



BU127 Midterm Aid Session
David Di Filippo & Mailon
Kengeswararajah
March 4 2021

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Youtube: We Are Students Offering Support

Welcome: BU 127

Mailon Kengeswararajah

- **1st Year BBA , looking to major in Accounting**
- **Aspiring co-op student**
- **1st Semester with SOS**
- **Loves to play soccer**



David Di Filippo

- **2nd Year BBA , looking to major in Accounting**
- **Co-op student, term 1 begins Fall 2021**
- **Huge leafs fan, big hockey guy**
- **Mob movie fanatic**
- **Second semester with SOS**



Let's Begin!

Ch 1 Financial Statements and Business Decisions

Business Operations



*On Credit = Cash is paid later

Business Decision Makers

There are numerous individuals who need to make decisions regarding a company

- **Suppliers**
- **Customers**
- **Creditors**
- **Investors**
- **Managers**

SHAREHOLDERS!

These people need to be aware of the financial wellbeing of the company in order to make informed decisions

The Accounting System

Accounting provides information about the financials of a company to decision makers

Collect. Process. Report. (CPR)

Split into two categories

BU127!

Managerial Accounting	Financial Accounting
Reports information to internal decision makers <ul style="list-style-type: none">- People within the company- Managers, employees, etc.	Reports information to external decision makers <ul style="list-style-type: none">- People outside of the company- Investors, customers, suppliers, etc.

4 Financial

Statements

Statement of Financial Position (Balance Sheet)

Statement of Comprehensive Earnings (Income Statement)

Statement of Changes in Equity

Statement of Cash Flows

Statement of Financial Position (Balance Sheet)

Reports the amount of Assets, Liabilities, and Owners Equity

- **Assets:** Resources *owned* by the company
- **Liabilities:** Debts/Legal company's *obligations*
- **Owners Equity:** Part of company owned by Owners

Accounting Equation: Assets = Liabilities + Owners Equity

- **Must balance for every journal entry and on the Statement of Financial Position**
- **Great way to double check work!**

Typical Account Names

Assets (Anything of value the company owns)	Liabilities (Anything of Value the company owes)	Owners' Equity
Cash	Notes Payable	Contributed Capital
Accounts Receivable	Accounts Payable	Retained Earnings
Allowance for Doubtful Accounts	Wages Payable	
Inventory	Interest Payable	
Supplies	Unearned Revenues	
Prepaid Insurance	Mortgage Loan Payable	
Land	Bonds Payable	
Buildings		
Equipment		
Vehicles		
Accumulated Depreciation Buildings		
Accumulated Depreciation Equipment		
Accumulated Depreciation Vehicles		

How to Make a Statement of Financial Position

Example Company Balance Sheet December 31, 2018			
ASSETS		LIABILITIES	
Current assets		Current liabilities	
Cash	\$ 2,100	Notes payable	\$ 5,000
Petty cash	100	Accounts payable	35,900
Temporary investments	10,000	Wages payable	8,500
Accounts receivable - net	40,500	Interest payable	2,900
Inventory	31,000	Taxes payable	6,100
Supplies	3,800	Warranty liability	1,100
Prepaid insurance	1,500	Unearned revenues	1,500
Total current assets	<u>89,000</u>	Total current liabilities	<u>61,000</u>
Investments	<u>36,000</u>	Long-term liabilities	
Property, plant & equipment		Notes payable	20,000
Land	5,500	Bonds payable	400,000
Land improvements	6,500	Total long-term liabilities	<u>420,000</u>
Buildings	180,000		
Equipment	201,000	Total liabilities	<u>481,000</u>
Less: accum depreciation	(56,000)		
Prop, plant & equip - net	<u>337,000</u>		
Intangible assets		STOCKHOLDERS' EQUITY	
Goodwill	105,000	Common stock	110,000
Trade names	200,000	Retained earnings	220,000
Total intangible assets	<u>305,000</u>	Accum other comprehensive income	9,000
Other assets	<u>3,000</u>	Less: Treasury stock	(50,000)
Total assets	<u>\$ 770,000</u>	Total stockholders' equity	<u>289,000</u>
		Total liabilities & stockholders' equity	<u>\$ 770,000</u>

Step 1: Headings

1. Company Name
2. "Statement of Financial Position"
3. As of "the date" (**Snapshot** of financials at a point in time)

Step 2: Assets

1. Make Assets Heading
2. List Assets in order of liquidity
3. Add up and list Total Assets

How to Make a Statement of Financial Position (Cont.)

Example Company Balance Sheet December 31, 2018			
ASSETS		LIABILITIES	
Current assets		Current liabilities	
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Other assets	3,000	Less: Treasury stock	(50,000)
Total assets	\$ 770,000	Total stockholders' equity	289,000
		Total liabilities & stockholders' equity	\$ 770,000

Step 3: Liabilities

1. Make Liabilities Heading
2. List Liabilities in order of order they're due
3. Add up and list Total Liabilities

Step 4: Owners Equity

1. Make Owners Equity Heading
2. List Owners Equity
3. Add up and list Total Owners Equity

Step 5:

1. Add together Liabilities and Owner's Equity
(REMEMBER THE EQUATION!); they equal Total Assets

Statement of Comprehensive Earnings

Purpose: To report the company's earnings (income) in a given period

EARNINGS = REVENUE - EXPENSES

Revenue: Earnings made from the sale of goods and services

Expenses: Resources expended in order to make revenue

How to make an income statement

XXX COMPANY		
Statement of Comprehensive Earnings		
For the Month Ended September 30 th , 2018		
Revenues		
Sales	\$50,000	
Music Lesson Income	<u>70,000</u>	
Total Revenues		120,000
Expenses		
Cost of Goods Sold	20,000	
Wage Expense	35,000	
Rent Expense	1,000	
Supplies Expense	<u>500</u>	
Total Expenses		<u>56,500</u>
Net Income		<u>\$63,500</u>

Step 1: Headings

1. Company Name
2. “Statement of Comprehensive Earnings”
3. Period ended “For the month ended”

Step 2: Revenue

1. List all Revenues from biggest to smallest
2. Add up and list Total Revenues

Step 3: Expenses

1. List all Expenses (preferably alphabetically)
2. Add up and list Total Expenses

Step 4: Net Income

1. Subtract Total Revenue from Total Expenses to get Net Income

Accrual Based Accounting

Revenues are recorded in the period the event happens

Not necessarily when cash is earned

Example: You teach someone guitar in September 2019 but they pay you in March 2020

