ACC1701X Midterm Cheatsheet AY23/24 Sem 2

Financial Accounting

Financial Accounting: provides financial information primarily for external users to make decisions.
Management Accounting: provides financial information primarily for external users to make decisions.

- Provides information to management and staff for planning, implementation and control purposes to improve business performance.
- Provides reports which include budgets, cost analysis and divisional performance reports.
- Primarily for internal users, i.e., management and staff.

International Financial Reporting Standards (IFRS) set by IASB (International Accounting Standard Board) is primarily used for this course.

Financial Accounting Concepts and Assumptions

- **Separate Entity Concept:** activities of a business entity are separated from those of the individual owners.
- **Time-period assumption:** Long life of a company can be reported in a shorter time period (annually [fiscal year], quarterly, monthly)
- **Arm's-length transaction assumption:** business dealings between entities are conducted in a rational basis and all parties are acting for their own interests.
- **Cost principle:** financial statement items are measured at their historical costs/original costs at the transaction date. The historical cost is assumed to represent the fair market value of the item at the date of transaction.
- **Fair value principle:** the assets and liabilities should be measured at fair value to improve relevance of accounting information.
- **Monetary measurement concept:** Items in financial statements must have value measurable in dollar value.
- **Going concern assumption:** When preparing the financial statements, the business entity is assumed to be able to sustain itself for the foreseeable future (not under liquidation)

Limitations of Balance Sheet

- Assets are recorded at their purchase cost, not their current market value.
- Not all economic assets are included in the balance sheet. (e.g., internally generated brand, good reputation and human talents)
- The accounting book value of a company (measured by the amount of equity) is usually less than the company's market value (measured by market price per share × number of shares).

Financial Statements

- Statement of Comprehensive Income (SCI)
- Balance Sheet (Statement of Financial Position)
- Statement of Changes of equity
- Statement of Cash Flows
- Notes to Financial Statements

Balance Sheet Items

Assets: Cash, Accounts Receivable, Inventory, Buildings, Property, Plant and Equipment [Liquidity]
Liabilities: Accounts Payable, Income Taxes Payable, Mortgage Payable, Unearned Revenue [Due date]
Equity: Capital Stock, Retained Earnings [Dividends distributed reduce retained earnings]

- $Assets = Liabilities + Equity$
- $Assets = Current\ Asset + Non\text{-}Current\ Assets$
- $Liabilities = Current\ Liabilities + Non\text{-}Current\ Liabilities$
- $Retained\ Earnings(begin) + Net\ Income - Dividends = Retained\ Earnings(end)$
- $Equity(begin) + Increase\ in\ Capital\ Stock + Net\ Income - Dividends + Other\ Comprehensive\ Income = Equity(end)$

SCI Items

- $Expenses = Operating\ expense + Non\text{-}Operating\ Expense$
- $Revenue - Expenses = Net\ Income$
- $Net\ Income + Other\ Comprehensive\ Income = Comprehensive\ Income$
- $Revenue - COGS = Gross\ Profit$

Notes to Financial Statements

- Summary of Significant Accounting Policies
- Additional Information about the Summary Totals
- Disclosure of Information Not Recognized in the financial statements
- Supplementary Information required under the accounting standards

Mechanics of Accounting Cycle

1. Analyse transactions
2. Record effects of transaction
3. Summarise effects of transactions (journal entries & trial balance)
4. Prepare reports (adjusting entries, financial statements, closing the books)

Flow of Accounting Records:
Journal Entries, T Accounts, Trial Balance, Income Statement, Statement of Changes in Equity, Balance Sheet
Criteria for transaction recognition:
1. Involve exchange of resources
2. Conducted at Arm's Length between two independent entities
3. Can be reliably measured

Business Docs such as sales invoices, official receipts, purchases orders, suppliers' invoices capture business transaction. They provide independent objective evidence of transaction, establish dollar amount, and facilitate analysis of business events.

