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CONCEPT: TYPES OF LIABILITIES

● ***Current Liabilities*** are payable within ____________

□ ***Accounts Payable*** – amounts owed to ______________ of services or merchandise

- Accounts payable occur when the company purchases something on credit (day-to-day operations)

□ ***Accrued Expenses*** – liabilities that arise from ___________________ for benefits received

- The expense has occurred before the cash has been paid
- The most common accrued expenses are: Salaries/Wages Payable, Interest Payable, and Taxes Payable

□ ***Unearned Revenues*** – liabilities to deliver goods or services to customers who have paid __________________

- Unearned Revenues are also called *Deferred Revenues* and *Customer Deposits*

□ ***Payroll Liabilities*** – includes several types of liabilities related to paying employees

- Along with Salaries and Wages paid to employees, the employer also is liable for employment taxes

□ ***Current Maturities of Long Term Debt*** – upcoming ______________ payments of a long-term liability

● ***Long-term Liabilities*** are payable in more than ____________.

□ ***Notes Payable*** – a signed contract to repay a borrowed sum of money including ______________

- Notes Payable can be Current Liabilities or Long-Term Liabilities
- Notes Payable are the exact opposite of Notes Receivable

□ ***Bonds Payable*** – groups of debt that are issued to _____________ lenders

- Bonds are used to raise large sums of money that might be difficult to borrow from one source

CONCEPT: NOTES PAYABLE

● A ***note payable*** is similar to AP, except that it is supported by a ____________________ contract

☐ Different from AP, notes payable have a ___________________ and earn _____________

☐ ***Principal*** – the amount of money loaned (or borrowed)

☐ ***Interest*** – the cost of borrowing the principal

- Interest is calculated using the following basic formula:

$$Interest = Face\ Value\ of\ Note * Annual\ Interest\ Rate * (Time\ Factor)$$

● A note payable is **acquired** from a bank:

On October 1, Year 1, The Goods Company signed a $100,000, 12%, eight-month note payable maturing on May 1, Year 2.

Journal Entry:

Assets	=	Liabilities	+	Equity

● Interest **accrues** over the life of the note:

☐ Short-term Notes: The total amount of interest is paid at maturity

- Interest Expense is accrued to the Interest Payable until maturity

On October 1, Year 1, The Goods Company signed a $100,000, 12%, eight-month note payable maturing on June 1, Year 2. Prepare the adjusting entry to accrue interest on December 31, Year 1.

Journal Entry:

Assets	=	Liabilities	+	Equity

□ Long-term Notes: Interest is paid to the bank periodically, reducing the interest payable liability

- Interest Expense is accrued to Interest Payable until the interest payment date

On October 1, Year 1, The Goods Company signed a $100,000, 12%, ten-year note maturing on October 1, Year 11. Interest is payable annually on October 1. Prepare the adjusting entry on December 31, Year 1 and the journal entry on October 1, Year 2 for the payment of interest.

December 31, Year 1 Journal Entry:

October 1, Year 2 Journal Entry:

● Upon **maturity**, the principal and any unpaid interest are due.

□ Short-term Notes: The total amount of interest is paid at maturity

On October 1, Year 1, The Goods Company signed a $100,000, 12%, eight-month note payable maturing on June 1, Year 2. Prepare the entry to repay the note payable and all accrued interest on June 1, Year 2.

Journal Entry:

□ Long-term notes, interest is paid to the bank periodically, reducing the interest payable liability

On October 1, Year 1, The Goods Company signed a $100,000, 12%, ten-year note maturing on October 1, Year 11. Interest is payable annually on October 1. Prepare the entry to repay the note payable and all accrued interest on October 1, Year 11.

October 1, Year 11 Journal Entry:

CONCEPT: PAYROLL AND PAYROLL TAXES

● ***Payroll*** is generally one of the largest necessary expenses for a company to operate.

□ ***Salaries and Wage Expense*** – includes the _____________ pay earned by employees

- Employees are liable for certain payroll taxes that are withheld by the company
- Employers are also liable for their own payroll taxes

Tax	Responsible for Paying	Calculation
Federal Income Taxes	Employee	Based on IRS Tax Schedule (beyond scope of this class) Total amount due will be **given** to you
State Income Taxes	Employee	Based on State Tax Schedule (beyond scope of this class) Total amount due will be **given** to you
Federal Insurance Contribution Act (FICA)	Employer and Employee	Each pay 7.65% of gross pay Total FICA = 7.65% + 7.65% = 15.30%
Federal Unemployment Taxes Act (FUTA)	Employer	Employer pays 6.2% of first $7,000 earned by each employee Can be reduced by SUTA taxes paid
State Unemployment Taxes Act (SUTA)	Employer	Based on State SUTA rates (usually 5.4%)

□ ***Employee Benefits*** – any additional benefits paid by the employer are included in *Salaries and Wage Expense*

- Examples: Employer-Sponsored Health Insurance, 401(k) Plan Contributions
- The employee may have additional withholdings from their paycheck to pay for benefits (i.e. insurance)

EXAMPLE: During April, the employees of Stern Company earned wages of $120,000. The related withholdings included $7,000 for Social Security (FICA), $13,000 for federal income taxes, and $4,000 in state income taxes. Additionally, costs incurred for federal and state unemployment taxes totaled $180 and $300, respectively. Stern Company also paid $2,500 for an employer-sponsored health insurance program. Prepare April 30 journal entries, as if all amounts will be paid in May.

