Chapter 3

Current Liabilities

Financial Accounting, IFRS Edition
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Study Objectives

1. Explain a current liability, and identify the major types of current liabilities.
2. Describe the accounting for notes payable.
3. Explain the accounting for other current liabilities.
4. Accounting for payroll

Liabilities

Current Liabilities

- Notes payable
- Sales taxes payable
- Unearned revenues
- Current maturities of long-term debt
- Statement presentation and analysis

Accounting for payroll

- Meaning and Importance of Payroll
- Preparing Payroll
- Paying the Payroll
- Calculating Employees Earnings
- Payroll Deductions
- Recording the Payroll
- Preparing payroll register

Section 1 Current Liabilities

What is a Current Liability?

Current liability is debt with two key features:

1. Company expects to pay the debt from existing current assets or through the creation of other current liabilities.
2. Company will pay the debt within one year or

Current liabilities include **notes payable**, **accounts payable**, **unearned revenues**, and accrued liabilities such as **taxes payable**, **salaries payable**, and **interest payable**.

SO 1 Explain a current liability, and identify the major types of current

What is a Current Liability?

Notes Payable

- Written promissory note.
- Require the borrower to pay interest.
- Issued for varying periods.

SO 2 Describe the accounting for notes payable.

What is a Current Liability?

Illustration: On March 1, 2011, A company borrows Br100,000 from First National Bank on a 4-month, 12% note.

Instructions

a) Prepare the entry on March 1.

b) Prepare the adjusting entry on June 30, assuming monthly adjusting entries have not been made.

c) Prepare the entry at maturity (July 1).

SO 2 Describe the accounting for notes payable.

What is a Current Liability?

Illustration: On March 1, 2011, A company borrows Br100,000 from First National Bank on a 4-month, 12% note.

a) Prepare the entry on March 1.

Cash	100,000	
Notes payable		100,000

b) Prepare the adjusting entry on June 30.

Br100,000 x 12% x 4/12 = $4,000

Interest expense	4,000	
Interest payable		4,000

SO 2 Describe the accounting for notes payable.

What is a Current Liability?

Illustration: On March 1, 2011, A company borrows Br100,000 from First National Bank on a 4-month, 12% note.

c) Prepare the entry at maturity (July 1).

Notes payable		100,000
Interest payable		4,000
Cash		
	104,000	

SO 2 Describe the accounting for notes payable.

What is a Current Liability?

Sales Tax Payable

- Sales taxes are expressed as a stated percentage of the sales price.
- Either rung up separately or included in total receipts.
- Retailer collects tax from the customer.
- Retailer remits the collections to the state's department of revenue.

SO 3 Explain the accounting for other current liabilities.

What is a Current Liability?

Illustration: The March 25 cash register reading for A company shows sales of Br10,000 and sales taxes of Br600 (sales tax rate of 6%), the journal entry is:

Cash	10,600	
Sales		10,000
Sales tax payable		600

SO 3 Explain the accounting for other current liabilities.

What is a Current Liability?

Unearned Revenue

Revenues that are received before the company delivers goods or provides services.

1. Company debits Cash, and credits a current liability account (unearned revenue).
2. When the company earns the revenue, it debits the Unearned Revenue account, and credits a revenue account.

Type of Business
Airline
Magazine publisher
Hotel
Insurance company

What is a Current Liability?

Illustration: Assume that Superior Co. sells 10,000 season football tickets at Br50 each for its five-game home schedule. The Co. makes the following entry for the sale of season tickets:

Aug. 6	Cash	500,000	
	Unearned revenue		500,000

As the Co. completes each of the five home games, it would record the revenue earned.

Sept. 7	Unearned revenue	100,000	
	Ticket revenue		100,000

What is a Current Liability?

Unearned Revenue

Illustration 10-2
Unearned and earned revenue accounts

Type of Business	Account Title	
	Unearned Revenue	Earned Revenue
Airline	Unearned Passenger Ticket Revenue	Passenger Revenue
Magazine publisher	Unearned Subscription Revenue	Subscription Revenue
Hotel	Unearned Rental Revenue	Rental Revenue
Insurance company	Unearned Premium Revenue	Premium Revenue

SO 3 Explain the accounting for other current liabilities.

What is a Current Liability?

Current Maturities of Long-Term Debt

- Portion of long-term debt that comes due in the current year.
- No adjusting entry required.

SO 3 Explain the accounting for other current liabilities.

