’s bonus for 19X9.

\[
\text{Bonus} = \text{Bonus \%} \times (\text{Net Income} - \text{Bonus})
\]
\[
\text{Bonus} = 15\% \times (\$250,000 - \text{Bonus})
\]
\[
\text{Bonus} = \$37,500 - (0.15 \times \text{Bonus})
\]

\[
1.15\text{Bonus} = \$37,500
\]
\[
\text{Bonus} = \frac{\$37,500}{1.15}
\]
\[
\text{Bonus} = \$32,608.70
\]
Part 2: Contingencies

Contingency

An existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur. (SFAS No. 5)

Contingency: Definition

- A contingency is:
  - an existing condition, situation, or set of circumstances
  - involving uncertainty as to possible gain (gain contingency) or loss (loss contingency)
  - that will ultimately be resolved when one or more future events occur or when such event or events fail to occur

Subsequent Events

Events occurring between the year-end date and the date the report is issued can affect how the disclosures appear on the financial statements.

Gain Contingencies

- Accounting treatment based on conservatism
- Gain Contingencies
  - Possibility of a future gain; increase in an asset or decrease in a liability
  - Never accrued
  - May be disclosed if probable and material in amount

Gain Contingencies (或有利得)

- 18.或有利得無論金額能否合理估計，如屬很有可能產生利得者，應於資產負債表中揭露，…；如屬有可能產生利得者，得於資產負債表中揭露，…：如屬極少可能產生利得者，不得於財務報表中揭露。

Contingencies (或有事項)

- 財務會計準則公報第九號
- 3.或有事項係指資產負債表日以前既存之事實或狀況，可能已對企業產生利得或損失，惟其確切結果，有賴於未來未確定事件之發生或不發生以證實現者。上述利得或損失，在未證實其確切結果前稱為「或有利得」或「或有損失」。
Loss Contingencies

• Accrue and disclose if it is
  – Probable that a loss exists (an asset has
    been impaired or a liability has been incurred)
    at the balance sheet date, AND
  – The amount can be reasonably estimated

• If the estimate is a range, and no one
  amount is more likely than another,
  accrue the minimum and disclose the
  upper limit

Loss Contingencies

• Disclose (no accrual) if it is reasonably
  possible that the loss will occur

• Do nothing if there is a remote chance of
  the loss occurring, except that guarantees
  should be disclosed
  – General or unspecified business risks are
    also not disclosed
  – Strikes; wars; recessions

Loss Contingencies: General

• Loss contingencies involve situations of
  possible loss.
• A liability incurred as a result of a loss
  contingency is a contingent liability.
• The likelihood of occurrence of the event may
  be:
  a remote (slight)
  ∆ reasonably possible (more than remote but less than
  likely)
  ¶ probable (likely)

Loss Contingencies (或有損失)

• 15.凡或有損失同時符合下列兩種情況者，
  應認列其損失：
  (1)相關事項之發展很有可能確定在資產負
  債表日資產已經受損或負債已經發生者。
  (2)損失金額（應扣除可獲補償之金額）得以
  合理估計者。

• 16.凡或有損失符合下列情況之一者，應於
  財務報表中揭露其性質，並估計損失之金
  額或上下限，如無法合理估計損失金額，
  應說明無法合理估計之事實。
  (1)符合第15段第(1)項，而不符合第(2)項者：
  (2)相關事項之發展有可能確定在資產負債
  表日資產已經受損或負債已經發生者。

• 17.凡或有損失，其相關事項之發展極少可
  能確定在資產負債表日資產已經受損或負
  債已經發生者，得於財務報表中揭露其存
  在及性質，以及估計損失金額之確數或上
  下限。
Loss Contingencies: Accrual

- Estimated losses from loss contingencies are accrued as liabilities if:
  - it is probable that a liability has been incurred, and
  - the amount of loss can be reasonably estimated
- It is not necessary that the exact payee or the exact date of payment need be known.
- The interpretation of the three terms (probable to remote) is based on lawyers’ responses.

