Correlation between Accounting and Current Liabilities of Manufacturing Companies of India

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Abstract - This paper is based on the relationship between Accounting and Current Liabilities. A current liability is an obligation that is payable within one year. In those rare cases where the operating cycle of a business is longer than one year, a current liability is defined as being payable within the term of the operating cycle. The operating cycle is the time period required for a business to acquire inventory, sell it, and convert the sale into cash. In most cases, the one-year rule will apply.

Keywords: Liabilities, Asset, Manufacturing, Business, Companies

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INTRODUCTION

A current liability is an obligation that is

1) due within one year of the date of a company's balance sheet and

2) will require the use of a current asset or will create another current liability.

If a company's operating cycle is longer than one year, current liabilities are those obligations due within the operating cycle.

Current liabilities are usually presented in the following order:

1. the principal portion of notes payable that will become due within one year

2. accounts payable

3. the remaining current liabilities such as payroll taxes payable, income taxes payable, interest payable and other accrued expenses

A liability is an obligation of a company to pay in future for the present benefits or the acquisition of assets. Short term liabilities are those liabilities which become due within one year. Some of the common short term liabilities are: creditors, short term loans, outstanding expenses, and lease liabilities, tax payable and unearned incomes (income received but not due). Short term liabilities are generally called current liabilities. Table shows financing by current liabilities of some of the well-known companies of India:

Highest			Lowest		
A B B Ltd.	1372.87	58%	National Aluminium Co. Ltd.	607.33	8%
Siemens Ltd.	1275.9	45%	Tata Power Co. Ltd.	731.81	8%
Larsen & Toubro Ltd.	5896.28	45%	Gujarat Ambuja Cements Ltd.	288.98	7%
Hindustan Lever Ltd.	2959.43	44%	Sun Pharmaceutical Inds. Ltd.	166.18	5%
Bharat Heavy Electricals Ltd.	8810.68	43%	Reliance Communications Ltd.	612.62	4%

Table: Current Liabilities as % of Total Liabilities (Rs. Crore) as on 31 Mar 06

Creditors: When revenue goods are purchased on credit it results in a short term liability. Creditors are the money payable to the suppliers of revenue goods. Table shows that quite a large percentage of total current liabilities of some of the well-known companies are in the form of sundry creditors.

Company Name	Current liabilities	Sundry creditors	as %
Tata Motors Ltd.	5903.36	5535.87	94%
Steel Authority Of India Ltd.	6100.87	2111.23	35%
Maruti Udyog Ltd.	1411.2	555.1	39%
Ranbaxy Laboratories Ltd.	728.56	570.46	78%
Larsen & Toubro Ltd.	5896.28	4062.61	69%
I T C Ltd.	2200.09	2152.76	98%
Infosys Technologies Ltd.	808	578	72%

Table: Sundry Creditors (Rs. In Crore) as on 31 March 2006

The cluster of liabilities comprising current liabilities is closely watched, for a business must have sufficient liquidity to ensure that these liabilities can be paid off when due. Since current liabilities are typically paid by liquidating current assets, the presence of a large amount of current liabilities calls attention to the size and prospective liquidity of the offsetting amount of current assets listed on a company's balance sheet. Current liabilities may also be settled through their replacement with other liabilities, such as with short-term debt.

REVIEW OF LITERATURE -

Chakraborty (2008) evaluated the relationship between working capital and profitability of Indian pharmaceutical companies. He pointed out that there were two distinct schools of thought on this issue: according to one school of thought, working capital is not a factor of improving profitability and there may be a negative relationship between them, while according to the other school of thought, investment in working capital plays a vital role to improve corporate profitability, and unless there is a minimum level of investment of working capital, output and sales cannot be maintained - in fact, the inadequacy of working capital would keep fixed asset inoperative.

Garcia-Teruel and Martinez-Solano (2007) studied the effects of working capital management on the profitability of a sample of small and medium-sized Spanish firms. They found that managers can create value by reducing their inventories and the number of days for which their accounts are outstanding. Singh and Pandey (2008) suggested that, for the successful working of any business organization, fixed and current assets play a vital role, and that the management of working capital is essential as it has a direct impact on profitability and liquidity. They studied the working capital components and found a significant impact of working capital management on profitability for Hindalco Industries Limited. The conclusive sum of this retrospective review of relevant literature produced till date on the offered subject reveals wide room for the validity and originates of this work and reflects some decisive evidences that affirm its viability, as may be marked here it. Nor has any previous research examined the liquidity position and the existence of liquidity and profitability relationship of private sector steel companies in India.

The aggregate amount of current liabilities is a key component of several measures of the short-term liquidity of a business, including:

- Current ratio. This is current assets divided by current liabilities.
- Quick ratio. This is current assets minus inventory, divided by current liabilities.
- Cash ratio. This is cash and cash equivalents, divided by current liabilities.

For all three ratios, a higher ratio denotes a larger amount of liquidity, and therefore an enhanced ability for a business to meet its short-term obligations.

Examples of Current Liabilities

The following is a list of current and non- current liabilities:

Examples of Current Liabilities:	
Accounts Payable	Accounts payables are obligations of a company to vendors, suppliers, etc. Such obligations are normally settled with current assets (e.g. cash), and thus, they are considered current liabilities.
Accrued Expenses	Accrued expenses may include accrued (i.e. incurred but not paid) utility charges, insurance payments, and others. Such accrued expenses are usually paid within a year after the balance sheet date, and therefore, they are considered current liabilities.
Examples of Non-current Liabilities:	
Bank Loan	A bank loan that has a maturity date after one year from the balance sheet date is not going to be paid with current assets, and therefore, it is considered a non-current liability. However, if a portion of the loan is due within one year after the balance sheet date, that portion is classified as current liability on the balance sheet and is excluded from the non-current portion of the loan.

CONCLUSION:

In this article we found that a liability is a compulsion of a company to pay in future for the present benefits or the acquisition of assets. Short term liabilities are those liabilities which become due within one year. Accounts payable and accrued expenses are comes under the category of Current Liabilities while Bank Loan is an example of non-current Liabilities.

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Web links -

- http://www.accountingtools.com/current-liability

- http://simplestudies.com/difference-between-current-and-noncurrent-assets-liabilities.html/page/2

- http://www.accountingcoach.com/blog/what-is-a-current-liability