Chapter 9

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Reporting and Interpreting Liabilities

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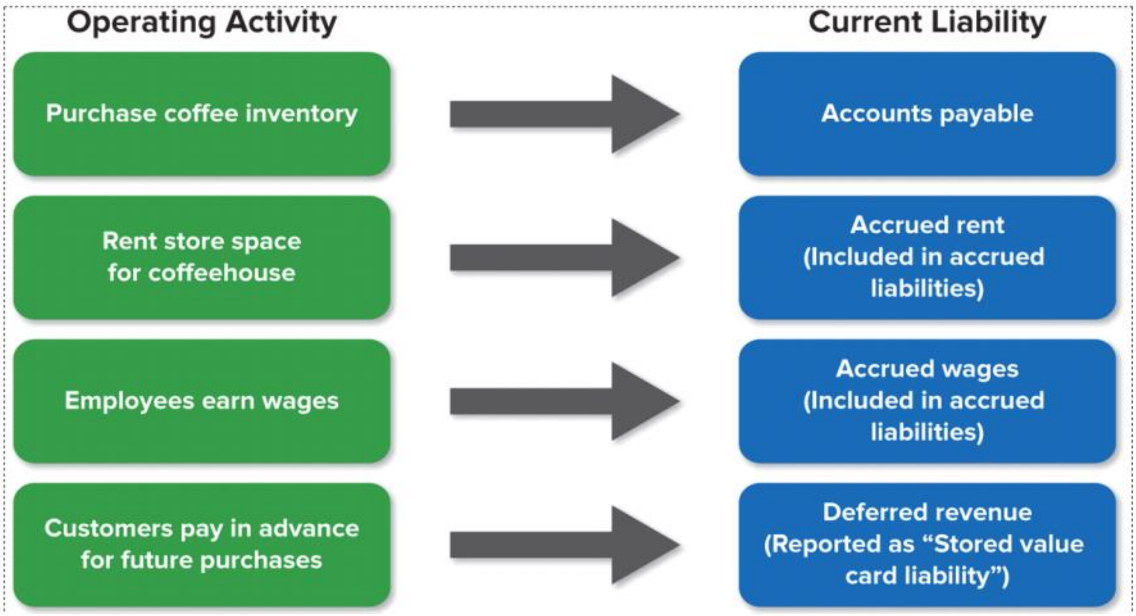
Capital structure - the mixture of debt and equity used to finance a corporation. **Debt capital is more risky** than equity capital because when a temporal cash shortage occurs, creditors may force the company into bankruptcy and require the sale of assets to satisfy the debt.

Liabilities:

1. When we record liability, only the cash amount borrowed would be recorded, and the interest would be later added during each accounting period, onto the liability amount, and recorded as interest expense

Current Liabilities



Many current liabilities have a direct relationship to operating activities

Accounts Payable

Accounts Payable - Obligations to pay other companies (usually suppliers) for goods and services purchased on credit.

Accounts Payable Turnover

$$\text{Accounts Payable Turnover} = \frac{Costs\ of\ Goods\ Sold}{Average\ Accounts\ Payable}$$

"How quickly does management pay its suppliers?"

Accrued Liabilities

Accrued liabilities - expenses that have been incurred before the end of an accounting period but have not yet been paid. 已经记了成本但实际上还没付钱

Accrued Taxes Payable

Fiscal Year Ended	Oct. 1, 2017	Oct. 2, 2016	Sept. 27, 2015
Current Taxes:			
U.S. federal	$ 931.0	$ 704.1	$ 801.0
U.S. state & local	170.8	166.5	150.1
Foreign	216.6	218.5	172.2
Total current taxes	$1,318.4	$1,089.1	$1,123.3

Accrued Compensation and Related Costs

At the end of each period, employees usually have **earned salaries that have not yet been paid**. And unpaid salaries may be reported as a separate item on the balance sheet (accrued compensation).
In addition to reporting compensation that has been earned but not paid, **companies also must report the cost of unpaid benefits**, including retirement programs, vacation time, and health insurance.

	Debit	Credit
Compensation expense (+E, −SE)	125,000	
Accrued vacation liability (+L)		125,000

Assets	=	Liabilities		+	Stockholders' Equity	
		Accrued vacation liability	+125,000		Compensation expense (+E)	−125,000

Payroll Taxes

Oh yes, employer pays some of those and employee pays some of those.

