

Current Liabilities

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Textbook: Financial Accounting, Spiceland

- This presentation contains information, in addition to the material prepared and provided by the professor, from the book Financial Accounting, 4th. Ed., Spiceland which is the textbook assigned for the course CONT 3105 – “Introducción a los Fundamentos de Contabilidad” at the University of Puerto Rico, Río Piedras Campus.

Topics

Topics

- 1.0 Current and Long-Term Classification
- 2.0 Notes Payable
- 3.0 Accounts Payable
- 4.0 Payroll Liabilities
- 5.0 Other Current Liabilities
- 6.0 Contingencies

Current and Long-Term Classification

Current and Long-Term Classification

1.1 Definition of Liabilities

Current and Long-Term Classification

1.1 Definition of Liabilities

- **Liabilities** are:
 1. probable future sacrifices of economic benefits,
 2. arising from present obligations to other entities, and
 3. resulting from past transactions or events.
- Consequently, a liability is a present responsibility to sacrifice assets in the future due to a transaction or other event that happened in the past.

Current and Long-Term Classification

1.2 Classification of Liabilities

Current and Long-Term Classification

1.2 Classification of Liabilities

- In a classified balance sheet, we categorize liabilities as either current or long-term.
 - **Current liabilities** are payable within one year.
 - **Long-term liabilities** are payable more than one year from now.

Current and Long-Term Classification

1.2 Classification of Liabilities

- **One Year Term:** Current liabilities are usually, but not always, due within one year. But for some companies (such a winery), it takes longer than a year to perform the activities that produce revenue. We call the time it takes to produce revenue the **operating cycle**.
- If a company has an operating cycle longer than one year, its current liabilities are defined by the operating cycle rather than by the length of a year.

Current and Long-Term Classification

1.2 Classification of Liabilities

- **Example of Current Liabilities:**
 1. Notes Payables
 2. Accounts Payable
 3. Payroll Liabilities
 4. Deferred Revenues
 5. Sales Tax Payable
 6. Current Portion of Long-Term Debt
- Let's discuss some of these liabilities.

Notes Payable

Notes Payable

2.1 Definition

Notes Payable

2.1 Definition

- Notes payable is the flip side of note receivable. Recall that notes receivable is an asset that creates interest revenue. In contrast, **notes payable** is a liability that creates interest expense.

Notes Payable

2.1 Definition

- When a company borrows cash from a bank, the bank requires the company to sign a note promising to repay the amount borrowed plus interest.
- The borrower reports its liability as notes payable.

Notes Payable

2.2 Stages of a Note

Notes Payable

2.2 Stages of a Note

- A note has three steps:
 1. Issuance of Note
 2. Accrual of Interests
 3. Payment of Note

Notes Payable

2.2 Stages of a Note

- 1. Issuance of Note:** The first step is the issuance of the notes. This is the moment when the borrower receives the cash borrowed from the lender.

Notes Payable

Example 1

Notes Payable

Example 1

- Vienna School borrows \$50,000 from One Bank on October 1, 2018, signing a 10%, six-month note.
 1. *What is the due date of this note?*

Notes Payable

Example 1

- Vienna School borrows \$50,000 from One Bank on October 1, 2018, signing a 10%, six-month note.
 1. *What is the due date of this note?*

April 1, 2019

Notes Payable

Example 1

- Vienna School borrows \$50,000 from One Bank on October 1, 2018, signing a 10%, six-month note.
 2. *What is the classification of this liability, current or long-term?*

Notes Payable

Example 1

- Vienna School borrows \$50,000 from One Bank on October 1, 2018, signing a 10%, six-month note.
 2. *What is the classification of this liability, current or long-term?*

Current liability, the note due date is within one year from the date the note was issued.

Notes Payable

Example 1

- Vienna School borrows \$50,000 from One Bank on October 1, 2018, signing a 10%, six-month note.
 3. *What is the journal entry to record the note payable?*

Notes Payable

Example 1

- Vienna School borrows \$50,000 from One Bank on October 1, 2018, signing a 10%, six-month note.
 3. *What is the journal entry to record the note payable?*

| GENERAL JOURNAL | | | | | JE # |
|-----------------|------------------------|------|--------|--------|------|
| Date | Account Title | Ref. | Debit | Credit | |
| Oct. 01 | Cash | | 50,000 | | |
| | Notes Payable | | | 50,000 | |
| | (Issue notes payable.) | | | | |

