ACC 300 · SESSION 11

Current obligations

ACC 300 · Session 11 · October 6, 2026



ACC 300 · SESSION 11

Account for current obligations

Last class: balance-sheet classification and liquidity.

Today: record obligations, classify debt, and account for uncertainty.

What creates the obligation? When do we record it? How much do we record?



Past events and present obligations

A liability is a present obligation to transfer an economic benefit to another party.

Settlement: cash, goods, or services.

PAST EVENT	WHAT REMAINS OWED?
Work completed by employees	Compensation
Accepted goods received on credit	Payment to supplier
Customer payment before service	Promised service

A spending plan alone creates no payable. The company must already have an obligation, even if its amount requires an estimate.

Existing obligation or future spending?

For each situation, identify whether an obligation exists and what created it.

- Employees have completed work and remain unpaid.
- Management plans to replace equipment next year but has made no purchase commitment.
- The company has received and accepted goods on credit.
- Management is considering an advertising campaign and has ordered no services.
- A customer has paid for service the company still owes.

Existing obligation or future spending: answers

Identify what the company already owes.

Employees have completed work and remain unpaid.
Existing obligation: compensation for completed work.

Management plans to replace equipment next year but has made no purchase commitment.
Future plan: no purchase commitment exists.

The company has received and accepted goods on credit.
Existing obligation: payment for accepted goods.

Management is considering an advertising campaign and has ordered no services.
Future plan: no advertising service has been ordered.

A customer has paid for service the company still owes.
Existing obligation: provide the prepaid service.

Accounting decisions and ASC sections

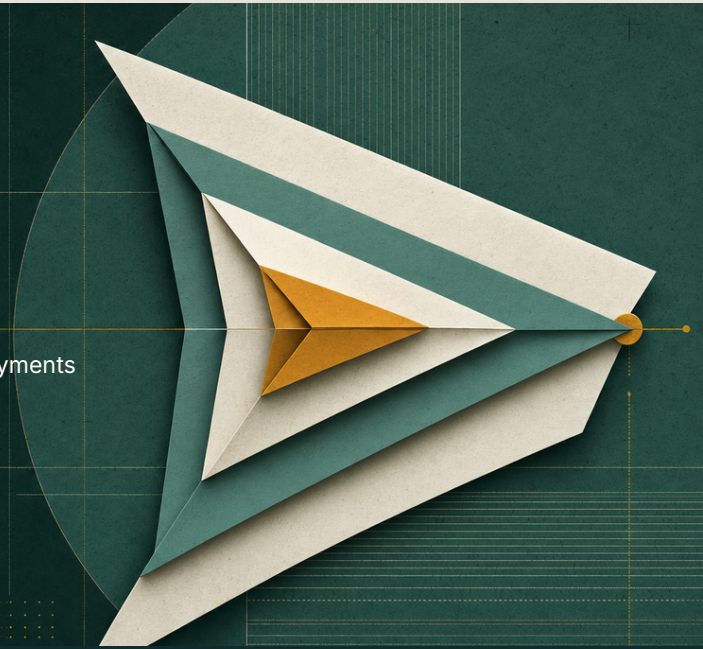
ASC format: Topic-Subtopic-Section-Paragraph

DECISION	QUESTION	ASC PARAGRAPH FORMAT
Recognition	Record a liability?	XXX-XX-25-X
Initial measurement	At what amount initially?	XXX-XX-30-X
Subsequent measurement	At what amount after initial recognition?	XXX-XX-35-X
Classification	Where to present it?	XXX-XX-45-X
Disclosure	What belongs in the notes?	XXX-XX-50-X

ACC 300 · SESSION 11

Operating obligations

Goods received, work performed, and payments received before service.



Goods received and services consumed

Receiving goods or services on credit creates an obligation to the supplier. The invoice documents the amount owed; its arrival need not create the obligation.

What was received?

- Resource still available for future use: asset
- Service or good already consumed: expense

Accrued expense: a cost incurred before payment.

WHAT THE COMPANY RECEIVED	DEBIT	CREDIT
Components still held for production	Inventory	Accounts Payable
Electricity already consumed	Utilities Expense	Utilities Payable

Unbilled utilities: estimate and adjust

Estimate unbilled service from evidence of what the company already used.

Riverton: December 31, 2026

- Recorded unpaid December bills: $6,000
- Additional December service: $4,000, unbilled and unrecorded
- Basis for the $4,000 estimate: meter readings and contract rates

Required Utilities Payable = $6,000 + $4,000 = $10,000.

December 31, 2026: record the unbilled service.

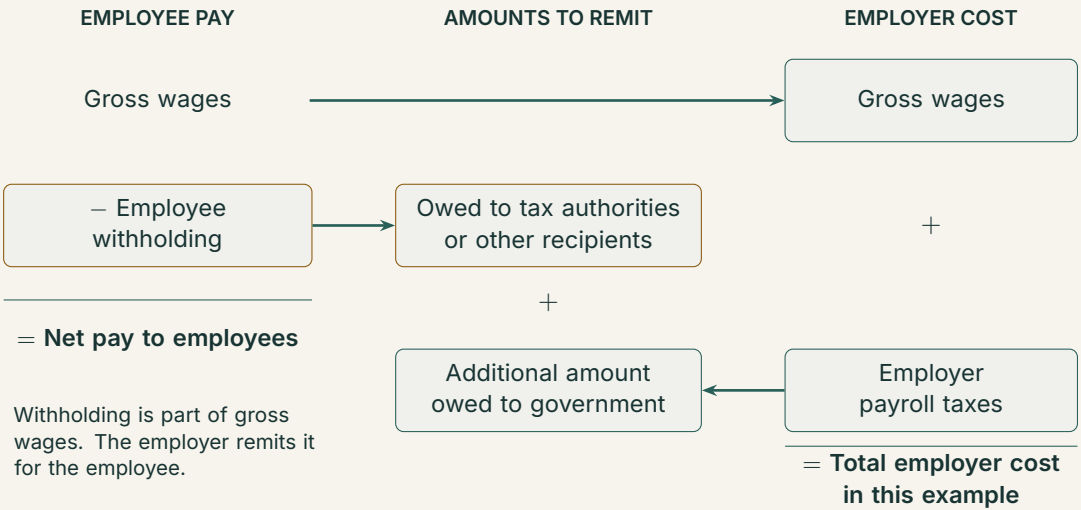
ACCOUNT	DEBIT	CREDIT
Utilities Expense	$4,000	
Utilities Payable		$4,000

January 18, 2027: pay the full balance.

