Chapter 8
Current Liabilities

QUESTIONS

Question 8-1
The definition of liabilities touches on the present, the future, and the past. A liability is a present obligation of a company to transfer some economic benefit in the future due to a past transaction or event.

Question 8-2
In most cases, current liabilities are payable within one year from the date of the balance sheet and long-term liabilities are payable in more than one year. Current liabilities are *usually,* but not always, due within one year. For example, if a company has an operating cycle longer than one year (a winery, for example), its current liabilities are defined by the operating cycle rather than by the length of a year.

Question 8-3
Distinguishing between current and long-term liabilities is important in helping investors and creditors assess the riskiness of a business' obligations. Given a choice, most companies would prefer to report a liability as long-term rather than current because it may cause the firm to appear less risky. In turn, less risky firms may enjoy lower interest rates on borrowing and command higher stock prices for new stock listings.

Question 8-4
Current liabilities common to the airline industry include payroll liabilities, deferred revenue in the form of advance ticket sales, and contingent liabilities due to litigation.

Question 8-5
The accrual basis requires expenses to be recorded when incurred. The cash basis requires expenses to be recorded when the cash is paid. Financial accounting requires use of the accrual basis rather than the cash basis as this best reflects the timing of the expense in the same period as the associated benefits.

Question 8-6
A line of credit is an informal agreement that permits a company to borrow up to a prearranged limit without having to follow formal loan procedures and paperwork. The line of credit works like a note payable except the company is able to borrow without having to go through a formal loan approval process each time it borrows money.

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answers to Questions (continued)

Question 8-7

If a company borrows from another company rather than from a bank, the note is referred to as commercial paper. The interest rate is often lower for commercial paper than a bank loan as the company is effectively bypassing the additional mark-up in interest rates by the bank.

Question 8-8

Four items commonly withheld from employee payroll checks include (1) federal and state income taxes, (2) Social Security and Medicare (FICA), (3) health, dental, disability, and life insurance premiums, and (4) *employee* investments to retirement or savings plans. The first two are required by law and the second two are voluntary.

Question 8-9

Four common employer costs in addition to the employee's salary include (1) federal and state unemployment taxes, (2) the employer portion of Social Security and Medicare (FICA), (3) employer contributions for health, dental, disability, and life insurance, and (4) *employer* contributions to retirement or savings plans. The first two are required by law and the last two are voluntary benefits paid by a company on behalf of its employees.

Question 8-10

Both the employer and the employee pay equal portions of social security taxes. Employers withhold from employee paychecks a 6.2% Social Security tax up to a maximum base amount and a 1.45% Medicare tax with no maximum. Therefore, the total FICA tax is 7.65% (6.2% + 1.45%) on income up to a base amount for Social Security ($142,800 in 2021) and 1.45% on all income above the base amount. Employers then pay an additional (matching) amount equal to the amount withheld from employee paychecks so the government actually is collecting 15.3% (7.65% employee + 7.65% employer) on each employee's salary.

Question 8-11

When a company receives cash in advance through the sale of gift cards, it debits cash and credits a current liability account called Deferred Revenue. When it provides the goods or services already paid for, the company debits Deferred Revenue and credits Revenue.

Question 8-12

(a) When ***Sports Illustrated*** sells magazine subscriptions, the company will debit Cash and credit Deferred Revenue. (b) As the subscription is provided through the distribution of magazines, the company debits Deferred Revenue and credits Revenue.

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answers to Questions (continued)

Question 8-13

The sales tax rate for Hollister is 6.5% calculated as $325 in sales taxes divided by sales of $5,000. The journal entry to record the transaction would debit Cash for $5,325, credit Sales for $5,000, and credit Sales Taxes Payable for $325.

Question 8-14

Dell will include $10 million as a current note payable and the remaining $120 million as part of long-term notes payable.

Question 8-15

A contingent liability is an existing, uncertain situation that might result in a loss. Examples include lawsuits, product warranties, environmental problems, and premium offers.

Question 8-16

The likelihood of the loss occurring can be probable, reasonably possible, or remote. Probable means likely to occur while remote means the chance is slight. Reasonably possible fits somewhere in between—more than remote but less than probable.

Question 8-17

A loss contingency is recorded only if a loss is probable and the amount is reasonably estimable.

Question 8-18

If the likelihood of loss is reasonably possible rather than probable, we record no entry but make full disclosure in a disclosure note to the financial statements to describe the contingency. Finally, if the likelihood of loss is *remote*, disclosure is usually not required.

Question 8-19

If one amount within a range of potential losses appears more likely than other amounts within the range, we record that amount. When no amount within the range appears more likely than others, we record the **minimum** amount and disclose information about the potential loss including the potential range of loss.

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Question 8-20

In a pending lawsuit, one side—the defendant—faces a loss contingency, while the other side—the plaintiff—has a gain contingency. The $2 million is a gain contingency and the outcome, while promising, is not yet certain. We do not record gain contingencies of this type until the gain is certain. Though firms do not record gain contingencies in the accounts, they sometimes disclose them in notes to the financial statements.

Question 8-21

Liquidity measures the ability of a company to pay current liabilities as they come due. Liquidity can be evaluated by examining the current ratio or the more specific acid-test ratio.

Question 8-22

Working capital is simply the difference between current assets and current liabilities. The current ratio is calculated by dividing current assets by current liabilities. The acid-test ratio is similar to the current ratio but is based on a more conservative measure of current assets available to pay current liabilities. We calculate the acid-test ratio by dividing "quick assets" by current liabilities. Quick assets include only cash, short-term investments, and accounts receivable. By eliminating current assets such as inventories and prepaid expenses that are less readily convertible into cash, the acid-test ratio may provide a better indication of a company's liquidity than does the current ratio.

