

Toward Business Literacy: Accounting Outlines



Contingencies

Defined: “an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to the enterprise that will ultimately be resolved when one or more future events occur or fail to occur.” FASB 5

Gain

- Possible receipts of gifts, donations, bonuses
- Possible government refunds in tax disputes
- Pending court cases where the outcome is probably favorable
- Tax loss carry forwards
- All of these are **not recorded** in line with the conservatism principle

Loss

- A contingent liability is recorded if the outcome is probable (likely) & the amount is reasonably estimable
- Litigation, claims and assessments
 - If the time of the cause is before the date on the financials, and the outcome is probably unfavorable (discerned from the nature of the case, progress, legal opinion, and similar cases), and the loss can be estimated → Record a current liability
 - Unfiled suits are recorded also if it is probable the suit will be filed and the outcome is probably unfavorable

Guarantee and Warranty costs

- Promise made by seller to buyer to make good on a deficiency of quantity, quality or performance of a product
 - Cash basis: expense as incurred (comply with warranty)
 - Accrual basis: expense in year of sale
 - A sales warranty is sold separately from the product
 - Revenue is deferred and recognized straight-line

Cash Basis

JE:	Warranty Expense	xxx	
	Cash, Inventory		xxx
	For costs incurred (cash method)		

Accrual Basis

JE:	Warranty Expense	xxx	
	Estimated liability under warranty		xxx
	To accrue expense		

JE:	Estimated Liability	xxx	
	Cash, Inventory		xxx
	For costs actualized		

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Premiums and Coupons: box tops, certificates, coupons, labels, wrappers for premium (goodies)

JE:	Inventory	xxx	
	Cash		xxx
	To buy premium		

JE:	Cash	1500	
	Premium Expense	3000	
	Inventory		4500
	To redeem premium (customer pays a percentage)		

JE:	Premium Expense	xxx	
	Estimated liability		xxx
	Adjusting entry (Total sales x estimated redemption % - years redemption = estimated future redemptions)		

Environmental Liability

- Superfund: government support and mandate to clean up waste sites, with EPA power to clean up and charge responsible companies
- Companies must recognize Asset Retirement Obligation
 - For nuclear, oil and gas, mining and landfills for examples
 - Cost is included in asset carrying value and depreciated
 - A liability is recorded

Self-insurance

This is risk assumption, and is a contingency only if there is an uninsured past injury prior to financial statement date

Presentation

Present liabilities at full maturity value and note secured liability with collateral pledged.

Contingencies should have in the notes the nature and estimate of loss.