The revenue was earned in September 2019 and would be recorded in Septembers income statement, despite you not getting paid until March 2020

- Balanced through the debit/credit offset
- i.e Revenue (credit) goes up and A/R (debit) goes up, increase in OE and Assets to make equation equal

Statement of Changes in Equity

Beginning Shareholders Equity

+ **Net Income**

+ **Other comprehensive
Income**

- **Dividends**

- **Drawings**

+/- **Other changes**

End Shareholders Equity

Retained Earnings VS. contributed capital

Retained Earnings - Total earnings of a company

Example: If in 2018, Joe's Java's net earnings were \$10,000, and in 2019 their net earnings were \$15,000. Then at the end of 2019, their retained earnings account would say \$25,000

Any changes in income affect retained earnings

Contributed Capital - Capital from shareholders (in exchange for shares of the company)

Example: If in 2019 Joe's Java sells 100 common shares for 5 dollars than their contributed capital will be \$500. However, if in 2019 they also give out \$100 in dividends, than contributed capital will only be \$400.

Any change in shares/stocks and dividends will affect contributed capital

Notes

Be sure to read the notes on the financial statements before starting a question!

Notes will do one of three things

1. Describe accounting rules applied
2. Provide additional details about about an item or account on a statement
3. Provide additional details about about an item or account not on a statement

Relationship between Statements

XXX COMPANY Statement of Comprehensive Earnings For the Month Ended September 30 th , 2018		
Revenues		
Sales	\$50,000	
Music Lesson Income	<u>70,000</u>	
Total Revenues		120,000
Expenses		
Cost of Goods Sold	20,000	
Wage Expense	35,000	
Rent Expense	1,000	
Supplies Expense	<u>500</u>	
Total Expenses		<u>56,500</u>
Net Income		<u>\$63,500</u>

XXX COMPANY Statement of Changes in Equity For the Month Ended September 30 th , 2018		
	Contributed Capital	Retained Earnings
Balance, September 1	\$15,000	\$36,500
Net income		<u>63,500</u>
Issuance of Shares	1,000	
Distribution of Dividends	<u>(4,000)</u>	
Balance, September 30	<u>\$12,000</u>	<u>\$100,000</u>

Net income from statement of comprehensive income is found on the statement of changes in equity

Relationship between statements

XXX COMPANY Statement of Financial Position At September 30, 2018		
SHAREHOLDER'S EQUITY		
Contributed Capital	12,000	
Retained Earnings	<u>100,000</u>	
Total Shareholder's Equity		<u>112,000</u>
Total Liabilities and Shareholder's Equity		<u>250,000</u>

XXX COMPANY Statement of Changes in Equity For the Month Ended September 30 th , 2018		
	Contributed Capital	Retained Earnings
Balance, September 1	\$15,000	\$36,500
Net income		63,500
Issuance of Shares	1000	
Distribution of Dividends	(4,000)	
Balance, September 30	<u>\$12,000</u>	<u>\$100,000</u>

End retained earnings & contributed capital on statement of changes in equity = retained earnings and contributed capital on statement of financial position.

*Good way to check if you have properly completed the statement of changes in equity

Financial Statement Regulations

Businesses need to comply to numerous rules and regulations while making financial statements

Decision makers use these rules to:

- understand the financial statements internationally
- make informed decisions

The two standard set of regulations are:

GAAP: Generally accepted accounting principles

IFRS: International Financial Reporting Standards

IFRS VS. GAAP

IFRS	GAAP
<ul style="list-style-type: none">- Principles Based- Required for all public companies- Allows for easy comparison of Public companies	<ul style="list-style-type: none">- Rules Based- Used by private companies- State that companies must incur the cost of preparing financial statements and bear the following economic consequences<ul style="list-style-type: none">- Effects on selling price of shares- Effects on bonuses received by employers- Loss of competitive information

History of IFRS and GAAP

Prior to 1933 companies could report their financial information however they wanted

- In 1933, the US Congress created the Securities Act
- In 1934, the US Congress created the Securities and Exchange Act

These two acts created the securities and exchange commission

-The canadian equivalent is the Ontario Securities Commission (OSC)

OSC establishes groups that are given the responsibility of formulating accounting rules

- This group in Canada is the Accounting Standards Board (AcSB).
- They formulate and regulate GAAP

Auditors

Management prepares financial statement

- Since management makes the statements, they have incentive to lie on them

Auditors

- Ensure statements comply with GAAP
- Examine the transactions associated with the financial statements
- Provide their opinion on the accuracy / fairness of the statements

CPAB (Canadian Public Accountability Board) issues the standards auditors must follow

CPA Code of Ethics

- **CPAs (Chartered Professional Accountants) are those who conduct audits**
 - **They are required to adhere to a code of ethics**
 - **An honourable reputation is a CPA's most valuable asset**

Appendix 1: Three types of Businesses

	Sole Proprietorship	Partnership	Corporation
What is it	- Owned by 1 person	- Owned by two or more individuals	- Firm that acts as a separate legal entity from its owners - Ownership is represented by shares and stock
Pros	Simple set-up with few legal requirements	Flexible tax structure and limited liability	- Raise large sums of money by selling shares - Limited Liability - Continuity of Life - Ease of transfer of ownership
Cons	100% unlimited liability for business income, losses, and debt	-Unlimited liability -May require additional legal fees	- Double taxation - Income is taxed when earned AND when distributed as dividends

Chapter 2

Investing and Financing Decisions, and the Statement of Financial Position

Conceptual Framework of Accounting

- **The framework prescribes the nature, function, and limitations of both financial accounting and financial statements**
- **The framework outlines the:**
 - Objective of External Financial Reporting
 - Qualitative Characteristics of Useful Accounting Information
 - Elements to Be Reported
 - Concepts for Measuring and Reporting Information

Objective of External Financial Reporting

External Financial accounting

- Accounting & reporting for external users such as suppliers, banks, customers, investors, potential investors, and tax authorities.