Question 8-23

(a) The purchase of inventory with cash would have no effect on the current ratio as one current asset (inventory) would increase while another current asset (cash) would decrease. The purchase of inventory with cash would decrease the acid-test ratio due to the decrease in cash. (b) The sale of inventory for more than its cost would increase the current ratio because the increase in cash or accounts receivable from the sale would more than offset the reduction of inventory at its cost. The sale of inventory for more than its cost would also increase the acid-test ratio due to the increase in cash or accounts receivable from the sale.

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BRIEF EXERCISES

Brief Exercise 8-1

November 1	Debit	Credit
Cash	**4,000,000**	
Notes Payable		**4,000,000**
(Issue note payable)		

December 31		
Interest Expense ($4,000,000 × 0.06 × 2/12)	**40,000**	
Interest Payable		**40,000**
(Record interest incurred, but not paid)		

Brief Exercise 8-2

November 1	Debit	Credit
Notes Receivable	**4,000,000**	
Cash		**4,000,000**
(Accept note receivable)		

December 31		
Interest Receivable	**40,000**	
Interest Revenue ($4,000,000 × 0.06 × 2/12)		**40,000**
(Record interest earned, but not received)		

Brief Exercise 8-3

Interest Expense	=	Face value	×	Annual interest rate	×	Fraction of the year
$4,800	=	$160,000	×	6%	×	6/12

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Brief Exercise 8-4

April 1	Debit	Credit
Cash	**13,000,000**	
Notes Payable - Commercial Paper		**13,000,000**
(Issue note payable)		

December 31		
Notes Payable - Commercial Paper	**13,000,000**	
Interest Expense ($13,000,000 × 0.09 × 9/12)	**877,500**	
Cash		**13,877,500**
(Pay note payable and interest)		

Brief Exercise 8-5

Total withheld for:			
Social Security	$142,800 × 0.062	=	$ 8,854
Medicare	$652,800 × 0.0145	=	9,466
Total			$18,320

The employer will contribute an additional (matching) $18,320.

Brief Exercise 8-6

December 18	Debit	Credit
Cash	**260,000**	
Deferred Revenue		**260,000**
(to record advance receipt of cash)		

January 23		
Cash	**2,340,000**	
Deferred Revenue	**260,000**	
Sales Revenue		**2,600,000**
Cost of Goods Sold	**1,600,000**	
Inventory		**1,600,000**
(to complete the sale)		

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Brief Exercise 8-7

June	$1,200
July	2,100
August	1,700*

*** Includes gift cards redeemed ($1,400) and gift cards unlikely to be redeemed ($300).**

Brief Exercise 8-8

	Debit	Credit
Accounts Receivable	**3,472**	
Sales Revenue		**3,200**
Sales Taxes Payable (0.085 × $3,200)		**272**
(Record sale)		

Brief Exercise 8-9

	Debit	Credit
Notes Payable (long-term)	**10,000,000**	
Notes Payable (current)		**10,000,000**
(Reclassify portion of long-term debt as current)		

Brief Exercise 8-10

Southwest Airlines
Partial Balance Sheet
December 31, 2024

Current Liabilities:	
Current portion of long-term debt	$ 10,000,000
Long-Term Liabilities:	
Notes payable	31,000,000
Total Liabilities	$41,000,000

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Brief Exercise 8-11

	Debit	Credit
Warranty Expense	**630,000**	
Warranty Liability		**630,000**
($630,000 = [$31,000,000 × 3%] − $300,000)		
(Record remaining warranty liability)		

Brief Exercise 8-12

Income Statement:	Revenues	−	Expenses	=	Net Income
			+8,000,000 Loss		−8,000,000
					↓

Balance Sheet:	Assets	=	Liabilities	+	Stockholders' Equity
			+8,000,000 Contingent Liability		−8,000,000

The loss contingency is probable and reasonably estimable, so a loss and a liability for $8 million must be recorded. The entry will reduce income before taxes on the income statement and increase total liabilities on the balance sheet by $8 million.

Brief Exercise 8-13

Electronic Innovators has a contingent liability that is probable, and reasonably estimable within a range between $6 and $10 million. Electronic Innovators should record a loss and a liability for the minimum amount ($6 million) and disclose the range between $6 and $10 million in the notes to the financial statements.

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Brief Exercise 8-14

Aviation Systems has a contingent gain that is probable and reasonably estimable, within a range between $6 and $10 million. Contingent gains are not recorded until the gain is certain. Though firms do not record contingent gains in the accounts, they sometimes disclose them in the notes to the financial statements.

Brief Exercise 8-15

Northwest Forest Products has a contingent liability that is reasonably possible and reasonably estimable at $25 million. Since the loss is reasonably possible, but not probable, we will disclose the situation, but not record the potential loss and liability in the financial records. Details regarding the investigation by the EPA, the reasonable possibility of an assessment, and the amount of settlement should be disclosed in the notes to the financial statements.

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Brief Exercise 8-16

(1) Not recorded (disclosure only) as the loss is reasonably possible, but not probable.

(2) Not recorded (disclosure only) as the loss is not reasonably estimable.

(3) Recorded because the warranty costs are probable and reasonably estimable.

Brief Exercise 8-17

Current Assets	÷	Current Liabilities	=	**Current Ratio**
($112 + 104 + 192 + 28)	÷	($118 + 45)	=	2.67

Quick Assets	÷	Current Liabilities	=	**Acid-Test Ratio**
($112 + 104)	÷	($118 + 45)	=	1.33

Brief Exercise 8-18

	Current Ratio	Acid-Test Ratio
1. Provide services to customers on account.	Increase	Increase
2. Borrow cash from the bank by signing a long-term note payable.	Increase	Increase
3. Purchase office supplies with cash	No change	Decrease
4. Pay rent for the current period.	Decrease	Decrease

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Brief Exercise 8-19 (LO 8-2)

(1)

Income Statement:	Revenues	−	Expenses	=	Net Income

Balance Sheet:	Assets	=	Liabilities	+	Stockholders' Equity
	+4,000,000		+4,000,000		
	Cash		Notes Payable		

