

Other liabilities

. **A contingency:** it is the existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur.

. **Loss contingency:** contingent liabilities are obligations that are dependent upon the occurrence or non occurrence of one or more future events to confirm either the amount payable, the payee, the date payable, or its existence.

. Some terms are used to identify some areas with in the range and assign the following meanings:

1. Probable: Accrue & Disclosed
 - . Not estimable – Disclosed only
- . Estimable With in range – Accrue Minimum of range
 2. Reasonably possible – Disclosed only
 3. Remote – Neither Accrued nor

Disclosed

Illustration:

Accounting Treatment of Loss Contingencies

	Usually Accrued	not Accrued	May be Accrued
Loss Related to			
1. Collectibility of receivables	X		
2. obligations related to product warranties and product defects	X		
3. Premiums offered to customers	X		
4. Risk of loss or damage of enterprise property by fire , explosion , or other hazards		X	
5. General or unspecified business risks		X	
6. Risk of loss from catastrophes assumed by property and casualty insurance companies including reinsurance companies		X	
7. Threat of expropriation of assets			
8. Pending or threatened litigation			X
9. Actual or possible claims and assessments			X
10. Guarantees of indebtedness of others			X
11. Obligations of commercial banks under " standby letters of credit "			X
12. Agreements to repurchase receivables (or the related property) that have been sold			X
. should be accrued when both criteria are met (probable and reasonable estimable)			
. Estimated amounts of losses incurred prior to the balance sheet date but settled subsequently should be accrued as of the balance sheet dates.			

1. Gain contingency: Are claims r rights to receive assets whose existence is uncertain but which may become valid eventually .

2. Gain contingency has some characteristics as :

3. Never accrue
4. May Disclose

2) Estimated & Accrued Amounts:

** Money 1st - Goods or Services 2nd

- . Expenses – Prepaid
- . Revenues – Unearned

** Goods or Services 1st – money 2nd

- . Expenses – Accrued
- . Revenues – Receivable

1) Revenue Items

Calculate Amount Earned or Amount Collected .

1) Determine Change in Accrual Items:

	Debit	Credit
Revenue Receivable	Increase	Decrease
Unearned Revenue	Decrease	Increase

2) Prepare Journal Entry

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Cash           XXX
Revenue Receivable  XXX or XXX
Unearned Revenue  XXX or XXX
Revenue           XXX
    
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3) If Amount Collected is given that is the Debit to Cash and the Amount required to Balance the entry is the Amount Earned.

4) If the Amount Earned is given that is the Credit to Revenues and the Amount Required to Balance the Entry is the Amount Collected.

II) Expense Items

Calculated Amount Incurred or Amount Paid

1) Determine Changes in Accrual Items

	Debit	Credit
Prepaid Expense	Increase	Decrease
Accrued Expense	Decrease	Increase

2) Prepare Journal Entry

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Expense       XXX
Prepaid Expense  XXX or XXX
Accrued Expense  XXX or XXX
Cash           XXX
    
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- 3) If Amount Paid is given. That is the Credit to Cash and the Amount required to Balance the entry is the Amount Incurred.
- 4) If the Amount Incurred is given, that is the Debit to Expense and the Amount Required to Balance the Entry is the Amount Paid.
- 3) Premiums and Coupons: Premiums are offered by companies in return for Box tops, certificates, labels, or wrappers. Amore recent marketing innovation is the cash Rebate , in which the buyer can obtain by returning the store receipt , a rebate coupon And a universal Product Code to the manufacturer

The following example illustrates the accounting treatment according a premium offer Fluffy cackemix Company offered its customers a large non-breakable Mixing bowl in exchange for 25 cents, and 10 box tops. The mixing bowl costs Fluffy Cake mix company 75 cents, and the company estimates that 60% of the box tops will be redeemed. The premium offer began in June 2001, and resulted in the following transactions and entries during 2001.

To record purchase of 20,000 mixing bowls at 75 cents each:

Inventory of premium mixing bowls	15,000	
Cash		15,000

To record sales of 300,000 boxes of cake mix at 80 cents:

Cash	240,000	
Sales		240,000

To record the actual redemption of 60,000 box tops, the receipt of 25 cents per 10 box tops, and the delivery of the mixing bowl.

