

BUS 312 TRANSPARENCIES
Chapter 13

CURRENT LIABILITIES

Defined: "Probable future sacrifices of economic benefits arising from present obligations for a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events" (per SFAC No. 6).

Classified as current if expected to be paid off using CA, or by the creation of other CL. Maturity of the liability is within 1 year or operating cycle (whichever is longer).

Valuation: usually at maturity value, not PV.

ACCOUNTS PAYABLE

- Obligations owed to other for goods, supplies, and services purchased on open account.

NOTES PAYABLE

- Obligations in the form of written promissory notes.

NONINTEREST-BEARING NOTES

- Interest is built into the maturity value (MV) and the amount of cash borrowed is less than the MV.

EXAMPLE 1

<u>November 1</u>		
Cash	12,000	
Notes payable		12,000
<u>December 31</u>		
Interest expense	240	
Interest payable		240
$(\$12,000 \times 1\% \times 2 \text{ months} = \$240)$		

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EXAMPLE 2

July 1

Cash	10,500	
Discount on notes payable	1,500	
Notes payable		12,000

December 31

Interest expense	750	
Discount on notes payable (SL = 1,500 ÷ 2 = 750)		750

Discount rate = $1,500 \div 12,000 = 12.5\%$

Actual rate = $1,500 \div 10,500 = 14.3\%$

COMMERCIAL PAPER

- **Defined**: unsecured notes sold by large corp.
- Minimum denominations are \$25,000
- Maturities range from 30-270 days
- Interest often discounted at date of issuance
- Usually issued directly to the lender (buyer) and backed by a line of credit with a bank
- Interest rates usually lower than borrowing from a bank
- CP is a form of NP and is accounted for the same way

ACCRUED LIABILITIES

Defined: expenses incurred but not yet paid

Examples: salaries, interest, rent, and taxes

AJEs are needed at the end of an accounting period to make sure the liabilities and related expense are recorded in the correct period.

EXAMPLE 3

Cash or accounts receivable	26,250	
Sales		25,000
Sales taxes payable (5% × \$25,000)		1,250

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PAYROLL WITHHOLDINGS

Payroll withholdings will be made as follows for each employee:

- **FICA: 6.2% on the first \$87,000 of wages (for 2003) plus 1.45% on all wages**
- **FIT and SIT: w/h according to level of income and # of exemptions.**
- **CIT: w/h usually according to level of income.**
- **Misc. items such as: union dues, insurance premiums, and employee savings.**

Withholdings are liabilities.

PAYROLL TAXES

Payroll taxes will be assessed on the employer as follows:

- **FICA: amounts that match employee w/h.**
- **FUTA: 6.2% on the first \$7,000 of each employee's income, but a credit of up to 5.4% is permitted because of pmts made to state unemployment plans.**
- **SUTA: each state has a plan, but the rates vary from state to state.**

Payroll taxes are employer expenses, and constitute liabilities until they are paid.

EXAMPLE 4

December 26--payment of salaries

Salary expense	10,000	
FICA withheld		765
FIT withheld		1,500
Cash		7,735

December 26--employer payroll tax

Payroll tax expense	765	
FICA payable		765

December 31--Accrued salaries

Salary expense	10,000	
Salaries payable		10,000

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ST OBLIGATIONS TO BE REFINANCED

Should be excluded from CL if the following conditions are met: (SFAS No. 6)

1. Must intend to refinance the obligation on a LT basis, and
2. Must demonstrate an ability to consummate the refinancing.

The *intention* to refinance means that the company intends to refinance so that the use of working capital will not be required during the coming year (or operating cycle).

ABILITY CAN BE DEMONSTRATED BY:

- Actually refinancing the obligation after B.S. date but before it is issued, or
- Entering into a financing agreement to refinance the debt on LT basis. The following conditions must be met:
 1. The agreement is noncancelable as to all parties and must extend beyond one year (or the operating cycle).
 2. At the B.S. date and the date of issuance, the company must not be in violation of the agreement.
 3. The lender or investor is expected to be financially capable of honoring the agreement.

AMOUNT TO SHOW AS LT DEBT

If obligation is actually refinanced, maximum amount is portion of new obligation applied to retire ST obligation.

If obligation is subject to a financing agreement, amount of debt that can be shown as LT:

- a. Can't exceed amount available for refinancing under the agreement.
- b. Must be adjusted for any items in the agreement that indicate that the full amount obtainable will not be available to retire the ST obligations.
- c. Can't exceed a reasonable estimate of the minimum amount available if that amount can fluctuate.

DISCLOSURES REQUIRED

When a ST obligation is excluded from CL, include a note indicating the following:

- a. A general description of the financing agreement.
- b. The terms of any new obligation incurred or to be incurred.
- c. The terms of any equity security issued or to be issued.

If the refinancing will be accomplished by issuing equity securities, the ST obligation cannot be shown as owners' equity.

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- a. The to-be refinanced debt may be shown as LT debt under captions such as "Interim Debt," "Short-term Debt Expected to be Refinanced," or "Intermediate Debt."

CONTINGENT LIABILITIES

SFAS No. 5 defines three degrees of likelihood:

- a. Probable: the future event is *likely* to occur.
b. Reasonably possible: the chance is more than remote but less than likely.
c. Remote: the chance of the future event occurring is slight.

Treatment in the statements:

- a. Record a liability if probable *and* estimable
b. Disclose only in the notes if:
 • probable but not estimable, or
 • reasonably possible
c. No disclosure needed if remote

DISCLOSURE OF CONTINGENCIES

If a loss contingency is either probable or estimable, but not both, and is at least reasonably possible, disclose the following:

- The nature of the contingency.
- An estimate of the possible loss or range of loss, or a statement that estimate can't be made.

Must make disclosure if no claimant has come forward but

- (1) it's probable that a claim will be asserted, and
(2) an unfavorable outcome is reasonably possible.

Certain other contingent liabilities should be disclosed, even when the possibility of loss may be remote:

- Guarantees of indebtedness of others.
- Obligations of commercial banks under "stand-by letters of credit."
- Guarantees to repurchase receivables (or any related property) that have been sold or assigned.

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WARRANTY COSTS - CASH METHOD

- Costs charged to expense as incurred.
- Method OK if warranty costs are immaterial or can't be estimated.
- Must be used for income tax purposes.

WARRANTY COSTS - ACCRUAL METHOD

Two possible approaches:

Expense warranty treatment: (used when warranty is an integral and inseparable part of product sale)

- warranty costs expensed in year of sale

Sales warranty treatment: (used when warranty sold separately from product)

- revenues from sale of warranty recognized over life of warranty contract
- expense recognized as incurred

CURRENT LIABILITIES ON B.S.

- CL generally first classification in liab. section of B.S.
- CL may be listed in order of maturity, by amount, or in order of liquidation preference.

SUPPLEMENTAL DISCLOSURES

- Assets pledged as collateral for secured liabilities.
- Purchase commitments (if material).
- ST obligations expected to be refinanced.
- Loss contingencies for which liability has not been recorded.