(2)

Income Statement:	Revenues	−	Expenses	=	Net Income
			+40,000		−40,000
			Interest Expense		
					↓

Balance Sheet:	Assets	=	Liabilities	+	Stockholders' Equity
			+40,000		−40,000
			Interest Payable		

$4,000,000 × 0.06 × 2/12 = $40,000

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Brief Exercise 8-20 (LO 8-4)

(1)

Income Statement:	Revenues	−	Expenses	=	Net Income

Balance Sheet:	Assets	=	Liabilities	+	Stockholders' Equity
	+260,000		+260,000		
	Cash		Deferred Revenue		

(2)

Income Statement:	Revenues	−	Expenses	=	Net Income
	+2,600,000		+1,600,000		+1,000,000
	Sales Revenue		Cost of Goods Sold		
					↓

Balance Sheet:	Assets	=	Liabilities	+	Stockholders' Equity
	+2,340,000		−260,000		+1,000,000
	Cash		Deferred		
	−1,600,000		Revenue		
	Inventory				

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Brief Exercise 8-21 (LO 8-4)

Income Statement:	Revenues	−	Expenses	=	Net Income
	+3,200				+3,200
	Sales Revenue				
					↓

Balance Sheet:	Assets	=	Liabilities	+	Stockholders' Equity
	+3,472		+272		+3,200
	Accounts Receivable		Sales Tax Payable		

Brief Exercise 8-22 (LO 8-5)

Income Statement:	Revenues	−	Expenses	=	Net Income
			+630,000		−630,000
			Warranty Expense		
					↓

Balance Sheet:	Assets	=	Liabilities	+	Stockholders' Equity
			+630,000		−630,000
			Warranty Payable		

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EXERCISES

Exercise 8-1

Reporting Method

C. Current liability
L. Long-term liability
D. Disclosure note only
N. Not reported

Item

Answer	Item
C	1. Accounts payable.
C	2. Current portion of long-term debt.
C	3. Sales tax collected from customers.
C	4. Notes payable due next year.
L	5. Notes payable due in two years.
C	6. Advance payments from customer.
C	7. Commercial paper.
D	8. Unused line of credit.
C	9. A contingent liability with a probable likelihood of occurring within the next year and can be estimated.
D	10. A loss contingency with a reasonably possible likelihood of occurring within the next year and can be estimated.

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Exercise 8-2

1. November 1, 2024	Debit	Credit
Cash	**60,000**	
Notes Payable		**60,000**
(Issuance of notes payable)		

2. December 31, 2024		
Interest Expense ($60,000 × 7% × 2/12)	**700**	
Interest Payable		**700**
(*Interest expense incurred, but not paid*)		

3. January 31, 2025		
Notes Payable	**60,000**	
Interest Payable ($60,000 × 7% × 2/12)	**700**	
Interest Expense ($60,000 × 7% × 1/12)	**350**	
Cash		**61,050**
(*Payment of notes payable and interest*)		

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Exercise 8-3

1. August 1, 2024	Debit	Credit
Cash	**21,000,000**	
Notes Payable		**21,000,000**
(Issuance of notes payable)		

2. December 31, 2024		
Interest Expense ($21 million × 9% × 5/12)	**787,500**	
Interest Payable		**787,500**
(*Interest expense incurred, but not paid*)		

3. January 31, 2025		
Notes Payable	**21,000,000**	
Interest Payable ($21 million × 9% × 5/12)	**787,500**	
Interest Expense ($21 million × 9% × 1/12)	**157,500**	
Cash		**21,945,000**
(*Payment of notes payable and interest*)		

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Exercise 8-4

1. August 1, 2024	Debit	Credit
Notes Receivable	**21,000,000**	
Cash		**21,000,000**
(Acceptance of notes receivable)		

2. December 31, 2024		
Interest Receivable ($21 × 9% × 5/12)	**787,500**	
Interest Revenue		**787,500**
(*Interest revenue earned, but not received)*		

3. January 31, 2025		
Cash	**21,945,000**	
Notes Receivable		**21,000,000**
Interest Receivable ($21 × 9% × 5/12)		**787,500**
Interest Revenue ($21 × 9% × 1/12)		**157,500**
(*Collection of notes receivable and interest*)		

Exercise 8-5

1.	$6,000,000	×	0.11	×	6/12	=	$330,000
2.	$6,000,000	×	0.09	×	3/12	=	$135,000
3.	$6,000,000	×	0.10	×	4/12	=	$200,000
4.	$6,000,000	×	0.07	×	7/12	=	$245,000

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Exercise 8-6

January 13
No Entry

February 1

Cash	**5,000,000**	
Notes Payable		**5,000,000**
(Issuance of note payable)		

May 1

Notes Payable	**5,000,000**	
Interest Expense ($5,000,000 × 0.07 × 3/12)	**87,500**	
Cash		**5,087,500**
(Payment of note and interest)		

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Exercise 8-7

Requirement 1

Total Salary Expense	(100 × 40 hours × $20)		$80,000
Less: Withholdings			
Federal Income Taxes	($80,000 × 0.15)	$12,000	
State Income Taxes	($80,000 × 0.05)	4,000	
FICA Taxes	($80,000 × 0.0765)	6,120	
Total Withholdings			22,120
Actual Direct Deposit			$57,880

Requirement 2

FICA Taxes	($80,000 × 0.0765)	$ 6,120
Unemployment Taxes	($80,000 × 0.062)	4,960
Total Payroll Tax Expense		$11,080

Requirement 3

The company does not make an accounting entry to record the free skiing given to employees on their days off; no additional costs are directly incurred by the company to provide this benefit.

