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CHAPTER 12

ACCOUNTING FOR LIABILITIES: Current Liabilities

INTERMEDIATE ACCOUNTING
Principles and Analysis
2nd Edition



What is a Liability?

FASB, defines liabilities as:

"probable future sacrifices of economic benefits
arising from present obligations of a particular entity
to transfer assets or provide services to other
entities in the future as a result of past transactions
or events."



What is a Current Liability?

Current liabilities are “obligations whose liquidation is reasonably expected to require use of existing resources properly classified as current assets, or the creation of other current liabilities.”

Typical Current Liabilities:

- Accounts payable.
- Notes payable.
- Current maturities of long-term debt.
- Dividends payable.
- Unearned revenues.
- Sales taxes payable.
- Income taxes payable.
- Employee-related liabilities.

What is a Current Liability?

Accounts Payable (trade accounts payable)

Balances owed to others for goods, supplies, or services purchased on open account.

- Arise because of time lag between receipt of goods or services and the payment for them.
- The terms of the sale (e.g., 2/10, n/30) state period of extended credit.

What is a Current Liability?

Notes Payable

Written promises to pay a certain sum of money on a specified future date.

- Arise from purchases, financing, or other transactions.
- Notes classified as short-term or long-term.
- Notes may be interest-bearing or zero-interest-bearing.

What is a Current Liability?

Exercise: (Accounts and Notes Payable) The following are selected 2008 transactions of Sean Astin Corporation.

Sept. 1 - Purchased inventory from Encino Company on account for \$50,000. Astin records purchases gross and uses a periodic inventory system.

Oct. 1 - Issued a \$50,000, 12-month, 8% note to Encino in payment of account.

Oct. 1 - Borrowed \$50,000 from the Shore Bank by signing a 12-month, zero-interest-bearing \$54,000 note.

What is a Current Liability?

Sept. 1 - Purchased inventory from Encino Company on account for \$50,000. Astin records purchases gross and uses a periodic inventory system.

Sept. 1	Purchases	50,000	
	Accounts payable		50,000

What is a Current Liability?

Oct. 1 - Issued a \$50,000, 12-month, 8% note to Encino in payment of account.

Oct. 1	Accounts payable	50,000	
	Notes payable		50,000
Dec. 31	Interest expense	1,000	
	Interest payable		1,000
	(\$50,000 × 8% × 3/12)		

What is a Current Liability?

Oct. 1 - Borrowed \$50,000 from the Shore Bank by signing a 12-month, **zero-interest-bearing** \$54,000 note.

Oct. 1	Cash	50,000	
	Discount on notes payable	4,000	
	Notes payable		54,000

$\$50,000 / \$54,000 = (.92593)$ Discount rate = 8%

Dec. 31	Interest expense	1,000	
	Discount on notes payable		1,000
	(\$4,000 × 3/12)		

What is a Current Liability?

Current Maturities of Long-Term Debt

Exclude long-term debts maturing currently as current liabilities if they are to be:

1. Retired by assets accumulated that have not been shown as current assets,
2. Refinanced, or retired from the proceeds of a new debt issue, or
3. Converted into capital stock.

What is a Current Liability?

Dividends Payable

Amount owed by a corporation to its stockholders as a result of board of directors' authorization.

- Generally paid within three months.
- Undeclared dividends on cumulative preferred stock not recognized as a liability.
- Dividends payable in the form of shares of stock are not recognized as a liability. Reported in equity.

What is a Current Liability?

Unearned Revenues

Payment received before delivering goods or rendering services?

Unearned and Earned Revenue Accounts

Illustration 12-2

Type of Business	Account Title	
	Unearned Revenue	Earned Revenue
Airline	Unearned Passenger Ticket Revenue	Passenger Revenue
Magazine publisher	Unearned Subscription Revenue	Subscription Revenue
Hotel	Unearned Rental Revenue	Rental Revenue
Auto dealer	Unearned Warranty Revenue	Warranty Revenue
Retailers	Unearned Gift Card Revenue	Sales Revenue

What is a Current Liability?

Exercise: Game Pro Magazine sold 10,000 annual subscriptions on August 1, 2008, for \$18 each. Prepare Game Pro's August 1, 2008, journal entry and the December 31, 2008, annual adjusting entry.

Aug. 1	Cash	180,000	
	Unearned revenue		180,000
	(10,000 × \$18)		

Dec. 31	Unearned revenue	75,000	
	Subscription revenue		75,000
	(\$180,000 × 5/12 = \$75,000)		