“To provide useful economic information to external users for decision making and assessing future cash flows”

Qualitative Characteristics of Useful Accounting Information

Accounting information should have these characteristics to be useful

RELEVANCE	Can make a difference in decisions
FAITHFUL REPRESENTATION	Free from error or bias
COMPARABILITY	Can be compared to other companies
VERIFIABILITY	An independent audit will find similar results
TIMELINESS	Information is available while its still useful
UNDERSTANDABILITY	Reasonably informed users see its usefulness



= Necessary to be useful



= Enhances usefulness but not necessary

Elements to be Reported

Financial reporting must record the following elements:

- Assets
- Liabilities
- Shareholders Equity
- Revenues
- Expenses
- Gains
- Losses

Gain = An increase in assets or a decrease in liabilities from peripheral (period to period) activities
Loss = increase in liabilities or decrease in assets from peripheral activities

Measuring and reporting information concepts

- **3 Assumptions**

- **Separate Entity** – Business activities are separate from the owners activities

- Ex. If Jeff Bezos spend \$10,000,000 on a yacht, this is not reported on Amazon's financial statements

- **Continuity/Going Concern** – The business is assumed to continue operating in the foreseeable future

- **Stable Monetary Unity** - Accounting measurements are in the national monetary unit (\$CAD) and are not adjusted for inflation

- **1 Principle**

- **Historical Cost** - Assets are recorded at the value the company originally acquired them for

- Ex. A company buys land in 1999 in Toronto for \$500,000. Now the land is worth \$2,000,000. On the balance sheet the land will still be recorded at value (\$500,000).

Classified Statements of Financial Position

- Statements of Financial Positions (balance sheets) are classified when assets and liabilities are broken down into further categories
- **Assets are broken down into**
 - Current Assets
 - Non-current Assets
- **Liabilities are Broken down into**
 - Current Liabilities
 - Non-current Liabilities

Current Vs. Non-current Assets

	Current Assets	Non-current Assets
Definition	Assets that will be used or turned into cash in a year or less	Assets that will be used or turned into cash in greater than one year
Example	<ul style="list-style-type: none">• Cash• Inventories• Accounts Receivable• Short-Term Investments• Prepaid Expenses	<ul style="list-style-type: none">• Land• Equipment• Buildings• Intangibles• Goodwill

Current Vs. Liabilities

Non-current

	Current Liabilities	Non-current Liabilities
Definition	Liabilities that will be paid for or settled within 1 year or less	Liabilities that will be paid for or settled in greater than one year
Example	<ul style="list-style-type: none">• Accounts Payable• Income Tax Payable• Accrued Liabilities• Short-Term Borrowings	<ul style="list-style-type: none">• Long-Term Debt• Provisions

Classified Statements of Financial Position cont.

XXX COMPANY		
Statement of Financial Position		
At September 30, 2018		
ASSETS		
Current Assets		
Cash	\$33,000	
Accounts Receivable	45,000	
Inventories	<u>6,000</u>	
Total Current Assets		84,000
Non-Current Assets		
Equipment	11,000	
Building	89,000	
Land	<u>66,000</u>	
Total Non-Current Assets		<u>166,000</u>
Total Assets		<u>250,000</u>
LIABILITIES		
Current Liabilities		
Accounts Payable	<u>70,000</u>	
Total Current Liabilities		70,000
Non-Current Liabilities		
Notes Payable	8,000	
Long-Term Liabilities	<u>60,000</u>	
Total Non-Current Liabilities		<u>68,000</u>
Total Liabilities		138,000
SHAREHOLDER'S EQUITY		
Contributed Capital	12,000	
Retained Earnings	<u>100,000</u>	
Total Shareholder's Equity		<u>112,000</u>
Total Liabilities and Shareholder's Equity		<u>250,000</u>

- Same steps as previous Statement of Financial Position
- Only differences:
 - Add headings for each subsection
 - Total each subsection

Nature of Business Transactions

Two kinds of business transactions

- **External Events**

- Exchange between a business and one or more other parties
 - E.g. buying supplies from a supplier

- **Internal Events**

- Exchanges that aren't with outside parties, but still have an effect on the company
 - E.g. loss due to fire damage

Nature of Business Transactions cont.

- With each transaction, the accounting equation must stay in balance
- This is called the “duality of effects”
- All transactions (internal and external) affect at least two accounts

ASSETS = LIABILITIES + OWNERS EQUITY MUST ALWAYS BALANCE

Balancing the Accounting Equation

- 1. Identify and classify accounts and effects**
 - Identify the accounts that are affected and make sure that two accounts are changing
 - Classify them by type of account. Was each account an Asset (A), Liability (L) or shareholder's equity (SE)
 - Determine the direction of the effect
- 2. Verify the accounting equation stays in balance**
 - After each transaction make sure the directions of the effect offset in the accounting equation

Accounting Cycle

During the period (Chapters 2/3)

- Analyze transactions
- Record Journal Entries
- Record T-Accounts

End of the period (Chapter 4)

- Adjust revenues and expenses and related statement of financial position accounts (record in journal and post to T-accounts)
- Prepare a complete set of financial statements
- Close revenues, gains, expenses, and losses to Retained Earnings (record in journal and post to ledger)

Journal Entry

- The general journal records all company transactions in chronological order

October 17th		Debit	Credit
(a)	Cash (A+)	10	
	Equipment (A-)		10
(b)	Inventory (A+)	20	
	Account Payable (L+)		12
	Cash (A-)		8

Reference letter/number and date required to identify transaction

Debited Accounts on top, credited accounts on bottom and indented

Debit amounts on left, credited amounts on right

Debits and Credits

Assets = **Liabilities** + **Owners Equity**
(Revenue & Expenses)

↑ with debits

↑ with credits

↑ with credits

**Accounts have
debit balances**

**Accounts have
Credit Balances**

**Accounts have
Credit Balances**

EVERY TRANSACTION SHOULD BALANCE THIS EQUATION!!

T-Accounts

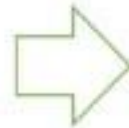
- **T-accounts are updated every time a transaction is recorded in the general journal**
 - T-accounts are primarily used as a more efficient way to determine account balances following transactions
 - Left side of T-account for debit balances, right side for credit balances



Journal Entry and T-account

- After every journal entry, reinput the dollar amount from each account in the transaction in a T-account

October 17th		Debit	Credit
(a)	Cash (A+)	10	
	Equipment (A-)		10
(b)	Inventory (A+)	20	
	Account Payable (L+)		12
	Cash (A-)		8