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Exercise 8-8

Requirement 1

January 31

Account	Debit	Credit
Salaries Expense	**3,000,000**	
Employee Income Tax Payable		**667,500**
FICA Tax Payable		**229,500**
Salaries Payable (to balance)		**2,103,000**
(Employee salary expense and withholdings)		

Requirement 2

January 31

Account	Debit	Credit
Salaries Expense (fringe benefits)	**90,000**	
Fringe Benefits Payable (to Blue Cross/Blue Shield)		**90,000**
(Employer-provided fringe benefits)		

Requirement 3

January 31

Account	Debit	Credit
Payroll Tax Expense	**415,500**	
FICA Tax Payable		**229,500**
Unemployment Tax Payable		**186,000**
(Employer payroll taxes)		

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Exercise 8-9

<u>January 31</u>

Account	Debit	Credit
Salaries Expense	**600,000**	
Employee Income Tax Payable		**120,000**
FICA Tax Payable ($600,000 × 0.0765)		**45,900**
Salaries Payable (to balance)		**434,100**
(Employee salary expense)		

<u>January 31</u>

Account	Debit	Credit
Payroll Tax Expense (total)	**83,100**	
FICA Tax Payable ($600,000 × 0.0765)		**45,900**
Unemployment Tax Payable ($600,000 × 0.062)		**37,200**
(Employer payroll tax expense)		

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Exercise 8-10

Requirement 1

November 30

Cash	**21,000,000**	
Deferred Revenue		**21,000,000**
(Advance collection for gift cards)		

Requirement 2

December 31

Deferred Revenue	**14,000,000**	
Sales Revenue		**14,000,000**
(Revenue recognized when gift cards are redeemed)		

Requirement 3

The ending balance in Deferred Revenue is $7,000,000.

Deferred Revenue	
	21,000,000
14,000,000	
	7,000,000 Ending balance

Exercise 8-11

Requirement 1

October 1, 2024

Cash	**100,000**	
Deferred Revenue		**100,000**
(Sale of gift cards)		

Requirement 2

December 31, 2024

Deferred Revenue	**20,000**	
Sales Revenue		**20,000**
(Revenue recognized when gift cards are redeemed)		

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Requirement 3

March 31, 2025

Deferred Revenue	**70,000**	
Sales Revenue		**70,000**
(Revenue recognized when gift cards are redeemed)		
($70,000 = $30,000 + $25,000 + $15,000)		

Requirement 4

April 1, 2025

Deferred Revenue	**10,000**	
Sales Revenue		**10,000**
(Revenue expiration of gift cards)		
($10,000 = $100,000 − $20,000 − $70,000)		

Exercise 8-12

1. September 1, 2024	Debit	Credit
Cash	**400,000**	
Notes Payable (long-term)		**400,000**
(Issuance of long-term notes payable)		

2. December 31, 2024

Interest Expense ($400,000 × 6% × 4/12)	**8,000**	
Interest Payable		**8,000**
(*Interest expense incurred, but not paid*)		

3. December 31, 2024

Notes Payable (long-term)	**100,000**	
Notes Payable (current)		**100,000**
(*Reclassify current portion of long-term debt*)		

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Exercise 8-13

Requirement 1
The contingent liability is probable and reasonably estimable, so it must be reported.

Requirement 2
A $4 million loss should be reported in its 2024 income statement.

Requirement 3
A $4 million liability should be reported in its 2024 balance sheet.

Requirement 4

	Debit	Credit
Loss	**4,000,000**	
Contingent Liability		**4,000,000**
(Record the contingent liability)		

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Exercise 8-14

Requirement 1

The contingent liability is probable and reasonably estimable, so it must be recorded as follows:

Loss	**1,300,000**	
Contingent Liability		**1,300,000**
(Record the contingent liability)		

Requirement 2

Pacific Cruise Lines should record a loss and a liability for the minimum amount ($1.1 million) and disclose the nature of the contingency in the disclosure notes to the financial statements. The journal entry is as follows:

Loss	**1,100,000**	
Contingent Liability		**1,100,000**
(Record the contingent liability)		

Requirement 3

If the likelihood of loss is reasonably possible rather than probable, we record no entry but make full disclosure in a note to the financial statements to describe the contingency.

Requirement 4

If the likelihood of loss is remote, disclosure is usually not required.

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Exercise 8-15

Requirement 1

Yes, it's probable that costs for warranties will be incurred and based on previous experience the amount is reasonably estimable.

Requirement 2

December 31

	Debit	Credit
Warranty Expense ($600,000 × 6%)	**36,000**	
Warranty Liability		**36,000**
(Record contingent liability for warranties)		

Requirement 3

January 31

	Debit	Credit
Warranty Liability	**13,000**	
Cash		**13,000**
(Record actual warranty expenditures)		

Requirement 4

Warranty Liability

Debit	Credit
	36,000 Expense
Payment 13,000	
	23,000 Balance

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Exercise 8-16

Requirement 1

<u>December 31, 2024</u>

Warranty Expense ($1,600,000 × 2%)	**32,000**	
Warranty Liability		**32,000**
(Record contingent liability for warranties)		

Requirement 2

<u>Summary entry in 2025</u>

Warranty Liability	**25,000**	
Cash		**25,000**
(Record actual warranty expenditures)		

Requirement 3

<u>December 31, 2025</u>

Warranty Expense	**29,000**	
Warranty Liability		**29,000**
(Record contingent liability for warranties)		
($36,000 = $2,400,000 × 1.5%)		
($29,000 = $36,000 − $7,000 current balance in Warranty Liability)		

Requirement 4

Warranty Liability

Debit	Credit
	0
	32,000 Adjusting entry
	32,000 Balance in 2024
Payment in 2025 25,000	
	7,000
	29,000 Adjusting entry
	36,000 Balance in 2025

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Exercise 8-17

Requirement 1

Yes, a contingent liability is an existing, uncertain situation that might result in a loss. The environmental remediation and restoration costs represent an existing uncertain situation that will likely result in a loss to the company.

Requirement 2

Dow would record a contingency if the loss is probable and is reasonably estimable.

