Benjamin Fenster
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Notes – Topic 7

Liabilities and Interest

- I. What are Liabilities?
    - a. A claim to assets by parties other than the owners.
    - b.
- II. Current Liabilities
    - a. Accounts Payable
        - i. Concerns
            1. Want to pay the right amount on-time and in an efficient manner.
            2. All purchase should be authorized and doned through pre-approved vendors.
            3. Prevent theft. (No fake invoices)
        - ii. Accomplished by
            1. Vendor approval process. Prevent conflicts of interest and assure vendor quality.
            2. Formal purchase order system.
            3. Requisition capability. Cut PO and submit for confirmation from vendor.
            4. Delegation of Authority. Specific individuals get authority for certain purchases.
            5. Pre-numbered Cheques.
            6. Centralized purchasing. More control but more overhead and less efficiency.
            7. Four-way matching
                - a. Done ultimately by every Accounts Payable department, though some get assistance from computers.
                - b. Match Purchase Order to receiving report
                - c. Match to invoice
                - d. Match to cheque
    - b. Taxes Payable
        - i. Real estate, sales, income
        - ii. Employee compensation (employee-related taxes)
            1. Wages ("plain vanilla")
                - a.
            2. Compensated absences (holidays, sick time, etc)
            3. Stock options
                - a. Gives the person the right to purchase stock at a set price for a given period of time.
                - b. Strike Price = Market Price on day options are offered.
                - c. Intrinsic Value Method
                    - i. Primary valuation approach used by 99% of companies.
                    - ii. Market Price = 10, Strike Price = 10, so there's no value.
                - d. Fair Value Method
                    - i. Saying there's no liability is misleading.
                    - ii. Estimate the future value of the stock at the time the options are issued.
            4. Post-Employment Benefits
                - a. Severence pay.
                - b. Often associated with restructuring.
            5. Pensions
                - a. Defined Contribution

            i. Simple.
            ii. Company promises to contribute certain amount every period.
        b. Defined Benefit
            i. Much more complex.
            ii. Company promises to pay certain amount throughout employee's post-retirement life based on their performance and length of stay in the firm.
            iii. Many unknowns!
            iv. Service Cost & Interest. Can be reduced by rate of return.
            v. Service Cost = Period contribution as employee works.
        c. Recorded under Pension Plan Assets (investments to cover plans) and Pension Plan Liability (liability to employees).
        d. To employees, a net debit of the two is a good thing.

iii. Payroll Taxes
    1. DR Salary Expense, CR Payroll Tax Withholdings
    2. Employee Withholdings
        a. FICA
        b. FIT & SIT (Federal & State Income Tax)
        c. DR Payroll Tax Withholdings and CR Cash to actually pay.
        d. NOT an actual expense! The salary is the expense!
    3. Company Taxes
        a. DR Payroll Tax Expense, CR Payroll Taxes Payable
        b. FICA (employer makes contribution too)
        c. FUCI & SUCI to support unemployment

iv. Sales Taxes
    1. DR Cash, CR Revenues, CR Sales Taxes Payable
    2. CR Sales Taxes Payable, CR Cash

v. Real Estate & Proprety Taxes
    1. Straightforward
    2. Timing glitches can result in big numbers on books.

vi. Income Taxes
    1. Payments on 4/15, 6/15, 9/15, 12/15. Everything must be paid by 3/15.
    2. FASB Taxable Income can differ from IRS taxable income.
    3. GAAP with its matching and the IRC with its revenue generation lead to differences.
    4. Could be perminant differences or temporary.
    5. Defer tax payments whenever possible, and legally avoid them whenever possible.
    6. DR Income Tax Expense, CR Deferred Tax Liability (or DR Deferred Tax Asset) and CR Income Taxes Payable
    7. If you owe MORE than the books indicate, DR Deferred Tax Asset. Otherwise use the liability account.