

ACC 1701XA

Accounting for Decision Makers

LECTURE 08

Lecturer: Dr. Hanny Kusnadi

Accounting
The language of the business world



Prior Lecture Refresher: Inventory

- Inventory for Merchandising companies
 - Perpetual System – Up to date inventory records. Record COGS during Sales.
 - Periodic System – Record COGS at the end of period using the COGS equation.
 - FOB Destination vs FOB Shipping
- Inventory Costing
 - Inventory costing methods : specific identification, FIFO, weighted average
 - Lower of cost and Net realizable value – recording inventory write down
 - Effect of Inventory Errors on FS
- FSA
 - Operating Cycle = Days' Sales in Inventory + Average Collection Period (for AR)
 - Net Operating Cycle = Days' Purchases in Accounts Payable – Operating Cycle





Current Liabilities

Goals for Lecture 08

**Current
Liabilities**
(Chapter 9,
LO3 only)

Financial Analysis

- Known Liabilities: (Refer **only** to this lecture 08 slides)
 - Accounts Payable
 - Accrued Liabilities: Sales Tax (GST), Payroll
 - Deferred Revenue (Unearned Revenue)
 - Short Term Notes Payable
- Estimated Liabilities: (Chapter 9, LO3)
 - Warranty provision
- Contingent Liabilities (Chapter 9, LO3)



- Current Ratio
- Acid Test Ratio

Liabilities (RECAP)

- A **present** debt or obligation
- As a result of **past** transactions or events
- To be **paid in the future** with assets or services
- Can be **measured** with reasonable precision
- Liabilities are recorded at their current cash equivalent, which is the cash amount a creditor would accept to settle the liability immediately.



Current Liabilities

Characteristics of Current Liabilities:

- Obligation payable within one year or within the firm's current operating cycle

Recording Current Liabilities:

- Liabilities should be recorded at their present values
- Liabilities that are payable within one year are ordinarily recorded at maturity amounts



"If an invoice is due in 30 days, we pay it in 60 days.
If it's due in 60 days, we pay it in 90 days. If it's
due in 90 days, then they probably don't
need the money anyway."

3 Major Uncertainties in Liabilities

Uncertainty in:

WHOM to pay



WHEN to pay



HOW MUCH to pay



- **Known Liabilities** – little uncertainty: who, when and how much is determinable.
- **Estimated Liabilities** – a known obligation of an uncertain amount, but one that can be reliably estimated.
- **Contingent Liabilities** – *potential* obligation created as a result of a past event, but which is not yet an effective liability until some future event happens.

Current Liabilities

Types of “Known” Current Liabilities

Account Name	Also known as	Definition
Accounts Payable	Trade Payable	Obligations to pay for goods or services used in the basic <u>operating activities</u> of the business.
Accrued Liabilities	Accrued Expenses	Expenses already incurred but not yet paid <i>e.g. Accrued Taxes Payable, Accrued Wages</i>
Deferred Revenues	Unearned Revenues	Revenues <u>not earned</u> , but company <u>already receive payment</u> in advance. It's a liability until the company renders the goods or services.
Short Term Notes Payable		Obligations supported by a <u>formal written contract</u> .
Current Portion of Long-term Debt		Part of a long-term debt that is due within a year.

Accounts Payable (RECAP)

- Amounts owed to suppliers for products or services purchased on credit in the normal course of operations.
- Purchasing inventory merchandise on credit:

Dr Inventory

Cr Accounts Payable

- Incurring operating expense on credit (e.g. repairs, utilities, fees etc...):

Dr Expense

Cr Accounts Payable



Accrued Liabilities (RECAP)

- Represent expenses already incurred but not yet paid (accrued expenses)
- Usually recorded by adjusting entries

Common examples:

- Taxes payable
- Salaries and wages payable
 - Including bonus, vacation, sick days and other paid future absences.
- Payroll liabilities
- Interest payable



Accrued Taxes

Sales Tax Payable

- Sales taxes – tax on retail sales
- Also known as “*goods and services taxes (GST)*” in Singapore
- When merchandise retailers sell goods, they collect sales tax which they are obligated to pay to the taxation authorities → current liability
- Recording \$10,000 sale transaction with GST (9%)

Cash/Accounts Receivable	\$10,900
Sales Revenue	\$10,000
GST Payable (9% x \$10,000)	\$900

- Recording payment of GST to the Inland Revenue Authority of Singapore (IRAS):