Requirement 3

Loss	**381,000,000**	
Contingent Liability		**381,000,000**
(Record the contingent liability)		

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Exercise 8-18

Requirement 1

Current Assets	÷	Current Liabilities	=	Current Ratio
$875	÷	$2,638	=	0.33

Quick Assets	÷	Current Liabilities	=	Acid-Test Ratio
$331 + $63 + $230	÷	$2,638	=	0.24

Requirement 2

Queen’s Line has a lower current ratio and a lower acid-test ratio than either United Airlines or American Airlines reported in the text. Queen’s Line appears more likely to have difficulty paying its currently maturing debts.

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Exercise 8-19

Requirement 1 Transactions during January, 2024

January 2	Debit	Credit
Cash	**8,000**	
Deferred Revenue		**8,000**
(Sell gift cards for cash)		

January 6	Debit	Credit
Inventory	**147,000**	
Accounts Payable		**147,000**
(Purchase inventory on account)		

January 15	Debit	Credit
Accounts Receivable	**135,000**	
Sales Revenue		**135,000**
(*Sell inventory on account*)		
Cost of Goods Sold	**73,800**	
Inventory		**73,800**
(*Record cost of inventory sold*)		

January 23	Debit	Credit
Cash	**125,400**	
Accounts Receivable		**125,400**
(*Receive cash on account*)		

January 25	Debit	Credit
Accounts Payable	**90,000**	
Cash		**90,000**
(*Pay cash on account*)		

January 28	Debit	Credit
Allowance for Uncollectible Accounts	**4,800**	
Accounts Receivable		**4,800**
(*Write off uncollectible accounts*)		

January 30	Debit	Credit
Cash	**11,000**	
Accounts Receivable	**132,000**	
Sales Revenue		**143,000**
(*Sell inventory for cash and on account*)		
Cost of Goods Sold	**79,500**	
Inventory		**79,500**
(*Record cost of inventory sold*)		

January 31	Debit	Credit
Salaries Expense	**52,000**	
Cash		**52,000**
(*Pay monthly salaries*)		

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Exercise 8-19 (continued)

Requirement 2 Adjusting entries at end of January, 2024

(a) January 31	Debit	Credit
Depreciation Expense	**500**	
Accumulated Depreciation		**500**
(Record depreciation for January)		
($500 = [$15,000−$3,000] / 24 months)		

(b) January 31	Debit	Credit
Bad Debt Expense	**12,500**	
Allowance for Uncollectible Accounts		**12,500**
(*Adjust uncollectible accounts)*		

(c) January 31	Debit	Credit
Interest Expense	**250**	
Interest Payable		**250**
(*Adjust interest expense*)		
(*$250 = $50,000 × 6% × 1/12*)		

(d) January 31	Debit	Credit
Income Tax Expense	**13,000**	
Income Tax Payable		**13,000**
(*Adjust income taxes*)		

(e) January 31	Debit	Credit
Deferred Revenue	**3,000**	
Sales Revenue		**3,000**
(*Adjust revenue for gift cards redeemed*)		

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Exercise 8-19 (continued)

Requirement 3

ACME Fireworks
Adjusted Trial Balance
January 31, 2024

Accounts	Debit	Credit
Cash	$ 27,500	
Accounts Receivable	183,000	
Inventory	13,700	
Land	46,000	
Equipment	15,000	
Allowance for Uncollectible Accounts		$ 11,900
Accumulated Depreciation		2,000
Accounts Payable		85,500
Deferred Revenue (gift cards liability)		5,000
Interest Payable		250
Income Tax Payable		13,000
Notes Payable		50,000
Common Stock		35,000
Retained Earnings		33,100
Sales Revenue		281,000
Cost of Goods Sold	153,300	
Salaries Expense	52,000	
Bad Debt Expense	12,500	
Depreciation Expense	500	
Interest Expense	250	
Income Tax Expense	13,000	
Totals	$516,750	$516,750

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Exercise 8-19 (continued)

Requirement 3 (concluded)

Accounts	Ending Balance		Beginning balance in **bold**, entries during January in blue, and adjusting entries in red.
Cash	$ 27,500	=	**25,100**+8,000+125,400−90,000+11,000−52,000
Accounts Receivable	183,000	=	**46,200**+135,000−125,400−4,800+132,000
Inventory	13,700	=	**20,000**+147,000−73,800−79,500
Land	46,000	=	**46,000**
Equipment	15,000	=	**15,000**
Allow for Unc. Accounts	11,900	=	**4,200**−4,800+12,500
Accumulated Depreciation	2,000	=	**1,500**+500
Accounts Payable	85,500	=	**28,500**+147,000−90,000
Deferred Revenue	5,000	=	8,000−3,000
Interest Payable	250	=	250
Income Tax Payable	13,000	=	13,000
Notes Payable	50,000	=	**50,000**
Common Stock	35,000	=	**35,000**
Retained Earnings	33,100	=	**33,100**
Sales Revenue	281,000	=	135,000+143,000+3,000
Cost of Goods Sold	153,300	=	73,800+79,500
Salaries Expense	52,000	=	52,000
Bad Debt Expense	12,500	=	12,500
Depreciation Expense	500	=	500
Interest Expense	250	=	250
Income Tax Expense	13,000	=	13,000

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Exercise 8-19 (continued)

Requirement 4

ACME Fireworks
Multiple-Step Income Statement
For the month ended January 31, 2024

Sales revenue	$281,000	
Cost of goods sold	153,300	
Gross profit		$127,700
Salaries expense	52,000	
Bad debt expense	12,500	
Depreciation expense	500	
Total operating expenses		65,000
Operating income		62,700
Interest expense		250
Income before taxes		62,450
Income tax expense		13,000
Net income		$ 49,450