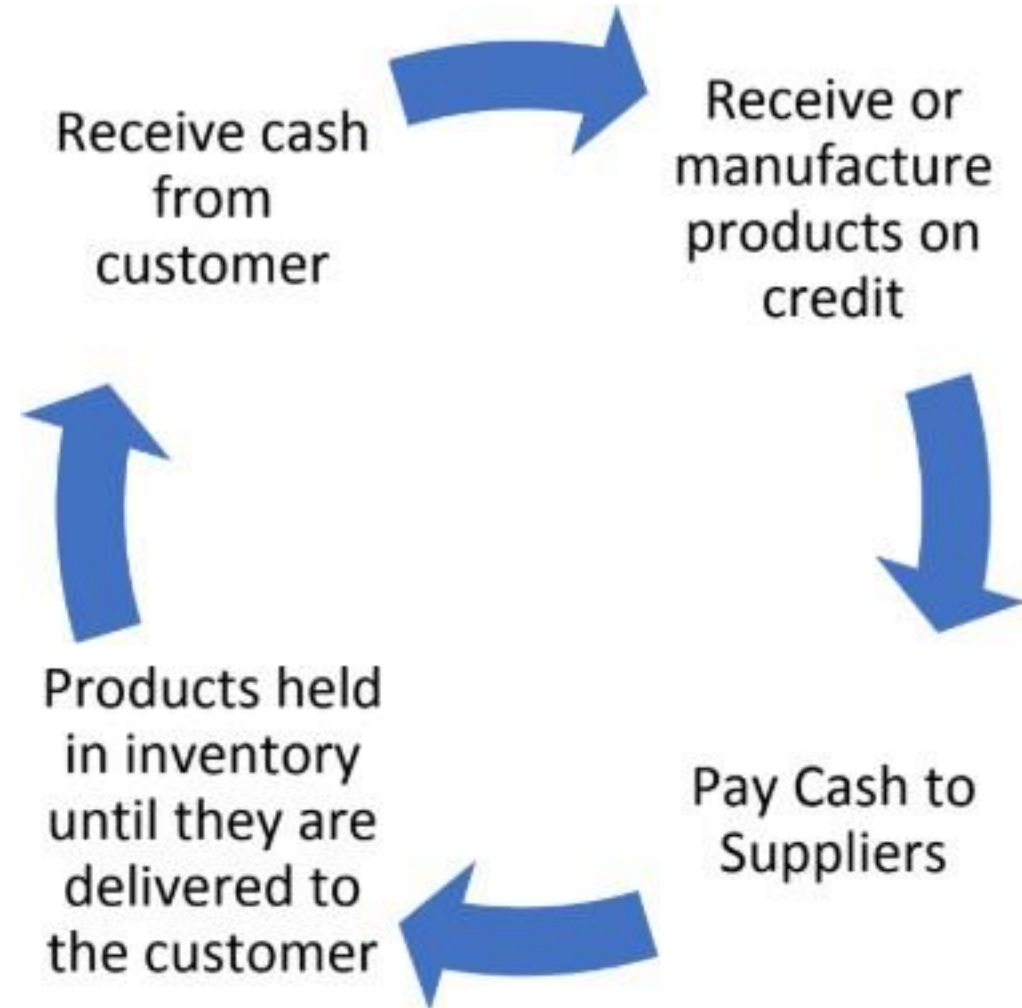
Cash	Equipment	Inventory																																				
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Chapter 3

Operating decisions and the statement of earnings

Operating Cycle

- **The Operating cycle represents the time it takes for cash paid to suppliers to turn into cash earned from customers.**
- **Completion Time depends on nature of the business**



Periodicity Assumption

In **accounting**, **periodicity** means that **accountants** will assume that a company's complex and ongoing activities can be divided up and reported in annual, quarterly and monthly financial statements.

- Annually, Semi annually, Quarterly

Statement of Earnings

- **Report flows of revenue and expenses for a given time period**
 - **Revenues: Increase in assets or settlement of liability from ongoing operations**
 - **Expenses: Decrease in asset or increase in liability from ongoing operations**

Revenue – Expenses + Gains – Losses = Net Income

Expenses and Revenues

REVENUES – CREDIT

EXPENSES - DEBITED

eg: paid rent expense

Rent Expense (-L)

10,000 Cash (-A) 10,000

Accounting Equation must remain in balance after each Transaction:

Assets = Liabilities + Shareholder's Equity

Single Format vs. comprehensive income statement

- **Results from Continuing Operations can be presented in two formats:**
 1. **Single Step Format – list all revenues, followed by all expense items and then show the difference between the two (Net Income/Earnings)**
 2. **Multiple Step Format – Cost of Goods sold are deducted from sales to present gross profit, then operating expenses are deducted to present income as a second subtotal**

Cash Basis vs. Accrual Basis

Cash Basis:

- Revenue is recognized when cash is received
- Expenses are recorded when they are paid
- GAAP does not allow cash basis accounting

Accrual Basis:

- Revenues and Expenses recognized when transactions that caused them occurred and not necessarily when cash is paid or received
- Required by GAAP and IFRS

Revenue Recognition principle

- The revenue recognition principle is a cornerstone of accrual accounting
- The revenue recognition principle using accrual accounting requires that revenues are recognized when realized and earned—not when cash is received.

- **Recognizes revenue when:**

- A. The “risks and rewards” of the ownership are transferred to the buyer
- B. The seller does not retain involvement or control of the good sold
- C. Collection is reasonably assured and measurable
- D. Relating costs can be measured reliably

Revenue Recognition Principle

- **Cash received before company delivers good or service**
 - **Liability account Deferred revenue gets recorded**

Cash (+A)	xxx	
Deferred revenue (+L)		xxx
Deferred revenue (-L)	xxx	
Service revenue (+R)		xxx

Revenue recorded when earned/when the company delivers

- **Cash received after the company delivers good or service**
 - **Asset account: account receivable is debited**

Accounts receivable (+A)	xxx	
Revenue (+R)		xxx
Cash (+A)	xxx	
Accounts receivable (-A)		xxx

Revenue recorded when earned/when the company delivers, Cash recorded when received

Revenue Recognition Principle

Example

- **You are a plumber. Someone pays you \$1,000 to fix their pipes. You get paid Today. Even though you aren't fixing their pipes until six months from now. Therefore the journal entry would be a \$1,000 debit to cash, and a \$1,000 credit to deferred revenue. Than in six months from now, once you fix the pipes, you credit deferred revenue and credit service revenue.**

Expense Matching Principle

- **Resources consumed to earn revenues in an accounting period should be recorded in that period, regardless of when cash is paid.**
 - **Costs incurred to generate revenue must be recognized in the same period.**

Expense Matching Principle

- **Cash paid before company receives good or service**
 - **Asset account prepaid expenses is debited**