ACCOUNT	DEBIT	CREDIT
Utilities Payable	$10,000	
Cash		$10,000

December service creates December expense. January payment settles the recorded obligation.

Gross wages and employer cost



Practice: record Riverton's December payroll

Take a few minutes to work through this on your own or with those around you.

Riverton: December 2026 administrative payroll

- Gross wages: $34,000
- Employee tax withholding: $4,000
- Employer payroll taxes: $4,000
- Work consumed in December; payroll unrecorded and unpaid
- Tax amounts supplied; no tax-rate calculation

Payment dates

- Employees: January 4, 2027
- Tax authorities: January 15, 2027

Determine the amounts owed to employees and tax authorities. Record the December 31 accrual and both January payments. Explain which entries affect expense.

Record gross wages and employer payroll taxes

Riverton's payroll

- Gross wages: $34,000
- Employee withholding: $4,000
- Employer payroll taxes: $4,000

December 31, 2026: accrue the payroll.

ACCOUNT	DEBIT	CREDIT
Wage Expense	$34,000	
Employer Payroll Tax Expense	$4,000	
Wages Payable		$30,000
Payroll Liabilities		$8,000

Total expense is $38,000. Employees earned the full $34,000, including the amount withheld for their taxes. Only the employer's own $4,000 tax adds another cost.

Accrual effects: expense and liabilities increase; cash unchanged.

Payroll payments and tax remittance

Riverton's December 31, 2026, payables

- Employees: $30,000
- Tax authorities: $8,000

January 4, 2027: pay the employees.

ACCOUNT	DEBIT	CREDIT
Wages Payable	$30,000	
Cash		$30,000

January 15, 2027: remit employee withholding and employer taxes.

ACCOUNT	DEBIT	CREDIT
Payroll Liabilities	$8,000	
Cash		$8,000

Both payments reduce cash and the corresponding liability. Neither records another expense for December work.

Earned paid leave

Earned paid leave is compensation for work already performed. The employer pays compensation during a later absence using rights the employee earned earlier.

RIGHT	WHAT THE EMPLOYEE RETAINS
Vested rights	Payment even if the employee leaves the employer.
Accumulating rights	Unused leave that carries forward to a later period.

Both can apply to the same benefit. Carryforward alone does not guarantee payment after leaving.

Accrue when all four conditions hold:

- Related work already performed
- Rights that vest or accumulate
- Probable payment
- Reasonably estimable amount

Source: ASC 710-10-25-1.

Northfield's earned vacation and adjustment

Northfield: December 31, 2026

- Earned, unused vacation: 240 hours at $25 per hour
- Unused hours carry forward; lost if the employee leaves
- Use during 2027: probable
- Hours already reduced for expected forfeitures, meaning benefits employees are expected to lose
- Payroll taxes excluded

Later payment debits Vacation Payable and credits Cash for the amount settled. The employee earned that compensation through earlier work.

REQUIRED ENDING LIABILITY

$6,000

Required Vacation Payable = 240 x $25 = $6,000.

ADJUSTMENT STILL NEEDED

$1,500

Adjustment = $6,000 required - $4,500 recorded = $1,500.

ACCOUNT	DEBIT	CREDIT
Compensation Expense	$1,500	
Vacation Payable		$1,500

iClicker: would expiring leave create a liability?

Assume Northfield's leave policy: Unused leave expires at year-end; No carryforward or cash payment; Actual practice follows the policy; no other obligation

Should Northfield accrue the unused leave at December 31?

iClicker · Question 1 of 4

- **A** Yes, because employees have performed service.
- **B** Yes, because unused hours can be multiplied by a pay rate.
- **C** No, because employees retain no vested or accumulating right.
- **D** No, because paid leave is always expensed only when taken.

iClicker answer: the continuing right is missing

Assume Northfield's leave policy: Unused leave expires at year-end; No carryforward or cash payment; Actual practice follows the policy; no other obligation
Should Northfield accrue the unused leave at December 31?

iClicker · Answer 1 of 4

A	Yes, because employees have performed service. Incorrect. Past service alone does not satisfy all recognition conditions.
B	Yes, because unused hours can be multiplied by a pay rate. Incorrect. Measurement does not establish a continuing right.
C	No, because employees retain no vested or accumulating right. **Correct.** The required liability is $0 under these facts.
D	No, because paid leave is always expensed only when taken. Incorrect. The answer is no, but the reason is wrong. Paid leave can create expense as employees earn it, before they take leave.

Sick leave: required or optional accrual?

For sick leave earned through past work:

EMPLOYEE RIGHTS	TREATMENT
Vested: payment rights after leaving	**Accrual required** if payment is probable and reasonably estimable
Nonvesting, with unused days carried forward	**Accrual optional** if payment is probable and reasonably estimable
Neither vested nor carried forward	**No accrual** for unused days under the earned-leave rule

Without probable payment and a reasonable estimate, do not accrue under this rule.

If the employer chooses nonaccrual: record sick-pay expense when qualifying leave is taken.

The sick-pay exception concerns illness-related absences. The next slide distinguishes other benefits called "sick leave."

Sources: ASC 710-10-25-1 and 25-6 through 25-8.

When the sick-pay exception applies

The benefit employees receive determines whether the sick-pay exception applies, regardless of the policy name.

- Illness-related absences only
- Unused days carry forward
- No payment right after leaving

→ **Nonvesting sick-pay exception: accrual of unused days optional**

Routine pay without illness, including paid leave before retirement → **General paid-leave accrual rule**

Sources: ASC 710-10-25-6 through 25-8.

Sick pay without prior accrual

Employer chooses nonaccrual

- Unused sick days accumulate: no expense or liability recorded
- Qualifying sick leave taken: record sick-pay expense

Leave taken; compensation unpaid

ACCOUNT	DEBIT	CREDIT
Sick-Pay Expense	Amount owed	
Wages Payable		Amount owed

Later payment

ACCOUNT	DEBIT	CREDIT
Wages Payable	Amount paid	
Cash		Amount paid

If the sick pay is paid immediately, debit Sick-Pay Expense and credit Cash directly. Do not count the same compensation again as ordinary wage expense.