Notes Payable

2.2 Stages of a Note

- 2. Accruals of Interest:** After the issuance of the note, the company must pay interest in return for using the lender's money during the term of the loan.
 - **Interest** is stated in terms of an annual percentage rate to be applied to the face value of the loan. Consequently, when calculating interest for a current note payable, we must adjust for the fraction of the year the loan spans:

$$\text{Interest} = \text{Face value} \times \text{Annual interest rate} \times \text{Fraction of the year}$$

Notes Payable

Example 2

Notes Payable

Example 2

- Refer to **Examen 1**. Vienna School borrows \$50,000 from One Bank on October 1, 2018, signing a 10%, six-month note.
 1. *How much interest cost does Vienna School incur for the six-month period October 1, 2018 to April 1, 2019?*

Notes Payable

Example 2

- Refer to **Examen 1**. Vienna School borrows \$50,000 from One Bank on October 1, 2018, signing a 10%, six-month note.
 1. *How much interest cost does Vienna School incur for the six-month period October 1, 2018 to April 1, 2019?*

Interest = Face value X Annual interest rate X Fraction of the year

$$\underline{\$2,500} = \$50,000 \times 10\% \times 6/12$$

Notes Payable

Example 2

- Refer to **Examen 1**. Vienna School borrows \$50,000 from One Bank on October 1, 2018, signing a 10%, six-month note.
 2. *What is the interest expense as of December 31, 2018?*

Notes Payable

Example 2

- Refer to **Examen 1**. Vienna School borrows \$50,000 from One Bank on October 1, 2018, signing a 10%, six-month note.
 2. *What is the interest expense as of December 31, 2018?*

$$\underline{\$1,250} = \$50,000 \times 10\% \times 3/12$$

- *Pay attention, the time lapsed between the issuance of the note and December 31, 2018 is three (3) months (October, November and December)*

Notes Payable

Example 2

- Refer to **Examen 1**. Vienna School borrows \$50,000 from One Bank on October 1, 2018, signing a 10%, six-month note.
 - What is the journal entry to record the interest expense for 2018?

| GENERAL JOURNAL | | | | JE # |
|-----------------|---|------|-------|--------|
| Date | Account Title | Ref. | Debit | Credit |
| Dec. 31 | Interest Expense | | 1,250 | |
| | Interest Payable | | | 1,250 |
| | (Record interest incurred, but not paid.) | | | |

Notes Payable

2.2 Stages of a Note

- 3. Payment of Note:** When the note comes due, the borrower must pay the principal plus interest accrued until the due date.

Notes Payable

Example 3

- Refer to **Examen 1 and 2**. Vienna School borrows \$50,000 from One Bank on October 1, 2018, signing a 10%, six-month note.
 1. *What is the total amount the School must pay at the due date?*

Notes Payable

Example 3

- Refer to **Examen 1 and 2**. Vienna School borrows \$50,000 from One Bank on October 1, 2018, signing a 10%, six-month note.
 1. *What is the total amount the School must pay at the due date?*
 - *As of April 1, 2019 the payment consists of:*

| Description | Amount |
|---|------------------------|
| Principal | \$50,000 |
| Interest Payable 12/31/18 | 1,250 |
| Interest Expense (Jan 1 to Apr 1, 2019) | <u>1,250</u> |
| Total Payment | <u>\$52,500</u> |

Notes Payable

Example 3

- Refer to **Examen 1 and 2**. Vienna School borrows \$50,000 from One Bank on October 1, 2018, signing a 10%, six-month note.
 2. *What is the journal entry to record the payment of the note at maturity date?*

Notes Payable

Example 3

- Refer to **Examen 1 and 2**. Vienna School borrows \$50,000 from One Bank on October 1, 2018, signing a 10%, six-month note.
 2. *What is the journal entry to record the payment of the note at maturity date?*

| GENERAL JOURNAL | | | | JE # |
|-----------------|--|------|--------|--------|
| Date | Account Title | Ref. | Debit | Credit |
| Dec. 31 | Notes Payable | | 50,000 | |
| | Interest Payable | | 1,250 | |
| | Interest Expense | | 1,250 | |
| | Cash | | | 52,500 |
| | <i>(Pay notes payable and interest.)</i> | | | |

Accounts Payable

Accounts Payable

3.1 Summary

Accounts Payable

3.1 Summary

- **Accounts payable**, or **trade accounts payable**, are balances owed to others for goods, supplies, or services purchased on open account.
- Accounts payable arises because of the time lag between the receipt of services or acquisition of assets and the payment for them. [**Kieso**]

Accounts Payable

3.1 Summary

- Measuring the amount of an account payable poses no particular difficulty. The invoice received from the creditor specifies the due date and the exact outlay in money that is necessary to settle the account. [**Kieso**]

Payroll Liabilities

Payroll Liabilities

4.1 Introduction

Payroll Liabilities

4.1 Introduction

- Companies report as a current liabilities amounts owes to:
 1. employees for salaries or wages at the end of the accounting period.
 2. government for payroll taxes.
 3. Third parties for fringe benefits and employee voluntary withholdings.