Prepaid expense (+A)	xxx	
Cash (-A)		xxx

Expense (+E)	xxx	
Prepaid expense (-A)		xxx

Expenses recorded when incurred

- **Cash is paid after company receives good or service**
 - **Liability account Accounts Payable is credited**

Expense (+E)	xxx	
Accounts Payable (+L)		xxx

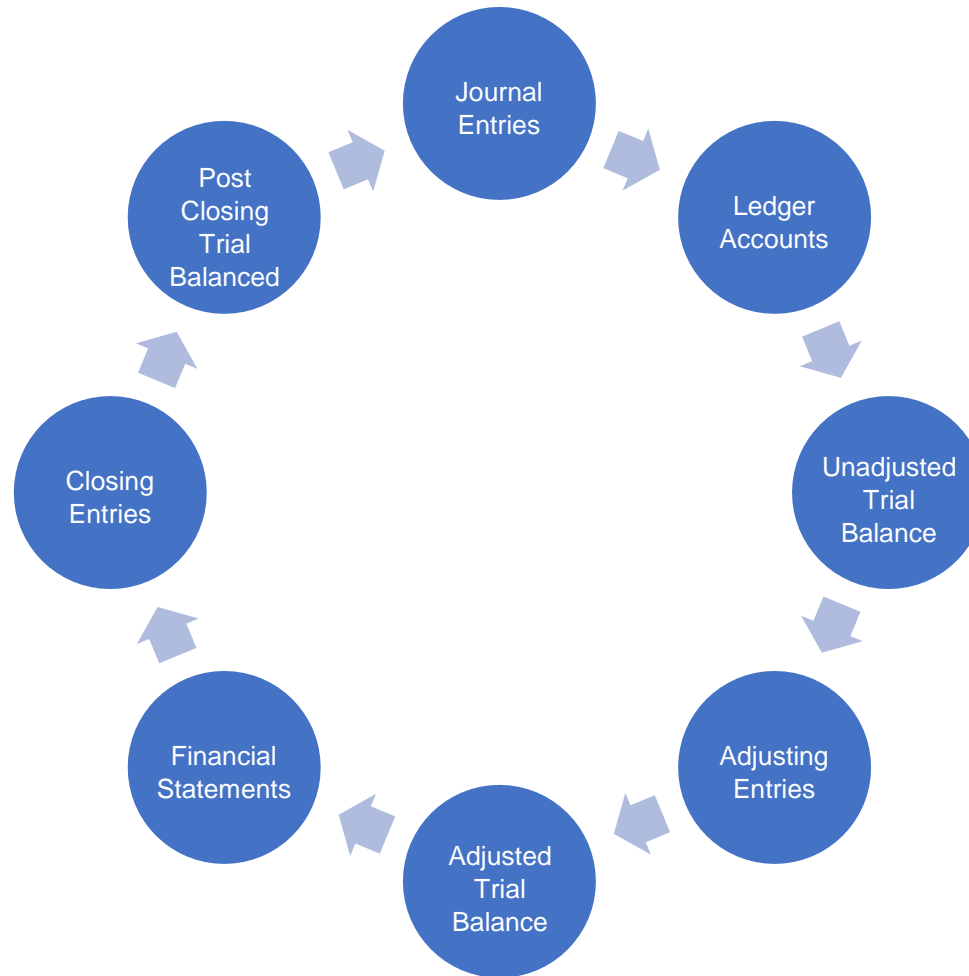
Accounts Payable (-L)	xxx	
Cash (-A)		xxx

Accounts Payable removed when cash is paid

Chapter 4

Adjustments, Financial Statements, and the Quality of Earnings

The Accounting Cycle



Unadjusted Trial Balance

Jonas Rentals			
Unadjusted Trial Balance			
December 31 2017			
	Debit	Credit	
Cash	\$11,440		
Accounts receivable	20,800		
Supplies	8,740		
Prepaid insurance	3,480		
Equipment	62,400		
Accumulated depreciation—equipment		\$29,120	
Accounts payable		5,200	
Interest payable		0	
Notes payable		5,000	
Unearned revenue		7,280	
Salaries and wages payable		0	
Common shares		10,400	
Retained earnings		3,840	
Service revenue		60,940	
Salaries and wages expense	10,400		
Insurance expense			
Interest expense	360		
Depreciation expense			
Supplies expense			
Rent expense	4,160		
	<u>\$121,780</u>	<u>\$121,780</u>	

Key Details

- Same format as other sheets (company name, title...)
- Single underline vs double underline!
- **DEBITS = CREDITS!**



EASY MARKS

Adjusting Entries & Adjusting Trial Balance

- **Adjusting entries**: Journal entries made at the end of the accounting period to ensure that the revenue recognition and matching principal are followed
 - **Purpose**: Since transactions occur over time, adjustments are required at the end of each fiscal period to ensure that the revenues & expenses are recorded in the “right” period
- **Adjusted trial balance**: a list of all open accounts in the ledger and their balances taken immediately after all adjusting entries have been made

Types of adjustments

Revenues

- **Deferred Revenues:** Cash that was received prior to delivery of goods or services
- **Accrued Revenues:** Revenues that are earned but have not been recorded

EXPENSES:

- **Deferred Expenses:** When cash is paid for before the company receives the benefit of the good or service
- **Accrued Expenses:** Expenses that have been incurred but not recorded

Example 1: Accrued Revenue

SOS Inc sold Jason 75 printers for \$170 each on December 30th, and they agreed that the full amount will be paid some time in next January

Date	Account	Debit	Credit
30-Dec	Accounts Receivable- Jason	\$12,750	
	Sales Revenue		\$12,750

Example 1: Accrued Revenue

On January 1st, Jason finally paid SOS the amount that he owed SOS Inc for the printers

Date	Account	Debit	Credit
1-Jan	Cash	\$12,750	
	Accounts Receivable- Jason		\$12,750

Example 2: Accrued Expenses

Window Cleaning company is depreciating its equipment at the end of the fiscal year using the straight-line method. It is estimated that the useful life of the equipment is 5 years. The equipment account has an amount of \$105,000.