Source: ASC 710-10-25-7 through 25-8.

Collect sales tax, then pay the government

The sales-tax portion of a customer's payment belongs to the government. Riverton records an obligation while it holds that cash.

Assume Riverton collects: $1,000 for a delivered bicycle plus $60 sales tax.

Collection entry

ACCOUNT	DEBIT	CREDIT
Cash	$1,060	
Sales Revenue		$1,000
Sales Tax Payable		$60

January 15, 2027: remit the tax.

ACCOUNT	DEBIT	CREDIT
Sales Tax Payable	$60	
Cash		$60

The tax collection and remittance change cash and the payable. Neither creates revenue or expense for Riverton.

Advance payment leaves performance owed

A customer who pays in advance still has a claim to the promised goods or services. The seller has cash, but it has not yet fulfilled that promise.

Qualifying customer contract

- Payment received or due before performance: contract liability
- Promised service provided: liability decreases; revenue increases
- Another cash receipt: not required

Northfield calls these contract liabilities Customer Advances.

Source: ASC 606-10-25-1 and 45-2.

Record Northfield's advance and earned revenue

Northfield's prepaid service

- Collection: $15,000 in December 2026
- Service: evenly during January and February 2027
- December service: none

December 2026: record the collection.

ACCOUNT	DEBIT	CREDIT
Cash	$15,000	
Customer Advances		$15,000

January 31, 2027: record the service provided during January.

ACCOUNT	DEBIT	CREDIT
Customer Advances	$7,500	
Service Revenue		$7,500

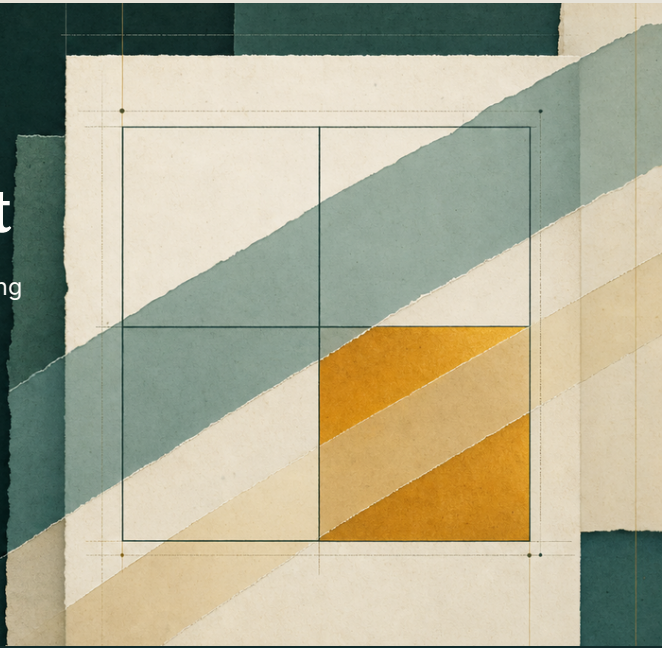
The remaining $7,500 is for February service still owed. January revenue requires no new cash receipt. Northfield accounts for its service costs separately.

Source: ASC 606-10-45-2.

ACC 300 · SESSION 11

Debt and interest

Separate the cost of borrowing from the timing of principal repayment.



Recall the principal payments from last class

Debt: obligation arising from borrowing.

Principal: borrowed amount remaining to be repaid.

Recall Riverton's December 31, 2026, principal schedule:

PRINCIPAL DUE	AMOUNT
March 31, June 30, September 30, and December 31, 2027	$25,000 each
After 2027	$360,000

Classification reminder: $100,000 current; $360,000 noncurrent, unless other loan terms change when repayment can be demanded.

Now distinguish principal repayment from the interest cost of borrowing.

Principal and interest obligations

Principal
Repayment of the amount borrowed

Interest
Cost of using the borrowed funds during the borrowing period

SIMPLE INTEREST =

Principal × Annual interest rate × Elapsed fraction of a year

Interest expense arises as borrowing time passes, even if interest is paid later. Unpaid interest already incurred becomes Interest Payable.

Classification: use interest's own payment date. Interest payable can be current even when principal is noncurrent.

Northfield accrues interest at year-end

Assume Northfield borrows:

- Principal: $60,000 on October 1, 2026
- Rate: 6% annual simple interest
- Principal and interest due: April 1, 2027
- Recorded: Cash and Notes Payable, $60,000
- Interest recorded: none
- No interim payments, fees, discounts, or capitalized borrowing costs

Year fraction = elapsed months / 12.

December 31 interest = $60,000 x 6% x 3/12 = $900.

December 31, 2026: accrue interest for October through December.

ACCOUNT	DEBIT	CREDIT
Interest Expense	$900	
Interest Payable		$900

Interest for January through March has not yet been incurred at December 31.

Principal and interest at maturity

Northfield's note

- Principal: $60,000; annual simple interest: 6%
- Borrowing period: October 1, 2026, to April 1, 2027

Total interest = $60,000 x 6% x 6/12 = $1,800. Cash paid at maturity is $61,800.

Already recorded: December accrual, $900.

Assume: no 2027 interest posted before payment.

April 1, 2027: repay the note and interest.

ACCOUNT	DEBIT	CREDIT
Notes Payable	$60,000	
Interest Payable	$900	
Interest Expense	$900	
Cash		$61,800

Only January through March creates new interest expense in 2027. Principal repayment creates no expense. Charging all $1,800 to 2027 would count the accrued $900 twice.

What refinancing changes

Refinancing: replacing, renewing, or extending existing borrowing.

- New loan used to repay an old loan
- Renewal or extension with the existing lender

The company still owes principal. Its repayment schedule may change.

