Chapter 9

Reporting and Interpreting Liabilities

ANSWERS TO QUESTIONS

1. Liabilities are obligations that result from past transactions that require future payment of assets or the future performance of services, that are definite in amount or are subject to reasonable estimation. A liability usually has a definite payment date known as the maturity or due date. A current liability is a short-term liability; that is, one that will be paid during the coming year or the current operating cycle of the business, whichever is longer. It is assumed that the current liability will be paid out of current assets. All other liabilities are defined as long-term liabilities.

2. External parties have difficulty determining the amount of liabilities of a business in the absence of a balance sheet. Therefore, about the only sources available to external parties for determining the number, type, and amounts of liabilities of a business are the published financial statements. These statements have more credibility when they have been audited by an independent CPA.

3. A liability is measured at acquisition at its current cash equivalent amount. Conceptually, this amount is the present value of all of the future payments of principal and interest. For a short-term liability the current cash equivalent usually is the same as the maturity amount. The current cash equivalent amount for an interest-bearing liability at the going rate of interest is the same as the maturity value. For a long-term liability, the current cash equivalent amount will be less than the maturity amount: (1) if there is no stated rate of interest, or (2) if the stated rate of interest is less than the going rate of interest.

4. Most debts specify a definite amount that is due at a specified date in the future. However, there are situations where it is known that an obligation or liability exists although the exact amount is unknown. Liabilities that are known to exist but the exact amount is not yet known must be recorded in the accounts and reported in the financial statements at an estimated amount. Examples of a known obligation of an estimated amount are estimated income tax at the end of the year, property taxes at the end of the year, and obligations under warranty contracts for merchandise sold.

5. Working capital is computed as total current assets minus total current liabilities. It is the amount of current assets that would remain if all current liabilities were paid, assuming no loss or gain on liquidation of those assets.

6. An accrued liability is an expense that was incurred before the end of the current period but has not been paid or recorded. Therefore, an accrued liability is recognized when such a transaction is recorded. A typical example is wages incurred during the last few days of the accounting period but not recorded because no payroll was prepared and paid that included these wages. Assuming wages of $2,000 were incurred, the adjusting entry to record the accrued liability and the wage expense would be as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| December 31: |  |  |  |
| Wage expense (+E, -SE)…………………………………… | 2,000 |  |  |
| Wages payable (+L) ………………………………….. |  |  | 2,000 |

7. A deferred revenue (usually called unearned revenue or revenue collected in advance) is a revenue that has been collected in advance of being earned and recorded in the accounts by the entity. Because the amount already has been collected and the goods or services have not been provided, there is a liability to provide goods or services to the party who made the payment in advance.

8. A note payable is a written promise to pay a stated sum at one or more specified dates in the future. A secured note payable is one that has attached to it (or coupled with it) a mortgage document which commits specified assets as collateral to guarantee payment of the note when due. An unsecured note is one that does not have specific assets pledged, or committed, to its payment at maturity. A secured note carries less risk for the note holder (creditor).

9. A contingent liability is not an effective liability; rather it is a potential future liability. A contingent liability arises because of some transaction or event that has already occurred which may, depending upon one or more future events, cause the creation of a true liability. A typical example is a lawsuit for damages. Whether the defendant has a liability depends upon the ultimate decision of the court. Pending that decision there is a contingent liability (and a contingent loss). This contingency must be recorded and reported (debit, loss; credit, liability) if it is “probable” that the decision will require the payment of damages that can be reasonably estimated. If it is only “reasonably possible” that a loss will be incurred, only footnote disclosure is required.

10. $4,000 x 12% x 9/12 = $360.

11. The time value of money is another way to describe interest. Time value of money refers to the fact that a dollar received today is worth more than a dollar to be received at any later date because of interest.

12. Future value—The future value of a number of dollars is the amount that it will increase to in the future at *i* interest rate for *n* periods. The future value is the principal plus accumulated interest compounded each period.

Present value—The present value of a number of dollars, to be received at some specified date in the future, is that amount discounted to the present at *i* interest rate for *n* periods. It is the inverse of future value. In compound discounting, the interest is subtracted rather than added as in compounding.

13. $8,000 x .3855 = $3,084.

14. An annuity is a term that refers to equal periodic cash payments or receipts of an equal amount each period for two or more periods. In contrast to a future value of $1 or a present value of $1 (which involve a single contribution or amount), an annuity involves a series of equal contributions for a series of equal periods. An annuity may refer to a future value or a present value.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 15. |  |  |  |  | Table Values | | | | |
|  | Concept |  |  |  | *i* = 5%; *n* =4 |  | *i* = 10%; *n* =7 |  | *i* = 14%; *n* = 10 | |
|  | PV of $1 |  |  |  | .8227 |  | .5132 |  | .2697 | |
|  | PV of annuity of $1 |  |  |  | 3.5460 |  | 4.8684 |  | 5.2161 | |

16. $18,000 – $3,000 = $15,000 ÷ 4.9173 = $3,050.

ANSWERS TO MULTIPLE CHOICE

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1. c) | 1. e) | 1. d) | 1. c) | 1. c) |
| 1. a) | 1. c) | 1. b) | 1. b) | 1. d) |

Authors’ Recommended Solution Time

(Time in minutes)

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *Mini-exercises* | | *Exercises* | | *Problems* | | *Alternate Problems* | | *Cases and Projects* | |
| *No.* | *Time* | *No.* | *Time* | *No.* | *Time* | *No.* | *Time* | *No.* | *Time* |
| 1 | 5 | 1 | 30 | 1 | 35 | 1 | 45 | 1 | 30 |
| 2 | 5 | 2 | 30 | 2 | 45 | 2 | 40 | 2 | 30 |
| 3 | 5 | 3 | 30 | 3 | 30 | 3 | 40 | 3 | 30 |
| 4 | 5 | 4 | 30 | 4 | 25 | 4 | 30 | 4 | 20 |
| 5 | 5 | 5 | 20 | 5 | 45 | 5 | 30 | 5 | 45 |
| 6 | 5 | 6 | 20 | 6 | 30 | 6 | 35 | 6 | \* |
| 7 | 5 | 7 | 20 | 7 | 30 | 7 | 35 |  |  |
| 8 | 5 | 8 | 20 | 8 | 40 | 8 | 45 |  |  |
| 9 | 10 | 9 | 30 | 9 | 40 |  |  |  |  |
| 10 | 10 | 10 | 20 | 10 | 25 |  |  |  |  |
| 11 | 5 | 11 | 20 | 11 | 40 |  |  |  |  |
|  |  | 12 | 15 | 12 | 30 |  |  |  |  |
|  |  | 13 | 20 | 13 | 35 |  |  |  |  |
|  |  | 14 | 20 | 14 | 30 |  |  |  |  |
|  |  | 15 | 15 |  |  |  |  |  |  |
|  |  | 16 | 20 |  |  |  |  |  |  |
|  |  | 17 | 20 |  |  |  |  |  |  |
|  |  | 18  19  20  21  22  23  24  25 | 20  20  15  20  20  15  20  20 |  |  |  |  |  |  |