Date	Account	Debit	Credit
31-Dec	Depreciation Expense	\$21,000	
	Accumulated Depreciation- Equipment		\$21,000

Example 3: Accrued Expenses

At year end, Goldenhawk company recounted its inventory and realized that the amount of supplies was overstated by \$225

Date	Account	Debit	Credit
31-Dec	Supplies Expense	\$225	
	Supplies		\$225

Example 4: Deferred Revenue

On December 31st (Fiscal Year end), we record the earned portion of \$75 for Ryan's magazine subscription which he previously paid in advanced on Dec. 1st

Date	Account	Debit	Credit
Dec 1st	Cash	\$75	
	Deferred Revenue		\$75

Adjusting

Date	Account	Debit	Credit
31-Dec	Deferred Revenue	\$75	
	Revenue- Subscription		\$75

Example 6: Deferred Expenses

Kelly pays \$1,000 per month for rent. On September 30th, Kelly pays for the remainder of the year in advance. 3 months have past and it is now December 31st.

Original Entry
(When initial
transaction
occurred)

Date	Account	Debit	Credit
Sept 30th	Prepaid Rent	\$3,000	
	Cash		\$3,000

Adjusting entry
(end of period)

Date	Account	Debit	Credit
31-Dec	Rent Expense	\$3,000	
	Prepaid rent		\$3,000

Closing the Books

Why?

The account balances of the Statement of Financial Position carry over from period to period, whereas the accounts of the income statement **DO NOT**.

What?

- Transfer of Net Earnings (Loss) to Retained Earnings
- Establish a **ZERO** balance in Temporary Accounts

Steps to Closing the Books

4 steps:

- Step # 1** Close revenue and gains into Income Summary
- Step 2** Close expenses and losses into Income Summary
- Step 3** Close the Income Summary into the Retained Earnings
- Step 4** Close dividends into the Retained Earnings

Closing Entries

Mowing revenue (−R)	5,600	
Income summary (+T)		5,600
Income summary (−T)	4,951	
Fuel expense (−E)		410
Wages expense (−E)		4,030
Insurance expense (−E)		50
Utilities expense (−E)		52
Depreciation expense (−E)		38
Interest expense (−E)		22
Income tax expense (−E)		349
Income summary (−T)	649	
Retained earnings (+SE)		649

Credit Expenses and Debit Revenues.

To balance the equation, you use income summary

Statement of Changes in Equity

The **statement of changes in equity** shows the **change** in an owner's or shareholder's **equity** throughout an accounting period.

	Contributed Capital	Retained Earnings	Accumulated Other Comprehensive Income	Shareholders' Equity
Beginning balance	\$18,421	\$28,681	\$(66)	\$47,036
Issuance of shares	1,300			1,300 ←
Net earnings		498		498 ←
Distribution of dividends		(200)		(200) ←
Ending balance	<u>\$19,721</u>	<u>\$28,979</u>	<u>\$(66)</u>	<u>\$48,634</u> ←

CHAPTER 6

Reporting and Interpreting sales Revenue, Receivables, and Cash

Sales Revenue

Businesses can

- Allow customers to pay on credit
- Provide Discounts
- Allow Returns

Remember: All of these lead to a reduction in sales revenue (a debit balance)

These items are also known as contra revenue accounts

Sales Revenue cont.

Credit Card Sales Example

Assume Visa charges the business a 4% fee for all sales accepted on credit and you make a \$2000 sale, and the customer uses visa.

Accounts receivable	\$1920	
Credit Card Discount	\$80	
Sales Revenue		\$2000

Discount Sales

2/10 n/30 is extremely common in business, and is when clients can opt to either receive a 2 percent discount for payment to a vendor within 10 days or pay the full amount (net) of their accounts payable in 30 days.

Discount Sales cont.

E.g. On Jan 1st, Walter White Corporation sold safety boots to Lenny on terms 2/10 n/30

January 1'st

Trades Receivables	\$2000	
Sales Revenue		\$2000

Lets say he pays on January 5th

Cash	\$1960	
Sales Discount		\$40
Trades Receivables		\$2000

Sales Returns and Allowances

E.g. \$200 worth of products are defected and a customer wants to return them

Sales Returns and Allowances

\$200

Cash

\$200

Effect on Net Sales

Sales Revenue		\$2,000.00
Less:		
Credit Card Discount	\$ 80.00	
Sales Discounts	\$ 40.00	
Sales Returns and All	<u>\$ 200.00</u>	<u>\$ 320.00</u>
Net Sales		<u><u>\$1,680.00</u></u>

Accounting for Bad Debts

Bad Debt Expense: The expense associated with uncollectible trades receivables (they aren't gonna pay you)

Recorded in the journal at the end of the accounting period



Estimating Bad Debts

There are two methods of estimating bad debts:

- Aging of trade receivables method
- Percentage of credit sales method

Aging of Trade Receivables

Method

Focus is on determining the desired balance in the Allowance for Doubtful Accounts on the balance sheet.

Need to look at an aging schedule, which breaks down A/R amounts currently due and those overdue by various number of days.

Aging of Accounts E.g.

Acton owes you 235, however it was due 1 week ago

Baxter owes you 1500, 1200 isn't due yet and 300 was due 4 days ago

Chung owes you 750, 50 was due 35 days ago, 200 63 days ago, and 500 210 days ago

Zara owes you 325 due 35 days ago

Aging of Accounts E.g. (cont)

Based on past experience on overdue accounts:

1-30 days = 2% uncollectable

31-60 = 5% uncollectable

61-90 = 10% uncollectable

90+ = 35%

Aging of Accounts E.g. (cont)

Customer	Not Yet Due	Days Past Due				Total A/R Balance
		1-30	31-60	61-90	Over 90	
Acton, R.		\$ 235				\$ 235
Baxter, T.	\$1,200	300				1,500
Chung, J.			\$ 50	\$ 200	\$ 500	750
Zahra, R.			325			325
Total	\$1,200	\$ 535	\$ 375	\$ 200	\$ 500	\$ 2,810
% Uncollectable		0.02	0.05	0.10	0.35	
Uncollectable Accounts		11	19	20	175	225

Aging of Accounts E.g. (cont)

- Uncollectable Accounts = \$225
- If balance in AFDA is = \$125
- Adjust only for the difference!

Dr. Bad Debt Expense \$100
 Cr. AFDA \$100

Allowance for Doubtful Account	
Dr	Cr
	125
	100 Bad Debt Expense
	225

% of Credit Sales Example

During 2014, for ABC Inc. sales totaled \$24M. Net credit sales amounted to 25% of sales. Through 2014, the company recorded bad debt expense of 2% of net credit sales. What is the bad debt expense during the year?

Bad Debt Expense	\$120,000
AFDA	\$120,000

(AFDA = Allowance for doubtful accounts)

% of Credit Sales (Cont.)