PRINCIPAL REPAYMENT	CLASSIFICATION
Within the next year or longer operating cycle	Current
Financed beyond that period, with the applicable conditions met	Noncurrent

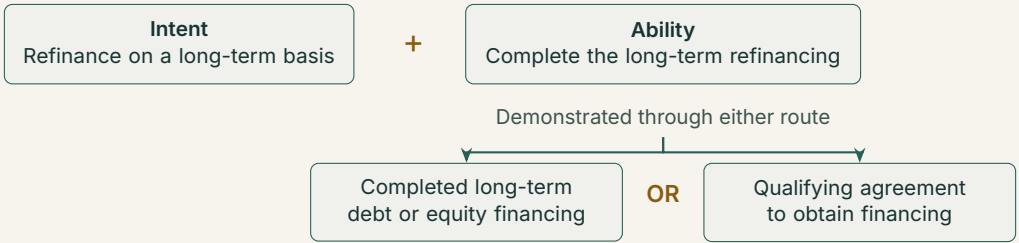
A final maturity date states when the last payment is due. Inspect earlier installments before classifying the full loan as noncurrent.

Source: ASC 470-10-45-12B.

Refinancing after year-end

An existing loan may be due within the year after the reporting date. US GAAP can consider qualifying refinancing arranged after year-end.

Both required for noncurrent classification



Deadline: before the financial statements are issued or available to be issued.

The qualifying portion remains a liability, classified as noncurrent. An undrawn agreement records no new borrowing or cash receipt.

Sources: ASC 470-10-45-12B and 45-14.

Qualifying financing agreements

A financing agreement commits the lender to provide funds under stated terms.

REQUIRED CONDITION	REASON
Commitment beyond the next year or longer operating cycle from year-end; determinable terms	Financing must extend beyond the current period.
Cancellation or early repayment only for objectively measurable violations	The lender cannot withdraw solely because it judges operations unsatisfactory.
No unwaived violation through financial-statement issuance or availability for issuance	A violation could prevent access to the funds.
Financially capable lender	The lender must be able to supply the promised funds.

Failed condition: the agreement does not support noncurrent classification. Without other qualifying refinancing, scheduled current amounts remain current.

Source: ASC 470-10-45-14(b).

How much becomes noncurrent?

First establish qualifying refinancing. The amount reclassified as noncurrent cannot exceed the amount available to refinance this debt on a long-term basis.

EVIDENCE	MAXIMUM AMOUNT ELIGIBLE FOR NONCURRENT CLASSIFICATION
Completed financing	Proceeds raised for qualifying refinancing
Qualifying agreement	Funds obtainable to refinance this obligation

A credit limit is the maximum the lender promises to lend. Restrictions may reduce the funds usable for this debt.

Keep current:

- Principal installments still due within the current period under the replacement financing
- Any portion of the old debt not covered by qualifying financing

A later final maturity does not make earlier installments noncurrent.

Sources: ASC 470-10-45-12B and 45-14 through 45-17.

Practice: Riverton's refinancing agreement

Assume Riverton has the following obligations at December 31, 2026:

- Principal due in 2027: $100,000
- Principal due after 2027: $360,000
- Intended long-term refinancing: $70,000 of the 2027 payments

February 1, 2027, lender commitment

- Up to $70,000; borrowing permitted through December 31, 2029
- All borrowed principal due December 31, 2030
- No principal installments are due earlier.
- Determinable terms and rates; financially capable lender
- Cancellation or acceleration only for objective violations

Through March 15, 2027, financial-statement availability: no violations or funding restrictions; no borrowing under the agreement; old debt unpaid.

Determine current and noncurrent principal at December 31, 2026.

Separate the covered and uncovered repayments

Riverton's 2027 principal payments

- Total due: $100,000
- Qualifying financing: $70,000
- Replacement principal: no payment before December 31, 2030

PORTION OF PRINCIPAL AT DECEMBER 31, 2026	CLASSIFICATION
The uncovered $30,000 remains due during 2027.	Report $30,000 current.
The qualifying agreement covers $70,000 of the 2027 payments.	Report $70,000 noncurrent under the US GAAP exception.
Another $360,000 was already scheduled after 2027.	Keep $360,000 noncurrent.

Total noncurrent principal is $70,000 + $360,000 = $430,000. Total principal remains $460,000.

Earlier installments would remain current. A final maturity date alone does not justify classifying the full $70,000 as noncurrent.

Repayment before refinancing

Assume Riverton has $460,000 of principal outstanding at December 31, 2026, with $100,000 due during 2027.

DECEMBER 31, 2026	JANUARY 20, 2027	FEBRUARY 1, 2027
The existing debt includes $100,000 due in 2027.	Riverton pays $70,000 of that debt with existing cash.	Riverton borrows $70,000 under a new loan due in 2030.

No new refinancing arrangement existed before the January payment. Both events occur before March 15, when the financial statements are available to be issued.

- January repayment: uses current assets
- February borrowing: replaces cash after repayment

At December 31, report $100,000 current and $360,000 noncurrent. Later replenishment of cash does not qualify the repaid amount for noncurrent classification.

Source: ASC 470-10-45-15.

Covenant violations and immediate repayment

A covenant is a condition in a borrowing agreement. A covenant violation may let the lender demand repayment before the scheduled maturity.

Assume Riverton:

- Covenant violation: December 31, 2026
- Immediately callable principal: $460,000
- No qualifying relief by March 15, 2027, when financial statements are available to be issued

Classification: $460,000 current; $0 noncurrent.

Source: ASC 470-10-45-11.

The lender can require payment now, so the repayment obligation is current despite the original schedule.

Reclassification effects:

- Current liabilities increase; noncurrent liabilities decrease equally
- Cash and total debt unchanged
- Working capital and current ratio decrease if current assets stay unchanged

Waivers and grace periods

FORM OF RELIEF	WHAT CHANGES?
Waiver	The lender agrees not to demand repayment for a specified violation.
Contractual grace period	The borrower has time to correct a violation before it permits a demand.

Current/Noncurrent Classification under US GAAP

- Qualifying waiver: use the scheduled payment dates.
- Correction probable within the grace period: use the scheduled payment dates.
- Correction not probable, with no other qualifying relief: classify the callable amount as current.

Scheduled installments still apply. Neither a waiver nor correction cancels those payments.

Source: ASC 470-10-45-11.

When lender relief changes classification

Cutoff: relief obtained before financial statements are issued or available to be issued.