\* Due to the nature of this project, it is very difficult to estimate the amount of time students will need to complete the assignment. As with any open-ended project, it is possible for students to devote a large amount of time to these assignments. While students often benefit from the extra effort, we find that some become frustrated by the perceived difficulty of the task. You can reduce student frustration and anxiety by making your expectations clear. For example, when our goal is to sharpen research skills, we devote class time to discussing research strategies. When we want the students to focus on a real accounting issue, we offer suggestions about possible companies or industries.

**MINI-EXERCISES**

**M9–1.**

**1st Year** $600,000 × .11 ×1/12 = $5,500

**2nd Year** $600,000 × .11 × 2/12 = $11,000

**M9–2.**

October 1

|  |  |  |  |
| --- | --- | --- | --- |
| Cash (+A) | 290,000 |  |  |
| Note payable (+L) |  |  | 290,000 |

December 31

|  |  |  |  |
| --- | --- | --- | --- |
| Interest expense (+E, -SE) | 7,250 |  |  |
| Interest payable (+L) |  |  | 7,250 |

**M9–3.**

1. Computed from balance sheet data
2. Balance sheet
3. Notes to the statements
4. Not reported but can be computed from balance sheet and income statement data.
5. Statement of cash flows

**M9–4.**  Working Capital: $ 120,000 - $ 90,000 = $ 30,000

**M9–5.**

|  |
| --- |
| **Working Capital** |
| Remain the same |
| Decrease |
| Remain the same |
| Remain the same |

**M9–6.**

**2014** Buzz does not have to record or disclose the liability because the chance of the liability occurring is remote.

**2015** Buzz must disclose the liability in a note because the liability is reasonably possible.

**2016** Buzz must disclose the liability in a note since the existence of a liability is reasonably possible. If the lawyers believe that the case will be lost on appeal, a liability should be recorded.

**2017** Buzz must record the loss and the liability because the out of court settlement made the $150,000 loss probable.

**M9–7.**

|  |  |  |
| --- | --- | --- |
| $500,000 × 0.4632 | = | $231,600 |

**M9–8.**

|  |  |  |
| --- | --- | --- |
| $15,000 × 6.1446 | = | $92,169 |

**M9–9.**

|  |  |  |
| --- | --- | --- |
| $118,000 | = | $118,000 |
| + $129,000 × 0.9524 | = | 122,860 |
| + $ 27,500 × 5.0757 | = | 139,582 |
| Total | = | $380,442 |

**M9–10.**

|  |  |  |
| --- | --- | --- |
| $27,500 × 5.9847 | = | $164,579 |
| $16,250 × 15.1929 | = | $246,885 |

It is much better to save $16,250 for 10 years.

**M9–11.**

|  |  |  |
| --- | --- | --- |
| $125,000 | = | X (7.3359) |
| $17,039 | = | X |

**EXERCISES**

**E9–1.**

Req. 1

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| (a) | Current assets |  |  | $168,000 |  |
|  | Current liabilities: |  |  |  |  |
|  | Accounts payable | $56,000 |  |  |  |
|  | Income taxes payable | 14,000 |  |  |  |
|  | Liability for withholding taxes | 3,000 |  |  |  |
|  | Rent revenue collected in advance | 7,000 |  |  |  |
|  | Wages payable | 7,000 |  |  |  |
|  | Property taxes payable | 3,000 |  |  |  |
|  | Note payable, 10% (due in 6 months) | 12,000 |  |  |  |
|  | Interest payable | 400 |  | (102,400 | ) |
|  | Working capital |  |  | $ 65,600 |  |

Working capital is critical for the efficient operation of a business. Current assets include cash and assets that will be collected in cash within one year or the normal operating cycle of the company. A business with insufficient working capital may not be able to pay its short term creditors on a timely basis.

Req. 2

No, contingent liabilities are reported in the notes, not on the balance sheet. Therefore, they are not included in the required computations.

**E9–2.**

Req. 1

March 31

|  |  |  |  |
| --- | --- | --- | --- |
| Salary and wage expense (+E, -SE) | 200,000 |  |  |
| Liability for income taxes withheld-employees (+L) |  |  | 40,000 |
| Liability for insurance premiums withheld-employees (+L) |  |  | 1,000 |
| FICA taxes payable-employees (+L) |  |  | 15,000 |
| Cash (-A) |  |  | 144,000 |
| Payroll for March including employee deductions. |  |  |  |

Req. 2

March 31

|  |  |  |  |
| --- | --- | --- | --- |
| Payroll tax expense (+E, -SE) | 15,000 |  |  |
| FICA taxes payable-employer (+L) |  |  | 15,000 |
| Employer payroll taxes on March payroll. |  |  |  |
|  |  |  |  |
|  |  |  |  |

Req. 3

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Liability for income taxes withheld-employees (-L) | 40,000 |  |  | |
| Liability for insurance premiums withheld-employees (-L) | 1,000 |  |  | |
| FICA taxes payable-employees (-L) | 15,000 |  |  | |
| FICA taxes payable-employer (-L) | 15,000 |  |  | |
| Cash (-A) |  |  | 71,000 | |
| Remittance of payroll taxes and deductions for March payroll. |  |  |  | |
|  |  |  |  | |
|  | | | |

**E9–3.**

Req. 1

The additional labor expense was $6,000, which is the total of payroll taxes that must be paid by the employer. The $10,000 income taxes and the $6,000 FICA taxes paid by the employees did not add to the labor cost of the employer. The total labor cost to the company was $86,000 + $6,000 = $92,000. The employees’ take-home pay was $70,000; that is, the total of salaries and wages less the deductions paid by the employees (i.e., $86,000 – $10,000 – $6,000).