GST Payable	\$900
Cash	\$900



Accrued Payroll Liabilities

CPF contributions

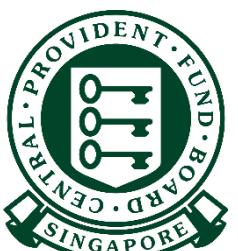
- Employers incur expenses and liabilities from having employees – payroll expenses
- Some are amounts withheld from employee's wages by the employer and to be paid by the employer on the employee's behalf to the relevant authorities (e.g. employee's CPF contribution @ 20%)

E.g.	Salaries Expense	\$10,000
	Salaries Payable – to employee	\$8,000
	CPF Payable – employee contribution	\$2,000

- Some are amounts borne by the employer as part of employment and are costs to the employer (e.g. Employer's CPF contribution @ 17%)

E.g.	Payroll Expense – CPF	\$1,700
	CPF Payable – employer contribution*	\$1,700

* Assuming salaries expense of \$10,000



Advance from Customers

Unearned Revenue (RECAP)

- Amounts received in advance from customers for future products or services.
- Receiving payment in advance of \$12,000 for goods yet to be delivered / services yet to be rendered:

Cash	\$12,000
Unearned Revenues	\$12,000

- Recognizing revenue upon delivery of goods / performance of services* (assuming only half of the goods/services from above is rendered):

Unearned Revenues	\$6,000
Sales Revenue	\$6,000

**Recall that this is typically entered as your adjusting journal entry (AJEs)*

Short-Term (ST) Notes Payable

- A formal written promise to pay a specified amount on a definite future date within one year
 - To the lender, interest is a revenue.
 - To the borrower, interest is an expense.
- Calculating daily interest using Actual/360 convention:

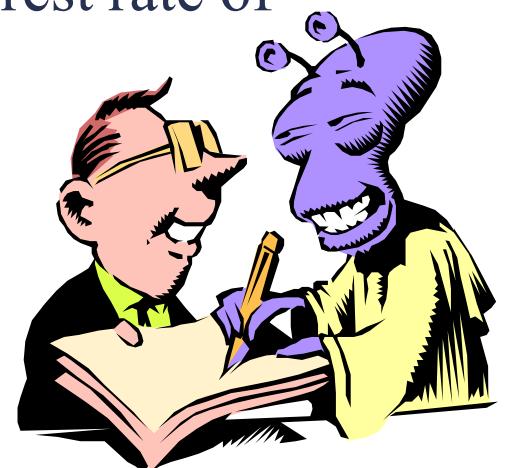
$$\text{Interest} = \text{Principal} \times \text{Interest Rate} \times \frac{\text{Time period (in days)}}{360}$$

- For example: Lenovo borrows \$100,000 for 60 days at an annual interest rate of 12%. Interest on the note is:

$$\text{Interest} = \text{Principal} \times \text{Interest Rate} \times \text{Time}$$

$$= \$100,000 \times 12\% \times \frac{60}{360}$$

$$= \$2,000$$



ST Notes Payable

How to calculate the interest days under Actual/360

- Steps in using the Actual/360 convention to calculate interest:
 - (1) Annual interest rate is divided by 360 days to get the daily interest
 - (2) Daily interest rate is multiplied by the actual number of days in the month that the note is outstanding for.
- E.g. For a 180 days Notes dated November 13th, the days for interest each month is:
 - November: 17 days ($30-13=17$)
 - December: 31 days
 - January: 31 days
 - February: 28 days (assuming 28 days in February)
 - March: 31 days
 - April: 30 days
 - May: 12 days ($180-17-31-31-28-31-30=12$)

Due date of the Note is on May 12th.

Trivia Q : If you are calculating interest using Actual/365 method (i.e. daily interest is calculated using 365 days), does this method gives you a HIGHER or LOWER interest expense?

ST Notes Payable Logic Co Example

- Notes Payable can arise when companies borrow money from an external party.
- On Feb 1st 2024, Logic Company borrows \$7,000 from one of its business partner, Generous Co. at 10% interest for 180 days. The entry to record the transaction is:

Cash	\$7,000
Notes Payable – Generous Co.	\$7,000

- When Logic repays the note plus interest to Generous Co, it will record:

Notes Payable – Generous Company	\$7,000
Interest Expense (10% x \$7k x 180/360)	\$350
Cash	\$7,350

- *Notes can also arise from conversion of an accounts payable to a notes payable.*

Trivia Q: How would you record the conversion of AP to NP?

