



Class Notes (217) (All Chapters)

Financial Accounting (Concordia University)



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Chapter 1: The Definitions

- Creditors are more privileged when compared to investors since they are not at risk of stock change (Def: a person or company to whom money is owed)
- Cash flow: Trail of what the company spend and what it makes
- $\text{Asset} = \text{Liabilities (Creditors)} + \text{Share Holders Equity (Investors)}$
- $\text{SHE (AKA: Residual Claim)} = \text{Assets} - \text{Liabilities}$
- Intangible Assets = Software, Patterns, Licenses
- If an Asset lasts longer than a year, it is labeled as a “long term investment/asset”. They are not sold for money within that year
- Accrued Liability: Advanced cash (Ex: Gift card to a shop, warranty to a product or deposit from a costumer which will return later on)
- Contributed Capital (In Shareholder’s equity) = The money that investors put on the company
- Retained Earnings = Profits that have not yet been distributed in dividends (not cash)
- Gain: A one-time revenue that is not related to the business’ core sells
- Loses: A one time lose that does not apply to frequent expenses
- Assets are used for the future. They have future value.
 - 1) They are economic resources controlled or owned by the entity
 - 2) They result from past business events/transactions
 - 3) Future economic benefits will be obtained from them.
- Temporary accounts represent all the elements on the income statement (revenues and expenses). These accounts are closed out at the end of the year. Temporary accounts represent the activities of a given fiscal period.

Income Statement starts from zero once the accounting period has finished while everything else is left untouched

- Income Statement is recorded over a period of time rather than a specific date (For the year ended)

* A contract does not mean a liability as long as the thing bought is obtained from the supplier

Statements of Comprehensive Income

Expenses:

- Cost of Sales = How much it cost to sell the product
- Cost of producing revenue (Manufacturers) = How much it costs to produce the product
- Wage Expense = How much is payed to employee
- Rent Expense = Pay for the land or building if renting
- Interest Expense = Company might have an interest with the bank (Annually)
- Depreciation Expense = Assets loose value over time
- Advertising Expense= Paying money to make publicity
- Insurance Expense = Paying usually Monthly for assets in general
- Repair Expense = Money to be spent to fix asset and expand its lifespan
- Income Tax Expense = Government regulated percentage that must be payed from (total revenue minus expense= Profit)

➤ *Example Statement of Income:*

Revenue before tax = 1M

Expense before tax= 500k

Income before tax = 500k

Tax Expenses (30%) = 150k

Final Net income: 350k

Earning per Share= **Final Net Income**/ shares

Unearned Revenue Example: Gift Card

Common Shares: Funds that the owners bring to the company

Loan Payables (dept due between two and 10 years): Statement of Financial Performance/ Non-Conforming Loan

Statement of Changes in Equity:

Equity, beginning of period

Plus: Net earnings for the year

Plus: Other comprehensive income

Less: Dividends
Plus, Less: Other changes, net
Equity, end of the period

Exercise Example: Statement of Changes in Equity

Liabilities and Shareholders' Equity

Current Liabilities

Utilities Payable	70
Accrued Expenses (or Accounts) Payable	200
Income Taxes Payable	426
Total Liabilities	696

Shareholders' Equity

Contributed Capital	32,000
Retained Earnings*	1,704
Total Shareholders' Equity	33,704
Total Liabilities and Shareholders' Equity	\$34,400

Selling in credit: The company sells the goods but does not collect the money right away. The figures are still placed on the day that the product was sold

Types of Businesses

1. Sole Proprietorship – This is the type of business that is run by one person and there is no legal distinction between the owner and the business that they are running. Owner has full control over the business and is legally liable for all lawsuits that are filed against the business. They have a limited life as one day the owner will pass away

2. Partnerships – This is the type of business that is run by two or more people and there is no legal distinction between the partner's and the business that they are running. Each partner is liable for up to the maximum investment they made in the business.

3. Corporations – The main difference between a corporation and the two other forms of businesses previously discussed is the fact that the corporation is a separate legal entity that is distinct from the owners (shareholders).

Chapter 2: The Conceptual Framework

These reports are prepared for those who are outside of the company such as shareholders and creditors. It is also accessible to the public in general

Qualitative Characteristics:

Fundamental (to be useful for investing or analysing)

Relevance (makes a difference in a decision, predictive value, feedback, confirmatory value)

Faithful representation (complete, neutral, reasonably free from error or bias)

Ex: Not inflate assets by making it unclear to understand amortization

Enhancing: (degree of usefulness)

Comparability (across companies (same quarters as others) as well as using the same type of accounting over time)

Verifiability (similar results under independent measures)

Timelessness (information must be available before it loses its usefulness (making business decisions))

Understandability (reasonably informed users will understand the significance of the info)

Prudence: Make sure to not overstate assets and revenues, understand liabilities and expenses, understand the source of trouble for a company from the financial statement

Assumptions:

Separate entity: Business activities separate from owner's

Continuity: Company assumes it will keep operating soon

Stable monetary unit: Accounting measurements will be in the national monetary unit and will not be adjusted with inflation or purchasing power. The value of the money does not change

Constraints:

Cost – Benefit: An entity will have to weigh the costs with the benefits of providing information that meets the needs of the users without altering their decisions

Materiality: This is the concept that an item needs to have a significant effect on the user's decision that it could sway it from one side to another. Ex: 20K of 10M does not mean much in decision making

Principles:

Historical cost: Cash equivalent cost given up is the basis for the initial recording of elements. The expenses and revenues are placed in the same accounting period (even when the thing being sold was bought a long time ago)

Peripheral Activities: A company's activities outside of its main activities of buying/producing and selling.