Req. 2

Balance sheet liabilities:

|  |  |
| --- | --- |
| Liability for income taxes withheld | $ 10,000 |
| FICA taxes payable ($6,000 + $6,000) | 12,000 |
| Total | $22,000 |

Req. 3

Both managers and analysts would understand that a 10% increase in salaries is more expensive than a 10% increase in the employer’s share of FICA (or any other benefit). The reason is that many benefits are stated as a percentage of salary. As a result, the cost of a 10% increase in salaries is an increase in both salaries and fringe benefits.

**E9–4.**

Req. 1

November 1

|  |  |  |  |
| --- | --- | --- | --- |
| Cash (+A) | 4,800,000 |  |  |
| Note payable (+L) |  |  | 4,800,000 |
| Borrowed on 6-month, 8%, note payable. |  |  |  |

Req. 2

December 31 (end of the accounting period):

|  |  |  |  |
| --- | --- | --- | --- |
| Interest expense (+E, -SE) | 64,000 |  |  |
| Interest payable (+L) |  |  | 64,000 |
| Adjusting entry for 2 months’ accrued interest  ($4,800,000 x 8% x 2/12 = $64,000). |  |  |  |

Req. 3

April 30 (maturity date):

|  |  |  |  |
| --- | --- | --- | --- |
| Note payable (-L) | 4,800,000 |  |  |
| Interest payable (per above) (-L) | 64,000 |  |  |
| Interest expense ($4,800,000 x 8% x 4/12) (+E, -SE) | 128,000 |  |  |
| Cash (-A) |  |  | 4,992,000 |
| Paid note plus interest at maturity. |  |  |  |

Req. 4

It is doubtful that long-term borrowing would be appropriate in this situation. After the Christmas season, Neiman Marcus will collect cash from its credit sales. At this point, it does not need borrowed funds. It would be costly to pay interest on a loan that was not needed. It might be possible to borrow for a longer term at a lower interest rate and invest idle cash to offset the interest charges. Neiman Marcus should explore this possibility with its bank but in most cases it would be better to borrow on a short-term basis to meet short-term needs.

**E9–5.**

Req.1

|  |  |  |  |
| --- | --- | --- | --- |
| Date | Assets | Liabilities | Stockholders’ Equity |
| November 1 | Cash + | Note Payable + | Not Affected |
| December 31 | Not Affected | Interest Payable + | Interest Expense – |
| April 30 | Cash – | Note Payable –  Interest Payable – | Interest Expense – |

Req. 2

It is doubtful that long-term borrowing would be appropriate in this situation. After the Christmas season, Neiman Marcus will collect cash from its credit sales. At this point, it does not need borrowed funds. It would be costly to pay interest on a loan that was not needed. It might be possible to borrow for a longer term at a lower interest rate and invest idle cash to offset the interest charges. Neiman Marcus should explore this possibility with its bank but in most cases it would be better to borrow on a short-term basis to meet short-term needs.

**E9–6.**

Analysts want to evaluate the short-term obligations of a business in order to assess liquidity or the ability to satisfy a liability that must be paid in the near future. If PepsiCo had to pay the $3.6 billion immediately, the analysts would want to know the source of the needed cash. Because PepsiCo plans to refinance the debt, it will not have to pay it immediately. Therefore, an analyst would be less concerned about this type of debt.

The key condition that must be satisfied for a short-term borrowing to be classified as long term is the assurance that the debt can be refinanced. A desire or a plan is not sufficient. There must be evidence that the company has the capability to do so.

**E9-7**

Total assets = $1,200,000

Noncurrent liabilities + Stockholders equity = $780,000

Therefore, current liabilities = $420,000

Working capital = $750,000 – $420,000 = $330,000

**E9–8.**

Req. 1

|  |  |  |  |
| --- | --- | --- | --- |
| Date | Assets | Liabilities | Stockholders’ Equity |
| January 10 | Inventory + | Accounts Payable + | Not Affected |
| March 1 | Cash + | Note Payable + | Not Affected |

Req. 2

August 31 Cash Paid: $47,250 (Principal plus interest)

Req. 3

Transaction (a) has no impact on cash flows because there is neither an inflow nor an outflow of cash. Transaction (b) results in an inflow of cash from financing activities. The August 31 payment is an outflow of cash. (Note to instructor: If you have emphasized the Statement of Cash Flows, you should discuss the specific nature of these cash flows. The repayment of principal is a cash flow from financing activities and the payment of interest expense is a component of cash flows from operating activities.)

**E9–9.**

The note does not give us sufficient information to reach a definitive conclusion but there a several factors that should be discussed. No obligation for future payments is recorded if the lease is short term, but the note indicates that the leases are long term and are designed to provide long-term occupancy rights. The critical issue is whether the leases meet one of the criteria to be classified as a capital lease in which case the present value of the lease payments would be recorded as a liability. We find that students enjoy talking about why McDonald’s buys some properties but leases others and how the accounting treatments differ.

**E9–10.**

The question of whether a lease will be recorded as a liability depends on the specific facts and circumstances associated with the lease. In the most simple terms, a short-term lease probably would not have to be recorded as a liability but a long-term lease would probably be recorded as a liability. The assistant is correct in the sense that assets could be acquired under a lease and, if the transaction is structured in the proper manner, no liability would be recorded.

In class, we like to use this question to explore two issues: (1) Should managers structure transactions to meet the business needs of the company or to comply with rules associated with a preferred accounting treatment, and (2) Do users of financial statements react to the manner in which a transaction is reported or to the underlying economic reality of the transaction?

**E9–11.**

Req. 1

**Year 2014 Year 2015**

Income taxes payable $250,000 $290,000

Increase in deferred tax liability 54,000 58,000

Income tax expense $304,000 $348,000

Req. 2.

Tax expense is based on income reported on the income statement while tax liability is based on income reported on the tax return. Because different rules govern the preparation of the two statements, the tax expense and taxes currently payable are usually different.

