

Current Liabilities

by Sophia



WHAT'S COVERED

This tutorial will cover the topic of current liabilities.

Our discussion breaks down as follows:

1. Current Liabilities

Current liabilities show a company's obligation to pay debts to others within one year or the operating cycle, whichever is shorter. In other words, current liabilities represent a business's short-term debt obligations.

There are several types of current liabilities:

- Accounts payable
- Sales tax payable
- Unearned revenue
- Contingent and uncertain liabilities

2. Accounts Payable and Sales Tax Payable

Let's start by focusing on the first two, accounts payable and sales tax payable.

Accounts payable are amounts owed to external vendors for items that were purchased on account.

We can also have some specific financial statement accounts that are set up for some of our other payables, such as:

- Wages payable
- Rent payable
- Short-term notes payable

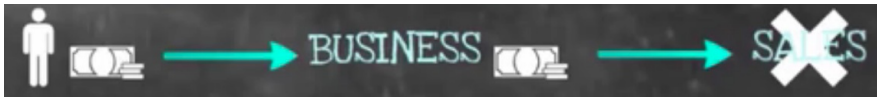
Sales tax payable is collected from customers at the time of sale. All businesses have to collect that sales tax at the time of sale, if the state in which it conducts business has a sales tax. It represents a percentage of sales owed to the state.

Sales tax gets paid when the business collects the sales tax from the customers at the time of sale, and then remits payment to the government, whether on a monthly, quarterly, or annual basis.

Businesses have to set up a liability for sales tax payable, because of the timing of the payment. Companies don't make that payment immediately; therefore, they have money that we owe, based on those sales.

3. Unearned Revenue

Unearned revenue is a liability account that records cash received *before* revenue is earned--the key word being "before." This refers to payments made to the company for performance of services or delivery of merchandise that is to be completed in the future; the revenue has not been earned yet at the time of payment.



It's important to note that it is not a revenue account. We don't record sales, because we haven't earned that revenue. Instead, it is a liability account, because of the nature that the company is *required* to perform future services or provide future goods. The company has an obligation to perform these services or provide these goods.

Note, unearned revenue is contained within the current liabilities section of the balance sheet.



TERM TO KNOW

Unearned Revenue

A liability account that records cash received before revenue is earned.

4. Contingent and Uncertain Liabilities

Contingent liabilities and uncertain liabilities are potential liabilities that have the possibility to become actual liabilities, dependent on some future event.

➔ **EXAMPLE** Examples of contingent liabilities would include lawsuits, as well as guarantees or warranty costs.

When it comes to recording contingent liabilities, there are three categories that need to be considered, that speak to the likelihood of that future event taking place:

- Probable
- Possible
- Remote

A contingent liability will be recorded and disclosed if the likelihood of the event is probable, meaning it's probable that the event is going to take place, and the amount is estimable, meaning we can estimate what the liability is going to be.

A contingent liability will *not* be recorded, but will be disclosed in our notes to the financial statements, if the likelihood of that future event taking place is possible and the amount is estimable.

Lastly, a contingent liability will not be recorded or disclosed in our financial statements if the possibility of that future event is remote.

Likelihood of Event	Contingent Liability Outcome
Probable (amount estimable)	Recorded and disclosed
Possible (amount estimable)	Not recorded, but disclosed
Remote	Not recorded or disclosed



TERM TO KNOW

Contingent Liability

A potential liability that has the possibility to become an actual liability dependent on some future event.



SUMMARY

Today we learned all about **current liabilities**, which represent a business's short-term debt obligations. We focused on **accounts payable**, **sales tax payable**, **unearned revenue**, and wrapped up with a discussion of **contingent and uncertain liabilities**. We learned about the three categories that need to be considered when recording contingent liabilities, that speak to the likelihood of that future event taking place (see chart above).

Source: Adapted from Sophia instructor Evan McLaughlin.



TERMS TO KNOW

Contingent Liability

A potential liability that has the possibility to become an actual liability dependent on some future event.

Unearned Revenue

A liability account that records cash received before revenue is earned.