* The balance sheet begins with the most liquid assets to the least liquid (land, building). The sheet is recorded at a specific time rather than over a span of time

The T-Account: Assets and Liabilities not shown

CONTIBUTED CAPITAL		RETAINED EARNINGS		OTHER COMPONENTS	
Debit for Decrease	Credit for Increase	Debit for Decrease	Credit for Increase	Debit for Decrease	Credit for Increase

REVENUES and GAINS		EXPENSES and LOSSES	
Debit for Decrease	Credit for Increase	Debit for Increase	Credit for Decrease

General Journal Entry

c	Property and Equipment (+A)	22	
	Cash (-A)		15
	Notes Payable (+L)		7
Letter, number or date	Debited Account of top and credit account on bottom	Debit	Credit

Example of Statement of Financial Position (Balance Sheet)

Bobbles Today Ltd. Balance Sheet As at June 30, 2019			
ASSETS			
Current assets:			
	Cash	\$231,000	
	Merchandise inventory	130,000	
	Prepaid rent	3,200	
	<i>Total current assets</i>		364,200
Non-current assets:			
	Office equipment, at cost	\$6,000	
	Less: Accumulated depreciation	200	5,800
	<i>Total Assets</i>		370,000
LIABILITIES AND SHAREHOLDER'S EQUITY			
Current Liabilities:			
	Accounts payable	70,000	
	Wages payable	12,000	
	Bank loan	16,000	
	Interest payable	100	
	Income tax payable	5,000	
	<i>Total liabilities</i>		103,100
Shareholder's equity:			
	Common shares (5,000 shares)	200,000	
	Retained earnings	66,900	
	<i>Total shareholder's Equity</i>		266,900
	<i>Total Liabilities and Shareholder's Equity</i>		370,000

Example of Statement of Earnings (Income Statement)

MGC INC.
Statement of Earnings
For the year ended December 31, 2016

Revenues	
Sales revenue	\$ 808,100
Less: Sales Discount	\$ 2,700
Net Sales	\$ 805,400
Cost of sales	201,750
Gross Profit	603,650
Operating Expenses	
Utilities expense	\$ 56,000
Salaries expense	99,600
Depreciation Expense	38,000
Insurance Expense	5,300
Shipping Expense	1,500
Bad debt expense	6,480
Total Operating Expenses	206,880
Earnings From operations	396,770
Non-operating Activities	
Rent revenue	48,000
Interest expense	(36,000)
Total Non-operating Activities	12,000
Earnings Before Income Tax Expense	408,770
Income Tax Expense	102,193
Net Earnings	\$ 306,578

Chapter 3: Understanding the Business

The Operating Cycle:

- 1) Purchase or manufacture product or supplies on credit
- 2) Pay cash to suppliers
- 3) Deliver products or provide costumer service on credit
- 4) Receive cash from costumer

Time period: The long life of a company can be reported over a series of shorter time periods (monthly, quarterly and annually)

Recognition Issue: When should it affect the records

Measurement Issues: What amounts should be recognized?

Canadian compagnies are forced to use the IFRS accounting fashion

Continue operations profit = revenue – expenses (Single Step) + gains – losses (Multiple Step)

The higher the earning per share, the better the investment

Cash Basis	Accrual Basis
Revenue recorded when cash received	Revenue recorded as earned
Expense recorded when cash paid	Expenses recorded as incurred
NOT GAAP appropriate	GAAP appropriate

Cash Basis: Revenues are recorded when cash is received, and expenses are recorded when cash is paid

Statements of Earnings	Year 1	Year 2	Year 3	Total
Sales on credit	\$ 60,000	\$60,000	\$60,000	\$180,000
Cash receipts from customers	20,000	70,000	90,000	180,000
Cash payments for:				
Salaries to employees	(30,000)	(30,000)	(30,000)	(90,000)
Insurance for three years	(12,000)	(0)	(0)	(12,000)
Supplies	<u>(3,000)</u>	<u>(7,000)</u>	<u>(5,000)</u>	<u>(15,000)</u>
Net operating cash flows	<u>\$(25,000)</u>	<u>\$33,000</u>	<u>\$55,000</u>	<u>\$ 63,000</u>

Accrual Basis (Required by IFRS and GAAP): revenues and expenses are recorded when earned accordance with revenue recognition criteria (Entity has been transferred, the business no longer has control over the asset, revenue is reliably measured). Revenues and Expenses are recorded at the same time

Statements of Earnings	Year 1	Year 2	Year 3	Total
Sales revenue (earned)	\$60,000	\$60,000	\$60,000	\$180,000
Expenses (resources used or incurred):				
Salaries expense	(30,000)	(30,000)	(30,000)	(90,000)
Insurance expense	(4,000)	(4,000)	(4,000)	(12,000)
Supplies expenses	(5,000)	(5,000)	(5,000)	(15,000)
Net earnings	<u>\$21,000</u>	<u>\$21,000</u>	<u>\$21,000</u>	<u>\$ 63,000</u>

Ex Accrual: Buying an expensive phone with a plan. While the phone is not completely paid, it is said to be part of the business

When cash is received before revenue (Service is paid but not fully completed), the liability account “Deferred Revenue” is recorded

* If revenue is recognized and recorded before consumers pay for goods, the revenue is credited (Financial Statement)

Once delivered, deferred revenue decreases while service revenue increases

CASH COLLECTED (Goods or services due to customers)	over time will become	REVENUE (Earned when goods or services provided)
Rent collected in advance	→	Rent revenue
Deferred air traffic revenue	→	Air traffic revenue
Deferred subscription revenue	→	Subscription revenue

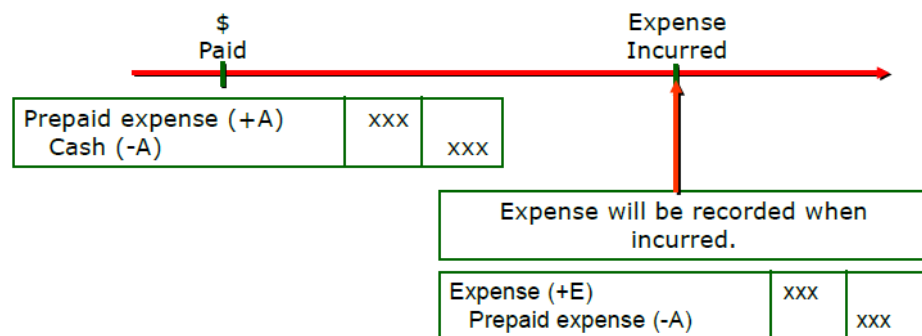
Ex: Gym membership (Gets recorded as revenue after a year)

Deferred = Paid in advance




* Resources consumed to earn revenues in an accounting period, should be recorded that period (Regardless of when cash is paid)

Prepaid Expense:

When the expense is incurred (paid) before deed is fully finished, it is placed in a “prepaid expense” account



Depreciation Expense:

CASH PAID FOR	as used over time becomes	EXPENSE
Supplies inventory		Supplies expense
Prepaid insurance		Insurance expense
Buildings and equipment		Depreciation expense

Accumulated depreciation is a contra asset.