Payroll Liabilities

4.2 Salaries and Wages

Payroll Liabilities

4.2 Salaries and Wages

- As you recall, companies pay for employee salaries and wages after the services have been performed.
- However, in some occasions at the end of the accounting period the employees have performed services to the company but the company will pay salaries in a date after the end of the accounting period.
- Consequently, salaries and wages for these days before the end of the period represent an accrued expense and a related liability for the company.

Payroll Liabilities

Example 4

- Vienna School pays \$1,000 in salaries on a daily basis. The payroll is paid every Friday. At the end of the accounting as of December 31, 2018, Vienna School owes to its employees \$1,000 as follows:

| DECEMBER 2018/JANUARY 2019 | | | | |
|----------------------------|---------|-----------|----------|---------|
| Monday | Tuesday | Wednesday | Thursday | Friday |
| 31 | 1 | 2 | 3 | 4 |
| \$1,000 | \$1,000 | \$1,000 | \$1,000 | \$1,000 |

- What is the salary expense to be accrued by the company as of December 31, 2018?*

Payroll Liabilities

Example 4

- *What is the salary expense to be accrued by the company as of December 31, 2018?*

| DECEMBER 2018/JANUARY 2019 | | | | |
|----------------------------|---------|-----------|----------|---------|
| Monday | Tuesday | Wednesday | Thursday | Friday |
| 31 | 1 | 2 | 3 | 4 |
| \$1,000 | \$1,000 | \$1,000 | \$1,000 | \$1,000 |

- **Although the payroll amounting \$5,000 will be paid in Friday, January 4, as of December 31 the company has incurred in a salary expense of \$1,000 for one day of services performed by employees before the end of the accounting period.**

Payroll Liabilities

4.3 Payroll Taxes

Payroll Liabilities

4.3 Payroll Taxes

- **Employment and unemployment taxes** are a group of taxes imposed by the government. The tax base for those taxes are generally the wages or salaries of the employees.
- In some circumstances, the employer, in addition to employees, is responsible to pay a portion of these taxes.
- This portion can be claimed as an expense by the employer and the amount unpaid at the end of the accounting period should be recognize as a current liability.

Payroll Liabilities

4.3 Payroll Taxes

- **Employment taxes** consist of the Old age, Survivors, and Disability Insurance (OASDI) tax, commonly called:
 1. the **Social Security**, and
 2. the Medical Health Insurance (MHI) tax known as the **Medicare tax**.
- Both taxes are collectively referred to as **FICA taxes**. (Federal Insurance Contributions Act)

Payroll Liabilities

4.3 Payroll Taxes

- **Unemployment taxes** provides to fund temporary unemployment benefits for individuals. Referred to as **FUTA Tax**.
- Let's discuss these taxes.

Payroll Liabilities

4.3 Payroll Taxes

1. **Social Security Tax:**

- **Purpose:** The Social Security tax pays the monthly retirement, survivor, and disability benefits for qualifying individuals.
- **Tax Authority:** Federal government (IRS).
- **Tax Base and Rate:** The tax base is wages or salaries of employees and the tax rates is 12.4% for the social security.

Payroll Liabilities

4.3 Payroll Taxes

1. **Social Security Tax:**

- **Who Pays the Tax:** Employers and employees are both responsible to pay this tax and they split it equally. (**6.20% each**)
- **Limitation to Tax Base:** In 2018, the limitations follow:
 - *Social Security Tax:* The tax is imposed for the first \$128,400 of salary of each employee.

Payroll Liabilities

Example 5

Payroll Liabilities

Example 5

- Carlos is an employee of Beach Surf Company with an annual salary of \$35,000 for 2018.
1. What is the total Social Security Tax on Carlos's salary for 2018?
 2. What is the amount payable by Carlos and Beach Surf Company?
 3. What amount can the employer claim as a payroll tax expense regarding this tax?

Payroll Liabilities

Example 5

- Carlos is an employee of Beach Surf Company with an annual salary of \$35,000 for 2018.

