

# **CURRENT LIABILITIES**



# DEFINITION

- Liabilities
  - Probable future economic sacrifice of cash, goods, or services, and
  - Creates a present, unavoidable obligation, and
  - Results from a past transaction
- Current liabilities (two ways to look at it)
  - Due within one year (or the operating cycle whichever is longer)
  - Expected to be paid with current assets



# ACCOUNTS & NOTES PAYABLE

- Accounts Payable
  - For “normal” purchases on account (inventory)
  - Discounts if paid on time (2/10, n/30)
- Notes Payable
  - Usually simple interest is charged ( $\text{Rate} \times \text{Time} \times \text{Principal}$ )
  - Can be short-term or long-term



# UNEARNED REVENUE

- When customer pays before any goods delivered or services provided
  - Advances from Customers
  - Gift cards
- You owe the good or service, so it's a liability when you get the cash
- **Example:** A customer uses layaway to buy a TV. The customer gives you \$100 to hold a TV with a retail price of \$1,400 until the week before Christmas.
  - (We'll ignore the inventory entry since it doesn't change.)
- **When we receive the \$100:**

Cash		100	
	Unearned Revenue		100

## When the customer picks up TV:

Cash		1,300	
	Unearned Revenue	100	
	Revenue		1,400



# PAYROLL IN THE UNITED STATES

- Employers withhold some items from employee paychecks:
  - Social Security Taxes (OASDI)
  - Medicare Taxes (Sometimes combined with Social Security and called FICA)
  - Income Tax Withholdings
  - These are NOT expenses for the employer
- Employers also pay payroll taxes
  - Social Security Taxes (OASDI)
  - Medicare Taxes (Sometimes combined with Social Security and called FICA)
  - Unemployment Taxes
  - These are expenses for the employer



# PAYROLL EXAMPLE

- Employees earn \$200,000 this pay period. There are \$25,000 in income tax withholdings, \$12,000 in social security tax and \$3,000 in Medicare taxes owed by both the employee and employer. In addition, the employer owes \$1,000 in unemployment taxes.
- **To record payment to employees:**
- **To record employer taxes**

Wage Expense	200,000	
Income Tax Withholdings Payable		25,000
Soc. Sec. Payable		12,000
Medicare Payable		3,000
Income Tax Withholdings Payable		1,000
Cash (or Wages Payable)		159,000

Payroll Tax Expense	16,000	
Soc. Sec. Payable		12,000
Medicare Payable		3,000
Unemployment Tax Payable		1,000



# WARRANTIES

- Overarching Principle
  - We want all costs related to a sale expensed in the period of the sale
- When you sell an item that automatically comes with a warranty:
  - Owe the customer the repair if item breaks
  - Estimate based on past experience the amount
- Example: Sell 100 TVs for \$1,400 each. They come with a 1 year warranty. You estimate repair costs of 8% of the sales price.

- **At the time of the sale**

Cash	140,000	
Revenue		140,000
Warranty Expense	11,200	
Warranty Liability		11,200

- **When \$200 repair made**

Warranty Liability	200	
Cash (or Inventory)		200



# CONTINGENT LIABILITIES

- When there might be an obligation in the future, but the timing and/or amount is uncertain.
  - Lawsuits
  - Fines or penalties
  - Tax disputes
- The rules:
  - If it's probable that you will lose and the amount is estimable, then book the loss (or expense)
  - If it's possible that you will lose, then disclose the issue in the footnotes
  - If it's remote that you will lose, ignore the issue



# SUMMARY

- If you have an obligation to provide cash, goods, or services to another, it's a liability
- Issues with management:
  - Credit is a liability
  - Often debit is an expense
  - So what's FASB's goal for most of the liability rules?
  - Try to book as soon as it becomes an obligation

