Week 4 DQ 1 Current Liabilities

The nature and recording up typical current liabilities. The definition of current liabilities in a very general sense would be debts that are due to be paid within one year or the operating cycle, whichever is longer. This typically involves a current asset or the creation of another current liability or perhaps the providing of some service to satisfy an obligation.

This follows the operating cycle, that's the length of time it takes to turn a business cash back into business cash. Others might start with cash by inventory and sell those goods, incur a receivable and then eventually collect the receivable. The length of time it takes to do that is the operating cycle and that's part and parcel considering the definition of current liabilities. For most businesses the operating cycle is less than one year but that's not always the case.

Accounts Payable are amounts due to suppliers relating to the purchase the goods and services. These may be supported by a written agreement but typically it's based on an informal working relationship. Another not so obvious account perhaps would be the current portion of long-term debt. The long duration is of course reported as a long-term liability on the balance sheet. However, the amount of principal that is due to be repaid within the operating cycle or one year, whichever is longer, should be separate and classified in the current liability section.

Here's an example. We have a one hundred thousand dollar note that's to be paid in equal annual installments of ten thousand dollars each plus accrued interest. At the end of any given year ten thousand dollars for the principal should be shown as a current liability and the remaining balance will be shown in the non-current liability section.

Accrued liabilities are another example of other current liabilities. These are expenses that accumulate with the passage of time but will be paid in one lump sum amount in the future. An example would be that our employee wages accumulate each day our employees work for us. That is the amount that all the employees at any point in time would be shown as an accrued liability wages payable reported in the current liability section. When paid of course the liability would be removed from the books.

Taxes and interest are other items that are often shown as an accrued liability. Customer deposits where customers deposit money in advance of receiving expected goods or services is another example. Those deposited monies will be shown as a current liability because they represent an obligation to either return the money or provide the service. These amounts often called unearned revenue. Examples would be selling magazine subscriptions in advance or selling gift cards tickets for an airline or a concert or something of that nature. All the money is paid by the customer to the company in advance of the service being provided and would be carried as a liability. Provider resources collections for third parties is another important current liability that sometimes may not be considered. Sales tax is a good example when the store sells goods and collection in addition to the sales price is the sales tax on the transaction. That company has an obligation to remit that sales tax to a city or state taxing organization so the amount of the transaction is reflected on the sales tax will be carried as a current liability.

Obligations that are expected to be refinanced raise interesting questions. Sometimes the company has a long-term liability that's coming due and they intend to essentially pay it off by borrowing from another lender or even from the same lender in a new transaction. These are major obligations that we expect to refinance rather than actually paying off so these amounts should be shown as a current liability for the year prior to their due date. Unless there's an intent and ability to refinance on a long-term basis so I say currently maturing long-term obligations to be shown as a current liability unless the company both intends to renew the debt on a long-term basis.