1. What is the total Social Security Tax on Carlos's salary for 2017?

$$\mathbf{\$35,000 \times 12.4\% = \$4,340}$$

Payroll Liabilities

Example 5

- Carlos is an employee of Beach Surf Company with an annual salary of \$35,000 for 2018.
2. What is the amount payable by Carlos and Beach Surf Company?
- **They split the tax between Carlos and Beach Surf Company.**
 - **Carlos will pay \$2,170 ($\$35,000 \times 6.2\%$ or $\$4,340 \times 50\%$) through withholdings in his salary.**
 - **Beach Surf Company will pay \$2,170 in addition to the \$2,170 withheld to Carlos.**

Payroll Liabilities

Example 5

- Carlos is an employee of Beach Surf Company with an annual salary of \$35,000 for 2018.
3. What amount can the employer claim as a payroll tax expense regarding this tax?
- **Beach Surf Company can claim as a payroll tax expense \$2,170, the amount of Social Security Tax the employer is responsible to pay over Carlos's salary.**

Payroll Liabilities

Example 6

Payroll Liabilities

Example 6

- Carlos is an employee of Beach Surf Company with an annual salary of \$135,000 for 2018.
1. What is the total Social Security Tax on Carlos's salary for 2018?

Payroll Liabilities

Example 6

- Carlos is an employee of Beach Surf Company with an annual salary of \$135,000 for 2018.
1. What is the total Social Security Tax on Carlos's salary for 2018?
 - **$\$128,400 \times 12.4\% = \$15,921.60$**
 - **The first \$128,400 out of \$135,000 is subject to Social Security Tax. The amount in excess of \$128,400 is exempt.**

Payroll Liabilities

4.3 Payroll Taxes

2. **Medicare tax:**

- **Purpose:** The Medicare pays for medical insurance for individuals who are elderly or disable.
- **Tax Authority:** Federal government (IRS).
- **Tax Base:** The tax base is wages or salaries of the employees.
- **Who Pays the Tax:** Employers and employees are both responsible to pay this tax and they split it equally.

Payroll Liabilities

4.3 Payroll Taxes

2. **Medicare tax:**

- **Tax Base and Rate:** The tax rates is 2.9% for the Medicare.
 - There is a 0.9% additional Medicare Tax levied on income earned by employees above a certain income threshold according to employee's filing status. This additional amount is not matched by the employer.
- **Limitation to Tax Base:** The Medicare Tax is not capped.

Payroll Liabilities

Example 7

- Carlos is an employee of Beach Surf Company with an annual salary of \$35,000 for 2018.
1. What is the total Medicare Tax on Carlos's salary for 2018?
 2. What is the amount payable by Carlos and Beach Surf Company?
 3. What amount can the employer claim as a payroll tax expense regarding this tax?

Payroll Liabilities

Example 7

- Carlos is an employee of Beach Surf Company with an annual salary of \$35,000 for 2018.
1. What is the total Medicare Tax on Carlos's salary for 2018?

$$\mathbf{\$35,000 \times 2.9\% = \$1,015}$$

Payroll Liabilities

Example 7

- Carlos is an employee of Beach Surf Company with an annual salary of \$35,000 for 2018.
2. What is the amount payable by Carlos and Beach Surf Company?
- **They split the tax between Carlos and Beach Surf Company.**
 - **Carlos will pay \$507.50 ($\$35,000 \times 1.45\%$ or $\$1,015 \times 50\%$) through withholdings in his salary.**
 - **Beach Surf Company will pay \$507.50 in addition to the \$507.50 withheld to Carlos.**

Payroll Liabilities

Example 7

- Carlos is an employee of Beach Surf Company with an annual salary of \$35,000 for 2018.

- 3. What amount can the employer claim as a payroll tax expense regarding this tax?
 - **Beach Surf Company can claim as a payroll tax expense \$507.50, the amount of Medicare Tax the employer is responsible to pay over Carlos's salary.**

Payroll Liabilities

Example 8

Payroll Liabilities

Example 8

- Carlos is an employee of Beach Surf Company with an annual salary of \$135,000 for 2018.
1. What is the total Medicare Tax on Carlos's salary for 2018?

Payroll Liabilities

Example 8

- Carlos is an employee of Beach Surf Company with an annual salary of \$135,000 for 2018.
1. What is the total Medicare Tax on Carlos's salary for 2018?
 - **$\$135,000 \times 2.9\% = \$3,915$**
 - **The tax base for the Medicare Tax is not capped.**

Payroll Liabilities

4.3 Payroll Taxes

3. **Federal Unemployment Tax:**

Payroll Liabilities

4.3 Payroll Taxes

3. **Federal Unemployment Tax:**

- **Purpose:** Unemployment taxes fund temporary unemployment benefits for individuals terminated from their jobs without cause.
- **Tax Authority:** Federal government (IRS).
- **Tax Base:** The tax base is wages or salaries of employees. However, the wage base is the first \$7,000 of wages received during the year.

