



# Business Liabilities and Contingent Funding Solutions

Issue 14 - 23 April 2009

## Overview

In the context of Business Contingency Assessment and Planning many Advisers mistakenly believe that liabilities equate to business borrowings only. However a review of Australian Accounting Standard AASB 137 incorporating International Accounting Standard IAS 37 reveals that there are four kinds of liabilities:

- Creditors;
- Borrowings;
- Provisions; and
- Deferred Income.

What follows is a review of Australian Accountancy Standard AASB 137 and the opportunities presented to correctly identify all businesses liabilities to meet the suitability requirements of sec 945A of the Corporations Act.

## Defining and Valuing Liabilities

Liabilities are amounts owing or anticipated to become owing in the future as a result of transactions and events of the entity that have occurred by the balance sheet preparation date. They are generally valued at the amount required to pay them out if they were paid at balance sheet preparation date.

**Implication:** Care needs to be taken when reviewing financial statements to ensure that all

liabilities are not only found but also valued correctly, funded and reviewed as per the balance sheet preparation date.

## Current and Non-Current Liabilities

Liabilities are classed as current liabilities if they are expected to be paid or extinguished in some other way within one year of the balance sheet date. Other liabilities are classed as non-current.

**Implication:** Do not overlook non-current liabilities and note that a contingent event such as death may change the status of liabilities.

## Review and Fund for all Liabilities

There are really four kinds of liabilities: creditors, borrowings, provisions and deferred income.

**Implication:** Few Financial Advisers identify or fund for all business borrowings let alone all liabilities including business creditors, business provisions and deferred income.

## Reviewing Liability Risks

There are two significant risks that need to be considered when reviewing liabilities. Firstly, liabilities that are not included on the balance sheet. The second is that liabilities are deliberately created to be off balance sheet (e.g. where a finance lease is made to look like an operating lease).



**Implication:** Failure to fund for all liabilities whether on the balance sheet or not may result in failure to fund for all contingencies which could impact on the Principal of a business' personal Estate.

#### **Consider Creditor Liabilities**

Creditors, also called accounts payable, are suppliers of goods and services received but not paid for by balance sheet preparation date. Accrued expenses can be the same, except that an invoice is not received prior to the preparation of the accounts and the amount owing is estimated. Accrued expenses also allow for items such as salaries that are paid in the next financial year, but part of the payment is for the last few days of the current financial year. Another typical accrual is unpaid interest on borrowings. Creditors might be shown as trade creditors and other creditors.

**Implication:** Do not overlook creditors as a contingent liability and fund accordingly.

#### **Consider all Borrowings**

Borrowings is the principal sum owing to lenders at the balance sheet preparation date. These borrowings may be secured or unsecured. Typical borrowings are bank overdrafts, bank loans, other loans, loans from shareholders and lease liabilities. Leases are treated as a liability when classed as a finance lease - that is, the lease is really an arrangement to finance the purchase of an asset.

**Implication:** All borrowings in their various forms - as either secured or unsecured borrowings should be reviewed and funded.

#### **Consider all Business Provisions**

Provisions are a means of recognising an event or transaction that has occurred before the balance sheet date, but are not necessarily legally due, not necessarily as readily measured and not payable until some time in the future. Typical provisions are for dividends, income tax (shown separately on the balance sheet), employee entitlements, deferred tax (shown separately on the balance sheet), warranty, and restructuring, restoration and general insurance claims.

Provisions, being estimates, provide an opportunity for manipulation. Increasing provisions reduces profit, whereas decreasing provisions increases profit. An Adviser can monitor potential manipulation by monitoring the change in level of the provision against the appropriate item to which the provision relates.

**Implication:** Provisions are often overlooked and should always be identified and considered and funded. Note that whilst provisions are estimates, they should be correctly reviewed in order that under funding does not occur.

#### **Consider all Unearned Income and Future Commitments**

Unearned income arises when money (or other valuable settlement) is received in advance of providing the goods or services. An example is premium income received at the beginning of the insurance period. The unearned portion remaining at balance sheet date is included under a balance



sheet liability, usually called 'unearned premium'

Information on commitments is of interest when they are unusually large in relation to the size, activity and normal situation of the entity.

**Implication:** Unless an appropriately funding solution for information on commitments or unearned income is considered there may be a funding liability shortfall in the event of a contingency.

Contingent liabilities should always be considered for revealing items which may become significant liabilities in the future and thus funded correctly.

Understanding financial statements will enable Advisers to correctly determine all liabilities pertaining to a business to preserve the business in the event of a contingency such as Death, Critical Illness or Total and Permanent Disablement.

To find out more about ili courses and workshops in respect to identifying all business liabilities please visit the ili website [www.ili.com.au](http://www.ili.com.au).

#### Copyright Notice

©ili.

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, transmitted or copied in any form or by any means (graphic, electronic, mechanical, photocopying, microcopying, scanning or otherwise) except as permitted under the Copyright Act, without the prior written permission of ili. Any enquiries should be addressed to ili.

#### Disclaimer

This publication is designed to provide accurate information regarding the subject matter which it covers. It is distributed on the understanding that ili is not engaged in rendering professional or expert services or advice (legal, accounting, financial planning or otherwise). The information provided in this publication does not constitute such advice or services and should not be relied on as such. If professional or expert assistance is required, the services or advice of a competent person should be sought.

Neither ili nor its directors, employees, associates, agents or other representatives and affiliates are liable for any liability, loss, damage or injury arising from or in relation to the direct or indirect use of, or reliance on, the whole or any part of the information contained in this publication. Without limiting the generality of the above, neither ili nor its authors, consultants and writers are liable or responsible for anything done or omitted to be done by any person in respect to this publication.

For Further information please visit [www.ili.com.au](http://www.ili.com.au)  
or contact:

Melinda Wood - ili Enquiries  
(02) 9251 3611

[enquiries@ili.com.au](mailto:enquiries@ili.com.au)