Ex:

Jan 1, 2019 Value of building = 2, 400, 000

Buildings – depreciation = $2400000 / 20$
= 120,000

December 31, 2019

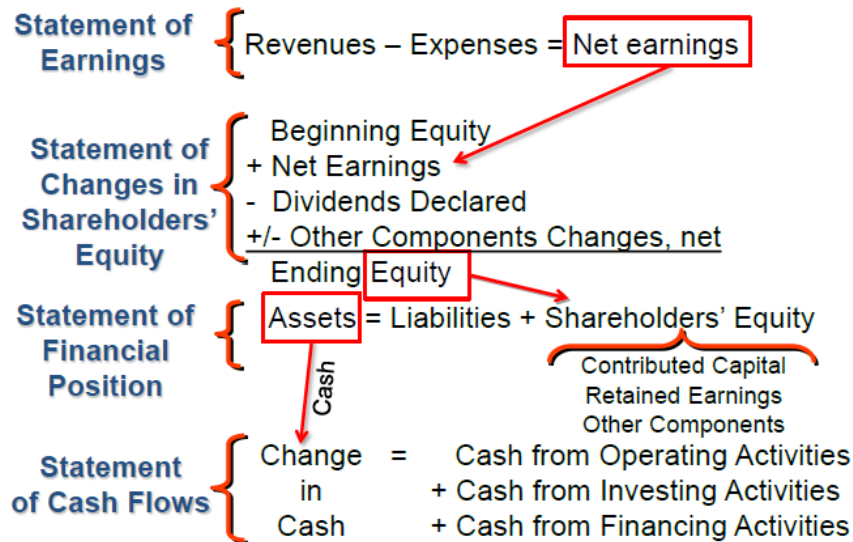
Depreciation expense: 120,000

Accumulated depreciation 120, 000

Net value = $2,400, 000 - 120, 000$

Book Value = 2, 280, 000

In Summary:



Important Formulas

Current Ratio: Current Assets/ Current Liabilities

-The higher the ratio, the healthier the company when it comes to paying debt

Return on Asset Ratio (ROA): Net Earnings + Interest expense/ **Average total Assets**

-Average total Assets: (Beginning total assets + Ending total assets) / 2

Return on Equity (ROE): Net Earnings/ Average Shareholder's Equity

-How much earned for each dollar from a shareholder's investment

Total Asset Turnover: Net Sales/ Average Total Assets

- Sales generated for every dollar value of an asset

- Creditors use this ratio to look at the effectiveness/ productivity of using current assets

Net Profit Margin: Net Earnings/ Net Sales (Revenue before expenses)

- Money made for every dollar sold after expenses

- how much profit is earned as a percentage of revenues generated during the period

Receivables Turnover Ratio: Net Credit Sales/ Average Net Accounts Receivable

- How good the company is at collecting debt

- How long a company extends their credit

- The higher the number, the more days the company is extending their debt

Inventory Turnover Rate: Cost of Goods Sold/ Average Inventory

Average Days to Sell: 365 days/ Inventory turnover rate

Price Per Share =/= earnings per share

Gross Profit Percentage: Gross Profit/ Net Sales

- Higher gross profits means higher net earnings

In 2015, Gildan reported gross profit of \$687,259 on sales of \$2,568,618.

$$\text{Gross Profit Percentage} = \frac{\$687,259}{\$2,568,618} = 26.8\%$$

More Definitions

Bad debt: Lending money that might not be reimbursed. You don't know how much the customer will be able to pay back (Part of accrued Expense)

Cost of land is register as historical cost.

Land and Buildings assets should always be separate

After increasing the Allowance for Doubtful Accounts, the Accounts Receivable has to be reduced

Deckers estimated bad debt expense for 2018 to be \$27,567,000. Prepare the adjusting entry.

GENERAL JOURNAL				
Date		Description	Debit	Credit
Dec.	31	Bad Debt Expense (+E, -SE)	27,567,000	
		Allowance for Doubtful Accounts (+XA, -A)		27,567,000

Contra asset account

What the company estimated as lost:

Date	Allowance for Doubtful Accounts	25,000,000	
	Account Receivable		25,000,000

What was recover:

Date	Account Receivable	1,000,000	
	Allowance for Doubtful Account		1,000,000
	Cash	1,000,000	
	Account Receivable		1,000,000

Revenue Recognition Principle: (If not met, it is not recorded)

- Entity has transferred to the buyer the risks and rewards of ownership
- Entity no longer controls item once it is sold (If ever the buyer needs returning)
- The revenue is valid and easy to understand
- Probable that the economic benefits will flow to the seller
- Cost incurred or to be incurred is reliable

Chapter 4: Accounting Cycle



Accumulated Depreciation- Account: It is a contra-asset that is placed on an unadjusted Trial balance by the end of the accounting cycle

