Lesson 9 - Accounting for Liabilities

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9.1 Liabilities

Defined as the present obligation of a company resulting from past events.

An obligation is a duty or responsibility to perform in a certain way. Obligation may be legally enforceable because of a binding agreement.

A liability can be an alternative to equity as a source of a company's financing.

Moreover, some liabilities, such as accounts payable or income taxes payable, are essential parts of day-to-day business operations.

9.2 Classification of Liabilities

The primary classification of liabilities is according to their due date:

a) Current Liabilities

are a company's short-term financial obligations that are due within one year or within a normal operating cycle.

are typically settled using current assets, which are assets that are used up within one year.

Below is a list of the most common current liabilities that are found on the balance sheet:

- Trade payable
- Dividends payable
- Interest payable
- Income taxes owed within the next year
- Accrual Expenses
- Bank Overdraft

b) Non -Current Liabilities

also known as long-term liabilities, are obligations listed on the balance sheet not due for more than a year.

Various ratios using noncurrent liabilities are used to assess a company’s leverage, such as bank borrowing.

Below is a list of the most common non-current liabilities that are found on the balance sheet:

- Bank Borrowing
- Hire Purchase Creditors
- Deferred Revenue (can be Current Liabilities depends on the period contracted)
- Deferred Tax Liabilities

9.3 Account Payable

Accounts payable (AP) is an account within the general ledger that represents a company's obligation to pay off a short-term debt to its creditors or suppliers.

Another common usage of "AP" refers to the business department or division that is responsible for making payments owed by the company to suppliers and other creditors.

It is amounts due to vendors or suppliers for goods or services received that have not yet been paid for.

The sum of all outstanding amounts owed to vendors is shown as the accounts payable balance on the company's balance sheet.

Accounts payable include all the company's short-term debts or obligations. It includes both:

9.3.1 Trade Payable

Trade payables constitute the money a company owes its vendors for inventory-related goods, such as business supplies or materials that are part of the inventory.

9.3.2 Non-Trade Payable

Non-Trade Payable refer to obligation resulted from non-primary business. In other words, it refers to the amount that a company owes to any parties other than trade suppliers.

Examples of non-trade payables are:

- Tax Payable
- Dividend Payable
- Interest Payable
- Accrued Expenses
- EPF Payable
- Salary Payable
- Other Income Received in advance
- Deposits Received

9.4 Recording for Account Payable

Proper double entry bookkeeping requires that there must always be an offsetting debit and credit for all entries made into the general ledger.

To record accounts payable, the accountant:

Cr: Accounts payable when the bill or invoice is received.
Dr: Expenses Account / Purchases Account / Fixed Assets

The debit offset for this entry is typically to an expense account for the good or service that was purchased on credit.

The debit could also be to an asset account if the item purchased was a capitalizable asset.

When the bill is paid, the accountant:

Dr: Accounts payable to decrease the liability balance.
Cr: Bank / Cash / Borrowing

The offsetting credit is made to the cash account, which also decreases the cash balance. The credit could also be to borrowing account if the settlement were done by using a loan.

9.5 Trade Payable

On 20 August, Mesra Sdn Bhd purchase trading stock from Big Oranges Sdn Bhd. The stock was delivered and invoiced for RM30,000. Mesra Sdn Bhd was granted a credit term of 30 days from invoice date and payment was made by cheque on 19th September.

Prepare Journal Entries to record the transactions.

Date	Description	Dr	Cr
20 Aug	Purchases	30,000	
	Trade Payable - Big Oranges Sdn Bhd		30,000
19 Sep	Trade Payable – Big Oranges Sdn Bhd	30,000	
	Bank		30,000

9.6 Non-Trade Payable

Refer to non-trade liabilities that the company owing to someone. It is included:

- Loan from someone
- Expenses that incurred this year but paid next year
- Other Income that received in advance
- Security Deposit received

9.6.1 Deferred / Accrued Revenue / Other income Received in advance

Deferred revenue, also known as unearned revenue, refers to advance payments (deposit) a company receives for products or services that are to be delivered or performed in the future.

The company that receives the prepayment records the amount as deferred revenue, a liability, on its balance sheet.