ST Notes Payable: End-of-Period Adjustments

Logic Co Example

- If a short-term note payable is issued in one accounting period but is not payable until the following accounting period, an adjusting entry at year-end to record the **accrued interest expense** is needed.
- E.g. On Nov 16th 2024, Logic Company borrows \$9,600 from a bank at 15% interest for 120 days. At Dec 31st 2024, an adjusting entry is needed to record interest expense for 45 days (14 days in November + 31 days in December):

Interest Expense (15% x \$9.6k x 45/360)	\$180
Interest Payable	\$180

- On March 16th 2025, Logic repays the note principal plus interest:

Interest Expense (15% x \$9.6k x 75/360)	\$300
Interest Payable	\$180
Notes Payable	\$9,600
Cash	\$10,080



Current and Noncurrent Classification

- Companies typically prefer to report an obligation as noncurrent rather than current.
- Noncurrent classification results in **higher working capital** and a **higher current ratio**.
- Some portion of long term liabilities that are due within a year will have to be reclassified as current:

Current Maturities of Long-Term Debt

Long-term obligations

- Bonds
- Notes
- Lease liabilities
- Deferred tax liabilities

→
Reclassified

Current liabilities when they become payable within the upcoming year or operating cycle

Estimated Liabilities: Provisions

- Estimated liabilities - a known obligation of an *uncertain amount*, but one that can be *reliably estimated*.
- To recognize provision as a liability:
 - (1) Present obligation must **exist** at the balance sheet date
 - Legal obligation – arising from contract, legislation or other operation of law
 - Constructive obligation – arising from the firm's actions, leading others to believe/expect that the firm has accepted the responsibility to discharge certain duties
 - (2) A future cash/resource outflow is **probable**
 - (3) Outflow amount can be **reliably measured**
 - “best estimate” – based on past experience or based on how much the company will have to pay a third party to take over its obligation.
 - Time value of money is taken into consideration if effect is material

Estimated Liabilities: Provisions

Warranty

- **Warranty Liabilities:**

Seller's obligation to replace or correct a product (or service) that fails to perform as expected within a specified period. To comply with the **full disclosure** and **matching** principles, the seller reports ***expected warranty expense*** in the period when revenue from the sale is reported.

- Warranty expense must be recorded in the same period as the sales revenue
- Warranty expense is an estimation.



Recording Warranty Liabilities

Rimowa Example

- On 15th Sept 2024, Rimowa sold luggage for \$100,000 with a 2 years warranty covering parts. Past experience indicates that warranty expenses average about 5% of the luggage's selling price (time value of money effect is immaterial).

Warranty Expense (5% x \$100k)	\$5,000
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Warranty Provision	\$5,000
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- On April 24th 2025, a customer returns a luggage for repairs, which costs Rimowa \$120 in replacement parts.

Warranty Provision	\$120
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Inventory – Replacement parts	\$120
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Extended Warranty Contracts

- An extended warranty provides warranty protection beyond manufacturer's original warranty.
- Priced & sold separately from the warranted product → separate performance obligation.
- Revenue recognition: first recorded as deferred revenue and then recognized on a straight line basis over the contract period.
 - E.g. On Jan 2022, Rimowa sold luggages that carry a 2 year manufacturer's warranty. Rimowa additionally offered and sold 2-years extended warranty beyond the original manufacturer's warranty period worth \$8,000.

(1) Jan 2022:	Cash/ AR	\$8,000
	Unearned Revenue – extended warranties	\$8,000
(2) Dec 2024 & 2025:	Unearned Revenue – extended warranties	\$4,000
	Revenue – extended warranties	\$4,000