Cost – Accumulated depreciation = Carrying amount/ Net Book Value

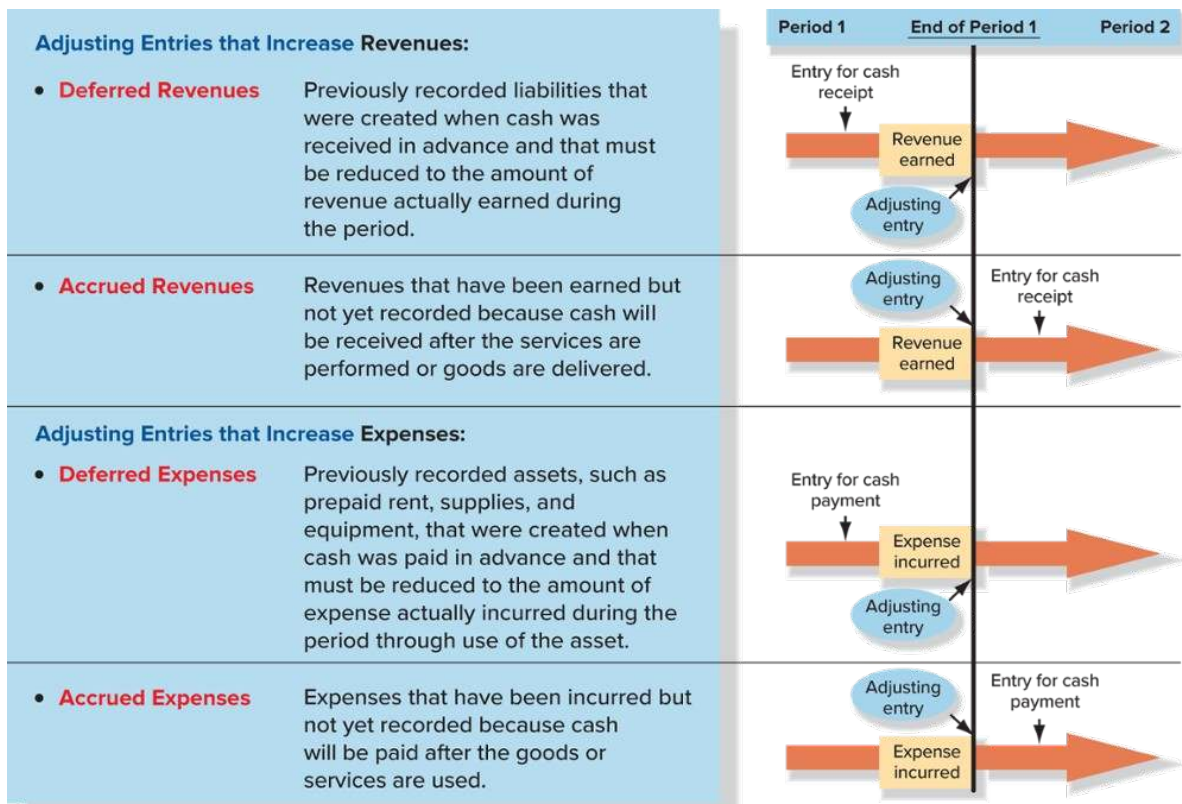
* It goes into the trial balance only

Ducharme, Inc. Unadjusted Trial Balance At December 31, 2018		
Description	Debit	Credit
Cash	\$ 3,900	
Accounts receivable	4,985	
Inventory	3,300	
Equipment	4,800	
Accumulated depreciation – equipment		\$ 1,440
Furniture and fixtures	6,600	
Accumulated depreciation – furniture & fixtures		2,200
Accounts payable		2,985
Notes payable		4,000
Common shares		10,000
Retained earnings, 12/31/2017		1,760
Sales revenue		35,000
Cost of sales	27,500	
Operating expenses	6,300	
Totals	\$ 57,385	\$ 57,385

Types of Adjustments:

Deferred Revenues: The company records the account regardless if the service has yet been performed or not. Receiving cash but has not yet performed the service. Has a gift card been used?

Accrued Revenues: Revenue that has been earned but not collected. Ex: Having interest on a deposit from a bank but it has still not been payed



Deferred Expenses: Prepaying an expense and it is recorded immediately. (Never when cash basis)

Accrued Expenses: Expense recorded that have been incurred (had the service) but will be paid after the good/service are used (Never with Cash Basis). Phone bill

Accumulate (Accrue)

Adjusting Deferred and Accrued Revenues:

	During the period	End of period	Next period
	Entry when cash is received before the company performs (earns revenue)	AJE needed because the company has performed (earned a revenue) during the period	Entry when cash is received after the company performs (earns revenue)
Deferred Revenues	Cash (+A) Deferred fee revenue (+L)	Deferred fee revenue (−L) Fee revenue (+R, +SE)	
Accrued Revenues		Interest receivable (+A) Interest revenue (+R, +SE)	Cash (+A) Interest receivable (−A)

* Deferred (Future) rent revenue = Unearned Revenue

Prepaid insurance is an asset and not liability since the service has not yet been received

Once time passes, it transforms from Prepaid insurance to insurance expense

Closing Accounts:

1) Income Summary is mentioned in all, but dividend declared

GENERAL JOURNAL			Page	365
Date	Description	Debit	Credit	
Jan 31	Income summary (-T)	63		
	Retained earnings (+SE)		63	-

Dec. 31	DR	Revenue	250,000	
	CR	Income summary		250,000

Next, we close the expense accounts:

Dec. 31	DR	Income summary	220,000	
	CR	Cost of goods sold		100,000
	CR	Amortization expense		20,000
	CR	Interest expense		10,000
	CR	Rent expense		20,000
	CR	Salaries expense		48,000
	CR	Utilities expense		12,000
	CR	Amortization expense		10,000

Next, we close the income statement account to retained earnings:

Dec. 31	DR	Income summary	30,000	
	CR	Retained earnings		30,000

Finally, we close dividends to retained earnings:

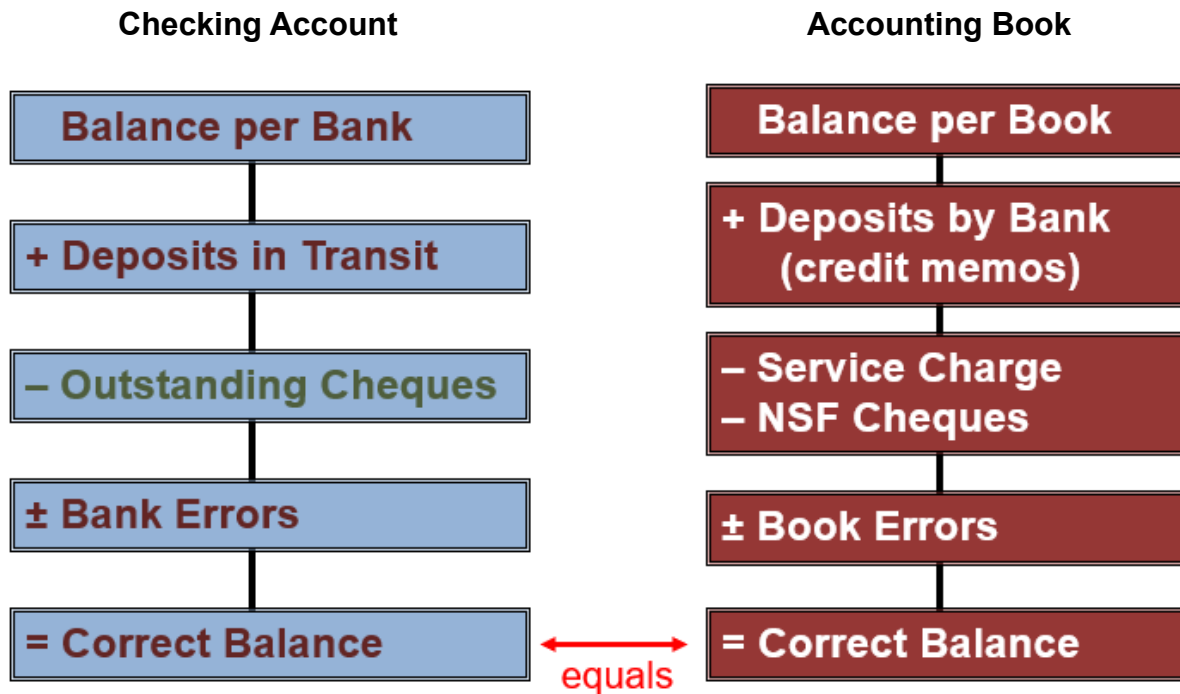
Dec. 31	DR	Retained earnings	15,000	
	CR	Dividends		15,000