**E9–12.**

Req. 1

|  |  |
| --- | --- |
|  | Income tax payable: |

Income tax expense $580,000

Less: increase in deferred taxes 108,000

Income taxes payable $472,000

Req. 2

There are separate rules governing the determination of tax expense (GAAP) and the amount of taxes currently payable (IRS regulations). Companies are required to keep separate records. Fortunately, most companies are able to reduce the amount of taxes currently payable by maintaining two sets of books. This savings justifies the additional bookkeeping costs.

**E9–13.**

Req. 1

For each year, income tax expense is less than income taxes currently payable. It is important for students to recognize that deferred taxes do not always result in lower taxes payable when compared to tax expense.

Req. 2

This note explains the difference between taxes currently payable and tax expense for each year. It is not the amount of deferred taxes reported on the balance sheet.

**E9–14.**

Req. 1

|  |  |  |
| --- | --- | --- |
| $60,000 x 0.7513 | = | $45,078 |

Req. 2

|  |  |  |
| --- | --- | --- |
| $10,000 x 2.4869 | = | $24,869 |

It is better to pay in three installments because the economic cost is less.

Req. 3

|  |  |  |
| --- | --- | --- |
| $90,000 x 0.5132 | = | $46,188 |

Req. 4

|  |  |  |
| --- | --- | --- |
| $40,000 x 6.1446 | = | $245,784 |

**E9–15.**

Present value of annuity: $20,000 x 4.8684 = $97,368

Because the present value of the annuity is less than the immediate cash payment, the winner should select the cash payment.

**E9–16.**

Present value of future amount: $1,000,000 x 0.5019 = $501,900

Because the client already has $300,000 in the account, she needs to deposit an additional $201,900.

**E9–17.**

Present value of annuity: $20,000 x 3.2397 = $64,794

**E9–18.**

Present value of unequal payments:

$20,000 x 0.9091 = $18,182

30,000 x 0.8264 = 24,792

50,000 x 0.7513 = 37,565

$80,539

**E9–19.**

Present value of cash payments:

$15,000 x 5.9713 = $89,570

150,000 x 0.5820 = 87,300

$176,870

**E9–20.**

|  |  |  |
| --- | --- | --- |
| $1,000,000 x 0.5584 | $ 558,400 |  |
| $200,000 x 7.3601 | 1,472,020 |  |
| Present value | $2,030,420 |  |
|  |  |  |

**E9–21.**

|  |  |  |
| --- | --- | --- |
| $10,000 x 0.6730 | $ 6,730 |  |
| $500 x 16.3514 | 8,176 |  |
| Present value | $14,906 |  |
|  |  |  |

**E9–22.**

Req. 1

$6,000 x 2.5937 = $15,562

Req. 2

$15,562 – $6,000 = $9,562 (time value of money, or interest)

Req. 3

**1st year:** $6,000 x 10% = $600 (interest)

**2nd year:** ($6,000 + $600) x 10% = $660 (interest)

**E9–23**

Req. 1

$58,800 x 1.3605 = $79,997

Req. 2

|  |  |  |  |
| --- | --- | --- | --- |
| Savings account (+A) | 58,800 |  |  |
| Cash (-A) |  |  | 58,800 |

Req. 3

$79,997 – $58,800 = $21,197 (time value of money or interest)

Req. 4

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | December 31 | | | | | | |
|  | 2014 | | |  | 2015 | | |
| Savings account (+A) | 4,704 |  |  |  | 5,080 |  |  |
| Interest revenue (+R, +SE) |  |  | 4,704 |  |  |  | 5,080 |

Computations:

**2014:** $58,800 x 8% = $4,704.

**2015:** ($58,800 + $4,704) x 8% = $5,080.

**E9–24**

Req. 1

December 31

|  |  |  |  |
| --- | --- | --- | --- |
| Savings account (+A) | 2,000 |  |  |
| Cash (-A) |  |  | 2,000 |

Req. 2

$2,000 x 15.1929 = $30,386 (balance)

Req. 3

$30,386 - ($2,000 x 10) = $10,386 (time value of money or interest)

Req. 4

**1st year:** $2,000 x 9% = $180

**2nd year:** ($2,000 + $2,000 + $180) x 9% = $376

Req. 5

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | December 31 | | | | | | |
|  | 2015 | | |  | 2016 | | |
| Savings account (+A) | 2,180 |  |  |  | 2,376 |  |  |
| Cash (-A) |  |  | 2,000 |  |  |  | 2,000 |
| Interest revenue (+R, +SE) |  |  | 180 |  |  |  | 376 |

**E9–25.**

Req. 1 $3,500 x 4.3746 = $15,311 (balance in the fund)

Req. 2 $15,311 – ($3,500 x 4) = $1,311 (time value of money or interest)

Req. 3

**1st year:** No interest because the deposit was at year-end.

**2nd year:** $3,500 x 6% = $210 (interest)

**3rd year:** ($3,500 + $3,500 + $210) x 6% = $433

**4th year:** ($3,500 + $3,500 + $3,500 + $210 + $433) x 6% = $669

**PROBLEMS**

**P9–1.**

Req. 1

January 15:

|  |  |  |  |
| --- | --- | --- | --- |
| Purchases (+A) | 26,500 |  |  |
| Cash (-A) |  |  | 26,500 |
|  |  |  |  |

April 1:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Cash (+A) | 700,000 |  |  | |
| Note payable, short term (+L) |  |  | 700,000 | |
|  | | | |

June 14:

|  |  |  |  |
| --- | --- | --- | --- |
| Cash (+A) | 15,000 |  |  |
| Unearned revenue (+L) |  |  | 15,000 |
|  |  |  |  |

July 15:

|  |  |  |  |
| --- | --- | --- | --- |
| Unearned revenue (-L) | 3,750 |  |  |
| Service revenue (+R, +SE) |  |  | 3,750 |
|  |  |  |  |

December 12:

|  |  |  |  |
| --- | --- | --- | --- |
| Electric expense (+E, -SE) | 27,860 |  |  |
| Electric payable (+L) |  |  | 27,860 |
|  |  |  |  |