Payroll Liabilities

4.3 Payroll Taxes

3. **Federal Unemployment Tax:**

- **Who Pays the Tax:** Employers (not employee) are responsible to pay this tax.
- **Tax Rate:** The tax rate is 6.0% for the Federal Unemployment Tax. But the U.S. Government allows a credit for state unemployment taxes paid up to 5.4%. Consequently, the effective Federal Unemployment Tax rate may be as low as 0.6% (6.0% - 5.4% = 0.6%)

Payroll Liabilities

Example 9

Payroll Liabilities

Example 9

- Carlos, resident of Puerto Rico, is an employee of Beach Surf Company with an annual salary of \$35,000 for 2018. The company pays to the government of Puerto Rico 5.4% of state unemployment tax.
1. What is the total Federal Unemployment Tax on Carlos's salary for 2018?

Payroll Liabilities

Example 9

- Carlos, resident of Puerto Rico, is an employee of Beach Surf Company with an annual salary of \$35,000 for 2018. The company pays to the government of Puerto Rico 5.4% of state unemployment tax.
1. What is the total Federal Unemployment Tax on Carlos's salary for 2018?
 - **$\$7,000 \times 0.6\% = \42**
 - **Only the first \$7,000 of wages earned in a year are subject to tax.**
 - **The tax rate is 0.6% because 5.4% is paid to Puerto Rico.**

Payroll Liabilities

Example 9

- Carlos, resident of Puerto Rico, is an employee of Beach Surf Company with an annual salary of \$35,000 for 2018. The company pays to the government of Puerto Rico 5.4% of state unemployment tax.
2. What is the amount payable by Carlos and Beach Surf Company?

Payroll Liabilities

Example 9

- Carlos, resident of Puerto Rico, is an employee of Beach Surf Company with an annual salary of \$35,000 for 2018. The company pays to the government of Puerto Rico 5.4% of state unemployment tax.
2. What is the amount payable by Carlos and Beach Surf Company?
- **This is a tax paid only by the employer. Employee is not subject to pay unemployment tax. Thus, Carlos pays \$0.**
 - **Beach Surf Company will pay \$42 of unemployment tax relating to the salary paid to Carlos in 2017.**

Payroll Liabilities

Example 9

- Carlos, resident of Puerto Rico, is an employee of Beach Surf Company with an annual salary of \$35,000 for 2018. The company pays to the government of Puerto Rico 5.4% of state unemployment tax.
3. What amount can the employer claim as a payroll tax expense regarding this tax?

Payroll Liabilities

Example 9

- Carlos, resident of Puerto Rico, is an employee of Beach Surf Company with an annual salary of \$35,000 for 2018. The company pays to the government of Puerto Rico 5.4% of state unemployment tax.
3. What amount can the employer claim as a payroll tax expense regarding this tax?
- **\$42**

Payroll Liabilities

4.3.1 Puerto Rico Payroll Taxes

Payroll Liabilities

4.3.1 Puerto Rico Payroll Taxes

- Resident in Puerto Rico are subject to all payroll taxes imposed by the Federal Government.
- Consequently, the following taxes, already discussed in this presentation are levied to salaries paid in Puerto Rico:
 1. Social Security Tax
 2. Medicare Tax
 3. Unemployment Tax

Payroll Liabilities

4.3.1 Puerto Rico Payroll Taxes

- However, in addition to the Federal Payroll Taxes, the residents of Puerto Rico are subject to local payroll taxes.
- The payroll taxes imposed in Puerto Rico are:
 1. State Unemployment Tax (maximum 5.4% of the first \$7,000)
 2. Disability Tax (0.6% of the first \$9,000, 0.3% employer, 0.3% employee)
 3. “Seguro Choferil”
 4. Workers’ Compensation

Payroll Liabilities

4.3.2 Income Tax Withholding

Payroll Liabilities

4.3.2 Income Tax Withholding

- Federal and some state income tax laws require employers to withhold from each employee's pay the applicable income tax due on those wages.
- The employer computes the amount of income tax to withhold according to a government-prescribed formula or withholding tax table.
[Kieso]

Payroll Liabilities

4.3.2 Income Tax Withholding

- Employer reports the income tax withheld as a liability until remitted to the tax agency.
- Pay attention that this withholding is a liability to the company, NOT payroll tax expense.
- The amount of income tax withheld is a portion out of the salary paid to the employee.

