



Enterprise Liabilities

Issue 29 – 13 August 2010

Understanding both the particular framework and financial circumstances of an Enterprise will enable appropriate funding solutions to cover liability shortfalls.

Nevertheless liabilities may not be easily recognisable.

What follows is an overview of items that should be considered when structuring financial solutions to cover potential shortfall considerations, particularly in the event of a contingency such as death.

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

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.

Enterprise Liabilities

There are really four kinds of liabilities:

1. Creditors;
2. Borrowings;
3. Provisions; and
4. Deferred income.

There are two significant risks facing a user when considering liabilities. The first is that some liabilities are not included on the balance sheet (e.g. due to the preparer's difficulty finding them all). 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).

Creditors

Creditors, also called accounts payable, are suppliers of goods and services received but not paid for by balance 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 wages 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.

Borrowings

Borrowings is the principal sum owing to lenders at the balance sheet date. These borrowings may be either:

1. Secured; or
2. Unsecured.

Typical borrowings are:

1. Bank overdrafts;
2. Bank loans;
3. Other loans;
4. Loans from shareholders; and
5. Lease liabilities.

Leases are treated as a liability when classed as a finance lease—that is, the lease is in effect an arrangement to finance the purchase of an asset.

Unless loans can be substantiated (particularly where large sums are involved) financial underwriting may become problematic. Substantiation requirements include either underwriter's reports copies of correspondence (including statements of advice), enterprise accounts (including timely tax returns, balance sheet, income statement) and depreciate loan documentation.

Furthermore it is important to distinguish between liabilities as defined in the accounting standards IAS 37, The Framework for preparation and Presentation of Financial Statements, the *Income Tax Assessment Act* and the *Corporations Act* (CA). For example under s.588 of the *Corporations Act* Directors of corporate entities have a duty to prevent the



company incurring debt where a director has grounds for suspecting that it may become insolvent. A debt may be incurred when a dividend is paid or when redeemable preference share is redeemed. With the new changes to section 254T of the CA, dividends may be paid from capital and not just from profits causing problems as to solvency or further capital erosion to keep the business going.

Consideration therefore of shareholder rights and entitlements should be considered when identifying the current liabilities.

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:

1. Dividends;
2. Income tax (shown separately on the balance sheet);
3. Employee entitlements;
4. Deferred tax (shown separately on the balance sheet);
5. Warranty;
6. Restructuring;
7. Restoration; and
8. General insurance claims.

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

Deferred Income

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'

Contingent liabilities should always be considered by the user for revealing items which may become significant liabilities in the future.

To find out more about ili online services, courses and workshops in respect to Business Financial management in respect to Contingency Funding and Financial Planning please visit our website 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 or contact:
Melinda Wood – ili Enquiries (02) 9251 3611 enquiries@ili.com.au**