Real FS

Samsung's Provisions

SFP

	Notes	December 31, 2024	December 31, 2023
		KRW	KRW
Liabilities and Equity			
Current liabilities			
Trade payables	4, 28	12,370,177	11,319,824
Short-term borrowings	4, 5, 12, 28	13,172,504	7,114,601
Other payables	4, 28	18,547,365	15,324,119
Advances received	17	1,841,420	1,492,602
Withholdings	4, 28	991,812	892,441
Accrued expenses	4, 17, 28	29,613,258	26,013,273
Current income tax liabilities		4,340,171	3,358,715
Current portion of long-term liabilities	4, 12, 13, 28	2,207,290	1,308,875
Provisions	15	8,216,469	6,524,876
Other current liabilities	4, 17, 28	2,025,833	2,308,472
Liabilities held-for-sale	33	-	61,654
		93,326,299	75,719,452
Non-current liabilities			
Debentures	4, 13, 28	14,530	537,618
Long-term borrowings	4, 12, 28	3,935,860	3,724,850
Long-term other payables	4, 28	5,510,455	5,488,283
Net defined benefit liabilities	14	521,410	456,557
Deferred income tax liabilities	25	528,231	620,549
Long-term provisions	15	3,120,044	2,878,450
Other non-current liabilities	4, 17, 28	5,383,049	2,802,356
		19,013,579	16,508,663
Total liabilities		112,339,878	92,228,115



Real FS

Samsung's Provisions

15. Provisions

Changes in provisions for the year ended December 31, 2024 are as follows:

<i>(In millions of Korean won)</i>	Warranty (A)	Royalty expenses (B)	Long-term incentives (C)	Other (D, E)	Total
Balance as of January 1	2,540,212	1,838,052	993,751	4,031,311	9,403,326
Charged to profit or loss	2,090,900	1,315,779	265,696	2,461,978	6,134,353
Payment	(2,035,240)	(532,481)	(458,731)	(1,603,945)	(4,630,397)
Other ^(*)	138,629	172,551	12,295	105,756	429,231
Balance as of December 31	2,734,501	2,793,901	813,011	4,995,100	11,336,513

(*) Other includes effects of changes in foreign currency exchange rates.

- (A) The Company accrues warranty provisions for estimated costs of quality assurance, exchanges, repairs, recalls, and future services based on historical experience and terms of warranty programs.
- (B) The Company recognizes provisions for the estimated royalty expenses that are under negotiation with counterparties. The timing and amount of payment depend on the settlement of the negotiation.
- (C) The Company has a long-term incentive plan for its executives based on a three-year management performance criteria and recognizes a provision for the estimated incentive cost.
- (D) The Company records provisions for estimated losses from contracts associated with discontinued products.



Contingent Liabilities

- Contingent liabilities are **potential** liabilities that are created as a result of a past event. It is not an effective liability until some future event happens.
 - E.g. lawsuits and litigation (legal claims), debt guarantees
- **When to record a contingent liability?**

	Probable	Reasonably Possible	Remote
Estimable	Record as Liability	Disclose in Notes	No disclosure needed
Non-estimable	Disclose in Notes	Disclose in Notes	No disclosure needed

The probabilities of occurrence are defined in the following manner:

1. **Probable**—the chance that the future event or events will occur is high; >50% (IFRS), > 70% (GAAP)
2. **Reasonably possible**—the chance that the future event or events will occur is more than remote but less than likely.
3. **Remote**—the chance that the future event or events will occur is slight.

Real FS

Samsung's Contingent Liabilities

- From Note 16: Commitments and Contingencies

16. Commitments and Contingencies

(A) Litigation

As of December 31, 2024, the Company is involved in various claims, disputes, and investigations conducted by regulatory bodies that arose during the normal course of business with numerous entities. Although the outflow of resources and timing of these matters are uncertain, the Company believes the outcome will not have a material impact on the financial position of the Company.

(B) Other commitments

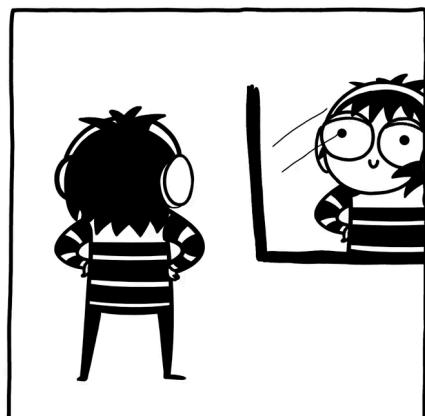
- (1) As of December 31, 2024, the Company has trade financing agreements, trade notes receivable discounting facilities, and loan facilities secured by accounts receivable with 27 financial institutions, including Woori Bank, with a combined limit of ₩23,536,721 million. In addition, the Company has a trade financing agreement with 22 financial institutions, including Shinhan Bank, with a limit of ₩18,172,601 million, and loan facilities with 12 banks, including Woori Bank, with a limit of ₩2,204,609 million.
- (2) As of December 31, 2024, contractual commitments for the acquisition of property, plant and equipment and intangible assets amount to ₩8,596,696 million.