Payroll Liabilities

4.4 Fringe Benefits and Other Withholdings

Payroll Liabilities

4.4 Fringe Benefits and Other Withholdings

- **Fringe Benefits:** Additional employee benefits (in addition to salary) paid for by the employer are referred to as **fringe benefits**. Employers often
 1. pay all or part of the employees' health insurance premiums, or
 2. Make contributions to retirement or saving plans.
- The fringe benefits are generally recorded by the employer as part of the salary expense.

Payroll Liabilities

4.4 Fringe Benefits and Other Withholdings

- **Other Withholdings:** Occasionally, employees voluntarily request to the employer to withhold a portion of the salary as a contribution to charitable organizations, such as **United Way**, among others.
- In addition, in some instances the employer is required to make a compulsory withholding (such as child care payments to ASUME). Similarly, the employee may allow the employer to withhold amounts payable to third parties in payment of liabilities (ex. Loan)

Payroll Liabilities

4.4 Fringe Benefits and Other Withholdings

- This types of withholdings do not represent an expense to the employer. This amount are withheld out of the salary paid to the employee.

Payroll Liabilities

Example 10 (Comprehensive – Payroll Taxes)

Payroll Liabilities

Example 10 (Comprehensive – Payroll Taxes)

- Marble Stone Company, located in New York, EE.UU., has a total payroll for the month of December, 2018 of \$21,500 as follows:

| # | Employee | Payroll | Income Tax Withheld | Year-to-Date |
|---|--------------|------------------------|-----------------------|-------------------------|
| 1 | Jose | \$5,000 | \$500 | \$50,000 |
| 2 | Carmen | 3,500 | 350 | 42,000 |
| 3 | Pedro | 7,000 | 700 | 84,000 |
| 4 | Maria | 4,000 | 400 | 10,000 |
| 5 | Sebastian | <u>2,000</u> | <u>200</u> | <u>4,000</u> |
| | Total | <u>\$21,500</u> | <u>\$2,150</u> | <u>\$190,000</u> |

- The company will contribute \$2,000 to the employees' health insurance and \$3,000 to the pension plan.

Payroll Liabilities

Example 10 (Comprehensive – Payroll Taxes)

- Requirements:
 1. Calculate the payroll withholdings.
 2. Record the salary expense and withholdings
 3. Record the fringe benefits.
 4. Calculate the employer payroll taxes. The unemployment tax rate is 0.6%.
 5. Record the employer payroll taxes.

Payroll Liabilities

Example 10 (Comprehensive – Payroll Taxes)

1. Calculate the payroll withholdings.

| # | (A) Employee | (B) Payroll | (C) Income Tax Withheld | (D) FICA Taxes (B x 7.65%) | (E) Withholdings (C + D) | Payment to Employee (B-E) |
|---|-----------------|------------------------|-------------------------------|----------------------------------|--------------------------------|---------------------------------|
| 1 | Jose | \$5,000 | \$500 | \$382.50 | \$882.50 | \$4,117.50 |
| 2 | Carmen | 3,500 | 350 | 267.75 | 617.75 | 2,882.25 |
| 3 | Pedro | 7,000 | 700 | 535.50 | 1,235.50 | 5,764.50 |
| 4 | Maria | 4,000 | 400 | 306.00 | 706.00 | 3,294.00 |
| 5 | Sebastian | <u>2,000</u> | <u>200</u> | <u>153.00</u> | <u>353.00</u> | <u>1,647.00</u> |
| | Total | <u>\$21,500</u> | <u>\$2,150</u> | <u>\$1,644.75</u> | <u>\$3,794.75</u> | <u>\$17,705.25</u> |

Payroll Liabilities

Example 10 (Comprehensive – Payroll Taxes)

- Record the salary expense and withholdings

| GENERAL JOURNAL | | | | JE # |
|-----------------|---|------|-----------|-----------|
| Date | Account Title | Ref. | Debit | Credit |
| Dec. 31 | Salary Expense | | 21,500.00 | |
| | Income Tax Withheld Payable | | | 2,150.00 |
| | FICA Tax Payable | | | 1,644.75 |
| | Salary Payable | | | 17,705.25 |
| | <i>(Record employee salary expense and withholdings.)</i> | | | |

Payroll Liabilities

Example 10 (Comprehensive – Payroll Taxes)