December 31:

|  |  |  |  |
| --- | --- | --- | --- |
| Wage expense (+E, -SE). | 15,000 |  |  |
| Wages payable (+L) |  |  | 15,000 |
|  |  |  |  |

Req. 2

December 31:

|  |  |  |  |
| --- | --- | --- | --- |
| Interest expense (+E, -SE). | 31,500 |  |  |
| Interest payable (+L) |  |  | 31,500 |
| ($700,000 x 6% x 9/12 = $31,500). |  |  |  |

**P9–2.**

Req. 1

January 8:

|  |  |  |  |
| --- | --- | --- | --- |
| Purchases (+A) | 14,860 |  |  |
| Accounts payable (+L) |  |  | 14,860 |
|  |  |  |  |

January 17:

|  |  |  |  |
| --- | --- | --- | --- |
| Accounts payable (-L) | 14,860 |  |  |
| Cash (-A) |  |  | 14,860 |
|  |  |  |  |

April 1:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Cash (+A) | 35,000 |  |  | |
| Note payable, short term (+L) |  |  | 35,000 | |
|  | | | |

June 3:

|  |  |  |  |
| --- | --- | --- | --- |
| Purchases (+A) | 17,420 |  |  |
| Accounts payable (+L) |  |  | 17,420 |
|  |  |  |  |

July 5:

|  |  |  |  |
| --- | --- | --- | --- |
| Accounts payable (-L) | 17,420 |  |  |
| Cash (-A) |  |  | 17,420 |
|  |  |  |  |

August 1:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Cash (+A) | 6,000 |  |  | |
| Rent revenue ($6,000 x 5/6) (+R, +SE) |  |  | 5,000 | |
| Deferred rent revenue ($6,000 x 1/6) (+L) |  |  | 1,000 | |
|  | | | |

December 20:

|  |  |  |  |
| --- | --- | --- | --- |
| Cash (+A) | 100 |  |  |
| Liability-deposit on trailer (+L) |  |  | 100 |
|  |  |  |  |

December 31:

|  |  |  |  |
| --- | --- | --- | --- |
| Wage expense (+E, -SE). | 9,500 |  |  |
| Wages payable (+L) |  |  | 9,500 |
|  |  |  |  |

**P9–2. (continued)**

Req. 2

December 31:

|  |  |  |  |
| --- | --- | --- | --- |
| Interest expense (+E, -SE). | 2,100 |  |  |
| Interest payable (+L) |  |  | 2,100 |
| ($35,000 x 8% x 9/12 = $2,100). |  |  |  |

Req. 3

Balance Sheet, December 31

|  |  |  |  |
| --- | --- | --- | --- |
| Current Liabilities |  |  |  |
| Note payable, short term | $35,000 |  |  |
| Deposit on trailer | 100 |  |  |
| Wages payable | 9,500 |  |  |
| Interest payable | 2,100 |  |  |
| Deferred rent revenue | 1,000 |  |  |
| Total |  |  | $47,700 |

Req. 4

|  |  |
| --- | --- |
| **Transaction** | **Effect** |
| January 8 | No effect |
| January 17 | Decrease |
| April 1 | Financing activity (no effect on operating activities) |
| June 3 | No effect |
| July 5 | Decrease |
| August 1 | Increase |
| December 20 | Increase |
| December 31 | No effects for either entry |

**P9–3**.

Req. 1

|  |  |  |  |
| --- | --- | --- | --- |
| Date | Assets | Liabilities | Stockholders’ Equity |
| January 8 | Purchases + | Accounts Payable + | No effect |
| January 17 | Cash – | Accounts Payable – | No effect |
| April 1 | Cash + | Note Payable + | No effect |
| June 3 | Purchases + | Accounts Payable + | No effect |
| July 5 | Cash – | Accounts Payable – | No effect |
| August 1 | Cash + | Deferred Revenue + | Revenue + |
| December 20 | Cash + | Deposit + | No effect |
| December 31 | No effect | Wages Payable + | Wage Expense - |
| December 31 | No effect | Interest Payable + | Interest Expense - |

Req. 2

|  |  |
| --- | --- |
| **Transaction** | **Effect** |
| January 8 | No effect |
| January 17 | Decrease |
| April 1 | Financing activity (no effect on operating activities) |
| June 3 | No effect |
| July 5 | Decrease |
| August 1 | Increase |
| December 20 | Increase |
| December 31 | No effects for either entry |

**P9–4.**

Req. 1

(a) December 31

|  |  |  |  |
| --- | --- | --- | --- |
| Wage expense (+E, -SE) | 4,000 |  |  |
| Wages payable (+L) |  |  | 4,000 |

(b) January 6

|  |  |  |  |
| --- | --- | --- | --- |
| Wages payable (-L) | 4,000 |  |  |
| Cash (-A) |  |  | 4,000 |

Req. 2

(a) December 10

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Cash (+A) | 2,400 |  | |  |
| Rent revenue (+R, +SE) |  |  | | 2,400 |
| Collection of rent revenue for one month. | | |

(b) December 31

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Rent revenue (-R, -SE) | 800 |  | |  |
| Rent revenue collected in advance (or Deferred rent   revenue) (+L) |  |  | | 800 |
| Unearned rent (10/30 x $2,400 = $800). | | |

Alternatively, the collection could have been originally recorded as follows, which would not require an adjusting entry:

|  |  |  |  |
| --- | --- | --- | --- |
| Cash (+A) | 2,400 |  |  |
| Rent revenue (+R, +SE) |  |  | 1,600 |
| Rent revenue collected in advance(+L) |  |  | 800 |

Req. 3

Balance sheet at December 31

|  |  |
| --- | --- |
| Current Liabilities: |  |
| Wages payable | 4,000 |
| Rent revenue collected in advance | 800 |

Req. 4

Accrual-based accounting is more beneficial to financial analysts because it records revenues when they are earned and expenses when they are incurred, regardless of when the related cash is received or paid. A financial analyst is looking towards the future of the company, so it is helpful to know how much cash will be coming into and out of the company at later dates.