On June 30, 2014 the company received notification that a major customer, Green Company Limited had gone bankrupt with no expectation of recovering any of the outstanding balance of \$250,000. Record the write off of the Green Company Limited.

AFDA

\$250,000

Accounts receivable

\$250,000

% of Credit Sales

On September 30 2014 the company did receive notice that the Receiver would be providing a recovery of 15% of the outstanding balance. Record the partial recovery of the account.

AR		\$37,500	
	AFDA		\$37,500
Cash		\$37,500	
	AR		\$37,500

Internal Controls

Internal controls refer to the policies and procedures created by businesses in an effort to:

- Properly account for Assets the company owns
- Safeguard Assets, especially easily manipulated ones such as Cash
- Ensure the accuracy of Financial Statements for internal and external decision makers

One internal control is designed to protect the asset that happens to be most susceptible to theft and fraud, is called the Separation of Duties. To make it more difficult for cash to be stolen, tasks must be accomplished by more than one individual.

Bank Reconciliations

The balances as reported on the bank statement may differ from what is reported on a company's books because of how and when tasks are reported. Bank and Cash reconciliations help explain the difference between cash reported by the bank and the cash balance the business itself states.

Important terms:

- NSF cheque: A bad cheque or bounced cheque
- Interest: The bank paying us interests for our savings
- Deposits in transit: Deposits recorded on our books but not by bank
- Outstanding cheques: Cheques written to people that they haven't cashed in yet
- Errors: people make errors all the time

Bank Reconciliation Template

Ending Balance for Book

Add:

Interest

Deduct:

NSF Cheques

Service Charges

Ending Correct Cash Balance

Ending Cash balance for Bank

Add:

Deposits in transit

Deduct:

Outstanding cheques

Ending Correct Cash Balance

Ethical Decisions

Ensure when making ethical decisions that you complete these steps:

1. Identify the ethical Issue
2. Specify the alternatives
3. Identify the people involved
4. Assess the outcomes
5. Determine the best solution

CHAPTER 7

Reporting and Interpreting Cost of Sales and Inventory

Inventory

Inventory is a tangible property listed under Current Assets

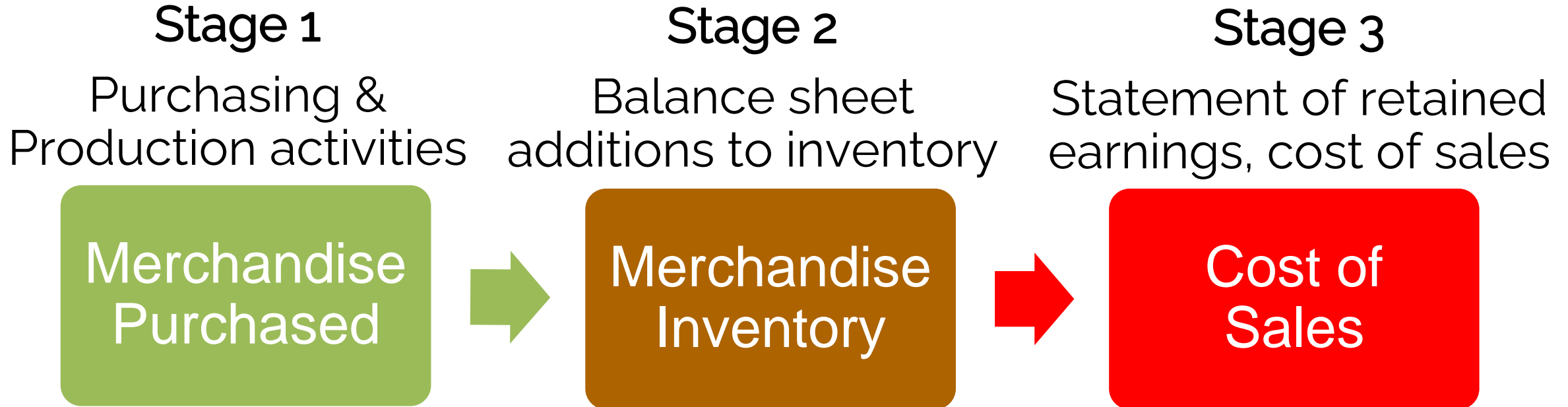
- Merchandise Inventory: Held for sale in the normal course of business
- Used to produce goods or services for sale – Raw Materials Inventory, Work in Process Inventory, Finished Goods Inventory

Cost Principle: requires that inventory be recorded at the price paid or the consideration given.

- Inventory Costs includes the sum of all costs incurred in bringing the asset to saleable/usable condition or location.
 1. Invoice Price
 2. Shipping (freight)
 3. Inspection Costs
 4. Preparation Costs (Costs (ex. wages) incurred over the period after inventory is ready for sale)
 5. Minus: returns & allowances

Flow of Inventory Costs

For a merchandiser (reseller)



Nature of Costs of Sales

COGS (Cost of Goods Sold): is the cost of inventory involved in the sales transaction



Two Inventory Systems

Perpetual System

- Accounts for changes in inventory on an ongoing basis (per transaction)
- Provides up-to-date inventory and COGS records
- Purchase transactions are recorded directly in an inventory account.

Periodic System

- Adjusts for the changes in inventory at points in time throughout the year
- Ending inventory and cost of sales are determined at the end of the accounting period based on physical counts

Periodic

- Beginning Inventory is carried over from the prior period Purchases are accumulated in the Purchases Account
- Beginning Inventory + Purchases = Cost of Goods available for Sale
- Ending Inventory (updated at the end) is subtracted from the previous total
- $(BI + P - EI) = \text{Cost of Sales measured as a residual amount}$

Perpetual

- Beginning Inventory is carried over from the prior period
- Purchases are accumulated in the Inventory Account
- Beginning Inventory + Inventory = Cost of Goods available for Sale
- Ending Inventory (updated with every sale) is subtracted from the previous total
- $(BI + P - EI) = \text{Cost of Sales measured with every sale}$

Periodic Inventory System Example

Transaction Description	Journal Entry	
Merchandise purchased on account	D: Purchases	C: Accounts Payable
Merchandise returned to supplier.	D: Accounts Payable	C: Purchase Returns and Allowances
Merchandise sold on account.	D: Accounts Receivable	C: Sales Revenue
	D: Cost of Sales	C: Beginning Inventory
End of the period accounting entry	D: Ending Inventory	C: Purchases

Perpetual Inventory System Example

Transaction Description	Journal Entry	
Merchandise purchased on account	D: Inventory	C: Accounts Payable
Merchandise returned to supplier.	D: Accounts Payable	C: Inventory
Merchandise sold on account. (The first entry is recorded at retail, the second one at cost)	D: Accounts Receivable	C: Sales Revenue
	D: Cost of Sales	C: Inventory

Purchase Returns, Allowances and Discounts

- Purchase Return and Allowances: Reduction in the cost of purchases and sales revenue associated with unsatisfactory goods.
- Purchase Discount: A cash discount received for prompt payment of account receivable.

