Chapter 9 – Accounting for Current Liabilities
MGMT 1A

I. Characteristics of Liabilities

A. Future Sacrifice *of Assets*

B. Unavoidable Obligation

C. The transaction creating the liability has already occurred – The Company has already:

1. Taken the goods = _*Accounts Payable*_________

2. Taken the money = _*Unearned Revenue*_______

3. Borrowed the money = _*Notes Payable*__

II. Current Liabilities – Liabilities that will be satisfied by the use of current assets (or paid off within a year) or the creation of other current liabilities.

A. A*ccounts Payable*_______

B. A*ccrued Expenses*____________

C. D*eferred Revenue*____________

D. N*otes Payable*_________________

III. Long Term Liabilities

A. L*ong-term Notes Payable*_____________

B. B*onds Payable*__________________

1. Current portion of long-term debt

2. Long-term debt

IV. Sales Tax - Payable to whom? *State Board of Equalization*

A. Example: We sell goods of _*$10,000*_ sales price on account; tax rate is _*10%*_.

What is the journal entry to record this sale?

DR: Accounts Receivable	*$11,000*	
CR: Sales		*$10,000*
CR: Sales Tax Payable		*$1,000*

V. Notes Payable

A. Very similar to Notes Receivable – *We owe $, but we did not purchase goods*

VI. Property Tax – assessed by county, taxes are paid by the property owner *all large assets*

A. Example: The county fiscal year runs from _*7/1*_ through _*6/30*_. The county

assesses your property in _*September*_ and sends you the bill on _*October 15*__.

The tax is due on _*November 15*_. Assume that we record monthly adjusting entries.

1. Entry on July 31, estimate annual property tax is _*$12,000*_; monthly is _*$1,000*__.

A: 7/31	*DR: Property Tax Expense*	*$1,000*	
	CR: Property Tax Payable		*$1,000*
	(Accrue estimated monthly property tax)		

2. Entry on October 31, actual property tax (annual) is _*$15,000*_; monthly is _*$1,250*____.

Was our estimate wrong? No – it was an estimate

A: 10/31	*DR: Property Tax Expense*	*$2,000*	
	CR: Property Tax Payable		*$2,000*

*[4 months elapsed * $1,250 / month] -$3,000 already accrued = $2,000*

3. Entry on November 15, when we pay.

11/15	*DR: Prepaid Property Tax*	*$10,000*	
	DR: Property Tax Payable	*$5,000*	
	CR: Cash		*$15,000*

4. What would be the adjusting entry to record on November 30?

A: 11/30	*DR: Property Tax Expense*	*$1,250*	
	CR: Prepaid Property Tax		*$1,250*

VII. Warranties *Promise from the seller to fix the product if it breaks*

A. When should they recognize the expense? Here are the choices:

1. When they sell the product

2. ~~When they fix the product~~

RULE: Recognize warranty expense at _*time of sale*_

B. Example: Sony estimates that _*5%*_ of all PlayStations sold will need to be repaired. The average repair bill (based on historical experience) is _*$90*_. During the year, Sony sold _*10,000*_ units. Prepare the adjusting journal entry at December 31 to record warranties.

A: 12/31	*Warranty Expense*	*$45,000*		
	Warranty Liability		*$45,000*	*← (10,000 units * 5% * $90)*
	(To accrue warranty liability)			

On 2/4, a customer brings in a PlayStation for repairs. Prepare the journal entry:

2/4	*Warranty Liability*	*$90*	
	Spare Parts Inventory (or Cash)		*$90*

C. Current or Long-Term? *Could be both. It depends – how much will break within 1 year? How much will break in > 1 year?*

VIII. Contingencies – loss or gain based on a future event. *Contingent = depends on*

A. Loss contingencies

1. Examples

a. Factoring receivables with recourse *contingent on customer not paying*

b. Warranties – what is the future event? *Contingent on product breaking*

c. Litigation *contingent on losing lawsuit*

2. Accounting
   a. If the loss is P*robable*_ and E*stimable*_, then

      A*ccrue*_ and D*isclose*__ the loss.

   b. If the loss is P*ossible*_, then just D*isclose*_ the loss.

   c. If the loss is R*emote*_, then do N*othing*_

   d. Entry to accrue:
      DR: Loss XX
      CR: Contingent Liability XX
      (Exact account names are not specific)

   e. Financial Reporting – Footnotes
      Disclose = Let the reader know
      Who is the reader of the financial statements? Potential Investors, Actual Investors, Regulators, Lenders

B. Insurance Deductibles
   1. Example: If I have an accident, and I get sued for _*$5,000*_ (or the repairs will cost

      _*$5,000*__) and my deductible is _*$500*____, what journal entry should I record?

