Current Liabilities

Obligations that must be discharged in a short period of time (generally less than one year)

Examples:
- Accounts payable
- Short-term borrowings
- Current portion of long-term debt (portion that requires the use of current assets)
- Deposits
- Warranties
- Deferred Revenues / Income
Contingencies

Resolution of uncertainty

*Gain contingency*
- Acquisition of asset
- Reduction of liability

*Loss contingency*
- Loss or impairment of asset
- Incurrence of liability
Accounting Guidelines on Contingencies

The accounting treatment of a contingency depends on
(1) whether the contingency is:

*Probable* - the future event is likely to occur

*Reasonably possible* - the chance of occurrence of the future event (or events) is more than remote but less than likely

*Remote* - the chance of occurrence of the future event (or events) is slight

(2) whether the amount of the gain or loss must be reasonably estimated.
## Loss Contingencies

<table>
<thead>
<tr>
<th></th>
<th>Measurable</th>
<th>Not Measurable</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Probable</strong></td>
<td>Accrue</td>
<td>Disclose in notes</td>
</tr>
<tr>
<td><strong>Reasonably possible</strong></td>
<td>Disclose in notes</td>
<td>Disclose in notes</td>
</tr>
<tr>
<td><strong>Remote</strong></td>
<td>None required, but note permitted</td>
<td></td>
</tr>
</tbody>
</table>

### Accrual of loss contingency:

\[
A = L + E
\]

- \(A\): Accrued liability
- \(L\): Loss on Contingency
### Gain Contingencies

<table>
<thead>
<tr>
<th></th>
<th>Measurable</th>
<th>Not Measurable</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Probable</strong></td>
<td>Accrue in unusual circumstances, else disclose</td>
<td>Disclose, but avoid misleading inferences</td>
</tr>
<tr>
<td><strong>Reasonably possible</strong></td>
<td>Disclose but avoid misleading inferences</td>
<td></td>
</tr>
<tr>
<td><strong>Remote</strong></td>
<td>Disclosure is not recommended</td>
<td></td>
</tr>
</tbody>
</table>
Disclosure: An Example


Sarbanes-Oxley Act of 2002

• Act is intended to
  (1) improve disclosure
  (2) increase quality of audits
  (3) increase effectiveness of corporate governance

With regard to contingencies, Sarbanes-Oxley requires companies to provide information on expected payouts including amounts and timing in the MD&A section of the financial statements.
Annuities

*Ordinary Annuity* (annuity in arrears) - payments occur at the end of the period

*Annuity due* (annuity in advance) - payments occur at the beginning of the period

What is the FV of a $100 ordinary annuity at the end of 3 years at 8%?

<table>
<thead>
<tr>
<th>0</th>
<th>1</th>
<th>2</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>--</td>
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</tbody>
</table>

A general formula:

\[
FV(a) = \left\{\left[(1+r)^N - 1\right] \times \left[1/r\right]\right\} \times \text{Fixed Period Cash Flow}
\]
Present Value Concepts

What is the PV of a 3 year $100 ordinary annuity at 8%?

0 1 2 3
|---------------------------|---------------------------|----------------------------|

A General Formula:

\[ PV(a) = \left\{ \left[1 - (1+r)^{-N}\right] \times \left[\frac{1}{r}\right]\right\} \times \text{Fixed Period Cash Flow} \]

Note: A perpetuity is an annuity that goes on forever. As \( N \) approaches infinity, the formula for \( PV(a) \) becomes \( \left[\frac{1}{r}\right] \times \text{Fixed Period Cash Flow} \). If you were to receive $100 a year forever, the PV of that stream of payments, given \( r = 8\% \), is \( 100/0.08 = 1,250 \). If you were to receive $100 a year for 50 years, the PV of that stream of payments, given \( r = 8\% \), is 1,223.35. Why is the difference so small?