Goals for Lecture 08

Financial Analysis

- Current Ratio
- Acid Test Ratio



“The liabilities are always 100% good! It’s the assets you have to worry about.”

- Charlie Munger

Assessing Liquidity

Current Ratio

Current Ratio

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

- Measures the ability of a company to pay its short-term obligations with short-term assets. The higher the ratio, the better a firm's liquidity is.
- Liquidity refers to how easily an asset can be converted to cash.
- However, a ratio that is too high might indicate that a firm is not using its resources efficiently.

Real FS

Samsung's Current Assets & Liabilities

		December 31, Notes	December 31, 2024	December 31, 2023			December 31, Notes	December 31, 2024	December 31, 2023
			KRW	KRW				KRW	KRW
Assets									
Current assets									
Cash and cash equivalents	4, 28		53,705,579		69,080,893		Trade payables	4, 28	12,370,177
Short-term financial instruments	4, 28		58,909,334		22,690,924		Short-term borrowings	4, 5, 12, 28	13,172,504
Short-term financial assets at amortized cost	4, 28		-		608,281		Other payables	4, 28	18,547,365
Short-term financial assets at fair value through profit or loss	4, 6, 28		36,877		27,112		Advances received	17	1,841,420
Trade receivables	4, 5, 7, 28		43,623,073		36,647,393		Withholdings	4, 28	991,812
Non-trade receivables	4, 7, 28		9,622,974		6,633,248		Accrued expenses	4, 17, 28	29,613,258
Prepaid expenses			3,362,824		3,366,130		Current income tax liabilities		4,340,171
Inventories	8		51,754,865		51,625,874		Current portion of long-term liabilities	4, 12, 13, 28	2,207,290
Other current assets	4, 28		6,046,740		5,038,838		Provisions	15	8,216,469
Assets held-for-sale	33		-		217,864		Other current liabilities	4, 17, 28	2,025,833
			227,062,266		195,936,557		Liabilities held-for-sale	33	-
									61,654
									93,326,299
									75,719,452



Samsung's Current Ratio

	2024	2023	2022	2021
Current Assets (CA)	227,062,266	195,936,557	218,470,581	218,163,185
Current Liabilities (CL)	93,326,299	75,719,452	78,344,852	88,117,133
Current Ratio (CA/CL)	2.43	2.59	2.79	2.48



Current Ratio

Samsung vs Apple

Let's compare Samsung with a competitor Apple:

	SAMSUNG <i>(in millions KWR)</i>			Apple <i>(in millions USD)</i>		
	2024	2023	2022	2024	2023	2022
Current Assets	227,062,266	195,936,557	218,470,581	152,987	143,566	135,405
Current Liabilities	93,326,299	75,719,452	78,344,852	176,392	145,308	153,982
Current Ratio	2.43	2.59	2.79	0.87	0.99	0.88

- Samsung maintains a high current ratio of above 2 → high liquidity
- Apple has current ratio that hovers below 1 → low liquidity
- What can you infer about each company's strategy on liquidity?
- Are you worried that Apple will not be able to fulfill its short term obligations?

Assessing Liquidity

Acid-Test Ratio

Acid-Test Ratio

$$\text{Acid-Test} \quad = \quad \frac{\text{Quick Assets}}{\text{Current Liabilities}}$$
$$\text{Ratio}$$

- Quick Assets = Cash + Short term investments + Current trade receivables
- Measures a company's ability to quickly pay its short term obligations using liquid assets (exclude inventory, prepaids and other current assets that are less liquid)
- Also known as "**Quick Ratio**"
- Useful to assess if company will face near term liquidity problems

Real FS

Samsung's Quick Assets & Liabilities

	Notes	December 31, 2024	December 31, 2023
		KRW	KRW
Assets			
Current assets			
Cash and cash equivalents	4, 28	53,705,579	69,080,893
Short-term financial instruments	4, 28	58,909,334	22,690,924
Short-term financial assets at amortized cost	4, 28	-	608,281
Short-term financial assets at fair value through profit or loss	4, 6, 28	36,877	27,112
Trade receivables	4, 5, 7, 28	43,623,073	36,647,393
Non-trade receivables	4, 7, 28	9,622,974	6,633,248
Prepaid expenses		3,362,824	3,366,130
Inventories	8	51,754,865	51,625,874
Other current assets	4, 28	6,046,740	5,038,838
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Other current liabilities	4, 17, 28	2,025,833	2,308,472
Liabilities held-for-sale	33	-	61,654
		93,326,299	75,719,452



Samsung's Acid-Test Ratio

	2024	2023	2022	2021
Quick Assets	156,274,863	129,054,603	150,948,849	164,863,607
Current Liabilities	93,326,299	75,719,452	78,344,852	88,117,133
Acid-Test Ratio (Quick Ratio)	1.67	1.70	1.93	1.87

A common rule of thumb is the acid-test ratio should have a value of at least 1.0 to conclude a company is unlikely to face liquidity problems in the near future.