3. Record the fringe benefits.

| GENERAL JOURNAL | | | | JE # |
|-----------------|--|------|----------|----------|
| Date | Account Title | Ref. | Debit | Credit |
| Dec. 31 | Salary Expense | | 5,000.00 | |
| | Accounts Payable – Health Insurance | | | 2,000.00 |
| | Accounts Payable – Pension Plan | | | 3,000.00 |
| | <i>(Record employer-provided fringe benefits.)</i> | | | |

Payroll Liabilities

Example 10 (Comprehensive – Payroll Taxes)

4. Calculate the employer federal payroll taxes. The unemployment tax rate is 0.6%.

| # | (A) Employee | (B) Payroll | (C) FICA Taxes (B x 7.65%) | (D) FUTA Tax (B x 0.6%) | TOTAL Payroll Taxes (C + D) |
|---|--|------------------------|----------------------------------|-------------------------------|-----------------------------------|
| 1 | Jose (already earned + \$7,000) | \$5,000 | \$382.50 | \$0 | \$382.50 |
| 2 | Carmen (already earned + \$7,000) | 3,500 | 267.75 | 0 | 267.75 |
| 3 | Pedro (already earned + \$7,000) | 7,000 | 535.50 | 0 | 535.50 |
| 4 | Maria (Before this payroll she earned \$6,000. \$1,000 to reach the \$7,000 limit.) | 4,000 | 306.00 | 6.00 | 312.00 |
| 5 | Sebastian (Before this payroll he earned \$2,000. Total salary paid below the \$7,000 limit.) | <u>2,000</u> | <u>153.00</u> | <u>12.00</u> | <u>165.00</u> |
| | Total | <u>\$21,500</u> | <u>\$1,644.75</u> | <u>\$18.00</u> | <u>\$1,662.75</u> |

Payroll Liabilities

Example 10 (Comprehensive – Payroll Taxes)

5. Record the employer's payroll taxes.

| GENERAL JOURNAL | | | | JE # |
|-----------------|---|------|----------|----------|
| Date | Account Title | Ref. | Debit | Credit |
| Dec. 31 | Payroll Tax Expense | | 1,662.75 | |
| | FICA Tax Payable | | | 1,644.75 |
| | FUTA Tax Payable | | | 18.00 |
| | <i>(Record employer payroll taxes.)</i> | | | |

Other Current Liabilities

Other Current Liabilities

5.1 Deferred Revenues

Other Current Liabilities

5.1 Deferred Revenues

- It's not uncommon for companies to require advance payments from customers that will be applied to the purchase price when they deliver goods or provide services, for example an airline.
- These companies must record the receipt of cash, not as revenue, but as a liability (**Deferred Revenue**). Remember, having already collected the cash, the company now has the obligation to provide a good or service. Otherwise, it has to return the cash to the customer.

Other Current Liabilities

5.1 Deferred Revenues

- When the company provides the goods or service, then decrease the deferred revenue account and records the revenue.

Other Current Liabilities

5.2 Sales Taxes

Other Current Liabilities

5.2 Sales Taxes

- Most states impose a state sales tax, and many areas include a local sales tax as well. Each company selling products subject to sales tax is responsible for collecting the sales tax directly from customers and periodically sending the sales taxes collected to the state and local governments.
- The selling company collects the sales tax and record a Sales Tax Payable.

Other Current Liabilities

Example 11

- Marble Stone Company sales on December 2018 amounts \$100,000. The sales tax rate is 11.5%. The sales taxes collected amounts \$11,500. The company records the transaction this way:

| GENERAL JOURNAL | | | | JE # |
|-----------------|--|------|---------|---------|
| Date | Account Title | Ref. | Debit | Credit |
| Dec. 31 | Cash (\$100,000 + \$11,500 sales tax) | | 111,500 | |
| | Sales Tax Payable | | | 11,500 |
| | Sales Revenue | | | 100,000 |
| | <i>(Record sales and sales taxes.)</i> | | | |

Other Current Liabilities

5.3 Current Portion of Long-Term Debt

Other Current Liabilities

5.3 Current Portion of Long-Term Debt

- The current portion of long-term debt is the amount that will be paid within the next year. Management needs to know this amount in order to budget the cash flow necessary to pay the current portion as it comes due.
- Long-term obligations, such as notes, mortgages, bonds, usually are reclassified and reported as current liabilities when they become payable within the upcoming year.