Chapter 6: Reporting & Interpreting Sales Rev, Receivables and Cash

Increase credit time depending how much the company knows the other party

Bank Reconciliation: the process of comparing (reconciling) and verifying the accuracy of both the ending cash balance in the company's records and the ending cash balance reported by the bank on the monthly bank statement

ABC Corp Bank Reconciliation At February 28, 2017			
Balance per bank, February 28			\$4,150.00
<u>Add:</u> Deposits in transit			2,890.00
<u>Deduct:</u> Outstanding cheques			(2,136.05)
Corrected balance, February 28			<u>\$4,903.95</u>
Balance per books, February 28			\$3,999.85
<u>Add:</u> Error on cheque#747 (\$582.00 – \$58.20)	523.80		
Note Receivable collection	900.00		
Interest on Note receivable	<u>36.00</u>	1,459.80	
<u>Deduct:</u> NSF cheque	453.20		
Error on cheque no. 742 (\$491 – \$419)	72.00		
Bank service charges	25.00		
Charges on collection of note receivable	<u>5.50</u>	(555.70)	
Corrected balance, February 28			<u>\$4,903.95</u>



Discounts:

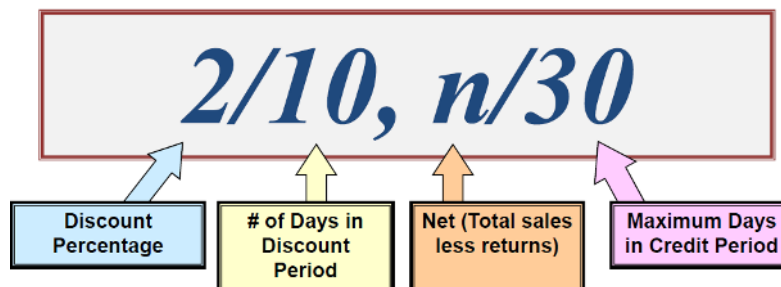
Sales Revenue are affected by (Credit Cards, Sales Discount, Sales Returns & Allowance, Bad Debt)

Sales revenue	\$3,000
Less: Credit card discounts ($0.03 \times \$3,000$)	90
Net sales (reported on the statement of earnings)	\$2,910

THESE ARE CONTRA REVENUE ACCOUNTS

* If you buy with a Credit Card, the seller will not earn the full amount since a small percentage goes to the credit card company

Sales Discount: If a person pays back within a certain amount, they have a discount on the object that they bought



If all 3 are applied at the same time:

Sales revenue	\$6,000
Less: Credit card discounts (a contra revenue)	90
Sales discounts (a contra revenue)	20
Sales returns and allowances (a contra revenue)	500
Net sales (reported on the statement of earnings)	\$5,390

More Definitions

Non-Trade Receivables: Amounts owed to other business but not related to transactions. (A company giving a loan to an employee)

Trade Receivables: open accounts owed to the business by trade customers

Note Receivables: Written promise made by another party (e.g., a customer) to pay the company a specified amount of money

NSF: Non-Sufficient Funds

FOB shipping point: The Buyer is responsible for the shipping

FOB Destination point: The seller pays for shipping

Cash Equivalent: Assets is very liquid like cash

Completed Contract Method: When revenue is only recorded when the product is fully delivered (Construction on big projects).

* The money that is to be received or paid needs to be adjusted to the currency exchange used by the other party by the end of the fiscal year

* The longer it takes for an account receivable to be paid off, the higher the chance of it becoming bad debt

* Sometimes revenue is measured by the percentage finished (percentage of completion method). It is based on the budget used

Safety Measurements: (Avoid Corruption or Theft)

Principles of Internal Control:

- 1) Establishment of Responsibility
- 2) Segregation of Duties
- 3) Document all transactions
- 4) Physical Control: Use locks, Safes

- 5) Electronic Control (Password, fingerprint)
- 6) Internal Verification: Spot checks and Auditors
- 7) Human Resource control (Screening, rotating Duties)

Control Account Receivables:

- 1) Analyse age of A. Receivable & Check periodically
- 2) Require credit history
- 3) Reward for timely collections

Control of Cash:

- 1) Prepare bank reconciliation
- 2) Allow limited number of people to sign cheque

Control Inventory:

- 1) Separation of duties when counting inventory
- 2) Limit access to the inventory
- 3) Have a perpetual accounting system

Chapter 7: Reporting and Interpreting Cost of Sales & Inventory

Merchandise will have a less complicated inventory flow compared to Manufacturing

* Consignment is when the revenue is not recorded until the last buyer buys it (Not from manufacturer to Retailer)

Manufactures:

- 1) Raw Material Inventory
- 2) Work in Process Inventory
- 3) Finished Goods Inventory

Cost Principle: Record at price paid or the consideration given

All costs are incurred to bring asset to usable/saleable condition (Invoice Price, Freight, Inspection Cost, Preparation Cost, return an allowance)

* Marketing and Sales Expense have their own categories

Most companies report inventory cost as:

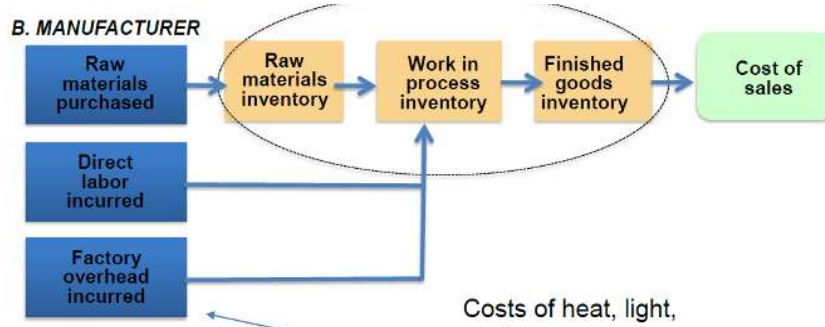
Invoice Price		XX
Less Returns	-	XX
<u>Less Discounts</u>	<u>-</u>	<u>XX</u>
Total Inventory Cost		XX

Material incident costs are recorded as expense rather than cost of goods sold

Direct Labor incurred and Factory overhead incurred (heat, light, power to operate factory) are part of **Work in Process Inventory**.