Statement Presentation and Analysis

Presentation

Illustration 10-3
Statement of financial position presentation of current liabilities (in thousands)

CROIX COMPANY
Statement of Financial Position
(partial, in thousands)

Current liabilities	
Short-term borrowings (notes payable)	€ 4,157
Accounts payable	3,990
Long-term debt due within one year	3,531
Accrued expenses	1,847
Accrued wages, salaries, and employee benefits	1,730
Customer advances	555
Deferred and current income taxes payable	259
Dividends payable	141
Total current liabilities	€16,210

SO 3 Explain the accounting for other current liabilities.

PAYROLL ACCOUNTING IN ETHIOPIA

Importance of Payroll Accounting

The concept *payroll* is often used to refer to the total amount paid to employees of a firm as a compensation for the service rendered to the firm in a given period of time. The payroll accounting of a firm has to be given emphasis of significance for the following reasons:

1. Employees are sensitive to payroll errors and irregularities, and maintaining good employees moral requires that the payroll be paid on a timely and accurate basis.
2. Payroll expenditures are subject to various government regulations.
3. The payment for payroll and related taxes has significant effect on the net income of most business enterprises.

Definition of Payroll Related Terms

- **Pay Period**: The pay period is the length of time covered by each payroll payment. Pay periods for wageworkers are usually made on weekly or biweekly. On the other hand, salaried employees' pay periods are monthly or semi-monthly.
- **Pay Day**: The pay day is the day on which wages or salaries are paid to employees, usually the last day of the pay period.
- **"Payroll"** pertains to both:

  Salaries - managerial, administrative, and sales personnel (monthly or yearly rate).

  Wages - store clerks, factory employees, and manual laborers (rate per hour).

Basic Records of Payroll System

- The basic records of a payroll accounting system include:

1. A payroll register (or sheet),
2. Individual employees' earnings records, and
3. Pay checks (if checks are used).

Payroll Register

- **The entire list of employees of a business along with each employee's gross earnings, deductions and net pay (or the take home pay) for a particular payroll period. The basis for the preparation of the payroll register can be the attendance sheets, punched (clock) cards or time cards. A typical payroll register may include the following items:**

1. ***Gross Earnings***: The total pay to an employee before deductions for the pay period.
2. ***Payroll Taxes*****:** Taxes levied against the employer on the payroll of a firm. It is an additional payroll related expense to an employer.
3. ***Withholding Taxes*****:** These are taxes levied against the earnings of employees of an organization and withheld by the employer per the regulations of the concerned government**.**
4. ***Payroll Deductions*****:** All the reductions from the gross earnings of an employee such as withholding taxes, union dues, fines, credit association pays, etc.
5. ***Net Pay*****:** The gross earnings after subtracting all the deductions. It is sometimes known as take home pay the amount collected by an employee on the pay.

Payroll Accounting

Determining the Payroll

Involves computing three amounts:

(1)gross earnings,

(2)payroll deductions, and

(3)net pay (or the take home pay).

Payroll/Gross Earnings

Gross Earnings: Money earned by an employee(s) of a firm from various sources. Total compensation earned by an employee (wages or salaries, plus any bonuses and commissions). It may include:

1.Basic Salary or Regular Earning: A flat monthly salary of an employee that is paid for carrying out the normal work of employment and subject to change when the employee is promoted.

2.Allowances: Money paid monthly to an employee for special reasons, which may include:

Payroll/Gross Earnings

Type of Allowance	Description
Position Allowance	A monthly sum paid to an employee for bearing a particular office responsibility, e.g. head of a particular department or division.
House Allowance	A monthly allowance given to cover housing costs of the individual employee when the employment contract requires the employer to provide housing but fails to do so.
Hardship Allowance	A sum of money given to an employee to compensate for an inconvenient circumstance caused by the employer. For instance, unexpected transfer to a different and distant work area or location. It is sometimes known as disturbance allowance.
Dessert Allowance	A monthly Allowance given to an employee because of assignment to a relatively hot region.
Transportati	

Payroll/Gross Earnings

3.Overtime Earnings

- Overtime work is the work performed by an employee beyond the regular working hours or days.
- According to Art. 68 of Proclamation No. 176/2019:
  - ✓ Regular/Normal hours of work: the time during which a worker actually performs work in accordance with law, collective agreement, or work rules.
  - ✓ Overtime working hours should not exceed four hours a day and 12 hours in a week (Proclamation No. 176/2019)
  - ✓ Maximum normal hours of work is: 8hrs/day and 48hrs/week.
- Ordinary Hourly Rate = $\frac{\text{Monthly salary}}{\text{Monthly normal (regular)working hours}}$

S.No.	OVERTIME PERIOD	RATE
1	AFTER OFFICE HOURS - 10PM	1.5 X ORDINARY HOURLY RATE
2	10PM-6AM	1.75 X ORDINARY HOURLY RATE
3	WEEKLY REST DAYS	2.0 X ORDINARY HOURLY RATE

