Liabilities and their valuation in financial accounting and reporting

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Short introduction of myself

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Balance Sheet

- It is a set of mutually balancing assets and sources of financing (liabilities and equity).
- A “snapshot" of a company – reflects the financial situation of the enterprise on a given day.

Sources of financing

- **Stockholders' equity** – the equivalent of the assets contributed to the enterprise by its owners and income retained by the entity in the course of business.
- **Liabilities** (external capital) – a result of past events and the obligation to pay with a reliably estimated value. They result in use of current or future assets.
- Net assets – assets less liabilities

Liabilities – categories (1)

- **Reserves** (long-term) – these are specific obligations whose maturity or amount is not certain.
- Reserves for liabilities can be created only if the entity has no legal or customary obligation to provide goods or services or if it can not reliably determine the likely amount of the liability, example: provision for retirement benefits.

Liabilities – categories (2)

- **Long-term liabilities** (noncurrent liabilities)– liabilities other than trade liabilities that become payable in a period of more than 12 months from the balance sheet date.
- Examples:
  - Bank loans and credits
  - Bonds payable
  - Notes payable

Liabilities – categories (3)

- **Current liabilities** – trade liabilities and all or part of other obligations that become due within 12 months from the balance sheet date.
- Examples:
  - Accounts payable (A/P) / Settlements with suppliers
  - Current portion of long-term debt
  - Settlements with employees
  - Public settlements
  - Settlements pursued in court

Deferred income

- **Deferred income** – includes negative goodwill and the equivalent of already received payments from customers in anticipation of performance in subsequent reporting periods.
- Deferred income is used to ensure matching of revenues and expenses (matching principle).

Accured expenses

- **Accrued expenses** – provisions with a known value but for which accounting document is not available (yet).
- Deferred income is connected with an outflow of money, but accrued expenses are created by a paper transaction.

Deferred tax liabilities (1)

- **Deferred tax liabilities** are amounts of income taxes payable in future periods as a result of taxable temporary differences.
- They are created when the amount of income tax expense recognized in the income statement is greater than taxes payable.

Deferred tax liabilities (2)

- This can occur when costs or losses are tax deductible before they are recognized in the income statement.
- Example: when a company uses an accelerated depreciation method for tax purposes and the straight-line method for financial reporting.

Valuation methods (1)

- **Historical cost principle** – liabilities are measured at a value equal to the amount of cash received in exchange for a committment.
- **Current cost principle** – liabilities are valued at non discounted amount that would be required at the moment to settle the obligation.

Valuation methods (2)

- **Realizable value principle** – liabilities are valued at a discounted amount of cash that needs to be paid to settle the obligation.
- **Present value principle** – liabilities are disclosed at the discounted present value of future anticipated cash expenses to be paid to settle the obligation.

Measurement concepts

- Historical cost – the amount originally paid for the asset.
- Amortized cost – the historical cost adjusted for depreciation, amortization, and impairment.
- Current cost – the amount the firm would have to pay today for the same asset.
- Realizable value – the amount for which the firm could sell the asset.
- Fair value – the amount at which two parties in an arm's-length transaction would exchange the asset.

THANK YOU!

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