Journal Entry

A recording of a business transactions; usually includes a debit entry and a credit entry to the relevant accounts with amount, a date and sometimes an explanation of the transaction.
Asset Accounts:
Typically has debit balances.
DR Asset (Increase) CR Asset (Decrease)
Liability or Equity Accounts:
Typically has credit balances.
DR Liability/Equity (Decrease) CR Liability/Equity (Increase)
Revenue and Expenses Accounts:
Expenses typically has debit balances.
Revenue typically has credit balances
DR Expense (Increase) CR Expense (Decrease)
DR Revenue (Decrease) CR Revenue (Increase)
Capital Stock, Retained Earnings, Dividends
DR Capital Stock (Decrease) CR Capital Stock (Increase)
DR Retained Earnings (Decrease) CR Retained Earnings (Increase)
DR Dividends (Increase) CR Dividends (Decrease)
Personal journal entries notes:
- Try to think in terms of cash flow
- DR Cash – CR Revenue
- DR Expense – CR Cash
- DR Cash – CR Capital Stock
- DR Cash – CR Revenue; DR COGS – CR Inventory
- DR Notes Payable, Interest Expense – CR Cash (paying back notes)
- DR Dividends – CR Cash

T-Accounts

- Basically combine all journal entry transactions by accounts used and calculate ending balances (can be debit or credit).

Trial Balance

- Prepare trial balance using the ending balances from all T-accounts.
- Total debit balance should be equivalent to total credit balance.

Accrual Accounting

System of accounting in which revenues are recognized when certain criteria are satisfied (i.e., revenues are earned); and expenses are recorded as they are incurred to generate the revenue (matching principle). This is regardless of when cash is paid or received.
- Revenues can be recognized **even cash is not received**.
- Expenses can be recorded **even cash is not paid**.
- The matching principle requires that all costs and expenses incurred in generating revenues must be recognized in the same reporting period as the related revenues.
- **Follows the time-period assumption** which is that the life of a business is divided into distinct and relatively short time periods(e.g., 12-month) so that accounting information can be timely.

Adjusting entries

Prepared at the end of each accounting period to adjust accounts to their proper amount on an accrual basis.
Do not involve cash. Involves a BL account or SCI account.

1. Accrued/Unrecorded receivable (asset)

In Arrears. Revenues earned during a period that have not been recorded by the end of that period. Represent amount of cash or resources to be collected by the entity in the future.
DR Accounts Receivable – CR Revenue

2. Accrued/Unrecorded liabilities (liability)

Expenses incurred and not paid during a period and are not recorded at the end of that period. Represents entity's obligation to pay for the expense in the future.
DR Expense – CR Payable
Example: DR Interest Expense – CR Interest Payable (Adj Entry)
Dr Interest Payable, Loan Payable – CR Cash

3. Prepaid Expense (asset)

Payments made in advance for expense items, e.g., prepaid insurance or rent.
Journal Entry (day of payment):
DR Prepaid Expense – CR Cash
Adjusting Entry (expense incurred up to date)
DR Expense – CR Prepaid Expense
- Calculate fraction of prepaid expense used up at current date
- Supplies Example: DR Supplies – CR Cash; DR Supplies Expense – CR Supplies;

4. Unearned Revenue (liability)

Cash amounts received from customers before its corresponding revenue can be recognized.
Journal Entry (Customer advance payment):
DR Cash – CR Unearned Revenue
Adjusting Entry (revenue earned up to date):
DR Unearned Revenue – CR Revenue - Calculate fraction of revenue earned using time

Closing the books

Adjust trial balance → Prepare SCI → Ending Retained Earnings → Closing books
Making all the Revenue, Expense, Retained Earnings and Dividends account balance to zero.
Debit and Credit balances are swapped for these entries.

- **DR Revenue – CR Expense, Retained Earnings (Net income)**
- **DR Retained Earnings – CR Dividends**

Revenue and Receivables

Revenue Recognition

1. Identify the contract with the customer.
2. Identify performance obligation(s) in the contract.
3. Determine the transaction price.

4. Allocate the transaction price to the separate performance obligations (if more than one) [pro-rate].
5. Determine when the performance obligation is satisfied and revenue can be recognized.

Sales Discount

To encourage customers to pay early, companies use sales discounts (also called cash discount) as an early payment incentive.