Requirement 5

ACME Fireworks
Classified Balance Sheet
January 31, 2024

Assets			Liabilities		
Current Assets:			*Current Liabilities:*		
			Accounts payable	$ 85,500	
Cash		$ 27,500	Deferred revenue	5,000	
Accounts receivable	183,000		Interest payable	250	
Less: Allowance	(11,900)	171,100	Income tax payable	13,000	
Inventory		13,700	Total current liabilities	103,750	
Total current assets		212,300	*Long-term Liabilities:*		
			Notes payable	50,000	
Property, Plant and Equipment:			Total liabilities	153,750	
Land		46,000	**Stockholders' Equity**		
Equipment		15,000	Common stock	35,000	
Less: Accumulated Depreciation		(2,000)	Retained earnings	82,550	*
			Total stockholders' equity	117,550	
Total assets		$271,300	Total liabilities and stockholders' equity	$271,300	

* Retained earnings = Beginning retained earnings + Net income − Dividends
= $33,100 + $49,450 − $0
= $82,550

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Exercise 8-19 (concluded)

Requirement 6

January 31, 2024	Debit	Credit
Sales Revenue	281,000	
Retained Earnings		281,000
(*Close revenue accounts*)		
Retained Earnings	231,550	
Cost of Goods Sold		153,300
Salaries Expense		52,000
Bad Debt Expense		12,500
Depreciation Expense		500
Interest Expense		250
Income Tax Expense		13,000
(*Close expense accounts*)		

Requirement 7

(a) The current ratio is:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$212{,}300}{\$103{,}750} = \mathbf{2.05}$$

ACME Fireworks is **more** liquid than the industry average. ACME Fireworks has a greater proportion of current assets to pay current liabilities compared to the industry average of 1.8.

(b) The acid-test ratio is:

$$\text{Acid-Test Ratio} = \frac{\text{Quick Assets*}}{\text{Current Liabilities}} = \frac{\$27{,}500 + \$0 + \$171{,}100}{\$103{,}750} = \mathbf{1.91}$$

*Quick Assets = Cash + Current Investments + Accounts Receivable

ACME Fireworks is **less** likely to have difficulty paying its currently maturing debts. ACME Fireworks has a greater proportion of quick assets to pay current liabilities compared to the industry average of 1.5.

(c) The current ratio, assuming the notes payable are current liabilities, is:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{\$212{,}300}{\$153{,}750} = \mathbf{1.38}$$

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Assuming the notes payable were due on April 1, 2024, they would be included in total current liabilities. This would increase current liabilities and **decrease** the current ratio, since dividing by a larger number reduces the ratio.

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PROBLEMS: SET A

Problem 8-1A

	List A	List B
i	1. An IOU promising to repay the amount borrowed plus interest.	a. Recording of a contingent liability
d	2. Payment amount is reasonably possible and is reasonably estimable.	b. Deferred revenue
h	3. Mixture of liabilities and equity a business uses.	c. The riskiness of a business's obligations
a	4. Payment amount is probable and is reasonably estimable.	d. Disclosure of a contingent liability
b	5. A liability that requires the sacrifice of something other than cash.	e. Interest on debt
j	6. Long-term debt maturing within one year.	f. Payroll taxes
f	7. FICA and FUTA.	g. Line of credit
g	8. Informal agreement that permits a company to borrow up to a prearranged limit	h. Capital structure
c	9. Classifying liabilities as either current or long-term helps investors and creditors assess this.	i. Notes payable
e	10. Amount of note payable x annual interest rate x fraction of the year.	j. Current portion of long-term debt

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Problem 8-2A

Requirement 1

(a). October 1, 2024

Cash	**41,000,000**	
Notes Payable		**41,000,000**
(Issuance of notes payable)		

(b). October 1, 2024

Notes Receivable	**41,000,000**	
Cash		**41,000,000**
(Acceptance of notes receivable)		

Requirement 2

(a). December 31, 2024

Interest Expense ($41 million × 9% × 3/12)	**922,500**	
Interest Payable		**922,500**
(*Interest expense incurred, but not paid*)		

(b). December 31, 2024

Interest Receivable	**922,500**	
Interest Revenue		**922,500**
(*Interest revenue earned, but not received)*		

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Requirement 3

(a) September 30, 2025

Account	Debit	Credit
Notes Payable	**41,000,000**	
Interest Payable ($41 million × 9% × 3/12)	**922,500**	
Interest Expense ($41 million × 9% × 9/12)	**2,767,500**	
Cash		**44,690,000**
(*Payment of notes payable and interest*)		

(b). September 30, 2025

Account	Debit	Credit
Cash	**44,690,000**	
Interest Receivable ($41 million × 9% × 3/12)		**922,500**
Interest Revenue ($41 million × 9% × 9/12)		**2,767,500**
Notes Receivable		**41,000,000**
(*Collection of notes receivable and interest*)		

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Problem 8-3A

Requirement 1

January 31

Account	Debit	Credit
Salaries Expense	**600,000**	
Employee Income Tax Payable		**60,000**
FICA Tax Payable		**45,900**
Salaries Payable (to employees)		**494,100**
(Employee salary expense and withholdings)		

Requirement 2

January 31

Account	Debit	Credit
Salaries Expense (fringe benefits)	**34,800**	
Fringe Benefits Payable (to Blue Cross)		**10,800**
Fringe Benefits Payable (to Fidelity)		**24,000**
(Employer-provided fringe benefits)		

Requirement 3

January 31

Account	Debit	Credit
Payroll Tax Expense	**83,100**	
FICA Tax Payable		**45,900**
Unemployment Tax Payable		**37,200**
(Employer payroll taxes)		

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Problem 8-4A

Requirement 1

February 14

Account	Debit	Credit
Salaries Expense	**1,500,000**	
Employee Income Tax Payable		**375,000**
FICA Tax Payable		**114,750**
Fringe Benefits Payable (Retirement Plan)		**63,000**
Salaries Payable (to employees)		**947,250**
(Employee salary expense and withholdings)		