**P9–5.**

Req. 1

|  |  |  |  |
| --- | --- | --- | --- |
| Date | Assets | Liabilities | Stockholders’ Equity |
| (a) December 31 | No impact | Wages Payable + | Wages Expense - |
| (b) January 6 | Cash - | Wages Payable - | No impact |
| (c) December 10 | Cash + | No impact | Rent Revenue + |
| (d) December 31 | No impact | Deferred Rent + | Rent Revenue - |

Req. 2

Accrual-based accounting is more beneficial to financial analysts because it records revenues when they are earned and expenses when they are incurred, regardless of when the related cash is received or paid. A financial analyst is looking towards the future of the company, so it is helpful to know how much cash will be coming into and out of the company at later dates.

**P9–6.**

1. December 31

|  |  |  |  |
| --- | --- | --- | --- |
| Warranty expense (+E, -SE) | 500,000,000 |  |  |
| Warranty payable (+L) |  |  | 500,000,000 |

Total effect of various transactions during 2015:

|  |  |  |  |
| --- | --- | --- | --- |
| Warranty payable (-L) | 500,000,000 |  |  |
| Cash (-A) |  |  | 500,000,000 |

2. Total effect of various transactions during 2014:

|  |  |  |  |
| --- | --- | --- | --- |
| Cash (+A) | 90,000,000 |  |  |
| Unearned revenue (+L) |  |  | 90,000,000 |

For 2015:

|  |  |  |  |
| --- | --- | --- | --- |
| Unearned revenue (-L) | 54,000,000 |  |  |
| Revenue (+R, +SE) |  |  | 54,000,000 |

3. The company should report litigation expense and the related liability after the jury awarded damages. If lawyers for Brunswick are confident of their grounds for appeal, the company might simply report a contingent liability.

4. As an oil and gas company, Halliburton can be expected to have some adverse impact on our environment. In many cases, federal law requires these companies to rectify these negative effects. Halliburton records the cost of future environmental cleanup efforts in the year that the damage is done instead of the year that the work is performed. This policy is consistent with the matching principle. Environmental damage can be thought of as a necessary cost of producing oil and gas. The cost should be matched with the revenue generated by the sale of gas and oil instead of being recorded as an expense in the period in which the cleanup work actually takes place.

**P9–7.**

Req. 1 Not reported---Amount not subject to estimate

Req. 2 Not reported---No reason to believe that loss is probable

Req. 3 Report liability---Amount can be estimated and loss seems probable

Req. 4 Judgment call depending on circumstances. A footnote disclosure might be sufficient, but some auditors would insist on a liability.

Req. 5 Report liability--- Amount is known and loss is probable

**P9–8.**

a. Remain the same

b. Decrease

c. Remain the same

1. d. Remain the same (because it is a financing activity)

e. Remain the same

f. Decrease

g. Remain the same

h. Remain the same

i. Increase

**P9–9.**

The current liability classification is based on the expectation that the company will pay the liabilities during the subsequent year. Analysts are interested in this classification because it provides important information to use when predicting future cash flows. If management has the intent and the ability to refinance a short-term liability, then it will not result in a cash outflow. In this circumstance, it is appropriate to reclassify the debt as long term.

The working capital for PepsiCo should be compared over time and to other companies before the analyst makes a determination. In the case of PepsiCo, the company is not experiencing a liquidity problem. It generates large cash flows from operations and has a significant line of credit available if it needs additional funds. Furthermore, the industry traditionally operates with a relatively low amount of working capital. It is therefore that  **P9–9. (continued)**

unlikely management made the reclassification simply to increase its working capital. Instead the company was probably trying to get a better balance between short-term and long-term borrowings.

Because management has the ability and intent to refinance the borrowings on a long-term basis working capital should be based on the reclassification. The analyst might want to use the number before reclassification if he or she thought that the reclassification was only intended to manipulate working capital (which does not appear to be the case). The analyst should use caution when comparing working capital for the current year (after reclassification) with the number for the previous year (before reclassification).

**P9–10.**

Req. 1

GAAP Depreciation: $1,000,000 ÷ 20 years = $50,000

Tax Depreciation: $1,000 000 × 10% = $100,000

Book Value:

**2014** **2015**

GAAP Tax GAAP Tax

Cost $1,000,000 $1,000,000 $1,000,000 $1,000,000

Acc. Dep 50,000 100,000 100,000 200,000

Book Value $ 950,000 $ 900,000 $ 900,000 $ 800,000

Deferred tax liability 2014:

($950,000 - $900,000) × 34% = $17,000

Deferred tax liability 2015:

($900,000 - $800,000) × 34% = $34,000

The difference is a liability because additional income taxes must be paid in the future. This is a result of lower depreciation deductions in the tax return for the future; that is, lower tax deductions means more income tax in the future on other taxable amounts.

**P9–10. (continued)**

Req. 2: **Income tax expense 2014:**

Taxes payable $400,000

Deferred taxes 17,000

Income tax expense $417,000

**Income tax expense 2015**:

Taxes payable $625,000

Deferred taxes 17,000

Income tax expense $642,000

**P9–11.**

Req. 1

Present value of debt:  
 $115,000 x 0.6227 = $71,611

  $6,000 x 5.3893 = 32,336

$103,947

Req. 2

Single sum to deposit:  
 $490,000 x .5820 = $285,180

Interest revenue:  
 $490,000 - $285,180 = $204,820

Req. 3

Present value of payments:

$75,000 x 0.9346 = $70,095

$112,500 x 0.8734 = 98,258

$150,000 x 0.8163 = 122,445

$290,798

**P9–11. (continued)**

Req. 4

Equal annual payments on note payable:   
   $136,000 ÷ 4.1002 = $33,169

Interest expense:  
   ($33,169 x 5) - $136,000 = $29,845

**P9–12.**

**Option 1:**

|  |  |  |
| --- | --- | --- |
| $1,250,000 × 6.1446 | = | $7,680,750 |

**Option 2:**

|  |  |  |
| --- | --- | --- |
| $10,000,000 | = | $10,000,000 |

**Option 3:**

|  |  |  |
| --- | --- | --- |
| $4,000,000 + ($1,000,000 × 5.3349) | = | $9,334,900 |

Option 2 is the best option because it provides the greatest present value when all options are discounted.

