Tutorial 8 (Week 9) – Operating Activities: Current Liabilities

In January 2026, Hunt3X hired a new full-time accounting manager to help the growing company manage its accounts more efficiently. One of the accounting manager's main task was to prepare quarterly financial statements so that senior management can better track the company's performance. Under the helm of the new accounting manager, Hunt3X began performing regular *quarter-end* adjustments starting in January 2026.

The following events occurred for Hunt3X during the financial year of *2026*:

(a) On 1 July 2026, Hunt3X launched a new product, the Takedown2.0 Amplifier that comes with a one-year warranty. This is Hunt3X's first product that comes with a warranty. Hunt3X estimated that warranty expense will average about 2% of the product's selling price. It sold $24,800 worth of the products in the third quarter (Q3) of 2026, and $56,200 of the products in the fourth quarter (Q4) of 2026. There were no customers who returned the product for warranty repairs in Q3. However, some customers brought in the products for repair under warranty in Q4, and Hunt3X used $275 worth of inventory spare parts for repairs.

(b) Hunt3X also sold a 1-year extended warranty on its Takedown2.0 Amplifier. The amount of extended warranty sold in Q4 is $4,460.

(c) On 14 September 2026, Hunt3X borrowed $35,000 from one of its business partners and signed a short term note for 120 days at an annual interest rate of 10%. Interest on the note is payable on the date of the note's maturity and is calculated using the Actual/360 convention.

(d) In October 2026, a part-time worker was injured during a company event when an equipment malfunctioned. In November, the worker sued Hunt3X for workplace injury. Hunt3X's lawyers advised Hunt3X that there is a 70% chance that Hunt3X will have to settle the lawsuit and pay damages of $5,000 to the part-time worker. As at 31 December 2026, the lawsuit remains pending.

(e) In December, the Consumer Product Safety Office (CPSO), a government agency that safeguards consumer safety, launched an investigation on Hunt3X for alleged violations of product safety laws. Hunt3X could face significant fines if found guilty. However, Hunt3X's lawyers believe that the company has complied with all applicable laws and assess the

probability of incurring fines is less than 30%. As at 31 December 2026, the investigation is still pending.

Required for Tutorial 8:

Using your spreadsheet:

(1) Warranty:

    (i)   For event (a) above, calculate the amount of warranty expense that Hunt3X should recognize in Q3 and Q4. What is the balance of the warranty provision account at the end of Q3 and Q4?

    (ii)   If actual warranty claims consistently turn out lower than estimated (e.g., 1% instead of 2%), how should the management of Hunt3Xrespond? Should Hunt3X revise its warranty provision rate and what are the implications on its financial statements?

    (iii)   For event (b) above, what is the journal entry that Hunt3X should record for Q4? If Hunt3X's CEO insists that the revenue from the extended warranty be recognized in 2026, how should the accounting manager respond? When should Hunt3X recognize the revenues?

(2) For event (c) above, prepare the journal entries (including adjusting entries) that Hunt3X would record on the following dates: (round all your answers to 2 decimal places)

    (i)   On 14 September 2026

    (ii)   On 30 September 2026

    (iii)   On 31 December 2026

    (iv)   On the date of note repayment (also calculate the date the loan is due)

(3) Contingent Liabilities:

    (i)   For events (d) and (e) above, what is the appropriate accounting treatment and how should Hunt3X account for these pending legal matters on its 2026 financial statements?

    (ii)   If Hunt3X's CEO pressures the accounting manager not to disclose the CPSO investigation, how should the accounting manager respond from both a professional and ethical standpoint? What avenue is available to the accounting manager if the CEO is adamant about not disclosing the pending investigation?

~ End of Tutorial 8 ~