Cash (50,000 / 10) * \$0, 25	1,500	
Premium expense	3,000	
Inventory of Premium Bowls		4,500
Computation (50,000 / 10) * \$0, 75 = \$4,500		

To record end of Period adjusting entry for estimated Liability for outstanding Premium offers (box tops):

Premium Expense	6,000	
Estimated Liability for Premiums		6,000

Computations	
Total box tops sold in 2001	<u>300,000</u>
Total estimated redemption (50%)	<u>130,000</u>
Box tops redeemed in 2001	<u>60,000</u>

Estimated redemption in 2001 120,000

Cost of estimated claims outstanding
 $(120,000 / 10) * (\$0,75 - \$0,25) = \$6,000$

The December 31 , 2001 , balance sheet of Fluffy Cakemix Company will report an Inventory of Premium Mixing Bowls of \$10,500 as current assets and Estimated Liability for Premiums of \$6,000 as a current liability .

The 2001 income statement will report a \$9,000 Premium Expense among selling expenses .

4) Warranties :

a) A warranty is a written gurantee of the integrity of a product or service and an undertaking by the seller to repair or repla a product it is customarily offered for a limited such as 90 days .

b) If the incurrence of the warranty expense is proobable , the amount is material , under the expense warranty approach , the total estimated warranty cost is debited to operating expense and credited to liability in the year of sale . This method is accepted when the warranty is not seprable .

c) The sales warranty approach is appropriate when the warranty and the product are seprate , under this method, the warranty revenue is deferred and amortized over the term of the contract , usually on the straight line method .

** Warranty Expense
 Sales
 * % warranty Costs
 = Expense for Period
**Warranty Liability

Estimated Warranty Liability

Payments	Beg. Bal. Expense
	End Bal.

Illustration of Expense Warranty Approach . to illustrate the expense warranty , methods , assume that the denson Machinery Company begins production on a new machine in July 2001 , and sells 100 units at \$5,000 each by its year-end , December 31 , 2001 . Each machine under warranty for one year and the company has etimated , from past experince with a similar machine , that the warranty cost will probably average \$200 per unit . Further , asa result of parts replasements and services rendered in compliance with machinry warranties , the company incurs \$4,000 in warranty costs in 2001 and \$16,00 in 2002 .

1)Sale of 100 machine at 55,000 each , July through December 2001 :

Cash or Accounts Receivable	500,000	
Sales		500,000

2) Recognition of warranty expense , July through December 2001 :

Warrantyexpense	4,000	
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Cash , Inventory , Account payroll (warranty costs incurred)		4,000
Warranty Expense	15,000	
Estimated Liability under Warranties (To accrue estimated warranty costs)		15,000

The December 31 , 2001 balance sheet would report Estimated Liability Under Warranties as a current liability of \$16,000 ,
And the income statement for 2001 would report Warranty Expense of \$20,000 .

3) Recognition of warranty costs incurred in 2002 (on 2001 machinrey sales) :

Estimated Liabillity under Warranties	16,000	
Cash , Inventory , or Accrued Payroll (Warranty costs incurred)		16,000

. Miscellaneous Liabilities

1) Refinancing Liabilities : To be excluded from current Liabilities
(2 Rquirments)

. Company Intends to Refinance on long term Basis

. Company can Demonstrate the ability

The ability to refinance can be demonstrate in either tow ways :

. Refinance on long-term Basis after balance sheet date but befor Issuance .

. Enter into firm agreement with lender having ability to Provide Long-term Finance .

II) Trouble Debt Restructuring

Transfer Property to Creditor

Liability (Amount Forgiven)	XXX	
Gain or Loss on Disposal	XXX or XXX	
Asset(Carrying Value)		XXX
Extraordinary Gain or Restructure		XXX

> Gain or Loss = Fair Value – Carrying Value

on Disposal of asset of Debit

> Extraordinary Gain = Fair Value – Carrying Value

on Restructure of Asset of Debit

III) Issuance of Equity

Liability (Amount Forgiven)	XXX	
Common Stock (Par Value)		XXX
APIC (Based on Fair Value)		XXX
Extraordinary Gain on Restructure		XXX

> APIC =Fair Value of Stock Issued – Par Value of Stock Issued

> Extraordinary Gain = Fair Value – Carrying Value

on Restructure of Stock of Debit

IV) Modification of Terms

Total Payment Under New Terms :

. If > Carrying Value of Debit → No Adjustment

. If < Carrying Value of Debit → Difference is Extraordinary Gain .