Payroll Deductions

Payroll Deductions/Withholdings: These are subtractions made from the earnings of employees because it is required by government or permitted by the employee himself. In Ethiopia some of the deductions against the earnings of employees are:-

Mandatory:

- Income tax
- Pension contribution
- Court orders

Voluntary:

- Charity
- Insurance
- Union dues
- Credit association
- Etc

Payroll Deductions

- Proclamation No. 979/2016
  - Schedule A – Income from employment
    - Income – means every form of economic benefit, including non-recurring gains, in cash or kind from whatever source derived and in whatever form paid, credited, or received.
  - Schedule E – Exempt income
    - Medical costs
    - Transport allowance
    - Hardship allowance
    - Per diem & travelling expenses
    - Board allowances for SOE
    - Pension contribution by employer
    - Salaries to domestic servants
    - Cash indemnity allowance
    - Etc.

Payroll Deductions

I. Employee Income Tax

- In Ethiopia every citizen is required to pay income tax from his/her earnings of employment. In this case a progressive income tax system that charges higher rates for higher earnings is applied on the gross earnings of each employee.
- According to **Proclamation No. 979/2016** exempts the first Br. 600 of the earnings of an employee from income tax. The money on which a person does not have to pay income tax is an exemption. The amended income tax proclamation states the following items about employment income tax and its computations:

Payroll Deductions

- **Schedule' A' Employment Income [**Proclamation No. 979/2016**]**

Taxable Income: Every person deriving income from employment is liable to pay tax on that income at the rate specified in Schedule A. The first Birr 600 (one hundred fifty Birr) of employment income is excluded from taxable income.

Salary Range (ETB)	Tax Rate	Deduction (ETB)
0 — 600	0%	0.00
601 — 1,650	10%	60.00
1,651 — 3,200	15%	142.50
3,201 — 5,250	20%	302.50
5,251 — 7,800	25%	565.00
7,801 — 10,900	30%	955.00
above 10.900	35%	1500.00

Payroll Deductions

- **Exemptions (non-taxable income)**

Generally, taxable income from employment includes salaries, wages, allowances, directors' fees and other personal emolument, all payments in cash and benefits in kind. However, according to income tax Proclamation the following categories of payment in cash or benefits in kind are exempted from tax.

- Medical costs incurred by employer or treatment of employees.
- Transportation allowances paid by employer to its employees.
- Reimbursement by employer to its employees.
- Travelling expenses paid to transport employees from else where to place of employment and to return them upon completion of employment.
- Pension contribution, provident fund and all forms of retirement benefit contributed by the employer that does not exceed 15% of the monthly salary.
- Income from employment received by casual employees who are not regularly employed provided that they do not work for more than one month for one employer.

Payroll Deductions

- **Pension Contributions**

  - **<u>Permanent employees</u>** of an organization **(Proclamation No. 714/2011)**, the employees of which are governed by the existing regulations of the Ethiopian public servants, are expected to pay or contribute 7% of their basic (monthly) salary to the government Pension Trust Fund.

  - On the other hand, the employer is also expected to contribute towards the same fund 11% of the basic salary of every permanent employee of it. It is this total amount that is called payroll taxes expense to the employer organization.

  - Consequently, the total contribution to the Pension Trust Fund of the Ethiopian government is equal to 18% of the total basic salary of all permanent employees of an organization.

Payroll Deductions

- **Other Deductions**

Apart from the above two kinds of deductions, employees may individually authorize additional deductions such as deductions to pay health or life insurance premiums; to repay loan from the employer or credit association; to pay for donations to charitable organizations; etc.

The net pay: This amount is held in one column of the payroll register representing the excess of gross earnings over the total deductions of an employee. The column ‘Net Pay’ total tells the grand total deductions made form the earnings of employees.

Net Pay

The net pay: This amount is held in one column of the payroll register representing the excess of gross earnings over the total deductions of an employee. The column ‘Net Pay’ total tells the grand total deductions made form the earnings of employees.

NET PAY = TOTAL EARNINGS – TOTAL DEDUCTIONS

Recording the Payroll/ Payroll Entry

1. **Recognizing Payroll Expenses and Liabilities**

Salaries and wages expense	xxxx	
Withholdings/Deductions (Various)		xxxx
Salaries and wages payable (Net pay)		xxxx

2. **Recording Payment of the Payroll**

Salaries and wages payable	xxxx	
Cash		xxxx

Employer Payroll Taxes

Payroll tax expense results from taxes that governmental agencies levy **on employers**. These taxes include state unemployment tax, i.e. pension contribution

Payroll tax expense	xxxx	
Pension contribution payable		xxxx

Illustration

- ABC Company pays the salary of its employees according to the Ethiopian Calendar month. The following data relates to the month of Sene, 2013 E.C.

