

Financial Accounting

Module 11: Current Liabilities



Module Learning Outcomes

Describe the accounting and reporting of current liabilities

- 11.1: Define current liabilities
- 11.2: Accounting for trade accounts payable
- 11.3: Describe payroll accounting
- 11.4: Identify other current liabilities
- 11.5: Illustrate proper reporting of current liabilities

Current Liabilities

Learning Outcomes: Current Liabilities

11.1: Define current liabilities

11.1.1: Identify common types and categories of current liabilities

11.1.2: Account for deferred and accrued current liabilities

Identify Common Types and Categories of Current Liabilities

Key metrics that analysts, investors, and management watch is working capital, which is the difference between current assets and current liabilities.

Liabilities are obligations to pay cash, provide services, or deliver goods at a future time.

FASB's Concept Statement No. 6, in place for more than 20 years, defines liabilities as "probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events."

Balance sheets divide liabilities into *current liabilities* and *long-term liabilities*.

Identify Common Types and Categories of Current Liabilities

- Short-term debt
- Accounts payable
- Sales tax payable
- Deferred revenue
- Income taxes payable
- Current portions of long-term debt
- Leases
- Other accrued expenses



Account for Deferred and Accrued Current Liabilities

- Accrue sales tax
- Record deferred revenues
- Accrue income tax expense

JOURNAL

Date	Description	Post. Ref.	Debit	Credit
	Accounts Receivable (1,000 + 60)		1,060	
	Sales			1,000
	Sales Tax Payable (1,000 x 6%)			60
	To record sales and sales tax payable.			

Practice Question 1

Which of the following would be categorized as a current liability on a company's Balance sheet?

- A. Deferred Tax Liability
- B. Accounts Payable
- C. Mortgage Payable
- D. Accounts Receivable

Accounts Payable

Learning Outcomes: Accounts Payable

11.2: Accounting for trade accounts payable

11.2.1: Define accounts payable and differentiate from other payables

11.2.2: Describe the subsidiary ledger for Accounts Payable and its relationship to the General Ledger

Define Accounts Payable and Differentiate From Other Payables

Accounts Payable. When a company orders and receives goods (or services) in advance of paying for them, the company is purchasing the goods *on account* or *on credit*.

- The supplier (or vendor) of the goods on credit is referred to as a creditor.
- If the company receiving the goods does not sign a promissory note, the vendor's bill or invoice will be recorded by the company in its liability account *Accounts Payable* (or *Trade Payables*).

Vendor Invoice. A bill or invoice from a supplier of goods or services on credit is often referred to as a vendor invoice.

- Vendor invoices are entered as credits in the Accounts Payable account, increasing the credit balance in Accounts Payable.
- When a company pays a vendor, it will reduce Accounts Payable with a debit amount.
- The normal credit balance in Accounts Payable is the amount of vendor invoices recorded but not yet paid. Unpaid invoices are sometimes referred to as open invoices.

Describe the Subsidiary Ledger for Accounts Payable and Its Relationship to the General Ledger

Accounts payable process is important since it involves nearly all of a company's payments outside of payroll. The accounts payable process might be carried out by an accounts payable department in a large corporation, by a small staff in a medium-sized company, or by a bookkeeper or perhaps the owner in a small business.

Regardless of the company's size, the mission of accounts payable is to pay only legitimate and accurate company bills and invoices. Before a vendor's invoice is entered into the accounting records and scheduled for payment, the invoice must reflect:

- what the company had ordered,
- what the company has received,
- the proper unit costs, calculations, totals, terms, etc.

Describe the Subsidiary Ledger for Accounts Payable and Its Relationship to the General Ledger

The accuracy and completeness of a company's financial statements are dependent on the accounts payable process. A well-run accounts payable process will include:

- the timely processing of accurate and legitimate vendor invoices,
- accurate recording in the appropriate general ledger accounts,
- the accrual of obligations and expenses that have not yet been completely processed,
- segregation of duties, and
- periodic review by either internal or external auditors.



Payrolls

Learning Outcomes: Payrolls

11.3: Describe payroll accounting

11.3.1: Account for common payroll transactions

11.3.2: Prepare entries to accrue payroll and payroll-related taxes

Account for Common Payroll Transactions

Common payroll transactions:

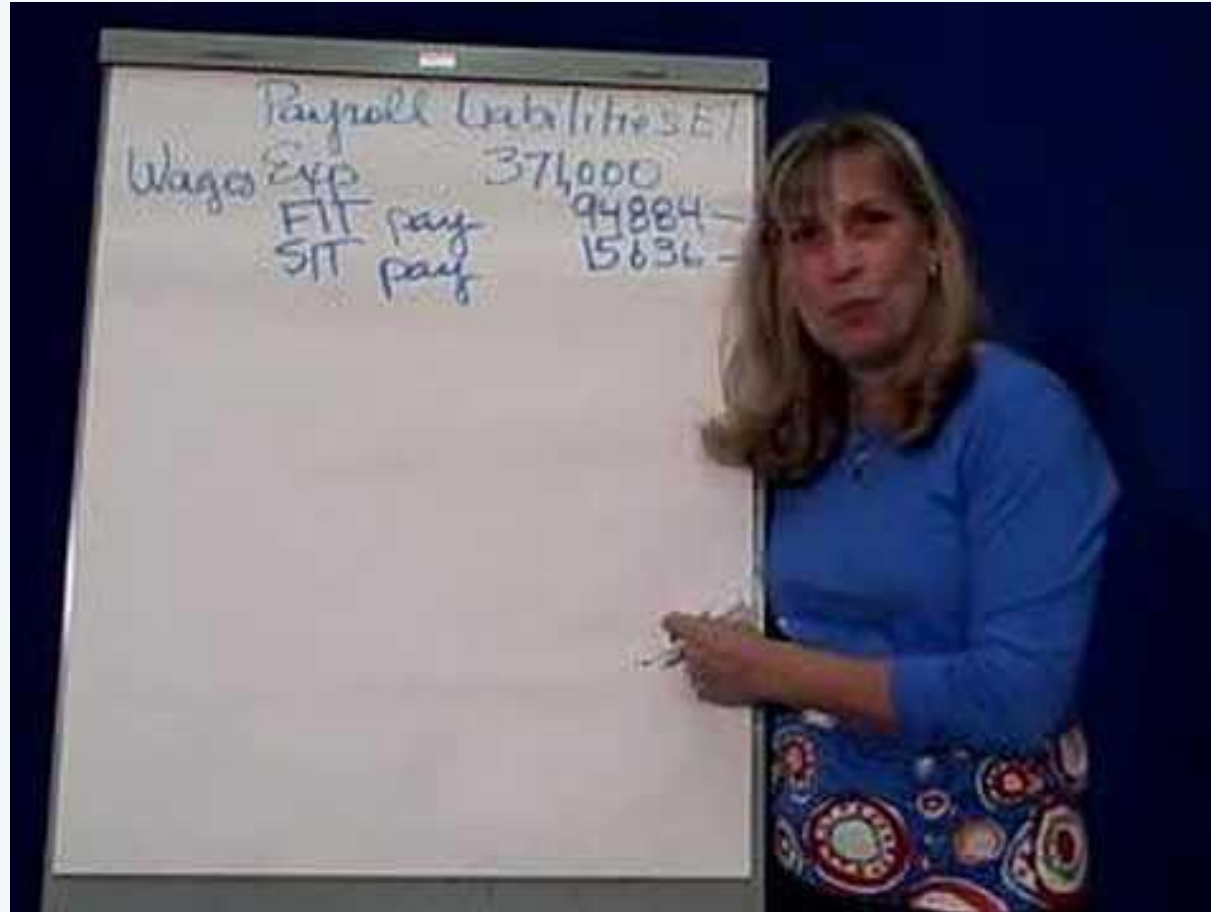
- **Federal Income Tax Withheld (also referred to as FIT):** Employees fill out a document called a W-4 when hired. This document is used to calculate the amount of federal tax withheld.
- **State Income Tax Withheld (also referred to as SIT):** A different form than the W-4 but the same concept, except it applies to the state. Not all states have a state income tax.
- **FICA Social Security Tax (also referred to as OASDI):** This tax helps fund social security and is calculated as gross pay x 6.2% unless employees make OVER \$118,500 in 2015 then employees are only responsible to pay 6.2% of \$118,500 and nothing more.
- **FICA Medicare Tax (also referred to as HI):** This tax helps fund medicare and is calculated as gross pay x 1.45%. Everyone must pay 1.45% of gross pay without limit.
- **Voluntary Deductions and Garnishments:** Any deductions employees authorize will also reduce gross pay. This includes things like medical premiums, 401K and savings accounts, charity donations, etc.

Account for Common Payroll Transactions

In addition to amounts set aside out of the employee's earnings, the company has to pay things like:

- **FICA Social Security Tax:** This tax helps fund social security and is calculated as gross pay x 6.2% unless an employee makes OVER \$118,500 in 2015 then employees are only responsible to pay 6.2% of \$118,500 and nothing more for that employee.
- **FICA Medicare Tax:** This tax helps fund medicare and is calculated as gross pay x 1.45%. Everyone must pay 1.45% of gross pay without limit.
- **Federal Unemployment Tax (FUTA):** This tax is for unemployment claims and is typically calculated as 0.8% of the first \$7,000 of an employee's earnings. Once the employee has earned more than \$7,000 in gross pay for the year, the company no longer has to pay FUTA tax.
- **State Unemployment Tax (SUTA):** This tax is for state unemployment and does not have a consistent rate. The rate is provided by the state annually and can change each year by business.
- **Voluntary Deductions Matching:** Any matching funds the company provides for insurance or retirement plans.