RELIEF	CLASSIFICATION
Waiver prevents demand for more than a year or longer operating cycle from year-end	Scheduled payment dates, subject to future covenant tests
Shorter waiver, with no other qualifying relief	Callable amount current
Correction removes the lender's demand right for the required period	Scheduled payment dates
Contractual grace period; correction within it probable	Scheduled payment dates

A short waiver leaves the lender able to demand payment within the current period.

Future covenant tests: if an uncured violation within the next year is probable, the waiver does not justify noncurrent classification.

Sources: ASC 470-10-45-1 and 45-11.

Practice: evaluate lender relief

Take a few minutes to work through this on your own or with those around you.

Assume Riverton's December 31, 2026, covenant violation makes all $460,000 immediately callable.

Lender relief and reporting dates

- Waiver obtained: February 1, 2027
- Waiver expiration: March 31, 2028
- Financial statements available to be issued: March 15, 2027

Other terms

- Scheduled principal: $100,000 during 2027; $360,000 after 2027
- Compliance at next annual test: probable
- Other violations: none

Determine the US GAAP classification. Explain what changes if the waiver instead expires June 30, 2027.

Answer: waiver duration and scheduled payments

Riverton's December 31, 2026, covenant violation

- Waiver obtained: February 1, 2027
- Financial statements available: March 15, 2027
- Compliance at next annual test: probable

WAIVER EXPIRATION	DECEMBER 31 CLASSIFICATION	REASON
March 31, 2028	Report $100,000 current and $360,000 noncurrent.	The lender cannot demand the full balance for more than a year after year-end. The ordinary scheduled payments still apply.
June 30, 2027	Report all $460,000 current, assuming no other qualifying relief.	The lender can demand the full balance within the year after year-end. The waiver does not cover the required period.

The short-waiver result concerns the duration of the lender's repayment right. It does not assume that Riverton failed to correct the violation.

Debt classification: US GAAP and IFRS

IFRS: the right to defer settlement for at least 12 months must exist at the reporting date.

US GAAP: qualifying refinancing or lender relief obtained after year-end can affect year-end classification. The cutoff is financial-statement issuance or availability for issuance.

IFRS means International Financial Reporting Standards.

RIVERTON'S LATER EVENT	US GAAP AT DECEMBER 31	IFRS AT DECEMBER 31
A qualifying February waiver addresses the December covenant violation.	Only scheduled current principal of $100,000 is current.	All $460,000 is current: the lender could demand it at year-end.
A qualifying February agreement refinances $70,000 of the $100,000 due in 2027.	The uncovered $30,000 is current.	The full $100,000 is current: the later agreement did not provide a year-end right to defer payment.

Sources: ASC 470-10-45-11 and 45-14; IAS 1.69(d) and 72-76.

iClicker: what changes when debt becomes current?

A company reclassifies part of an existing loan from noncurrent to current because repayment is due within the next year. No borrowing or payment occurs. Which statement describes the effect of this reclassification?

iClicker · Question 2 of 4

- **A** Cash decreases and total liabilities decrease.
- **B** Interest expense increases and equity decreases.
- **C** Current liabilities increase and noncurrent liabilities decrease.
- **D** Current liabilities increase and total liabilities increase.

iClicker answer: only the classification changes

A company reclassifies part of an existing loan from noncurrent to current because repayment is due within the next year. No borrowing or payment occurs. Which statement describes the effect of this reclassification?

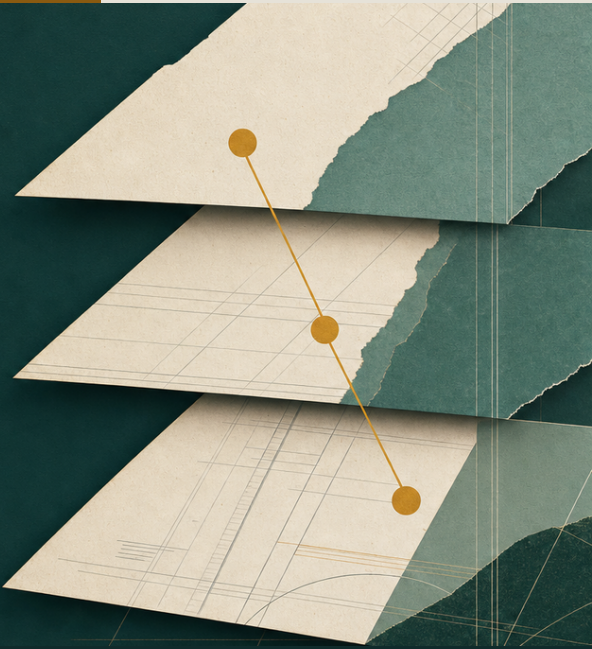
iClicker · Answer 2 of 4

- **A** Cash decreases and total liabilities decrease. Incorrect. Reclassification does not involve a payment.
- **B** Interest expense increases and equity decreases. Incorrect. Changing the classification does not create an expense.
- **C** Current liabilities increase and noncurrent liabilities decrease. **Correct.** The same debt moves between liability categories.
- **D** Current liabilities increase and total liabilities increase. Incorrect. Total liabilities stay unchanged.

ACC 300 · SESSION 11

Loss contingencies

Decide what to record and disclose when outcomes remain uncertain.



Loss contingencies: past event, uncertain outcome

A loss contingency is an existing condition whose loss outcome depends on uncertain future events.

PAST: BEFORE YEAR-END	PRESENT: REPORTING DATE	FUTURE: OUTCOME BECOMES KNOWN
An event creates possible exposure to loss.	The condition exists, but whether a loss occurred or its amount remains uncertain.	Settlement, judgment, or other evidence resolves the uncertainty.

The company need not wait for cash payment to report a loss. Apply ASC 450's loss-recognition conditions using the information about the existing condition.

A planned future expenditure alone does not establish a loss already incurred.

Source: ASC 450-20-25-2.

Likelihood and amount are separate questions

For a condition existing at year-end:

QUESTION	WHAT IT ESTABLISHES
Was a loss probably incurred?	Likelihood of loss
Can that loss be reasonably estimated?	Amount to record

The person or organization seeking payment, called the claimant, may demand a precise amount even when the company is unlikely to owe it. A dollar amount alone does not establish probable loss.