No.	Name	Basic Salary	Monthly Allowance	Over Time Hours Worked	Duration of Over Time Work	Basic Salary per Hour
1	Biniam	2080	100	10	Up to 10 p.m.	2080/160#
2	Hailu	640	-	8	10 p.m. to 5	=13
3	Kebede	1280	-	6	a.m.	640/160=
4	Petros	960	50	-	Weekly Rest	4
5	Mohammed Jemal Mulugeta	480	50	10	Days - Public	1280/160= 8 960/160=

Illustration

- **Additional Information**

1. Management of the agency usually expects a worker to work 40 hours in a week and during Sene 2013 all workers have done as they have been expected.
2. All workers of this agency are permanent employees except Kebede Petros;
3. Abdu Mohammed agreed to have a monthly Br. 200 be deducted and paid to the Credit Association of the Agency as a monthly saving.
4. All employees agreed to contribute starting from this month their monthly salaries within 8 months to Disaster Prevention and Preparedness Commission (DPPC).

Illustration

Instructions: Based on the above information
1.Prepare a payroll register (or sheet) for the company for the month of Sene, 2013.
2.Record the payment of salary as of Sene 30, 2013 using CK. No. 41 as a source Document
3.Record the payroll taxes expense or the month of Sene 2013.
4.Record the payment of the claim of the credit Association of the Company that arose from Sene's payroll assuming that the payment was made on Hamle 1, 2013.
5.Record the payment of the claim of the DPPC that arose from Sene's payroll assuming that the payment was made on Hamle 1, 2013.
6.Assuming that the withholding taxes and payroll taxes of the month of Sene, 2013 have been paid on

Illustration

I.Payroll Register for Sene 2013

A.Overtime Earnings

Overtime Earning = Overtime Hours Worked x (Ordinary Hourly Rate x OT Rate)

No.	Name	Computation	Overtime Earning (ETB)
1	Biniam Hailu	10 hrs x (Br13 x 1.5)	= 195
2	Kebede Petros	8 hrs x (Br4 x 1.75)	= 56
3	Abdu Mohammed	6 hrs x (Br8 x2)	= 96
4	Kirkos Teklu	10 hrs x (Br3 x	= 75

Illustration

B.Gross Earnings

Gross Earnings = Basic Salary + Allowance + OT Earnings

No.	Name	Computation	Gross Earnings
1	Biniam Hailu	2,080 + 100 + 195	= 2375
2	Kebede Petros	640 + 0 +56	= 696
3	Abdu Mohammed	1280 + 0 + 96	= 1376
4	Jemal Mulugeta	960 + 50 + 0	= 1010
5	Kirkos Teklu	480 + 50 + 75	= 605

Income Tax Rates

Salary Range (ETB)	Tax Rate	Deduction (ETB)
0 — 600	0%	0.00
601 — 1,650	10%	60.00
1,651 — 3,200	15%	142.50
3,201 — 5,250	20%	302.50
5,251 — 7,800	25%	565.00
7,801 — 10,900	30%	955.00
above 10.900	35%	1500.00

Illustration

C. Deductions and Net Pay

1. Biniam Hailu

Employee Income Tax			Pension Contribution			Other Deduction		
600.00	**x**	**=**	**2080.00**	**x**	**=**	**2080.00**	**=**	
0.00		**00.00**	**0.07**		**145.60**	**÷ 8**	**260.00***	
1050.00		**=**						
x		**105.00**						
0.10		**=**						
725.00	**x**	**108.75**						
0.15								
Total Deduction		**=**	Employee Income Tax	+	Pension Contribution	+	Other Deduction	
Total		**=**	**213.75**	+	**145.60**	+	**260.00**	**=**
			= 213.75	+	145.60	+	260.00	
			= **Br. 619.35**					

* **Contribution to DPPC.**

Net Pay	=	Gross Earnings	-	Total Deduction
	=	2375	-	619.35
	=	**Br. 1755.65**		

Illustration

2. Kebede Petros

Employee Income Tax		**Pension Contribution**	**Other Deduction**	
600.00 x 0.00 96.00 x 0.10 * Contribution to DPPC.	= 00.00 = 9.60	Pension contribution is zero because the employee is a contractual worker.	640.00 ÷ 8	= 80.00*
Total	=			=

Total	=	9.60	Employee	+	Pension	+	Other 80.00
Deduction		Income Tax		Contribution			Deduction
	=	9.60	+	0.00	+		80.00
	=	**Br. 9.60**					
Net Pay	=	Gross Earnings	-	Total Deduction			
	=	696.00	-	89.60			
	=	**Br. 606.40**					

Illustration

3. Abdu Mohammed

Employee Income Tax			Pension Contribution		Other Deduction	
600.00	x	=	1280.00	x	1280.00	=
0.00		00.00	0.07	= 89.60	÷ 8	160.00*
776.00	x	=				=
0.10		77.60				200.00**
Total		= 77.60		= 89.60		= 360.00

* Contribution to DPPC.
** Credit Association Pay.