Deferred revenue is a liability because it reflects revenue that has not been earned and represents products or services that are owed to a customer.

As the product or service is delivered over time, it is recognized proportionally as revenue on the income statement.

Dr: Bank
Cr: Deferred Revenue / Deposit Received

Received advance payment from a customer this year. The goods to be deliver next year.

Dr: Trade Receivable
Cr: Sales

Goods delivered to customer next year

Dr: Deferred Revenue / Deposits Received

Cr: Trade Receivables

Offsetting Trade received with advance payment received last year.

Example:

Orange Park received RM300,000 online payment in January 2016 for entry tickets to park throughout the year 2016. The company is preparing the first quarter financial report and it is determined that RM120,000 of the online tickets have been presented over the counters.

Prepare the journal entries to record in advance payment received and the 1st quarter adjustment.

Date	Description	Dr	Cr
Jan 16	Bank	300,000	
	Deferred Revenue – Liabilities		300,000
Mar 16	Trade Receivables	120,000	
	Sales		120,000
Mar 16	Deferred Revenue – Liabilities	120,000	
	Trade Receivables		120,000

9.6.2 Accrued Expenses

Accruals are expenses incurred during the financial period which impact a company's net income on the income statement, although such expenses remain unpaid.

Accrued expenses includes all operating and administrative expenses payables such as salary payable, Utility expense payable, Rental Payable and EPF Payable.

In double-entry bookkeeping, the offset to an accrued expense is an accrued liability account, which appears on the balance sheet.

Therefore, an adjusting journal entry for an accrual will impact both the balance sheet and the income statement.

Dr: Expenses – P&L

Cr: Accrual – Balance Sheet

Example 1:

On 25th December 2016, Phoenix Sdn Bhd received several monthly bills including the Astro bill, TNB Bill and TM Bill amounting to RM200, RM2,500 and RM250 respectively. The company will pay all the bills in the next month. The TNB bill (including arrears) is RM1,200 which has already been recorded in its account.

Prepare Journal entries to record the transactions.

Date	Description	Dr	Cr
25 Dec	Utility Expenses – Astro	200	
	Utility Expenses – TNB	1,300	
	Utility Expenses - TM	250	
	Utility Payable / Accruals		1,750

Example 2:

Eng Guat Sdn Bhd has 25 Employees and each employee having monthly salary of RM3,000.The employee will receive a net salary after deducting contribution to EPF and SOCSO and the payment made by 7th in the following month. It is determined that the employee and the employer contribution to EPF is 12% and 15% of monthly salary respectively. In addition, the employee has contributed 2% of the salary to PERKESO. The company will remit the payment to EPF and SOCSO in the following month. Prepare all journal entries to record the transactions for the month of December 2016.

Date	Description	Dr	Cr
Dec 16	Salary – P&L	75,000	
	Salary Payable		75,000
	EPF Contribution	11,250	
	Salary Payable	9,000	
	EPF Payable		20,250
	Salary Payable	1,500	
	SOCSO Payable		1,500
Jan 17	Salary Payable		
	Bank		
Jan 17	EPF Payable	20,250	
	Bank		20,250
	SOCSO Payable	1,500	
	Bank		1,500

Prepare T Ledger for Salary Payable Account to determine Net Salary Payable

		DR			**CR**
Dec 16	EPF	9,000	Dec 16	Salary	75,000
	SOCSO	1,500			
	Bal c/f	64,500			
		75,000			75,000
Jan 17	Bank	64,500	Jan 17	Bal b/f	64,500

Example 3:

Mega Moto Sdn Bhd is an imported car Dealer. Each car sold is taxed an import duty at rate of 50% of the price. During last quarter of 2016, the company sold 20 cars amounting RM1.75Million, excluding import duty. The duty collected from customers will be remitted to the government two months later. Prepare the journal entries to record the transactions.

Date	Description	Dr	Cr
Dec 16	Trade Receivables	2,625,000	
	Sales		1,750,000
	Import Duty Payable		875,000

9.7 Summary

In conclusion, all liabilities should be recorded at **Credit side**.

We shall **debit** when we subsequent

- made payment or
- reversal to P&L