**P9–13.**

Req. 1  
 $120,000 ÷ 4.4399 = $27,028 (annual deposits)

Req. 2  
 $120,000 - ($27,028 x 4) = $11,888 (time value of money or interest)

Req. 3

|  |  |
| --- | --- |
| **1st year:** None because the first deposit was at the end of the year. |  |
| **2nd year:** $27,028 x 7% | $ 1,892 |
| **3rd year:** ($27,028 + $1,892 + $27,028) x 7% | 3,916 |
| **4th year:** ($27,028 + $1,892 + $27,028 + $3,916 + $27,028) x 7% | 6,082 |
| Total interest revenue (differs from above because of rounding) | $11,890 |

**P9–14.**

Req. 1

Future Value of Deposit:

$50,000 × 1.2653 = $63,265

Interest Earned:

$63,265 - $50,000 = $13,265

Req. 2

Future Value of Deposits:

$130,000 × 7.3359 = $953,667

Interest Earned:

$953,667 - $780,000 = $173,667

Req. 3

Future Value of Deposit:

$250,000 × 1.5869 = $396,725

Interest Earned:

$396,725 - $250,000 = $146,725

**ALTERNATE PROBLEMS**

**AP9–1.**

Req. 1

January 15

|  |  |  |  |
| --- | --- | --- | --- |
| Tax expense (+E, -SE) | 125,000 |  |  |
| Taxes payable (+L) |  |  | 93,000 |
| Deferred tax liability (+L) |  |  | 32,000 |

January 31

|  |  |  |  |
| --- | --- | --- | --- |
| Interest payable (-L) | 52,000 |  |  |
| Cash (-A) |  |  | 52,000 |

April 30

|  |  |  |  |
| --- | --- | --- | --- |
| Cash (+A) | 550,000 |  |  |
| Note payable (+L) |  |  | 550,000 |

June 3

|  |  |  |  |
| --- | --- | --- | --- |
| Inventory (+A) | 75,820 |  |  |
| Accounts payable (+L) |  |  | 75,820 |

July 5

|  |  |  |  |
| --- | --- | --- | --- |
| Accounts payable (-L) | 75,820 |  |  |
| Cash (-A) |  |  | 75,820 |

August 31

|  |  |  |  |
| --- | --- | --- | --- |
| Cash (+A) | 12,000 |  |  |
| Revenue (+R, +SE) |  |  | 8,000 |
| Deferred revenue (+L) |  |  | 4,000 |

Req. 2

December 31

|  |  |  |  |
| --- | --- | --- | --- |
| Interest expense (+E, -SE) | 44,000 |  |  |
| Interest payable (+L) |  |  | 44,000 |

|  |  |  |  |
| --- | --- | --- | --- |
| Long-term liability (-L) | 100,000 |  |  |
| Current liability (+L) |  |  | 100,000 |

|  |  |  |  |
| --- | --- | --- | --- |
| Wage expense (+E, -SE) | 85,000 |  |  |
| Wages payable (+L) |  |  | 85,000 |
|  |  |  |  |

**AP9–1. (continued)**

Req. 3

Balance Sheet:

|  |  |  |
| --- | --- | --- |
| CURRENT LIABILITIES |  |  |
|  | Wages Payable | $85,000 |
|  | Taxes Payable | 93,000 |
|  | Deferred Tax Liability | 32,000 |
|  | Interest Payable | 44,000 |
|  | Deferred Revenue | 4,000 |
|  | Note Payable | 550,000 |
|  | Current Portion of Long-term Debt | 100,000 |
| TOTAL CURRENT LIABILITIES |  | $908,000 |

Req. 4

Cash from Operating Activities:

|  |  |
| --- | --- |
| January 15 | No effect |
| January 31 | Decreased |
| April 30 | No effect |
| June 3 | No effect |
| July 5 | Decreased |
| August 31 | Increased |
| All December 31 transactions | No effect |

**AP9–2.**

Req. 1

|  |  |  |  |
| --- | --- | --- | --- |
| **Date** | **Assets** | **Liabilities** | **Stockholders’ Equity** |
| January 15 | No effect | Deferred Tax Liability + Taxes Payable + | Expense – |
| January 31 | Cash – | Interest Payable – | No effect |
| April 30 | Cash + | Note Payable + | No effect |
| June 3 | Inventory + | Accounts Payable + | No effect |
| July 5 | Cash – | Accounts Payable – | No effect |
| August 31 | Cash + | Deferred Revenue + | Revenue + |
| December 31 | No effect | Interest Payable + | Interest Expense – |
| December 31 | No effect | Long-term Liability –  Current Liability + | No effect |
| December 31 | No effect | Wages Payable + | Wage Expense – |

Req. 2

Cash from Operating Activities:

|  |  |
| --- | --- |
| January 15 | No effect |
| January 31 | Decreased |
| April 30 | No effect |
| June 3 | No effect |
| July 5 | Decreased |
| August 31 | Increased |
| All December 31 transactions | No effect |

**AP9–3.**

Req.1

Warranty Expense +$3.9 billion

Warranty Liability +($3.9 billion –$4 billion)

Cash - $4 billion

Req. 2

In year 2014, no revenue has been earned. The liability is $23 million.

Using an estimated life of 39 months, Bally may report $589,744 in revenue each month ($23 million ÷ 39) or $7,076,923 for the year. The balance sheet in 2015 would report Unearned revenue in the amount of $15,923,077.

Req. 3

While the trend for working capital is downward, it is doubtful that ExxonMobil is experiencing financial difficulty. The company has a reputation for aggressive cash management. It would be useful to study the Statement of Cash Flows to determine if ExxonMobil is generating significant cash resources from operating activities.

Req. 4

The company estimates future costs and records them as a current expense. The matching concept dictates that all costs related to earning revenue should be reported in the same accounting period as the revenue.

**AP9–4.**

a. Decrease

b. Decrease

c. Decrease

d. Remain the same

e. Decrease

f. Remain the same

g. Decrease

h. Decrease

i. Remain the same

**AP9–5.**

The contractual agreement that General Mills entered into allows them to reclassify the current borrowings as noncurrent debt. Management would want to do this in order to improve measures of liquidity. A financial analyst’s answer would not be different. A financial analyst would not be concerned because the company has the ability to extend the maturity dates of the debt beyond the current year.

**AP9–6.**

Req. 1

|  |  |  |
| --- | --- | --- |
| $2,000,000 X 0.6806 | = | $1,361,200 |
| $150,000 X 3.9927 | = | 598,905 |
| $1,960,105 |

Req. 2

|  |  |  |
| --- | --- | --- |
| $1,000,000 × .4632 | = | $463,200 |

The total amount of interest earned = $536,800

Req. 3

|  |  |  |
| --- | --- | --- |
| $350,000 ÷ 3.3121 | = | $105,673 |
| $422,692 - $350,000 | = | $72,692 The total amount of interest |

**AP9–7.**

|  |  |  |
| --- | --- | --- |
| **Option 1:** |  |  |
| $750,000 | = | $750,000 |
| **Option 2:** |  |  |
| $60,000 × 11.4699 | = | $688,194 |
| **Option 3:** |  |  |
| $50,000 × 7.3601 | = | $368,005 |
| + $80,000 × 7.3601 × 0.5584 | = | 328,790 |
| Total | = | $696,795 |

Option one is the best because it gives you the highest return. The time value of money makes a dollar received today worth more than a dollar received one year from now.

**AP9–8.**

Req. 1  
   $320,000 x 3.2781 = $1,048,992

Req. 2

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Fund Accumulation Schedule | | | | | | | | | | | | | | | | | | |
| Date |  | Cash Payment (cr) |  | Interest Revenue (prior balance x 9%) (cr) | | | | | |  | | Fund Increase | |  | | Fund Balance (dr) | |
| 12/31/2014 |  | $320,000 |  |  |  |  |  |  |  | | $ 320,000 | |  | | $ 320,000 | |
| 12/31/2015 |  | 320,000 |  | $320,000 | x | 9% | = | $28,800 |  | | 348,800 | |  | | 668,800 | |
| 12/31/2016 |  | 320,000 |  | 668,800 | x | 9% | = | 60,192 |  | | 380,192 | |  | | 1,048,992 | |
| Total |  | $960,000 |  |  |  |  |  | $88,992 |  | | $1,048,992 | |  | |  | |

**CASES AND PROJECTS**

*FINANCIAL REPORTING AND ANALYSIS CASES*

**CP9–1.**

Req. 1 Accrued compensation and payroll taxes are $42,625,000.

Req. 2 Accounts payable increased by $17,934,000 (as reported on the SCF). This change increased operating cash flows.

Req. 3 Long-term liabilities (called non-current in this report) are $128,550,000.

**CP9–2.**

Req. 1 The amount of accrued compensation is $15,630,000.

Req. 2 Accounts payable increased by $21,310,000 (as reported on the SCF). This change increased operating cash flows.

Req. 3 Long-term liabilities are $183,974,000.

**CP9–3.**

Req. 2

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | Urban Outfitters | | | | | American Eagle | | | | | |
|  |  | Accounts Payable | = | Cost of Goods Sold |  |  | $1,613,265 | = | 18.1 |  |  | $2,031,477 | = | 11.6 |  |
|  |  | Turnover Ratio | Avg. Accts Payable |  |  | $89,329\* |  |  | $175,753\*\* |  |

\*$(95,754 + 82,904)/2 = $89,329

\*\*$(183,783 + 167,723)/2 = $175,753

|  |  |
| --- | --- |
|  |  |
|  |  |

Req. 3

|  |  |  |  |
| --- | --- | --- | --- |
|  | Industry  Average | Urban Outfitters | American Eagle |
| Payable Turnover = | 11.6 | 18.1 | 11.6 |

The payable turnover ratio for Urban Outfitters is above the industry average while the one for American Eagle is the same as the average. Based on the payable turnover ratio, only Urban Outfitters is doing better than the average company in their industry at paying trade creditors but most analysts would not be concerned because the ratio for American Eagle is good.

**CP9–4.**

Req. 1

In business transactions, it usually is unreasonable to assume that one party will lend money to an unrelated party without charging interest. It is likely that the advertised selling price of the home included the true cash selling price plus an amount equal to the time value of money (interest) for the four-year period. Therefore, to evaluate the offer, the required payments must be analyzed (as in 2 below).

Req. 2

If the monthly payments actually include principal and interest, the cash selling price can be found by calculating the present value of the monthly payments:

   $3,125 x 37.9740 = $118,669

*CRITICAL THINKING CASES*

**CP9–5.**

The jackpot does not have a present value of $3 million. The payments include interest earned by the state while it makes payments over the 20-year period.

We believe that this form of advertising is misleading. We think that lottery jackpots should be advertised at their cash value today (i.e., present value) not the total of future payments.

*FINANCIAL REPORTING AND ANALYSIS PROJECT*

**CP9–6.**

The response to this case will depend on the companies selected by the students.

*CONTINUING CASE*

**CC9–1.**

Req. 1

September 15:

|  |  |  |  |
| --- | --- | --- | --- |
| Purchases (+A) | 125,000 |  |  |
| Cash (-A) |  |  | 125,000 |
|  |  |  |  |

October 1:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Cash (+A) | 900,000 |  |  | |
| Note payable, short term (+L) |  |  | 900,000 | |
|  | | | |

October 5:

|  |  |  |  |
| --- | --- | --- | --- |
| Cash (+A) | 40,000 |  |  |
| Unearned revenue (+L) |  |  | 40,000 |
|  |  |  |  |

October 15:

|  |  |  |  |
| --- | --- | --- | --- |
| Unearned revenue (-L) | 18,000 |  |  |
| Service revenue (+R, +SE) |  |  | 18,000 |
|  |  |  |  |

**CC9–1 (Continued)**

December 12:

|  |  |  |  |
| --- | --- | --- | --- |
| Electric expense (+E, -SE) | 12,000 |  |  |
| Electric payable (+L) |  |  | 12,000 |
|  |  |  |  |

December 31:

|  |  |  |  |
| --- | --- | --- | --- |
| Wage expense (+E, -SE). | 52,000 |  |  |
| Wages payable (+L) |  |  | 52,000 |
|  |  |  |  |

Req. 2

December 31:

|  |  |  |  |
| --- | --- | --- | --- |
| Interest expense (+E, -SE). | 11,250 |  |  |
| Interest payable (+L) |  |  | 11,250 |
| ($900,000 x 5% x 3/12 = $11,250). |  |  |  |