1. Employee Income Taxes
    a. Employers required to withhold income taxes for some employee. It is recorded as current liability and remains a liability until the amount is paid to the government.
2. Employee and Employer FICA
    a. Social Security Taxes (FICA) - required by the Federal Insurance Contributions Act
    b. Imposed in equal amounts on both employers and employees.
    c. Employers not only pay their portion but also withhold the employee's portion from their paychecks as part of the payroll deductions.
3. Employer Unemployment Taxes
    a. Charged through Federal Unemployment Tax Act (FUTA) and State

Unemployment Tax Acts (SUTA)

Deferred Revenues

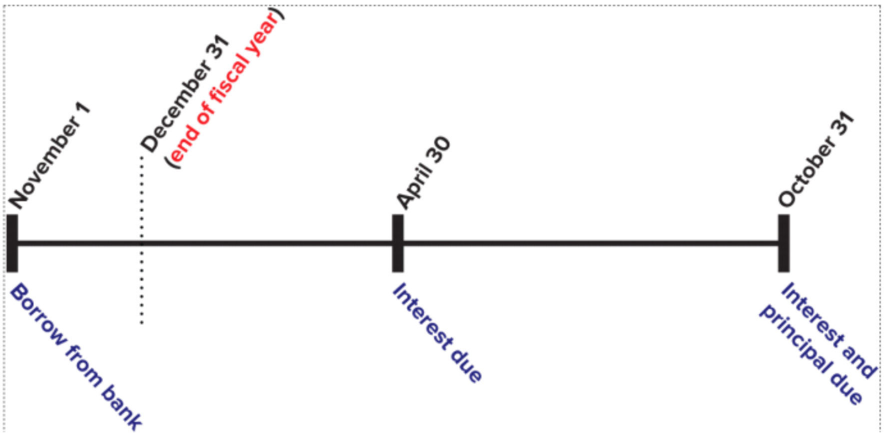
Deferred Revenues - When a company collects cash before the related revenue has been earned, the amount is called deferred revenue, or sometimes unearned revenue.

Notes Payable

When a company borrows money, it normally signs a formal written contract with a bank and reports the amount borrowed as **note payable**.
Earning interest by loaning money to others reflects the time value of the money.

Three pieces of info to calculate interest:

1. the Principle - amount borrowed
2. Annual interest rate
3. Time period of the loan



Current Portion of Long-time Debt

To provide accurate info on how much of its long-term debt is due in the current year, companies must reclassify its long-term debt as a current liability within a year of its maturity date.

December 31, 2018	
Long-term liabilities:	
Note payable	$5,000,000

December 31, 2019	
Current liabilities:	
Current portion of long-term note	$2,500,000
Long-term liabilities:	
Note payable	$2,500,000

December 31, 2020	
Current liabilities:	
Current portion of long-term note	$2,500,000

Contingent Liabilities

A contingent liability is created when a company offers a warranty with a product it sells. The cost of providing future repair work must be estimated and recorded as a liability (and expense) in the period in which the product is sold.

	Debit	Credit
Warranty expense (+E, −SE)	150,000	
Warranty payable (+L)		150,000

Contingent Liabilities in the Footnotes

Sometimes transactions or events creates a only possible (but not probable) future sacrifice of economic benefits, those create contingent liabilities that are reported in the footnotes.

	Probable	Reasonably Possible	Remote
Amount can be reasonably estimated	Record as liability	Disclose in footnotes	Disclosure not required
Amount cannot be reasonably estimated	Disclose in footnotes	Disclose in footnotes	Disclosure not required

Working Capital Management

Analyst say that a company has liquidity(流动性) if it has the ability to meet its current obligations.

A number of financial measurements are useful in measuring liquidity

1. Current Ratio (Ch.2)
2. Dollar Amount of Working Capital

Working Capital - Total **Current** Assets - Total **Current** Liabilities

Long-Term Liabilities
All obligations not classified as current liabilities. Long term notes payable, bonds payable, etc.

Long Term Notes Payable and Bonds Payable
Companies can raise capital directly from a number of financial service organizations such as banks, insurance companies, and pension plans. Raising capital from such organizations is called private placement(私募). And resulting liability is often a note payable, a written promise to pay a stated sum at one or more specified future dates (maturity dates)
Bonds - companies issue bonds when a company's capital needs exceed the financial ability of any single bank or other creditor.

Lease Liabilities
Companies often lease assets rather than purchase them.
Lessor - The party that owns the asset
Lessee - the party that pays for the right to use the asset.
Long term leases - more common, and divided into two types
1. Finance leases
    a. Effective control of the leased asset is transferred to the lessee
2. Operating leases
    a. Effective control of the leased asset remains with the lessor.

Under GAAP, lease is considered finance lease if it meets the following:
1. The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
2. The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise.
3. The lease term is for the major part of the remaining economic life of the underlying asset. . . .
4. The present value of the sum of the lease payments and any residual value guaranteed by the lessee . . . equals or exceeds substantially all of the fair value of the underlying asset.
5. The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term.*

Computing Present Values


Present value (PV) - concept based on the time value of the money

Present value of a single amount

$$\text{Present Value} = \frac{1}{(1+i)^n} \times amount$$

Where i denotes the future interest rate and n denotes the number of periods

Annuity 年金 - a series of consecutive payments characterized by:

1. An equal amount of dollar each period
2. Interest periods of equal length
3. The same interest rates every period

We compute the present value of an annuity by discounting each of the equal periodic amounts back to today. The present value of an annuity of $1 for three periods at 10% may be represented graphically as follows: