

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

	<u>Measurable</u>	<u>Not Measurable</u>
Probable	Accrue	Disclose in notes
Reasonably possible	Disclose in notes	Disclose in notes
Remote	None required, but note permitted	

Accrual of loss contingency:

$$A = L + E$$

Accrued liability Loss on Contingency

Gain Contingencies

	<u>Measurable</u>	<u>Not Measurable</u>
Probable	Accrue in unusual circumstances, else disclose	Disclose, but avoid misleading inferences
Reasonably possible	Disclose but avoid misleading inferences	
Remote	Disclosure is not recommended	

Disclosure: An Example

Archer Daniels Midland Company, 2003 Annual Report.

For this quote, see "Note 12 - Antitrust Investigation and Related Litigation" on pp. 41 of the Archer Daniels Midland Company's 2002 Annual Report, available at their web site, <http://www.admworld.com>.

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.

Present Value Concepts

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%?



A general formula:

$$FV(a) = \{[(1+r)^N - 1] * [1/r]\} * \text{Fixed Period Cash Flow}$$

Present Value Concepts

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



A General Formula:

$$PV(a) = \{[1 - (1+r)^{-N}] * [1/r]\} * \text{Fixed Period Cash Flow}$$

Note: A perpetuity is an annuity that goes on forever. As N approaches infinity, the formula for PV(a) becomes $[1/r] * \text{Fixed Period Cash Flow}$. If you were to receive \$100 a year forever, the PV of that stream of payments, given $r = 8\%$, is $100/.08 = 1,250$. 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?