Prepare Entries to Accrue Payroll and Payroll-Related Taxes



Other Current Liabilities

Learning Outcomes: Other Current Liabilities

11.4: Identify other current liabilities

11.4.1: Record transactions related to product warranties

11.4.2: Apply rules for contingent liabilities

Record Transactions Related to Product Warranties

Estimated product warranty payable. When companies sell products such as computers, often they must guarantee against defects by placing a warranty on their products. When defects occur, the company is obligated to reimburse the customer or repair the product. For many products, companies can predict the number of defects based on experience. To provide for a proper matching of revenues and expenses, the accountant estimates the warranty expense resulting from an accounting period's sales which will be used as a reserve to pull actual warranty expenses from at a later date. The debit is to Warranty Expense and the credit to Estimated Warranty Payable (or Liability).

Number of computers sold	1,000
Percent estimated to develop defects	x 10%
Total estimated defective computers	100
Deduct computers returned as defective to date	– 40
Estimated additional number to become defective during warranty period	60
Estimated average warranty repair cost per compute:	x \$ 150
Estimated warranty payable	\$9,000

Record Transactions Related to Product Warranties

When a customer returns one of the computers purchased for repair work during the warranty period, the company debits the cost of the repairs to Estimated Product Warranty Payable.

Journal				
Date	Description	Post. Ref.	Debit	Credit
	Product Warranty Expense		9,000	
	Estimated Warranty Payable			9,000
	To record estimated product warranty expense.			

Apply Rules for Contingent Liabilities

There are three GAAP-specific categories of contingent liabilities:

- Probable contingencies are likely to occur and can be reasonably estimated.
- Possible contingencies do not have a more-likely-than-not chance of being realized but are not necessarily considered unlikely either.
- Remote contingencies aren't likely to occur and aren't reasonably possible.

Any probable contingency needs to be reflected in the financial statements—no exceptions.

- If the liability is probable and the amount can be reasonably estimated, companies should record contingent liabilities in the accounts.
- If the liability is probable or possible but the amount can't be determined or estimated, it has to be disclosed in the footnotes to the financial statements.
- If the liability is remote, it should not be disclosed.

Reporting Current Liabilities

Learning Outcomes: Reporting Current Liabilities

11.5: Illustrate proper reporting of current liabilities

11.5.1: Reporting current liabilities on the financial statements

11.5.2: Identify common disclosures related to current liabilities

Reporting Current Liabilities on the Financial Statements

Apple Inc. Balance Sheet	
CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited) - USD (\$)	Jun. 29, 2019
\$ in Millions	
Current assets:	
Cash and cash equivalents	\$ 50,530
Marketable securities	44,084
Accounts receivable, net	14,148
Inventories	3,355
Vendor non-trade receivables	12,326
Other current assets	10,530
Total current assets	134,973
Non-current assets:	
Marketable securities	115,996
Property, plant and equipment, net	37,636
Other non-current assets	33,634
Total non-current assets	187,266
Total assets	322,239
Current liabilities:	
Accounts payable	29,115
Other current liabilities	31,673
Deferred revenue	5,434
Commercial paper	9,953
Term debt	13,529
Total current liabilities	89,704
Non-current liabilities:	
Term debt	84,936
Other non-current liabilities	51,143
Total non-current liabilities	136,079
Total liabilities	225,783
Commitments and contingencies	
Shareholders' equity:	
Common stock and additional paid-in capital, \$0.00001 par value: 12,600,000 shares authorized; 4,531,395 and 4,754,986 shares issued and outstanding, respectively	43,371
Retained earnings	53,724
Accumulated other comprehensive income/(loss)	(639)
Total shareholders' equity	96,456
Total liabilities and shareholders' equity	\$ 322,239

Identify Common Disclosures Related to Current Liabilities

Common disclosures:

- Use of estimates
- Leases
- Insurance

You can refer to the AICPA November 2017 Financial Reporting Framework for Small- and Medium-Sized Entities Presentation and Disclosure Checklist

https://www.aicpa.org/InterestAreas/FRC/AccountingFinancialReporting/PCFR/DownloadableDocuments/FRF-SME/FRFforSMEs_Presentation_Disclosure_Checklist.pdf

Practice Question 2

When creating a Balance Sheet, which of the following will usually be the first listed under the current liability section?

- A. Wages payable
- B. Interest payable
- C. Accrued expenses
- D. Accounts payable

Quick Review

- What are the common types and categories of current liabilities?
- How are deferred and accrued current liabilities accounted for?
- What is accounts payable and how is it different from other payables?
- What is the subsidiary ledger for accounts payable and how is it related to the General Ledger?
- How are common payroll transactions accounted?
- How are entries to accrue payroll and payroll-related taxes prepared?
- How are transactions related to product warranties recorded?
- What are the rules for contingent liabilities and how are they applied?
- How are current liabilities reported on financial statements?
- What are the common disclosures related to current liabilities?