Purchase Returns, Allowances and Discounts

On September 20, 2018, Carolyn purchased \$10,000 of equipment on credit, on terms 3/15, n/30. The periodic inventory system is used. If Carolyn paid for these goods on November 18th, the entry made to record the payment should include which of the following?

- A. \$300 debit to Purchases discounts.
- B. \$8,500 credit to Cash.
- C. \$9,700 debit to Purchases.
- D. \$10,000 debit to Trade payables.

Purchase Returns, Allowances and Discounts

On September 20, 2018, Carolyn purchased \$10,000 of equipment on credit, on terms 3/15, n/30. The periodic inventory system is used. If Carolyn paid for these goods on October 18th, the entry made to record the payment should include which of the following?

- A. \$300 debit to Purchases discounts.
- B. \$8,500 credit to Cash.
- C. \$9,700 debit to Purchases.
- D. \$9,700 debit to Trade payables.

Inventory Costing Methods

What is recorded in COGS and Inventory for a period?

Answer depends on which specific goods are assumed to be sold.

- Specific Identification
- First in, First Out (FIFO)
- Weighted Average Cost

Specific Identification

The specific Identification method keeps track of every individual item being sold, while the other two assume that inventory follows a particular physical flow.

the cost of every single unit sold is added to the Cost of Sales. This method is adequate when dealing with few goods that can be differentiated between, for example luxury cars sold at a dealership.

FIFO

assigns the older costs to the units sold,
while the most recent costs will comprise a higher
proportion of ending inventory.

Oldest goods are sold first

FIFO (Cont.)

1000 units
\$5 unit cost
January

800 units
\$7 unit cost
May

200 units
\$4 unit cost
July

1600 sold in august

$$\text{COGS} = (1000 * 5) + (600 * 7) = 9,200$$

$$\text{Ending inventory} = (200 * 7) + (200 * 4) = 2,200$$

Weighted Average Cost

• The average cost of each unit in inventory is assigned to cost of sales when a unit is sold. Average cost per unit:

$$\frac{\text{Cost of Goods Available for Sale}}{\text{Number of units available for sale}}$$

Used to evaluate what is left and what has been sold

Weighted Average Cost

Transactions	Units	Unit Costs	Total
Beginning Inventory	500	\$ 6.25	
Purchase: 03-Jun	200	\$ 6.30	\$ 1,260.00
Purchase: 04-Sep	300	\$ 6.60	\$ 1,980.00
Purchase: 08-Nov	250	\$ 6.80	\$ 1700
Goods Available For Sale			
Ending Inventory	500		
COGS			

Weighted Average Cost

Transactions	Units	Unit Costs	Total
Beginning Inventory	500	\$ 6.25	\$3125
Purchase: 03-Jun	200	\$ 6.30	\$ 1,260.00
Purchase: 04-Sep	300	\$ 6.60	\$ 1,980.00
Purchase: 08-Nov	250	\$ 6.80	\$ 1,700
Goods Available For Sale	1250 (sum of previous)	$(8065/1250) = 6.452\$$	\$ 8,065
Ending Inventory	500	$(500*6.452)$	\$ 3,226
COGS	750 (1250-500)	$(750*6.542)$	\$ 4,839

*DON'T ROUND UNIT COSTS AS YOU GO!

Perpetual Weighted Average Cost

- Called the moving weighted-average
- The nature of a perpetual inventory system requires a different method because inventory is updated continuously
- Inventory is updated on an ongoing basis, thus WAC per unit must be recalculated after every purchase.

Financial Statement Effects

FIFO

- Weighted average
 - Smooths out price changes
- Ending inventory
 - If inventory prices rise throughout the period then the ending inventory will be higher

Net Realized Value

- an estimate of how much the firm expects to receive when it sells its inventory
- Inventory is recorded at the lower cost of the net realized value
 - When the market value of inventory drops below what you paid for it, you can record a loss using COGS or an allowance account.
 - Company recognizes a holding loss in the current period rather than the period in which the item is sold.
- If the market value increases, the previous write-down can be reversed but no more than that

STAY IN THE LOOP!



@lauriersos



@jdcclaurier



@lauriersos



@JDCCLaurier

Thank you!

Please fill out this survey: rb.gy/n5iifo



Additional Practice Question: 1

SOS corporation reported the following amounts at the end of first year of operations, December 31 2018: share capital \$20,000; sales revenue \$95,000; total assets \$85,000, no dividends, and total liabilities, \$35,000. What would shareholders equity and total expenses be?

- A. Shareholders equity, \$50,000 and expenses \$65,000
- B. Shareholders equity, \$60,000 and expenses \$75,000
- C. Shareholders equity, \$50,000 and expenses \$40,000
- D. Shareholders equity, \$80,000 and expenses \$85,000

Additional Practice Question: 2

Which of the following costs is most likely to be the largest expense item on the statement of earnings of a merchandising chain such as Walmart?

- A. Wage, Salary, and benefits expense
- B. Advertising
- C. Cost of Sales
- D. Income tax expense

Additional Practice Question: 3

Which of the following statements is true?

- A. Debits increase assets and increase liabilities.
- B. Credits decrease assets and decrease liabilities.,
- C. Credits decrease assets and increase liabilities
- D. Debits increase liabilities and decrease assets.

Additional Practice Question: 4

Which financial statement would indicate whether the company relies more on debt or shareholders' equity to finance its assets?

- A. Statement of cash flows.
- B. Statement of changes in equity
- C. Statement of earnings.
- D. Statement of financial position

Additional Practice Question: 5

Which of the following defines shareholders' equity?

- A. Probable debts or obligations of an entity as a result of past transactions which will be paid with assets or services.
- B. Assets plus liabilities.
- C. Probable future economic benefits owned by an entity as a result of past transactions.
- D. The financing provided by the owners and the operations of a business.

Additional Practice Question Answers

1: A

2: C

3: C

4: D

5: D