Direct Labour is the earnings of the workers who work directly on the product

Cost of Sale is an expense account



Calculating Cost of Sale:

Beginning inventory
 + Purchases of merchandise during the year
 Goods available for sale
 - Ending inventory
 Cost of sales

IMPORTANT FOR PERIODIC ACCOUNTING SYSTEM

Perpetual VS. Periodic: (Summarised)

Perpetual: Provide Up to Date inventory record and cost of sales record (It is expensive)

Periodic: Not up to date inventory record. Ending inventory based on physical count.
Cost of sales determined at end of accounting period

Perpetual:

- Continuous recording of COGS for every transaction
- A unit sold is removed from inventory immediately
- No need to do end of year entries since they were already recorded

Periodic:

- Inventory purchased recorded in **purchases account**
- Inventory reduction is not recorded yet
- Requires regular inventory count
- Calculate COGS at the end of period

When calculating COGS, whatever is not sold is presumed to be sold

COGAS= Cost of Goods available for sale

Shrinkage= ending balance- ending balance physical count

1. Beginning balance + purchase = COGS + ending balance
 - ▶ $\text{COGAS} = \text{Beginning balance} + \text{purchase} = 40,000 + 55,000 = 95,000$
 - ▶ $\text{COGS} = 95,000 - \$35,000$
2. Under the perpetual system: the accounting system provide up-date record
 - ▶ $\text{Shrinkage} = \text{ending balance (sys)} - \text{ending balance (physical count)}$
 $= 40,000 - 35,000 = 5,000$

Example (Periodic):

31.12

- Physical Ending Inventory = 10,000
- Opening Balance = 9,000
- Purchase = 20,000

$\text{COGS} = 9,000 + 20,000 - 10,000 = 19,000$

Date	Description	Debit	Credit
31	Ending Inventory	10,000	
	Cost of Goods Sold	19,000	
	Purchases		20,000
	Opening Inventory		9,000

Inventory Costing Methods: Assign a total dollar amount of goods available

- 1) Specific Identification
- 2) First In, First Out (FIFO) = The oldest thing bought will be first thing to sell
- 3) Weighted Average

FIFO: If the cost of buying is increasing, the oldest cost will be the higher net earning.
The price of selling would be the same

Weighted Average Cost= Calculate average cost per unit (cost/unit)

Cost Flow Assumption	Description
Specific Identification	<ul style="list-style-type: none"> Each inventory item is assigned a specific cost. Usually for expensive/unique goods Recognizes as COGS the actual cost of the inventory sold Can be very costly to implement (detailed info) Calculations are identical using periodic or perpetual systems Allowed under GAAP
First-in First-out ("FIFO")	<ul style="list-style-type: none"> When inventory is sold, the oldest piece of inventory is deemed to have been sold (and therefore COGS reflects oldest units first) This also means the <u>newest</u> costs feed ending inventory Allowed under GAAP
Average/Moving Average Cost	<ul style="list-style-type: none"> Calculates COGS (and inventory) based on the average cost of the inventory on hand When used in conjunction with a perpetual inventory system, the average has to be re-calculated whenever new inventory is purchased (hence "moving average"): Allowed under GAAP

Ending inventory is reported at the lower of cost or net realizable value (NRV) because of theft or damages

Net Realizable Value of the inventory, which is essentially an estimate of the amount that a company expects to receive for selling its inventory in the ordinary course of business.

Ex: First Sell for 100, COGS for 80, Only Sellable Price is 50. The NRV is 50

Under LC (Lower of Costs) & NRV, companies recognize a loss in the period in which the net realizable value of an item drops rather than in the period in which the item is sold. Whenever the item is valued lower than cost, you recognize a loss in COGS

Ex Continuation: Go with 80 since its lowest price of COGS

Allowance for write-down of inventory to NRV (Contra Asset Account): Money that end up lost when choosing the lower of cost and NRV

NRV is added to the cost of sales figure

Dec 31	Cost of Goods Sold	100 (Cost – NRV)	
	Allowance Write Down		100

* As long as sale value is lower than cost

Allowance Write-Off is when the Asset loses all its value

Average Cost Method: Weighted Average

$$\text{Average Cost} = \frac{\text{Cost of Goods Available for Sale (COGAS)}}{\text{\# of Units Available for Sale}}$$

Chapter 8: Property, Plant and Equipment

Long Lived Assets: Resources (Tangible or Intangible) owned by a business that is used for in its operations to produce benefits for future years. They are listed as non-current assets

Tangible: Physical Substance (Building, Machine, Furniture, Biological, natural resources and Fixtures)

It loses value over time. Not because of use but because of planned obsolescence

Intangible: No Physical Substance (Patents, copyrights, franchises, trademarks, goodwill)

The value lasts as long a it was paid for. A company pays for the value of their name brand for a specific amount of time before renewing it

Fixed Asset (Tangible Asset) Turnover: Sales Revenue/ Average Net Fixed Assets
 -Company's ability to generate sale given the investment in fixed assets
 (Plant/Property/Equipment)

During 2015, WestJet Airlines had \$4,209,265 of revenue. End-of-year fixed assets were \$2,793,194 and beginning-of-year fixed assets were \$3,473,262. (All numbers in thousands.)

$$\text{Fixed Asset Turnover} = \frac{\$4,209,265}{(\$3,473,262 + \$2,793,194) \div 2} = 1.34$$

- * Amount has to be compared with the companies in the same industry
- * Interest related to the purchases is added to interest expense and not the value of the item
- * Renovation and Repair costs applied to asset are recorded as cost

Acquisition cost includes the purchase price and all expenditures done to the asset. It does not include financing charges and cash discounts (Do not include if item breaks during transportation)

Invoice price	\$27,500,000
Deduct: Discount from Bombardier	<u>800,000</u>
Net cash invoice price	26,700,000
Add: Transportation charges paid by WestJet	300,000
Preparation costs paid by WestJet	<u>1,000,000</u>
Cost of the aircraft (added to the asset account)	<u><u>\$28,000,000</u></u>

Recording Acquisition Cost:

<p><u>Equipment</u></p> <ul style="list-style-type: none"> Purchase price Installation costs Modification to building necessary to install equipment Transportation costs 	<p><u>Land</u></p> <ul style="list-style-type: none"> Purchase price Real estate commissions Title insurance premiums Delinquent taxes Surveying fees Title search and transfer fees
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For intangible value, they base themselves on the value of the shares.