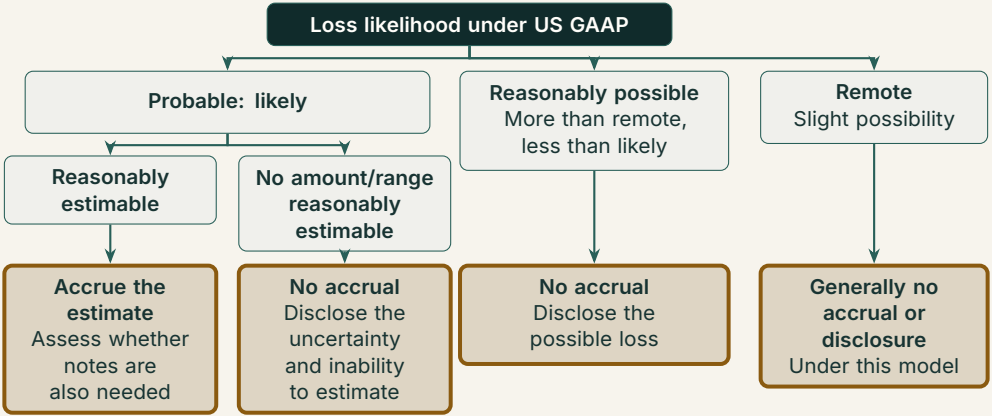
ASC 450 accrual requires both:

- Probable loss
- Reasonable estimate

Either missing: no accrual under this model; assess disclosure separately.

Source: ASC 450-20-25-2.

Accrual and disclosure decisions



US GAAP assigns no fixed probability percentages to these terms. Guarantees and other specialized obligations can have separate requirements.

Sources: ASC 450-20-25-2 and 50-3 through 50-4.

Contingency disclosures

A recorded liability does not reveal every possible loss. Use the notes to describe the uncertainty and additional exposure.

SITUATION	WHAT TO DISCLOSE
A loss is reasonably possible, but no accrual is recorded.	Describe the contingency and estimate the possible loss or range.
A required estimate cannot be made.	Describe the contingency and state that an estimate cannot be made.
A loss is accrued, but additional loss is reasonably possible.	Describe the contingency and estimate the additional possible loss or range, or state that it cannot be estimated.

An accrual and a disclosure can both be required for the same contingency.

Sources: ASC 450-20-50-3 through 50-4.

Claims not yet asserted

An unasserted claim is a potential claim the other party has not yet made.

If the potential claimant has shown no awareness, disclose when both hold:

- Assertion of the claim is probable.
- An unfavorable outcome is at least reasonably possible.

The likelihood of a claim being made differs from the likelihood of losing it.

Required disclosure: nature of the uncertainty; possible loss or range, or inability to estimate.

These are disclosure conditions. Evaluate accrual under the loss-recognition conditions.

Sources: ASC 450-20-25-2 and 50-3 through 50-6.

Measuring the loss

Apply after both accrual conditions hold: probable loss and reasonable estimation.

AVAILABLE ESTIMATE	US GAAP MEASUREMENT
A particular amount is the best estimate.	Accrue that amount.
Several amounts form a range, and one is better supported.	Accrue the better-supported amount.
No amount within a supported range is a better estimate.	Accrue the minimum of the range.

The minimum is a prescribed measurement rule. It does not establish that the minimum is the most likely outcome or the largest possible payment.

Then assess disclosure of reasonably possible loss beyond the accrual.

Sources: ASC 450-20-30-1 and 50-3 through 50-4.

Loss measurement: US GAAP and IFRS

IFRS provision: a liability with uncertain timing or amount.

Measurement: best estimate of expenditure required to settle the obligation.

MEASUREMENT SITUATION	US GAAP	IFRS
A single amount is the best estimate.	Use that amount.	Use that amount.
Every point in a continuous range is equally likely.	Use the minimum when no amount is a better estimate.	Use the midpoint.

Under IFRS, consider other possible outcomes when deciding whether the most likely amount is the best estimate.

A range's endpoints alone do not establish equal likelihood. The US GAAP rule also applies when no amount is a better estimate without requiring an equally likely continuous range.

Sources: ASC 450-20-30-1; IAS 37.36-40.

Gain contingencies

A gain contingency is an existing situation that may produce a gain depending on uncertain future events.

Recognition: generally no gain before realization.
Likely success does not establish that the company has realized the gain. Do not reverse the probable-loss rule to recognize an uncertain gain.

Disclosure: describe the possible gain without overstating the likelihood of realization.
Disclosure does not turn an uncertain gain into recorded income.

Sources: ASC 450-30-25-1 and 50-1.

Subsequent events and year-end conditions

Later information can clarify an existing year-end condition. The date of the underlying event determines which period is affected.

UNDERLYING EVENT	YEAR-END TREATMENT
December service claim assessed by counsel in February	Use the later assessment to evaluate the December 31 loss.
Damaging service first occurs in January	No December accrual; disclose the subsequent event if necessary.

New information about an earlier condition differs from a new condition arising after year-end.

Sources: ASC 450-20-25-2 and 25-6; ASC 855-10-25-1 and 25-3.

Practice: Riverton's damage claim

Assume Riverton faces a claim arising in December 2026, outside warranty coverage.

Counsel's assessment before March 15, 2027

- Loss: probable
- Estimated range: $18,000 to $30,000
- Better-supported amount: none
- Additional loss above the minimum: reasonably possible

Other facts

- No loss recorded; settlement expected during 2027
- Material claim: omission could affect a user's decision
- No insurance or tax effects

Determine the accrual and disclosure. Then explain what changes if counsel supports $24,000 as the best estimate.

Answer: accrual and additional exposure

Riverton: probable loss of $18,000 to $30,000; no better estimate.

Accrual: $18,000

ACCOUNT	DEBIT	CREDIT
Loss Contingency Expense	$18,000	
Loss Contingency Liability		$18,000

Disclose the nature of the claim and the reasonably possible additional loss, up to $12,000. The entry reduces income and increases liabilities without using cash.

If the best estimate becomes $24,000:

- Required accrual: $24,000
- Additional exposure: $6,000
- If an accrual is already recorded: adjust only the difference

iClicker: does either assessment permit accrual?

