How LIABILITIES are classified (continuation)

Lesson 09

In this lesson, we shall take a closer look at how liabilities are grouped for presentation in the balance sheet.

1. Current liabilities

Current liabilities are bills that must be settled within one year of the date of the balance sheet.

Accounts payable
Accounts payable are debts owed to other companies for materials, supplies, equipment and services bought on credit, which the company must pay within a year.

Accrued liabilities
Accrued liabilities (also called *accrued expenses*) are debts owed for materials, supplies, equipment and services bought on credit, which must be paid soon, but the invoices for which have not reached the company, as of the time the balance sheet is being prepared. In order to give a complete picture of the company's total indebtedness, the estimated values of these liabilities for which invoices are yet to arrive have to be presented under accrued liabilities. Common examples are telephone and electricity expenses. The invoices for these expenses normally arrive much later after the period during which they are incurred. Salaries for periods of time worked by employees but awaiting release are also accrued liabilities. Accrued liabilities may be sub classified depending on to whom the liability is owed.

Unearned income
Unearned income refers to payments made by clients in advance. For example, a client of a travel agency pays for a holiday package a few months before the planned holiday. As far as the travel agency is concerned, the prepayment is not considered to have been earned yet (hence the name *unearned income*) until the client commences his journey. Unearned income is a liability because the company remains indebted to client until the client receives the goods or services he has prepaid.

Notes payable
Notes payable refers to money borrowed from a bank, and which, according to the conditions set upon borrowing, must be paid back within a year.

Current portion of long-term debt
When a company borrows money from a bank, and the period to pay the money back covers several years, then the debt is said to be a long-term one. However, the portion of the borrowed money that must be paid within a year is a current liability, and is presented in the balance sheet as *current portion of long term debt.*

Income taxes payable

When a company makes a profit on a sales transaction, a portion of the profit is owed to the government, and this portion is called income tax. *Income taxes payable* are income taxes owed to the government but are awaiting settlement.

2. Long-term liabilities

Long-term liabilities include the portion of a long-term loan that does not need to be paid back to the bank within a year, as well as all forms of indebtedness that do not fall due for payment within a year.

The next lesson will be about the equity portion of the balance sheet.

Until the next e-lesson,

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