- * A building cost includes material, labour, overhead and interest expense

If debt is created when purchased:

Aircraft (A)	28,000,000	
Cash (A)		1,300,000
Note payable (L)		26,700,000

When purchased with Equity: Give away shares

Aircraft (A)	28,000,000	
Cash (A)		5,000,000
Common shares (SE)		23,000,000

Operating Lease: The lease given is short compared to the life of the item. Doing this will avoid the quick obsolescence

Finance Lease: Transfers all the risks and rewards of ownership from lessor to buyer

Capitalized Interest: Interest on borrowed funds **directly attributed to construction** until asset is ready. In other words, the interest cost/expense of the funds used to finance the construction of a long-term asset that an entity constructs for itself

Basket Purchase, is when part of a payment implies two or more payments (Ex; Phone data and new phone)

Other Example: When purchasing property, you pay the land and the building

The price is decided by the asset's relative market value

Asset	Appraised Value	% of Value
	a	b*
Land	\$ 126,000	40%
Building	189,000	60%
Total	\$ 315,000	100%

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Date		Description	Debit	Credit
Jan.	1	Land (+A)	120,000	
		Building (+A)	180,000	
		Cash (-A)		300,000

Subsequent Costs:

Costs incurred after an asset is purchased will be

- Capitalized- asset increases
- Expensed- Treated as period cost

Management needs to know if these assets create a future economic benefit
(Maintenance vs Renovation)

Repairs, Maintenance, and Betterments

1. **Ordinary Repairs and Maintenance** – Expenditures done to maintain the productivity capacity of the asset for the current accounting period (Only)
2. **Betterments** – Expenditures that increase the productive life, efficiency and capacity of asset (over many accounting periods). It does not happen frequently

Depreciation Concepts

Depreciation for Tangible

Amortization for Intangible

* Amount shown on the statement of financial position after depreciation does not represent the current market value. Only reflects the usefulness of item for the company

$$\frac{\text{Carrying amount}}{\text{Acquisition cost}} \times \text{Estimated useful life} = \frac{\$ 3,473,262}{\$ 4,871,153} \times 18 = 12.8 \text{ years}$$

What to consider for depreciation:

- 1) Acquisition Cost
- 2) Estimated Useful Life
- 3) Estimated Residual Value = What can be recovered after the period ends

The basis for most depreciating asset is the straight line

Residual Value: Cost remaining of asset after years of use

Depreciation Methods:

- 1) **Straight Line** – (most common) an equal portion of an asset's depreciation cost is allocated each accounting period

$$\underbrace{\text{Depreciable cost}}_{(\text{Cost} - \text{Residual value})} \times \underbrace{\text{Straight-line rate}}_{1 / \text{Useful life}} = \text{Depreciation expense}$$

The answers shows how much the asset will reduce per accounting period

- 2) **Units of Production** – allocates cost of asset over useful life based on relations of periodic output to its total estimated output

$$\frac{\text{Depreciation rate per unit}}{\frac{(\text{Cost} - \text{Residual value})}{\text{Estimated total production}}} \times \frac{\text{Actual production}}{\text{production}} = \text{Depreciation expense}$$

$$\frac{\$28,000,000 - \$6,000,000}{40,000 \text{ flights}} = \$550 \text{ per flight}$$

For every flight, WestJet should record depreciation by \$550

- 3) **Double Declining Balance** - Used when the asset is considered more efficient in earlier years and becomes slower over time (accelerated depreciation)

Double Declining-Balance Formula

$$\frac{\text{Carrying amount}}{(\text{Cost} - \text{Accumulated depreciation})} \times \frac{\text{Declining-Balance rate}}{\frac{2}{\text{Useful life}}} = \text{Depreciation expense}$$

Double Declining-Balance Method				
Year	Computation (Cost – Accumulated Depreciation) × 1/Useful Life	Depreciation Expense	Accumulated Depreciation	Carrying Amount
At acquisition:				\$28,000,000
2017	(\$28,000,000 – \$0) × 2/20	\$2,800,000	\$2,800,000	25,200,000
2018	(\$28,000,000 – \$2,800,000) × 2/20	2,520,000	5,320,000	22,680,000
2019	(\$28,000,000 – \$5,320,000) × 2/20	<u>2,268,000</u>	7,588,000	20,412,000
	Total	<u>\$7,588,000</u>		

*For each year that passes, the depreciation decreases since the base value is not worth as much

Double Declining Balance usually has the least amount of life span if we base ourselves on the same item

* If an asset is purchased anywhere within the fiscal year, the depreciation is calculated using months

$$\text{Depreciation expense} = (\$1,100,000 \div 12) \times 3 \text{ months} = \$275,000$$

Management must choose the best match for revenues and expenses given the asset.

- The decision is based on the residual value after the asset is completely used

Tax Reporting: One report for *Shareholders* and one for the *Government*

Financial Reporting (IFRS)	Tax Reporting
The objective of financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity.	The objective of the Income Tax Act is to raise sufficient revenues to pay for the expenditures of the federal government, with many provisions designed to encourage certain behaviours that are thought to benefit society (e.g., contributions to charities are tax-deductible to encourage people to support worthy programs).

For the most part, managers prefer to pay the least tax at the latest day in order to have more money to invest currently.

Impairment: Asset loses value due to causality, obsolescence or lack of demand

- If carrying amount (asset value) is bigger than recoverable amount, the asset is impaired

The Recoverable Amount/ Impairment Loss: Max (The total “revenue” that is expected to be created from this asset’s use)

- The asset’s fair value (carrying amount) – selling costs

Loss due to impairment of assets (SE)	7,000,000
Aircraft (A)	7,000,000

Disposal:

*Disposals are recorded on the last day of the accounting period

When disposed, two entries are required:

- 1) Update Depreciation Expense & Accumulated
- 2) Record Disposal

The gain obtained from selling (if sold) is considered revenue from “peripheral or incidental” activities. NOT in normal operations

Cash received		\$1,900,000
Original cost	\$2,600,000	
Less: Accumulated depreciation	<u>295,000</u>	
Carrying amount		<u>2,305,000</u>
Loss on disposal		<u>\$(405,000)</u>

1. Depreciation expense (E)	71,000	
Accumulated depreciation—Aircraft (XA)		71,000
2. Cash (A)	1,900,000	
Accumulated depreciation—Aircraft (XA)	295,000	
Loss on sale of asset (SE)	405,000	
Aircraft (A)		2,600,000

*Depreciation is always based on the original cost and not the market value

When trading an old item with a new one: C.A Vehicle (4,000) / C.H (4,600)/ C.M. Value (3,000)