Requirement 2

February 14

Account	Debit	Credit
Salaries Expense (fringe benefits)	**100,500**	
Fringe Benefits Payable (Medical Insurance)		**31,500**
Fringe Benefits Payable (Life Insurance)		**6,000**
Fringe Benefits Payable (Retirement Plan)		**63,000**
(Employer-provided fringe benefits)		

Requirement 3

February 14

Account	Debit	Credit
Payroll Tax Expense	**207,750**	
FICA Tax Payable		**114,750**
Unemployment Tax Payable		**93,000**
(Employer payroll taxes)		

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Problem 8-5A

Requirement 1

$$\frac{\$102,600,000}{100,000} = \$1,026 \text{ per season ticket}$$

$$\frac{\$1,026}{6 \text{ games}} = \$171 \text{ per individual game ticket}$$

Requirement 2

Cash	**102,600,000**	
Deferred Revenue		**102,600,000**
(Advance collection of ticket sales)		

Requirement 3

Deferred Revenue	**17,100,000**	
Sales Revenue ($102,600,000/6)		**17,100,000**
(Revenue recognized after first home game)		

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Problem 8-6A

Requirement 1

	Debit	Credit
Cash	**3,500**	
Deferred Revenue		**3,500**
(Sale of gift cards)		

Requirement 2

	Debit	Credit
Deferred Revenue	**728**	
Sales Revenue ($728 / 1.04)		**700**
Sales Taxes Payable		**28**
(Redemption of gift certificates)		

Requirement 3

Deferred Revenue

Debit	Credit	
	3,500	
728		
	2,772	**Balance**

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Problem 8-7A

Requirement 1

The likelihood of loss is reasonably possible rather than probable, so no journal entry is recorded. However, full disclosure of the contingent liability is made in a note to the financial statements.

Requirement 2

Environmental Printing has a contingent gain that is probable and is reasonably estimable within a range between $6.5 and $9 million. Contingent gains are not recorded until the gain is certain. Though firms do not record contingent gains in the accounts, they sometimes disclose them in notes to the financial statements.

Requirement 3

Environmental Printing should record a loss and a liability for the minimum amount ($500,000) and disclose the range between $500,000 and $900,000 in the notes to the financial statements. The entry is as follows:

	Debit	Credit
Loss	**500,000**	
Contingent Liability		**500,000**
(Record the contingent liability)		

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Problem 8-8A

Requirement 1

The reporting for this situation depends on the likelihood of loss occurring. Since Dinoco feels the likelihood of loss is probable, the following entry would be recorded:

	Debit	Credit
Loss	**130,000,000**	
Contingent Liability		**130,000,000**
(Record the contingent liability)		

Requirement 2

The contingent loss is probable and reasonably estimable, so it would be recorded as follows:

	Debit	Credit
Loss	**150,000,000**	
Contingent Liability		**150,000,000**
(Record the contingent liability)		

Requirement 3

Dinoco has a contingent gain that is probable and is reasonably estimable at $150 million. Contingent gains are not recorded until the gain is certain. Though firms do not record contingent gains in the accounts, they sometimes disclose them in notes to the financial statements.

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Problem 8-9A

Requirement 1

($ in millions)	Total Current Assets	÷	Total Current Liabilities	=	Current Ratio
ACME Corporation	$15,372	÷	$11,462	=	1.34
Wayne Enterprises	$9,784	÷	$7,708	=	1.27

ACME Corporation has a more favorable current ratio than Wayne Enterprises.

Requirement 2

($ in millions)	Quick Assets	÷	Total Current Liabilities	=	Acid-Test Ratio
ACME Corporation	$3,889	÷	$11,462	=	0.34
Wayne Enterprises	$883	÷	$7,708	=	0.11

ACME Corporation also has a higher acid-test ratio than Wayne Enterprises.

Requirement 3

The purchase of additional inventory on credit would increase current assets (inventory) and current liabilities (accounts payable) by the same amount. This transaction would cause the current ratios for ACME Corporation and Wayne Enterprises to *decrease* towards 1.0. This transaction would also cause the acid-test ratios to decrease as quick assets would remain the same, but current liabilities would increase.

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PROBLEMS: SET B

Problem 8-1B

	List A	List B
_i__	1. Interest expense is recorded in the period interest is incurred rather than in the period interest is paid.	a. The riskiness of a business's obligations
_d__	2. Payment is reasonably possible and is reasonably estimable.	b. Current portion of long-term debt
_h__	3. Cash, current investments, and accounts receivable all divided by current liabilities.	c. Recording a contingent liability
_c__	4. Payment is probable and is reasonably estimable.	d. Disclosure of a contingent liability
_j__	5. Gift cards.	e. Interest expense
_b__	6. Long-term debt maturing within one year.	f. FICA
_f__	7. Social Security and Medicare.	g. Commercial paper
_g__	8. Unsecured notes sold in minimum denominations of $25,000 with maturities up to 270 days.	h. Acid-test ratio
_a__	9. Classifying liabilities as either current or long-term helps investors and creditors assess this.	i. Accrual accounting
_e__	10. Incurred on notes payable.	j. Deferred revenue

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Problem 8-2B

Requirement 1

(a). November 1, 2024

Cash	**21,000,000**	
Notes Payable		**21,000,000**
(Issuance of notes payable)		

(b). November 1, 2024

Notes Receivable	**21,000,000**	
Cash		**21,000,000**
(Acceptance of notes receivable)		

Requirement 2

(a). December 31, 2024

Interest Expense ($21 million × 7% × 2/12)	**245,000**	
Interest Payable		**245,000**
(*To record interest expense incurred, but not paid*)		

(b). December 31, 2024

Interest Receivable ($21 million × 7% × 2/12)	**245,000**	
Interest Revenue		**245,000**
(*Interest revenue earned, but not received)*		

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Requirement 3

(a). April 30, 2025

Notes Payable	**21,000,000**	
Interest Payable ($21 million × 7% × 2/12)	**245,000**	
Interest Expense ($21 million × 7% × 4/12)	**490,000**	
Cash		**21,735,000**
(*Payment of notes payable and interest*)		

