LIABILITIES

Current vs. Non-current Liabilities

2

- Liabilities are classified as current and non-current
- **Current liabilities**
  - Are expected to be paid or settled within one year (or operating cycle) of the date on the statement of financial position
  - Reported as the first category of liabilities on the statement of financial position
  - Listed in the order in which they are due
  - Examples include accounts payable, bank indebtedness from operating lines of credit, unearned revenue, notes payable, and current portion of long-term debt
- **Non-current (or long-term) liabilities**
  - Include all other liabilities
  - Typically presented immediately following current liabilities
  - Typically measured and reported at amount expected to be paid when due
  - Examples include long-term portion of a bank loan, mortgage payable, and bonds payable

Current vs. Non-current portions

3

- The portion of long-term debt that is due within the current year or operating cycle should be classified as a current liability

Example: A company takes out a $30,000, 3-year bank loan due in $10,000 installments at the end of each year

	Year 0	Year 1	Year 2	Year 3
Current Portion	$10,000	$10,000	$10,000	$0
Long-term Portion	$20,000	$10,000	$0	$0

Payment of bank loan at fiscal year-end:

DR Current portion, bank loan	**10,000**	
CR Cash		**10,000**

Replenishment of current portion of bank loan at fiscal year-end:

DR Long-term portion, bank loan	**10,000**	
CR Current portion, bank loan		**10,000**

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Current Liabilities

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- **Sales Tax Payable**
  - Includes Federal Goods and Services Tax (GST), Provincial Sales Tax (PST or QST), or a Harmonized Sales Tax (HST) in some provinces
  - May or may not be included in the sale price
  - Collected by the company when sales are made and owed to the respective government
- **Property Tax Payable**
  - Owed to the municipal and/or provincial government
  - Calculated at a specified rate for every $100 of the assessed property value
- **Payroll**
  - Three types of liabilities related to employee salaries and wages
    - Salary or wages payable (net pay to employees)
    - Payroll deductions (e.g. income taxes, Canada pension plan (CPP) contribution, employment insurance (EI), union dues, benefits, charitable donations)
    - Employer payroll obligations (e.g. employer contributions to CPP or EI, employee benefits, worker's compensation)

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Uncertain Liabilities

5

- Uncertain liabilities arise when a company is not sure to whom an obligation is owed, when the obligation may have to be settled, or what amount is needed to settle the obligation
- **Provisions** are recorded on financial statements when
  - There is a present obligation with uncertain timing or amount
  - An outflow is likely (>50% probability of occurring under IFRS) and
  - The value of the outflow can be reliably estimated
- Examples of provisions may be product warranties, damages from a lawsuit, or potential regulatory fines
- **Contingent liabilities** are possible obligations that are dependent upon some future event. These obligations are not probable and/or measurable
- Contingent liabilities are not recorded and are only disclosed in the notes to the financial statements

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Interest-Bearing Liabilities

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- For some liabilities, the lender will charge interest in exchange for providing the principal

Principal:
- The original amount that the company borrowed

Interest:
- The cost of debt
- Provides an incentive to loan money and compensates the creditor for the risk of not being paid back
- Recorded as an expense on the income statement

- In Business 2257, we will focus on three types of interest-bearing liabilities
  - Liabilities with the principal due at maturity (e.g. notes payable)
  - Liabilities with instalment payments (e.g. mortgages payable)
  - Operating line of credit

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Liabilities with Principal at Maturity

- The company will pay a specified amount either at a fixed future date or on demand – this payment is made as a single one-time payment

Example: On January 1, 2018, Ace Inc. takes out a $10,000, 5% per annum bank loan due at maturity on January 1, 2020.

On January 1, 2018, Ace Inc. records the bank loan:

DR Cash	**10,000**	
CR Bank loan		**10,000**

On January 1, 2019, Ace Inc. records the accrued interest:

Interest expense: $10,000 × 5% = $500

DR Interest expense	**500**	
CR Interest payable		**500**

On January 1, 2020, Ace Inc. records the repayment of the bank loan and accrued interest for 2018 and 2019:

DR Interest payable	**500**	
DR Interest expense	**500**	
DR Bank loan	**10,000**	
CR Cash		**11,000**

Liabilities with Instalment Payments

- Normally non-current liabilities with a current portion
- The principal and interest are paid back in a series of period payments, called instalments
- Instalments include both
  - The interest on the unpaid balance of the loan and
  - A repayment of a portion of the principal

Liabilities with Instalment Payments

Example: On January 1, 2018, Spade Inc. borrows $20,000 for two years at 10% per annum with semi-annual instalment payments of $5,640 from the bank.

Interest Period	Cash Payment	Interest Expense	Reduction of Principal	Principal Balance	Accounting Entry
Jan. 1, 2018	$0	$0	$0	$20,000	DR Cash 20,000 CR Bank loan 20,000
Jul. 1, 2018	$5,640	$20,000 × 10% × $\frac{6 \text{ months}}{12 \text{ months}}$ = $1,000	$5,640 – $1,000 = $4,640	$20,000 – $4,640 = $15,360	DR Interest exp. 1,000 DR Bank loan 4,640 CR Cash 5,640
Jan. 1, 2019	$5,640	$15,360 × 10% × $\frac{6 \text{ months}}{12 \text{ months}}$ = $768	$5,640 – $768 = $4,872	$15,360 – $4,872 = $10,488	DR Interest exp. 768 DR Bank loan 4,872 CR Cash 5,640
Jul. 1, 2019	$5,640	$10,488 × 10% × $\frac{6 \text{ months}}{12 \text{ months}}$ = $524	$5,640 – $524 = $5,116	$10,488 – $5,116 = $5,372	DR Interest exp. 524 DR Bank loan 5,116 CR Cash 5,640
Jan. 1, 2020	$5,640	$5,372 × 10% × × $\frac{6 \text{ months}}{12 \text{ months}}$ = $268	$5,640 – $268 = $5,372	$5,372 – $5,372 = $0	DR Interest exp. 268 DR Bank loan 5,372 CR Cash 5,640

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Operating Line of Credit

- An **operating line of credit** is a **current liability** designed to help manage temporary cash shortfalls
- The agreement is pre-arranged between a company and a lender to borrow **up-to an agreed-upon amount** and interest is typically charged using a floating (or variable) interest rate
- The company can use as much or as little of the line of credit as necessary and can repay the line of credit at its discretion
- Interest is only charged on the portion used/borrowed

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Operating Line of Credit

Example: Diamond Ltd. secured a $5,000 operating line of credit from the bank. Interest was charged at a floating (variable) interest rate on the amount borrowed.

On July 15, 2018, Diamond Ltd. borrowed $1,000 on the line of credit:

DR Cash	**1,000**	
CR Bank indebtedness		**1,000**

On August 15, 2018, Diamond Ltd. repaid $500 and any accrued interest on the line of credit:

DR Bank indebtedness	**500**	
DR Interest expense	**75**	
CR Cash		**575**

On September 15, 2018, Diamond Ltd. repaid the remaining balance on the line of credit:

DR Bank indebtedness	**500**	
DR Interest expense	**42**	
CR Cash		**542**

On December 20, 2018, Diamond Ltd. borrowed $4,500 on the line of credit:

DR Cash	**4,500**	
CR Bank indebtedness		**4,500**