Total Deduction	=	Employee Income Tax	+	Pension Contribution	+	Other Deduction
	=	77.60	+	89.60	+	360.00
	=	**Br. 608.50**				
Net Pay	=	Gross Earnings	-	Total Deduction		
	=	1376.00	-	527.20		
	=	**Br. 848.80**				

Illustration

4. Jemal Mulugeta

Employee Income Tax		Pension Contribution		Other Deduction	
600.00 x 0.00 410.00 x 0.10	= 00.00 = 41.00	960.00 x 0.07	= 67.20	960.00 ÷ 8	= 120.00*
Total	= 41.00		= 67.20		= 120.00

*Contribution to DPPC.

Total Deduction	= Employee Income Tax	+	Pension Contribution	+	Other Deduction	
	= 41.00	+	67.20	+	120.00	
	= **Br. 291.20**					
Net Pay	= Gross Earnings	-	Total Deduction			
	= 1010.00	-	228.20			
	= **Br. 781.80**					

Illustration

5. Kirkos Teklu

Employee Income Tax⁺		Pension Contribution		Other Deduction	
600.00 x 0.00 5.00 x 0.10	= 00.00 = 0.50	480.00 x 0.07	= 33.60	480.00 ÷ 8	= 60.00*
Total	= 0.50		= 33.60		= 60.00

⁺ Contribution to DPPC.

Total Deduction	=	Employee Income Tax	+	Pension Contribution	+	Other Deduction
	=	0.50	+	33.60	+	60.00
	=	**Br. 94.10**				
Net Pay	=	Gross Earnings	-	Total Deduction		
	=	605.00	-	94.10		
	=	**Br. 510.90**				

ABC Company
Payroll Register
For the Month Ended Sene 30, 2013

No.	Name	Earnings			Gross Earnings	Deductions				Total Deduction	Net Pay
		Basic Salary	Allowance	Overtime		Income Tax	Pension	Contribution to DPPC	Other Deduction		
1	Biniam Hailu	2080.00	100.00	195.00	2375.00	213.75	145.60	260.00	-	619.35	1755.65
2	Kebede Petros	640.00	-	56.00	696.00	9.60	-	80.00	-	89.60	606.4
3	Abdu Mohammad	1280.00	-	96.00	1376.00	77.60	89.60	160.00	200.00	527.20	848.8
4	Jemal Mulugeta	960.00	50.00	-	1010.00	41.00	67.20	120.00	-	228.20	781.80
5	Kirkos					0.50	33.60		-	94.10	510.9

Illustration

II. Record the payment of salary as of Sene 30, 2013

2013			
Sene	Salary Expense	6062.00	
	Employees Income Tax Payable		342.45
	Pension Contribution Payable		336.00
	Credit Association Payable		200.00
	DPPC Payable		680.00
	Cash		4503.55

Illustration

III. Recording the payroll taxes expense for Sene 2013

ABC Company incurred payroll tax expense of Br. 432.00 during Sene 2013. This is because the company has to contribute 11% of the basic salary of every employee to the government pension trust fund. Thus

Total basic salary of all permanent employees (2080 + 1280 + 960 + 480)	x	11 %	=	Payroll taxes expense 528.00

By the amount of Br. 432.00 the company's expense, payroll taxes expense, and pension contributions payable increase. Therefore, the following journal entry is made as of Sene 30, 2013.

Payroll Taxes Expense		528.00	
Pension Payable	Contribution		528.00

Illustration

iv. Recording the payment of deduction from Abdu's earnings to the credit association.

Credit Association Payable		200.00	
	Cash		200.00

v. Recording the payment of DPPC's claim that arose from Sene's payroll assuming that the payment was made on Hamle 1, 2013.

DPPC Payable		680.00	
	Cash		680.00

vi. Recording the payment of withholding and payroll taxes to the Inland Revenue Administration on Hamle 6, 2013.

Employees Income Tax Payable		342.45	
	Cash		342.45
Pension Contribution Payable		864.00	
	Cash		864.00