Other Current Liabilities

Example 12

- Marble Stone Company had a total borrowings of \$1,000,000 as of December 31, 2018. Of that amount, \$200,000 is due during 2019. In its balance sheet, the company record \$200,000 as current and \$800,000 as long-term debt, as follows:

| Marble Stone Company Balance Sheet (Partial) December 31, 2018 | |
|--|---------------------------|
| <u>Current Liabilities</u> | |
| Current portion of long-term debt | \$200,000 |
| <u>Long-term Liabilities</u> | |
| Long-term debts | <u>800,000</u> |
| Total Liabilities | <u>\$1,000,000</u> |

Contingencies

Contingencies

6.1 Introduction

Contingencies

6.1 Introduction

- Companies often are involved in situations where uncertainty exists about whether an obligation to transfer cash or other assets has arisen and/or the amount that will be required to settle the obligation. Broadly, this situation is called contingencies.
- A **contingency** is “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.” [**Kieso**]

Contingencies

6.2 Contingent Liability

Contingencies

6.2 Contingent Liability

- A **contingent liability** is an existing uncertain situation that might result in a loss depending on the outcome of a future event.
- **Examples** include:
 1. Lawsuits and litigations
 2. Product warranties
 3. Environmental problems
 4. Others.

Contingencies

6.2 Contingent Liability

- When a loss contingency exists, the likelihood that the future event or events will confirm the incurrence of a liability can range from probable to remote.
- The FASB uses the terms probable, reasonable possible, and remote to identify three areas within that range and assigns the following meanings.
[Kieso]

Contingencies

6.2 Contingent Liability

1. **Probable:** The future event or events are likely to occur.
2. **Reasonably Possible:** The chance of the future event or events occurring is more than remote but less than likely.
3. **Remote:** The chance of the future event or events occurring is slight.

Contingencies

6.2 Contingent Liability

- Companies should accrue an estimated loss from a loss contingency by a charge to expense and a liability recorded only if both of the following conditions are met:
 1. Information available prior to the issuance of the financial statements indicates that it is **probable** that a liability has been incurred at the date of the financial statements.
 2. The **amount** of the loss can be **reasonably estimated.**
[Kieso]

Other Current Liabilities

Example 13 (Litigations and Claims)

Other Current Liabilities

Example 13 (Litigations and Claims)

- A pharmaceutical manufacturer believes it is **probable** to lose **\$50,000,000 million** lawsuit during the next year related to a drug manufactured by the company. The company would report a contingent liability at the end the year.

| GENERAL JOURNAL | | | | JE # |
|-----------------|---|------|------------|------------|
| Date | Account Title | Ref. | Debit | Credit |
| Dec. 31 | Loss in Litigation | | 50,000,000 | |
| | Contingent Liability | | | 50,000,000 |
| | <i>(Record a contingent liability.)</i> | | | |

Other Current Liabilities

Example 14 (Litigations and Claims)

Other Current Liabilities

Example 14 (Litigations and Claims)

- A pharmaceutical manufacturer believes it is **remote** to loss **\$50,000,000 million** lawsuit during the next year related to a drug manufactured by the company. Since the likelihood of payment is remote, the company would not report any contingent liability at the end of the year.

| GENERAL JOURNAL | | | | JE # |
|-----------------|----------------------------|------|-------|--------|
| Date | Account Title | Ref. | Debit | Credit |
| Dec. 31 | No journal entry required. | | | |
| | | | | |

Other Current Liabilities

Example 15 (Warranties)

Other Current Liabilities

Example 15 (Warranties)

- Toyota introduced a new auto model for 2018. Based on industry experience, the company expects warranty cost for the first year equal to 5% of sales. New model auto sales for December 2018 are \$10 million. The company records the warranty liability on December 31 as follows:

| GENERAL JOURNAL | | | | JE # |
|-----------------|---|------|---------|---------|
| Date | Account Title | Ref. | Debit | Credit |
| Dec. 31 | Warranty Expense | | 500,000 | |
| | Warranty Liability | | | 500,000 |
| | <i>(Record liability for warranties.)</i> | | | |

Other Current Liabilities

Example 15 (Warranties)

- When customers make warranty claims, Toyota incurs costs to satisfy those claims, the liability is reduced. Assume in January 2019, customers make warranty claims costing Toyota \$25,000. The payment for warranty work performed is recorded as follows:

| GENERAL JOURNAL | | | | JE # |
|-----------------|---|------|--------|--------|
| Date | Account Title | Ref. | Debit | Credit |
| 2019 | Warranty Liability | | 25,000 | |
| | Cash | | | 25,000 |
| | <i>(Record liability for warranties.)</i> | | | |

Contingencies

6.2 Contingent Liability

- A **contingent gain** is an existing uncertain situation that might result in a gain.
- We do not record contingent gains until the gain is certain and no longer a contingency.