Acid Test Ratio

Samsung vs Apple

Let's compare Samsung with a competitor Apple:

	SAMSUNG <i>(in millions KWR)</i>			Apple <i>(in millions USD)</i>		
	2024	2023	2022	2024	2023	2022
Quick Assets	156,274,863	129,054,603	150,948,849	98,581	91,063	76,488
Current Liabilities	93,326,299	75,719,452	78,344,852	176,392	145,308	153,982
Acid-Test Ratio	1.67	1.70	1.93	0.56	0.63	0.50

- Samsung maintains a high acid-test ratio of above 1.6 → high liquidity
- Apple has acid-test ratio that is below 1 → low liquidity
- Are you still worried that Apple will face short-term liquidity issues?



Take Away for Lecture 08

CURRENT LIABILITIES:

- Known Liabilities
 - Accounts Payable (*recap*)
 - Sales Tax Payable (GST)
 - Payroll Liabilities (CPF)
 - Unearned Revenue (*recap*)
 - Short Term Notes Payable
- Estimated Liabilities: Warranties/provision
- Contingent Liabilities
- FSA:
 - Current Ratio
 - Acid Test Ratio

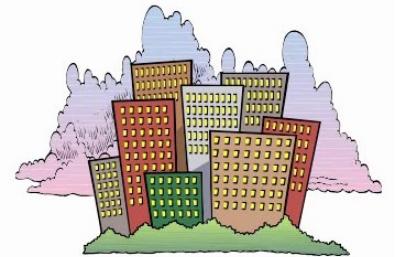


Next Week: Lecture 09

PPE (Property, Plant and Equipment) – Chapter 10

- What are long term operating assets? (LO1)
- How to record acquisition of PPE? (LO2)
- How to depreciate PPE? (LO3)
 - Straight-line depreciation
 - Units of production depreciation
 - Declining-balance depreciation
- How to account for changes in depreciation estimates? (LO4)
- How to capitalize certain expenses? (LO5) + (*Chapter 9 - LO4*)
- How to account for impairment and disposal of PPE? (LO6 & LO8)
- How to report PPE on FS? (LO7)

Note: We will NOT cover Exchanging PPE (LO11), Revaluation Model (LO12) and Assets Acquired by Leasing and/or construction (LO13) in this course.



REMINDER: MIDTERM TEST

Midterm Test is on 11th Oct (Saturday) @ 4pm!

- Midterm test will take place from **4pm – 5.30 pm @ MPSH 1**
- **90 minutes** digital test using **Examplify**. Please make sure you are familiar with the Examplify software.
- It is a **closed-book** test, consisting of 30 multiple choice questions (MCQs).
- Your midterm test will cover Lecture 01 – 06 topics. All materials covered in the lectures, assigned textbook readings and tutorials in relation to these topics are examinable.
- You are allowed to bring in **ONE A4 page of double-sided notes** (cheat-sheet). Can be printed or handwritten.
- You will be **given rough paper** to perform your workings on the day of the test. Do **NOT** bring in your own rough paper!
- You must bring your **LAPTOP**, calculator, ID cards and stationery. No other unauthorized materials will be allowed. There will be charging stations at MPSH.

Mock Practice Test

- There are **TWO mock midterm tests** for you to practice on.
- Available for download up to 5 times.
- Available until the day of the midterm test.
- Please ATTEMPT the mock midterm tests!!!!!!
- Answer solution to the mock midterm test is on Canvas.
- Cutoff for Qs on discussion forum: **6pm Wednesday (October 8th)**
All questions posted by the cutoff time will be answered by me latest by the end of Friday, October 10th.
- Please refer to Canvas for more information!

See you next week!



Post your questions on Canvas discussion forum.

My email: hanny.kusnadi@nus.edu.sg