Northfield has an unrecorded, material claim from a December service event. Consider two alternative cases, using legal counsel's assessment before financial-statement issuance.

Case A: Loss reasonably possible; estimated range $9,000 to $21,000

Case B: Loss probable; no amount or range reasonably estimable

The cases are independent. Case A's range does not apply to Case B. Which treatment applies to Case A and Case B, respectively?

iClicker · Question 3 of 4

- **A** Accrue $9,000 in both cases.
- **B** Disclose without accrual; disclose without accrual.
- **C** Neither accrue nor disclose; disclose without accrual.
- **D** Disclose without accrual; accrue the amount the other party demands.

iClicker answer: neither assessment permits accrual

Northfield has an unrecorded, material claim from a December service event. Consider two alternative cases, using legal counsel's assessment before financial-statement issuance.
Case A: Loss reasonably possible; estimated range $9,000 to $21,000
Case B: Loss probable; no amount or range reasonably estimable
The cases are independent. Case A's range does not apply to Case B. Which treatment applies to Case A and Case B, respectively?

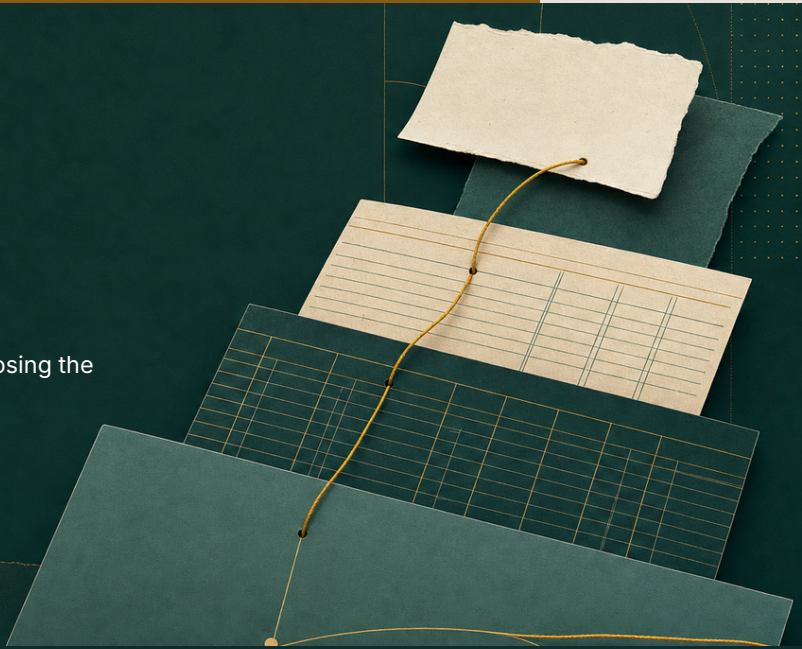
iClicker · Answer 3 of 4

A	Accrue $9,000 in both cases. Incorrect. Case A fails the probable-loss condition. Case B fails the reasonable-estimate condition.
B	Disclose without accrual; disclose without accrual. **Correct.** Case A: disclose the claim and range. Case B: disclose the claim and inability to estimate. Both require disclosure, but neither meets both accrual conditions.
C	Neither accrue nor disclose; disclose without accrual. Incorrect. Case A's reasonably possible material loss requires disclosure.
D	Disclose without accrual; accrue the amount the other party demands. Incorrect. A demand is not automatically a reasonable estimate.

ACC 300 · SESSION 11

Warranty obligations

Identify the promise before choosing the accounting treatment.



Assurance and service warranties

Assurance coverage promises that a product meets agreed specifications. Additional service gives the customer a benefit beyond that

PROMISE	ACCOUNTING MODEL
Correct qualifying defects in a sold product	Estimate assurance costs and the remaining liability.
Provide additional repair or maintenance service	Allocate customer consideration and recognize revenue as service is provided.

Separate purchase option: service warranty. Included coverage can also contain service.

For included coverage, decide whether the promise goes beyond correcting defects:

FACTOR	WHAT IT SUGGESTS
Required by law	Usually assurance: protection against defective products
Longer coverage period	More likely to provide an additional service
Tasks necessary to correct defects	Usually assurance, including return shipping for a defective product

Judge the promised benefit using all relevant terms. Coverage length alone does not decide the treatment.

Sources: ASC 606-10-55-30 through 55-33.

Assurance warranty entries

A covered sale creates responsibility for qualifying defects. When expected costs are probable and reasonably estimable, record Warranty Expense and Warranty Liability.

LATER EVENT	ACCOUNTING
The seller settles a claim.	Debit Warranty Liability and credit cash, parts, or the other resources used.
Expected remaining costs increase.	Debit Warranty Expense and credit Warranty Liability for the increase.
Expected remaining costs decrease.	Debit Warranty Liability and credit Warranty Expense for the decrease.

Sources: ASC 460-10-25-5 through 25-7.

Warranty liability reconciliation

Compare a revised remaining estimate with the amount still recorded for the same sales. Claims already settled are no longer part of that remaining obligation.

The ending liability includes estimated costs still to be settled.

Warranty Liability

	Beginning credit balance
Claims settled	Estimates for new sales
Downward estimate revisions	Upward estimate revisions
	Ending credit balance: estimated costs still owed

Keep the amounts distinct:

- Expense: new estimates and estimate revisions
- Claims settled: reduction of an existing obligation
- Ending liability: estimated costs still owed

New information can change an estimate without establishing an earlier error.

Sources: ASC 460-10-25-5 through 25-7; ASC 250-10-45-17.

Practice: Riverton's warranty liability

Bicycles sold before 2026

- January 1, 2026: Warranty Liability had a $9,000 credit balance.
- During 2026: Riverton paid $4,000 in claims and debited Warranty Liability.
- December 31, 2026: Riverton expects to pay $7,000 in future claims on those bicycles.

Bicycles sold during 2026

- Riverton sold 500 bicycles.
- Estimated warranty cost is $10 per bicycle.
- No claims have been paid on these bicycles.

Riverton recorded the claim payments but has not recorded either year-end estimate. The estimates meet the recognition conditions. Remaining claims will be settled within 9 months.