Contingent Liabilities

<table>
<thead>
<tr>
<th>Likelihood</th>
<th>Definition</th>
<th>Accounting Treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Probable</td>
<td>Future event is likely to occur</td>
<td>Record liability if estimable</td>
</tr>
<tr>
<td>Reasonably Possible</td>
<td>More likely than remote but less likely than probable</td>
<td>Disclose liability in footnotes</td>
</tr>
<tr>
<td>Remote</td>
<td>Future event is not likely to occur</td>
<td>No disclosure except regarding guarantees</td>
</tr>
</tbody>
</table>

Litigation, Claims, and Assessments

- To determine whether a liability should be recorded, evaluate:
  - the time period in which the underlying cause of action occurred
  - the probability of an unfavorable outcome
  - the ability to make a reasonable estimate of loss
- To determine the probability of outcome, evaluate:
  - nature of litigation and progress of case
  - opinion of legal counsel
  - response by management

Factors for determining probability

- The nature of the litigation
- Progress of the case
- Opinions of management, counsel, etc.
- Previous experience
- Footnote disclosure is most common

Examples of Loss Contingencies

- Guarantee and product warranties
  - Generally estimated and accrued based upon past experience
  - DR to estimated warranty expense and CR to estimated liability for warranties
- Premiums and coupons
  - Estimated and accrued based upon expected redemption rate
  - DR to premium expense and CR to estimated premium obligation

Loss Contingencies: Litigation, Claims, and Assessments

- Accrue if:
  - The cause for action occurs by the date of the financial statements
  - Information available before the issuance of the statements indicates it is probable that a loss has occurred as of the date of the statements, AND
  - It is possible to make a reasonable estimate of the amount

Loss Contingencies: Litigation, Claims, and Assessments

- Footnote disclosure is most common
  - Estimates of losses are difficult to determine
  - Publication of specific estimates could be harmful to the company’s position
Warranty
A promise by a manufacturer or seller to ensure the quality or performance of the product for a specific period of time.

Almost Honest
JOHN’S Used Cars

I’ll stand behind it for 50 miles or 50 minutes whichever comes first

Product Warranties and Guarantees
- Product warranties inevitably entail costs.
- The amount of those costs can be reasonably estimated.
- The estimate requires:

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Warranty Expense</td>
<td>$$$</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Estimated Warranty Liability</td>
<td>$$$</td>
<td></td>
</tr>
</tbody>
</table>

Extended Warranties
- Extended warranties are sold separately from the product.
- The related revenue is not earned until
  - Claims are made against the extended warranty, or
  - The extended warranty period expires.

Guarantee and Warranty Costs
- Cash basis (現金基礎): warranty costs are charged to the period in which the seller complies with the warranty.
  - It is not probable that a liability has been incurred, or
  - The amount of the liability cannot be reasonably estimated.
  - Used when costs are immaterial or when warranty period is less than one year.
  - Required for income tax purposes.
- Accrual basis (應計基礎)
  - It is used when the warranty is an integral and inseparable part of the product sale,
  - It requires warranty costs to be charged to operating expense in the year of sale of the product.
  - It requires that revenues from the sale of the warranty be deferred and subsequently recognized as income over the life of the warranty contract.

Guarantee and Warranty Costs: Example
- A units sold in 2000: 10,000 units at $300
- A expected return rate for repair: 3%
- A expected repair cost per unit: parts, $5; labor, $10
- A units returned in 2001: 170 units.
- A Actual repair costs: same as estimated

Entry in 2000
- Estimated warranty costs: 3% of 10,000 units at $15 each = $4,500
- Adjusting journal entry (Dec 31, 2000):
  - Warranty Expense $4,500
  - Estimated Liability under Warranties $4,500
- Entry in 2001: (170 units at 15 each)
  - Estimated Liability (warranties) $2,550
  - Parts Inventory $850
  - Wages Payable $1,700

Manufacturer’s Warranties
- Estimated warranty costs:
  - 3% of 10,000 units at $15 each = $4,500
- Adjusting journal entry (Dec 31, 2000):
  - Warranty Expense $4,500
  - Estimated Liability under Warranties $4,500
- Entry in 2001: (170 units at 15 each)
  - Estimated Liability (warranties) $2,550
  - Parts Inventory $850
  - Wages Payable $1,700
Extended Warranties: Example

- Refer to the previous example.
- Assume that the seller sold extended warranties on the 4,000 units as follows:
  - $30 per unit for years 2002 and 2003.
  - Record the sale in 2000 and show recognition of warranty revenue in 2002.