- **credit terms of 2/10, n/30** means that a sales discount has been given.
- Customer deducts 2% from invoice price if paid within 10 days. Customer has to pay full sales price within maximum of 30 days.
- **DR Accounts Receivable – CR Sales Revenue** (Revenue made, credit payment)
- **DR Cash, Sales Discount – Accounts Receivable**

Sales Returns and Allowances

DR Accounts Receivable – CR Sales Revenue
DR COGS – Inventory
If return required:
DR Sales Returns and Allowances – CR Accounts Receivable
DR Inventory – CR COGS
$Sales\ Revenue - Sales\ Discount - Sales\ Returns\ and\ Allowances = Net\ Sales$

Treatment of Bad Debt

- Uncollectible accounts receivable
- Allowance method estimates and records the amount of impairment of accounts receivable before they become uncollectible.
- Direct write-off method is NOT allowed under IFRS as it violates the matching principle.

ECL is an estimated expense in the SCI. Loss Allowance is a contra-asset account to Accounts Receivable in the balance sheet.
DR Expected Credit Loss – CR Loss Allowance
If specific customer identified specifically as uncollectible, write off:
DR Loss Allowance – CR Accounts Receivable
If written off subsequently pays the outstanding balance, reinstate:
DR Accounts Receivable – CR Loss Allowance
DR Cash – CR Accounts Receivable
$Accounts\ Receivable(net) = Accounts\ Receivable(begin) - Loss\ Allowance$

Estimating Loss Allowance
Estimate the amount of uncollectible as a percentage of the total receivables balance at the end of the period.
Normally has credit balance.
1. **Percentage of Total Receivables:**
Total Accounts Receivable × Percentage Uncollectible(%)
2. **Aging Method:**
Each receivable is categorized by the number of days it has been outstanding.
Multiplied by an appropriate uncollectible percentage. The older the receivable, the less likely the company is to collect.
$\sum$ Accounts Receivables in Age Category × Respective Percentage Uncollectible(%)
- If there is an existing **credit** balance in loss allowance. Top up less by $ECL - Unadjusted\ Balance$
- If there is an existing **debit** balance in loss allowance. Top up more by $ECL + Unadjusted\ Balance$

Notes Receivable

A legal contract in the form of a promissory note received by a company and written by its customer to settle accounts receivable after the credit period. A company can also lend money to an external party by accepting a promissory note.
$Interest\ Revenue = Face\ Value \times Annual\ Interest\ Rate \times Term\ of\ the\ node(credit\ duration)$

- **DR Notes Receivable – CR Accounts Receivable** (issuing note)
- **DR Cash – CR Notes Receivable, Interest Revenue** (accepting payment)

If note is dishonoured (convert into AR):

- **DR Accounts Receivable – CR Notes Receivable, Interest Revenue**

Foreign Currency

Reported in SCI as **Foreign exchange loss/gain**.
To reduce: Denominate the transaction in U.S. dollars; or Enter into a forward contract to hedge the exchange risk

	U.S. Dollar Value of Receivable	Gain or Loss	
April 23	\$20,000	Not applicable	
June 30	14,000	\$6,000 loss	**net exchange loss of \$4,000**
July 12	16,000	\$2,000 gain	

Efficiency Ratios

- $Average\ AR = (AR(begin) + AR(end))/2$
- Accounts Receivable Turnover $= \frac{\text{Net Sales}}{\text{Average AR}}$
- Average Collection Period $= \frac{365}{\text{Accounts Receivable Turnover}}$

The higher AR Turnover, the better.
The shorter Average Collection Period, the better
Not **Cash Poor**

Cash and Internal Controls

Purchase Discounts

DR Inventory – CR Accounts Payable
DR Accounts Payable – CR Cash, Inventory(discount amount on remaining AP)
Related to cost-principle.

Debit Memo

Returning stuff as a buyer.
DR Accounts Payable – CR Inventory

Bank Reconciliation

Balances are reconciled when both the adjusted balances are equal. Adjusted balance will be reported as "Cash" on balance sheet.			
Unadjusted Bank balance		Unadjusted Book balance	
+	Deposits in transit	+	Interest paid
–	Outstanding checks	+	Direct deposits
+/–	Bank errors	–	Service charges
		–	NSF checks
		–	Bank transfer
		+/–	Accounting errors
Adjusted **Bank** Balance	=	Adjusted **Book** Balance	

For bank errors, the company will notify the bank and have the bank make the corrections. No journal entries required

