Financial Accounting  
Chapter 11  
Current Liabilities

I. Liabilities in General

A. Present obligations from past transactions that must be satisfied with future payment of assets or performance of services

B. Recognized when incurred (often year end adjustments)

C. Current vs. long-term classification
   I. Current -- those to be paid within one year or operating cycle -- whichever is longer
      -- Requires use of current assets or creation of new current liability

II. Current liabilities

A. Classification schemes
   1. Definitely determinable
      a. Liability exists and amount can be determined with precision
      b. Examples --
         (1) Trade accounts payable
         (2) Short-term notes payable
         (3) Sales tax payable
         (4) Current portion of long-term debt
         (5) Unearned revenue (although due date may be uncertain)
         (6) Interest payable
            (a) Regular loans vs. discounted loans ("non-interest" bearing—interest included in face amount)

   2. Estimated liabilities
      a. Liability exists but exact amount is unknown -- must be estimated
      b. Examples (estimated so that the expense may be matched with revenue in the same period)
         (1) Pension obligations--defined benefit plan
         (2) Income taxes during interim periods
            (a) Deferred income taxes resulting from temporary differences between GAAP and tax regulations
         (3) Property taxes until assessment
         (4) Vacation pay--recorded when earned

3. Contingent liabilities
   a. Potential liability that may or may not become an actual liability

   b. Examples
      (1) Product warranties matched with sales revenue
      (2) Lawsuits
      (3) Guarantees of other debts
(4) Failure to comply with laws

c. Must assess likelihood of occurrence
   (1) Probable
   (2) Reasonably possible
   (3) Remote

III. Payroll Accounting
A. Three main issues
   1. Accounting for employee deductions and net pay
   2. Accounting for employer payroll taxes
   3. Maintenance of adequate records to comply with requirements of law

B. Internal Control Issues

C. Employee deductions and net pay
   1. Employee vs. Independent contractor status
      a. Main test is control over what is done and how it is done (Rev. Rul 87-41)
   2. Gross pay does not equal net pay for employees
      a. Regular pay + overtime pay = gross pay
      b. Majority of deductions are a result of legislation or for employee benefit programs
         (1) FICA (Federal Insurance Contribution Act)(two separate programs)
            (a) Current Rate 6.2% (OASDI) of 1st 72,600 plus 1.45% (Medicare) of all wages
         (2) FITW (Federal Income Tax Withheld)
            (a) Based on Gross Pay and # of withholding allowances
         (3) State Income Tax Withheld
         (4) Health and Life Insurance
         (5) Union dues
         (6) Retirement Plan Contributions
         (7) Credit Union Loan Repayments
   3. See Journal entry on page 431
   4. Remember -- these amounts withheld must be paid over to appropriate payees.

D. Employer Payroll Taxes
   1. Must match amount of employee FICA and Medicare
   2. Federal Unemployment Taxes (FUTA)
      a. Generally is .8% of 1st 7,000 paid to each employee
      b. Rate is actually 6.2% but 5.4% credit for state unemployment tax
   3. State Unemployment Tax
      a. Rates can vary tremendously-- depending upon stability of employment
   4. See journal entry on page 433

E. Maintaining adequate records
   1. First must account for time worked
      a. Time clocks, manual systems, etc.
b. Pay and deducts for each employee kept on employee individual earning records
   (1) Serves as basis for preparing W-2 at year end

c. Payroll register to record data for each payroll
   (1) Serves as basis for payroll and deductions entry

F. Payroll paperwork
   1. Quarterly Form 941's
      a. Reconciles payroll tax deposits with Employee FICA and FITW, and Employer FICA
   2. State withholding and unemployment tax (quarterly or monthly)
   3. Federal Form 940 (FUTA)
   4. Year end preparation of W-2's and W-3

G. Employee Fringe Benefits
   1. Examples
      a. Pension plans
      b. Post retirement benefits
      c. Paid absences -- vacation and sick pay

   2. Main objective -- record expense for such items as the employee works and renders services entitlement them to such benefits.