PRACTICE: The following information relates to the monthly payroll expenses at ABC Company:

Gross Salaries	$200,000
Federal and state income taxes withheld	$48,000
Health insurance premiums paid by employer	$10,000
401(k) contributions paid by employer	$20,000
FICA tax rate	7.65%
Federal unemployment tax rate	6.2%

Record three journal entries: (1) employee salary expense, (2) employer-sponsored benefits, and (3) employer payroll taxes

CONCEPT: SALES TAX PAYABLE

● Companies must often collect a ***sales tax*** based on a percentage of revenue.

□ Sales taxes are paid by customers, but are not ___________. They are collected and remitted to the government

The state of Oklabraska imposes an 8% sales tax on all sales. During the month of September, Oklabraska Riding Company made sales of $240,000.

Journal Entry:

Assets	=	Liabilities	+	Equity

ORC remitted the sales taxes collected to the government at the end of the month.

Journal Entry:

Assets	=	Liabilities	+	Equity

□ A company may also record total cash receipts and back into the amount of revenue using the following formula:

$$Sales\ Revenue = \frac{Total\ Cash\ Receipts}{1 + Sales\ Tax}$$

The state of Coloranifornia imposes a 5% sales tax on all sales. During the month of September, total cash receipts at Coloranifornia Ski Shop were $210,000.

Journal Entry:

PRACTICE: Blue Skies Supplies does not keep separate records of revenues and sales taxes at the time of sale. The register totals for October 21 are $20,776. All sales are subject to a 6% sales tax. If all cash receipts were originally included in Sales Revenue, the journal entry to adjust for sales taxes payable would include:

a) A debit to Sales Taxes Payable for $1,176
b) A debit to Sales Tax Expense for $1,246
c) A credit to Sales Taxes Payable for $1,176
d) A credit to Sales Taxes Payable for $1,246

PRACTICE: Crystal Company does not segregate sales and sales taxes in its register. The register total for May 5 is $27,560, which includes a 6% sales tax. Prepare the journal entry to record the sales and related taxes.

PRACTICE: ABC Company sold subscriptions to customers based on the following timeline:

September 1	Sold one-year subscriptions, collecting cash of $3,600, plus sales taxes of 10%.
October 31	Paid the sales taxes to the state taxing authority.
December 31	Recorded necessary year-end adjusting entries

Prepare journal entries for each of the events provided.

CONCEPT: CURRENT PORTION OF LONG-TERM DEBT

● Some long-term debt must be repaid in ________________

□ The ***current portion of long-term debt*** is the amount of ____________ that is payable within ____________

□ On the reporting date, we ______________ any upcoming payments of long-term debt to current liabilities

On January 2, Year 1, ABC Company signed a $100,000 long-term note payable. The note payable has a 10% interest rate and interest is payable each January 1. The repayment schedule denotes payment of principal on each January 1 of $10,000 for Years 2 – 11. Make any necessary journal entries on December 31, Year 1 and December 31, Year 2.

Journal Entries for December 31, Year 1:

Assets	=	Liabilities	+	Equity

Journal Entries for December 31, Year 2:

Assets	=	Liabilities	+	Equity

PRACTICE: ABC Company is preparing the liabilities section of its December 31, 2018 balance sheet. Selected information includes $20,000 in accounts payable, $100,000 in bonds payable, $80,000 of short-term debt, $10,000 in wages payable, $10,000 in prepaid rent expense, and $20,000 of unearned revenue. Furthermore, on January 1, 2018, ABC Company signed a $60,000, 10% note payable with interest payable annually on December 31. The principal of the note payable is repaid in $10,000 annual installments on January 1 of each year. The total of ABC's current liabilities is:

a) $300,000
b) $240,000
c) $150,000
d) $140,000

CONCEPT: CONTINGENT LIABILITIES

● ***Contingencies*** relate to situations that are _______________. Contingent gains and losses may not actually occur!

□ ***Contingent Gains*** – uncertainties that may result in a gain

- Contingent Gains are ________ recorded until the gain is completely certain!

□ ***Contingent Liabilities*** – uncertainties that may result in a loss

- Contingent Losses are either recorded as a liability, disclosed in the footnotes, or not recorded at all
- The reporting criteria for contingent losses depend on:

(1) Likelihood of ______________	
Probable	Likely to occur
Reasonably Possible	Somewhere in the middle
Remote	The chance is slight

(2) Ability to ______________ the payment amount
Known amount or reasonably estimable
Not reasonably estimable

	Ability to estimate	
If payment is	Known or Reasonably Possible	Not Reasonably Estimable
Probable		
Reasonably Possible		
Remote		

PRACTICE: Sumsang designs and sells smartphones for personal and commercial use. During the current year, the product engineers notified management of a flaw in the design that could cause the latest model to spontaneously combust. After a further investigation, it was noted that a product recall was probable, with an estimated cost to the company of $2,500,000. What influence might this information have on the current year financial statements?

a) The company should accrue a liability for the entire $2,500,000
b) The company should accrue a liability for an amount less than $2,500,000
c) The company should disclose information about this contingency in the notes to the financial statement
d) The company does not need to accrue a liability or disclose in the footnotes until the actual payments occur
e) Both (a) and (c)
f) Both (b) and (c)

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.
Year 1: Dell sells $100,000 of laptops with a 2-year warranty	Year 2: Some customers use warranties costing Dell $5,000.

● 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