NSF (Not Sufficient Funds)
Adjusting entry: **DR Accounts Receivable – CR Cash**
Misc Items unrecorded in books
Adjusting entry: **DR Service Expense – CR Cash**
Adjusting entry: **DR Cash – CR Interest Revenue**
Bank Transfers
Adjusting entry: **DR Expenses – CR Cash**
Direct Deposits
Adjusting entry: **DR Cash – CR Accounts Receivable**

Petty Cash Fund and Vouchers

Setting up:
DR Petty Cash – CR Cash
Replenishing:
DR Various Expenses..., Cash Short and Over – CR Cash(Initial petty - remaining)

Internal Controls

Control Environment	Control Activities (Procedures)
1. Management philosophy and operating style 2. Organizational structure 3. Audit committee	1. Segregation of duties (preventative control) 2. Proper procedures for authorization (preventative control) 3. Physical control over assets and records (preventative control) 4. Adequate documents and records (detective control) 5. Independent checks on performance (detective control)

Fraud

- Asset misappropriation
- Corruption (bribery and kickbacks)
- Financial misstatement or omission

Earning Management

Intentional, to manipulate financial results legally. To meet internal targets, external expectations, smooth income and window dress for public stock offering or loan application.
Two common ways:
- modify operating or investing decisions. E.g., changing the timing to invest or purchase goods and delaying expenditure;
- modify accounting estimates and methods. E.g., changing accounting estimate of loss allowance for accounts receivable.

Inventory and Cost of Sales

The cost of inventories shall comprise all costs of purchase and other costs incurred in bringing the inventories to their present location and condition. (costs directly attributable to the acquisition of goods.)
Excludes sales and marketing cost, those are operating expenses.
- FOB Destination (Ownership passes to buyer at destination)
- FOB Shipping Point (Ownership passes to buyer at shipping point)

There is no passing of ownership between the consignee and consignor (third party). Goods still belong to consignor.

Perpetual vs Periodic Method

Perpetual: Inventory and COGS are recorded on a continual basis for each purchase and sales transaction.
Periodic: Amounts of COGS and Inventory reported at year end, are computed based on the physical manual stock-take at year-end.
Temporary accounts are used to record the **purchases, freight-in, purchases returns and purchases discounts**.
Freight-in is the cost of having goods or materials delivered to a business for manufacture or resale.
Basically, replace all "Inventory" with temporary detailed accounts.
NO DR COGS – CR Inventory is recorded during date of sale for Periodic System.

Periodic System

At the end of reporting period (year), two steps:
1. All temporary accounts (purchases, freight-in, purchases returns and purchases discounts) are adjusted to Inventory account.
DR: Inventory(Net Purchases), Purchase Returns, Purchase Discounts – CR: Freight In, Purchases
2. Conduct Stock count or stock take at year-end to determine inventory(end) and compute COGS.
$COGS = Inventory(begin) + Net\ Purchases - Inventory(end)$
Then do one journal entry:
DR COGS – CR Inventory

Shrinkage:

Physical counts allow companies to determine inventory shrinkage. The difference between, the physical count's value and the book's value will be reported as the physical stock shrinkage. Reported as COGS.

Inventory Costing

- Specific Identification
- FIFO (End Inv count from most recent)
- LIFO (Not allowed under IFRS)
- Weighted Average Cost

$Cost\ of\ goods\ available\ for\ sale = Beginning\ Inv\ Balance + Net\ Purchases$
LIFO reports the Cost of goods with the most recent costs. FIFO reports inventory with the most recent cost.
When inventory price rises. Gross margin, net income, inventory(end) is highest with FIFO. WA and LIFO understate inventory(end).

Net Realizable Value

If NRV < Cost, write down item by item:
DR COGS – CR Allowance for Inventory Write Down (Contra-Inventory, BL)
If NRV $\geq$ Cost, no adjustments needed.
NOT ALLOWED to write inventories down on the basis of a classification of inventory.

Efficiency Ratios

- Inventory Turnover $= \frac{\text{COGS}}{\text{Average Inventory}}$ (higher, better)
- Num of Days Sales in Inventory $= \frac{365}{\text{Inventory Turnover}}$ (shorter, better)