Journal entry in 2000:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$3,120,000</td>
</tr>
<tr>
<td>Sales Revenue</td>
<td>$3,000,000</td>
</tr>
<tr>
<td>Unearned Warranty Revenue</td>
<td>$120,000</td>
</tr>
</tbody>
</table>

Journal entry in 2002 (relating to year 2000 sales):

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unearned Warranty Revenue</td>
<td>$60,000</td>
</tr>
<tr>
<td>Warranty Revenue</td>
<td>$60,000</td>
</tr>
<tr>
<td>(1/2 of deferred revenue now recognized)</td>
<td></td>
</tr>
</tbody>
</table>

Warranty Obligations

Sales Warranty Accrual Method

Anglee Machinery Corporation sells 200 machines for $6,000. This amount includes a service contract sale of $150 and a machine sale of $5,850.

Cash or Accounts Receivable: 1,200,000
Sales ($5,850 x 200): 1,170,000
Unearned Warranty Revenue: 30,000

Extended Warranties: Example

Journal entry in 2000:

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Journal entry in 2002 (relating to year 2000 sales):

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</tr>
<tr>
<td>Warranty Revenue</td>
<td>$60,000</td>
</tr>
<tr>
<td>(1/2 of deferred revenue now recognized)</td>
<td></td>
</tr>
</tbody>
</table>

Warranty Obligations

Expense Warranty Accrual Method

Anglee Machinery Corporation begins production on a new machine in April 2001 and sells 200 of these machines at $6,000 each by December 31, 2001.

Cash or Accounts Receivable: 1,200,000
Sales: 1,200,000

Warranty cost per machine is estimated at $150.

Warranty Expense: 30,000
Estimated Liability under Warranties: 30,000

Warranty Obligations

The corporation spent $5,000 in 2001 to fulfill warranty agreements for the 200 machines.

Estimated Liability under Warranties: 5,000
Cash (or other assets): 5,000

The corporation spent $25,150 in 2002 to fulfill warranty agreements for the two machines.

Estimated Liability under Warranties: 25,000
Warranty Expense: 150
Cash (or other assets): 25,150

Premiums

- Premiums included with the product are expensed in the period of sale.
- Premiums that are contingent on action by the customer require accounting similar to warranties.
 Accounting for premiums and coupons

- Purpose of offers is to increase sales
- Costs should be matched with revenues
- Future redemptions are probable and can be estimated
- May have an inventory of premium items
- Beware of postage, handling and other costs

Premium assumptions
Sunburst Orange Juice Company

- A knife for $.50 and two can labels
- Knives cost $.60 each
- Postage costs $.30 each
- Anticipated redemption rate 40 percent
- 50,000 cans of juice sold for $1.10 each
- 10,000 knives purchased
- 16,000 labels redeemed in first year
- 4,000 more redemptions expected

Environmental Liabilities

- Environmental liabilities represent estimated costs to clean-up waste and toxic sites.
- Currently, companies provide only disclosures without accruing any liabilities: they argue that best estimates are not feasible.
- The SEC argues that the companies must accrue the minimum expected cost (absent a best estimate).
- Environmental liabilities must be reported in the balance sheet independent of recoveries from third parties.

Entries for Sunburst Orange Juice

Sale of orange juice
Cash  55,000
Sales  55,000

Purchase of knives
Inventory of knives  6,000
Cash  6,000

Entries for Sunburst Orange Juice

Redemption of 16,000 can labels
Cash  1,600
Premium Expense  3,200
Inventory of Knives  4,800

Liability for premium offers outstanding
Premium Expense  800
Est. Premium Liability  800

自我保險

1. 自我保險即無保險，損害實際發生前，不應認列估計可能發生之損害與負債。
2. 若於結帳日，已對第三人或其財產造成傷害，則符合或有事項之定義，可依其金額是否可合理性決定認列損失與負債，或僅作揭露。
3. 預期對第三人或其財產可能造成之損害，仍不應入帳。

流動負債在資產負債表之表達

1. 通常按到期值列示其金額（APB No. 21，正常營業產生之應收、應付款，其到期日不逾一年者，免按現值評估）
2. 可按到期日先後金額大小，或其他因素排列先後順序，惟應一貫採行。
3. 流動負債之抵（質）押品、展期約定等應適當揭露。
4. 注意一年內到期之長期負債是否應轉列流動負債。
5. 可再融資之短期負債充分揭露其情況。
6. 或有事項應揭露其性質，可能金額或其上下限，並無法估計金額之原因。
Review of current ratio and quick ratio

- Current ratio

  Current assets
  Current liabilities

- Quick ratio

  Current assets - Inventories - Prepaid items
  Current liabilities

End of Chapter 13

You said that I will owe you $1,000,000 if I miss the next putt.

So does that mean I have to disclose a contingent loss on my personal financial statement?