What adjusting entry should Riverton record on December 31, 2026? What will the ending Warranty Liability balance be?

Answer: record the warranty expense

First, adjust the liability for bicycles sold before 2026.

EARLIER-SALES LIABILITY	CALCULATION OR AMOUNT
Balance still recorded after claims paid	$9,000 - $4,000 = $5,000
Required balance for expected future claims	$7,000
Increase needed: credit Warranty Liability	$7,000 - $5,000 = $2,000

Then add the estimate for bicycles sold during 2026: 500 x $10 = $5,000.

Total expense adjustment = $2,000 for earlier sales + $5,000 for 2026 sales = $7,000.

December 31, 2026

ACCOUNT	DEBIT	CREDIT
Warranty Expense	$7,000	
Warranty Liability		$7,000

Answer: reconcile the warranty liability

Warranty Liability

	$9,000 Beginning balance
Claims paid $4,000	
	$2,000 Earlier-sales revision $5,000 Estimate for 2026 sales
	$12,000 Ending balance

$7,000 warranty expense

Product and service promises

One customer payment may cover a delivered product and future service. Recording the whole price as revenue at delivery would include service still owed.

A distinct service requires both:

- Customer benefit from the service separately
- A promise separately identifiable within the contract

Inspect: whether the seller integrates or modifies the items into a single promised result. A separate invoice line alone does not establish a separate promise.

Source: ASC 606-10-25-19.

Allocating the contract price

Stand-alone selling price: the price for a separate sale.

Allocate the contract price in proportion to the promises' stand-alone selling prices.

Service allocation = contract price x service stand-alone price / total stand-alone prices.

For unperformed service:

- Consideration received or due: contract liability
- Liability amount: allocated customer price
- Estimated service costs: accounted for separately

The liability represents revenue not yet earned from providing the promised service.

Sources: ASC 606-10-25-19, 32-28 through 32-29, and 45-2.

Availability is the promised service

A seller can promise repair availability throughout a coverage period. The customer receives protection while that coverage is available, even without requesting a repair.

Revenue follows performance

- Promised service: continuing availability
- Recognition: as that availability is provided
- Equal monthly revenue: appropriate when service is provided evenly

Source: ASC 606-10-25-27(a) and 25-31.

Northfield's repair coverage

Northfield's additional repair coverage

- January 1, 2027: $2,400 collected and recorded
- Coverage: 12 months, provided evenly
- Qualifying contract; no other promise or price adjustment
- Through March 31: availability provided; no repair requests
- Revenue recorded so far: none

Revenue = $2,400 x 3 / 12 = $600.

March 31, 2027: record the coverage provided.

ACCOUNT	DEBIT	CREDIT
Service Contract Liability	$600	
Service Revenue		$600

The remaining liability is $1,800 for coverage still owed.

Costs of providing service require separate accounting.

Sources: ASC 606-10-25-27(a) and 25-31.

Practice: maintenance included in the price

Riverton: January 1, 2027

- Customer payment: $1,100
- Bicycle: transferred immediately
- Maintenance: 12 months of evenly provided availability
- Stand-alone prices: bicycle $1,000; maintenance $250
- No separate maintenance purchase option in this package

Tuneups go beyond defect correction. Another provider could perform them without altering the bicycle. Riverton does not integrate or modify the items into a different product.

Ignore assurance costs, financing, tax, refunds, and variable consideration.

Identify the promises and allocate the price. Determine service revenue after 3 months.

Answer: maintenance is a distinct service

Riverton receives $1,100 for a delivered bicycle and 12 months of maintenance. Separate prices are $1,000 and $250.

The customer can benefit from each, and Riverton does not combine them into one result. Maintenance is a distinct additional service despite the absence of a separate purchase option.

ALLOCATION	CALCULATION
Bicycle revenue at delivery	$1,100 x $1,000 / $1,250 = $880
Initial service liability	$1,100 x $250 / $1,250 = $220

March 31, 2027: record 3 of 12 equal months of maintenance availability.

ACCOUNT	DEBIT	CREDIT
Service Contract Liability	$55	
Service Revenue		$55

The remaining liability is $165. Costs of the bicycle and service are accounted for separately.

Comparing warranty obligations

QUESTION	ASSURANCE WARRANTY	SERVICE WARRANTY
What does the liability measure?	Estimated remaining defect-correction costs.	Customer consideration for unperformed service.
What affects income?	Estimated costs and revisions affect expense.	Performance earns allocated revenue; service costs have separate accounting.
What reduces the liability?	Claims settled or a lower remaining estimate.	Promised service provided.

If assurance and service components cannot reasonably be accounted for separately, treat both warranties together as a single performance obligation.

A separate warranty price is not required for an included service promise.

Source: ASC 606-10-55-34.

iClicker: record the warranty claim payment

A company pays an assurance-warranty claim that was included in its recorded warranty liability. The payment equals the amount previously estimated for that claim. How should the company record the payment?

iClicker · Question 4 of 4

- **A** Debit Warranty Liability and credit Cash.
- **B** Debit Warranty Expense and credit Cash.
- **C** Debit Warranty Liability and credit Warranty Revenue.
- **D** Debit Warranty Expense and credit Warranty Liability.

iClicker answer: settle the recorded obligation

A company pays an assurance-warranty claim that was included in its recorded warranty liability. The payment equals the amount previously estimated for that claim. How should the company record the payment?

iClicker · Answer 4 of 4

- **A** Debit Warranty Liability and credit Cash. **Correct.** Payment settles the obligation already recorded.
- **B** Debit Warranty Expense and credit Cash. Incorrect. The company already recognized this warranty cost. Expensing it again would count it twice.
- **C** Debit Warranty Liability and credit Warranty Revenue. Incorrect. Settling an assurance-warranty claim does not earn service revenue.
- **D** Debit Warranty Expense and credit Warranty Liability. Incorrect. This entry accrues a cost; it does not record payment.

ACC 300 · SESSION 11

Prepare the statement of cash flows

Next class: Thursday, October 8, 2026

Operating, investing, and financing activities; the indirect operating section; reconciliation of beginning and ending cash.

Friday, October 9, 2026 · 11:59 PM: initial company selections due.

Sunday, October 11, 2026 · 11:59 PM: Unit 3 review assignment due.