      I have to pay the first $500; Insurance will cover the remaining $4,500.
      DR: Expense $500
      CR: Liability $500

C. Gain Contingencies
   NEVER RECORD A CONTINGENT GAIN – Conservatism Principle
   Record a gain when the cash is collected.

IX. Payroll

A. Employees

1. Gross Pay – means before deductions
2. Less Deductions – *amounts withheld from paycheck*

   a. F*IT – Federal Income Tax Payable = 10% - 37%*_

   b. S*IT – State Income Tax Payable = 1% - 11% in CA*_

   c. F*ICA – Federal Insurance Contribution Act; made up of 2 pieces:*_

      i. O*ASDI – Old Age Survivors Disability Insurance (a.k.a. Social Security) = 6.2% of first ~$129,000 (ceiling)*_

      ii. M*edicare – 1.45% no ceiling*_

   d. S*DI = State Disability Insurance = 0.9% of first ~$109,000 (ceiling)*_

3. Equals net Pay ← *i.e., paycheck*

4. Example: Assume Joe Bruin earns _*$10,000*_ per pay period, his federal income tax rate is _*20%*_, and his state income tax rate is _*10%*. What is the entry for UCLA to record to accrue Joe's pay?

Salary Expense	*$10,000*		
FIT Payable		*$2,000*	*← $10,000 * 20%*
SIT Payable		*$1,000*	*← $10,000 * 10%*
SS Payable		*$620*	*← $10,000 * 6.2%*
Medicare Payable		*$145*	*← $10,000 * 1.45%*
SDI Payable		*$90*	*← $10,000 * 0.9%*
Salary Payable		*$6,145*	*← PLUG*

Joe "takes home" only about 60% of his gross pay

What is the entry for UCLA to record on pay day?

Salary Payable	*$6,145*	
Cash		*$6,145*

B. Employers' Payroll Taxes *(matching amount)*

1. F*ICA (7.65%)*________________________________ = to the amount the employee pays

2. F*UTA – Federal Unemployment Tax Act 6% of first $7,000 PER EMPLOYEE (ceiling) gets reduced for SUTA (see below)*

   Because the $7,000 ceiling is PER EMPLOYEE, a Company is better off paying $35,000 salary to ONE Employee, than paying $7,000 salary to 5 employees.

3. S*UTA – State Unemployment Tax Act 5.4% of first $7,000 PER EMPLOYEE (ceiling)*

4. Example continued: What is the journal entry for UCLA to accrue employer's taxes?

DR: Payroll Tax Expense	*$1,185*		
CR: SS Payable		*$620*	*← Same as employee*
CR: Medicare Payable		*$145*	*← Same as employee*
CR: SUTA /P		*$378*	*← $7k ceiling * 5.4%*
CR: FUTA /P		*$42*	*← $7k ceiling * (6.0% - 5.4%)*

C. Retirement Savings

1. 401k – employer sponsored retirement plan
   Employee contributes pre-tax earnings, up to $19,500 per year
   Employer will match some portion of contributions ← this is FREE MONEY, never turn this down
   Defer paying taxes until you retire and take the money out (presumably you will be in a lower income tax bracket when you retire
2. Traditional IRA (Individual Retirement Account)
   Contribute Pre-tax earnings; pay tax when you withdraw

3. Roth IRA
   Contribute AFTER TAX earnings – this is a good option for college students who are (presumably) in a low/no income tax bracket now, but will be in a higher bracket at retirement.

X. Fair Labor Standards Act

A. O*vertime*_

B. M*inimum Wage*_

XI. Financial Analysis

A. EBIT = E*arnings*_ B*efore*_ I*nterest*_ and T*axes*_

Companies pay vastly different amounts for interest and taxes; EBIT levels the playing field.

Formula: EBIT = Net Income + Interest Expense + Tax Expense

B. Times Interest Earned

EBIT / Interest Expense

Measures how well a Company uses its borrowings to grow/expand its operations. Higher is better

C. Calculate Times Interest Earned for Amazon and American Airlines

		2017
Amazon	Net Income	596
	Interest Expense	459
	Tax Expense	950
American Airlines	Net Income	1,919
	Interest Expense	1,053
	Tax Expense	1,165

Amazon: [596 + 459 + 950] / 459 = 4.37

American: [1,919 + 1,053 + 1,165] / 1,053 = 3.92