(b). April 30, 2025

Cash	**21,735,000**	
Notes Receivable		**21,000,000**
Interest Receivable ($21 million × 7% × 2/12)		**245,000**
Interest Revenue ($21 million × 7% × 4/12)		**490,000**
(*Collection of notes receivable and interest*)		

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Problem 8-3B

Requirement 1

January 31

Account	Debit	Credit
Salaries Expense	**500,000**	
Employee Income Tax Payable		**135,000**
FICA Tax Payable		**38,250**
Salaries Payable (to employees)		**326,750**
(Employee salary expense and withholdings)		

Requirement 2

January 31

Account	Debit	Credit
Salaries Expense (fringe benefits)	**73,000**	
Fringe Benefits Payable (to Blue Cross)		**13,000**
Fringe Benefits Payable (to Fidelity)		**60,000**
(Employer-provided fringe benefits)		

Requirement 3

January 31

Account	Debit	Credit
Payroll Tax Expense	**69,250**	
FICA Tax Payable		**38,250**
Unemployment Tax Payable		**31,000**
(Employer payroll taxes)		

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Problem 8-4B

Requirement 1

January 24

	Debit	Credit
Salaries Expense	**2,500,000**	
Employee Income Tax Payable		**537,500**
FICA Tax Payable		**191,250**
Fringe Benefits Payable (Retirement Plan)		**125,000**
Salaries Payable (to employees)		**1,646,250**
(Employee salary expense and withholdings)		

Requirement 2

January 24

	Debit	Credit
Salaries Expense (fringe benefits)	**201,250**	
Fringe Benefits Payable (Medical Insurance)		**50,000**
Fringe Benefits Payable (Dental Insurance)		**17,500**
Fringe Benefits Payable (Life Insurance)		**8,750**
Fringe Benefits Payable (Retirement Plan)		**125,000**
(Employer-provided fringe benefits)		

Requirement 3

January 24

	Debit	Credit
Payroll Tax Expense	**346,250**	
FICA Tax Payable		**191,250**
Unemployment Tax Payable		**155,000**
(Employer payroll taxes)		

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Problem 8-5B

Requirement 1

$$\frac{\$9{,}128{,}000}{16{,}300} = \$560 \text{ per season ticket}$$

$$\frac{\$560}{16 \text{ games}} = \$35 \text{ per individual game ticket}$$

Requirement 2

	Debit	Credit
Cash	**9,128,000**	
Deferred Revenue		**9,128,000**
(Advance collection of ticket sales)		

Requirement 3

	Debit	Credit
Deferred Revenue	**570,500**	
Sales Revenue ($9,128,000/16)		**570,500**
(Revenue recognized after first home game)		

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Problem 8-6B

Requirement 1

	Debit	Credit
Cash	**2,300**	
Deferred Revenue		**2,300**
(Sale of gift cards)		

Requirement 2

	Debit	Credit
Deferred Revenue	**742**	
Sales Revenue ($742/1.06)		**700**
Sales Taxes Payable		**42**
(Redemption of gift certificates)		

Requirement 3

Deferred Revenue

Debit	Credit	
	2,300	
742		
	1,558	**Balance**

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Problem 8-7B

Requirement 1

	Debit	Credit
Bad Debt Expense ($29 million × 3%)	**870,000**	
Allowance for Uncollectible Accounts		**870,000**
(Estimated uncollectible accounts)		

Requirement 2

Compact Electronics has a contingent gain that is probable and reasonably estimable. Contingent gains are not recorded until the gain is certain. Though firms do not record contingent gains in the accounts, they sometimes disclose them in notes to the financial statements.

Requirement 3

	Debit	Credit
Loss	**600,000**	
Contingent Liability		**600,000**
(Record the loss contingency)		

Requirement 4

The likelihood of loss is reasonably possible rather than probable, so no journal entry is recorded. However, full disclosure of the contingent liability and the estimated range of loss between $2.5 and $3.5 million is disclosed in notes to the financial statements.

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Problem 8-8B

Requirement 1

The contingent liability is reasonably possible and can be reasonably estimated within a range. Because the loss is not probable, no journal entry for a loss and liability is required. Authors Academic Press must disclose a description of the loss contingency in its notes to the financial statements.

Requirement 2

The contingent liability is probable and reasonably estimable, so it must be reported. Because the estimate of the loss is a range where no amount within the range is a better estimate than any other amount, the minimum amount of the range will be recorded as follows:

	Debit	Credit
Loss	**1,500,000**	
Contingent Liability		**1,500,000**
(Record the loss contingency)		

The range of the potential loss (from $1.5 to $2.25 million) should also be disclosed.

Requirement 3

Authors Academic Press has a contingent gain that is probable and can be reasonably estimated at $3 million. Contingent gains are not recorded until the gain is certain. Though firms do not record contingent gains in the accounts, they sometimes disclose them in notes to the financial statements.

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Problem 8-9B

Requirement 1

($ in millions)	Total Current Assets	÷	Total Current Liabilities	=	Current Ratio
Ferris Air	$4,227	÷	$4,650	=	0.91
Oceanic Airlines	$8,272	÷	$13,270	=	0.62

Ferris Air has a more favorable current ratio than Oceanic Airlines.

Requirement 2

($ in millions)	Quick Assets	÷	Total Current Liabilities	=	Acid-Test Ratio
Ferris Air	$3,548	÷	$4,650	=	0.76
Oceanic Airlines	$5,905	÷	$13,270	=	0.44

Ferris Air also has a more favorable acid-test ratio than Oceanic Airlines.

Requirement 3

The purchase of additional inventory with cash would not affect the current ratio as total current assets would remain unchanged. One current asset (inventory) would increase while another current asset (cash) would decrease by the same amount. The purchase of additional inventory with cash would decrease the acid-test ratio due to the decrease in cash. Recall that inventory is excluded from the acid-test ratio.

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