Computer hardware (A)	4,600	
Accumulated depreciation—Vehicle (XA)	16,000	
Loss on disposal of assets (SE)	1,000	
Vehicle (A)		20,000
Cash (A)		1,600

Depletion: systematic allocation of the cost of natural resources over the period of exploitation

Oil inventory (A)	6,000,000	
Oil reserves (A)		6,000,000
(or Accumulated depletion XA)		

Intangible Assets are also prone to amortization: Use Straight Line Method

Patent amortization expense (E)	40,000
Patent (A) (or Accumulated amortization XA)	40,000

* Intangible assets with indefinite lives are not amortized but are instead tested annually for impairment

If the intangible asset has lost value due to impairment, it is recorded as:

Loss due to impairment (SE)	30,000
Copyright (A)	30,000

Examples of Intangible assets:

- Broadcast Rights
- Publishing Rights

- Trademarks
- Patents
- Licenses
- Customer Lists
- Franchises

Goodwill: Power of a brand. The favourable reputation that a company has with its customers (loyalty)

* A company might buy a specific company for the goodwill rather than the assets it owns

Goodwill= Purchase Price – Market Value of Company Assets

*Trademarks are not in statement of financial positions since they are registered and not purchased.

Copyrights: Owner has exclusive rights to publish, use and sell exclusive items
- Limited to 50 years after the death of owner

Franchise: Contractual right to sell certain products or services. Their life varies from short to indefinite. Ex: McDonald name on stores across the world

Leaseholds: Right granted in a contract called a lease to use a specific asset. Ex: Rent

Chapter 9: Reporting and Interpreting Current Liabilities

Capital Structure: Mixture of Debt and Equity that finances the short/long term operating requirements of the company.

Quick Ratio: Quick Assets/ Current liabilities

- Indicates amount of quick assets available to satisfy current liabilities
- The higher the ratio, it is good liquidity

*Quick Assets (Cash, Short Term Investment, Net Receivables)

Cash (A)	44.80	
Sales revenue (R)		40.00
GST payable (L)		2.00
PST payable (L)		2.80

Employee Deductions:

Wages Payable does not go directly to the employee. It is divided into contributions and salary (Ex: Pension)

- Income Tax Payable
- CCP Payable (Canadian Pension Plan)
- EI Payable (Employment Insurance)

Wages Payable is the Wages Expense minus contributions

▶ Employee Entry

Dr. Wage Expense	\$10,000	
Cr. Income Taxes Payable	\$2,500	(A)
Cr. CPP Payable	\$ 495	(B)
Cr. EI Payable	\$ 188	(C)
Cr. Wages Payable	\$6,817	

▶ Employer Entry

Dr. Wage Expense	\$ 758	
Cr. CPP Payable	\$ 495	(D)
Cr. EI Payable	\$ 263	(E)

The Contribution however is reduced from cash

▶ Payment of Wages

Dr. Wages Payable	\$6,817	
Cr. Cash		\$6,817

▶ Remittance Entry

Dr. Income Taxes Payable	\$2,500	(A)
Dr. CPP Payable	\$ 990	(B+D)
Dr. EI Payable	\$ 451	(C+E)
Cr. Cash		\$3,941

Important Formulas

Accounts Payable Turnover Rate = (COGS + Purchases)/ Average Accounts Payable

- Measures how quickly management pays their suppliers for COGS and Purchase

Average age of Payables = 365 Days/ Accounts Payable Turnover Ratio

- The numbers shows how many times a year a company settled the payments

Working Capital = Current Asset - Current Liability

- Important since they are direct impact on cash flows from operating activities reported on statement of cash flow

Notes Payable:

* Lenders give cash since they plan on receiving the money back + Interest

Time Value of Money - Interest that is associated with the use of money over time (not yearly). This is prevalent in the bonds section

Annuity – Series of consecutive equal periodic payments

* The longer the money is borrowed, the larger the interest expense

To the **borrower**, interest is an **expense**

To the **creditor**, interest is **revenue**

Interest= Principal (how much cash was borrowed) X Annual Interest Rate X Time

$$\text{Interest} = \$100,000 \times 6\% \times 2/12 = \$1,000$$

Interest expense (E)	1,000
Interest payable (L)	1,000

Exercises in Bond Section

Current Portion of Long-Term Debt:

Ex: Sears signed a note payable of \$5 million on June 1, 2016. Repayment is required on May 31, 2019. The statements of financial position at February 3, 2018, and February 2, 2019

February 3, 2018	
Non-current liabilities	
Note payable	\$5,000,000
February 2, 2019	
Current liabilities	
Current portion of long-term note	\$5,000,000

*Long term liabilities become current liabilities since the date due for the note payable is approaching

Deferred Revenues:

Receiving Cash in advance for selling (Subscription, Warranty, etc..)

Cash (A)	81.6	
Deferred extended warranty revenue (L)		81.6

But if warranty is not granted by the end of the period:

Deferred extended warranty revenue (L)	74.7	
Revenue from extended warranties (R)		74.7

Provisions: Liability of uncertain timing or amount

- Exercise from Page 533:

1) Provision for Product Warranties or warranty liability	
	773 Beginning Balance 2015
<u>224 Warranty Payments</u>	<u>176 Warranty Expense</u>
	725 Ending Balance 2015

Warranty Expense= Ending Balance- Beginning balance + Reimbursement

* Warranties can vary greatly depending on whether there are mass defects or just a small portion of products are defected

An estimation is made by looking at the percentage of past warranty claims

Warranty expense (E)	600,000	
Provision for product warranty (L)		600,000

Once the warranty is redeemed:

Provision for product warranty (L)	3,600,000	
Cash (A)		3,600,000

* If customer exchanges defected item for another functioning one, inventory is credited rather than cash

Contingent Liability: Possible liability that is created as a result of past events. It is not a liability until some future event occurs (Lawsuits, Environmental Problems, Tax Disputes)

* Provision is not recognized if liability cannot be estimated reliably (Disclosure is required for the contingency as long as there is a chance of outflow of resources)

Working Capital: The difference between current assets and current liabilities. It has a significant impact on the health and profitability of the company

Deferred Income Taxes:

Permanent Difference – Specific differences between rules in IFRS and tax return. Some revenues are exempt from tax while others are not deductible

Temporary Difference – Timing differences that will cause deferred revenue taxes and will be received in the future.

If you pay less tax in 2018, you will have to pay higher in 2019

- Deferred tax liability account is what needs to be paid extra

* The difference between the amounts of income tax expense and income taxes payable is called deferred income tax

* Deferred Income Taxes can be either assets or liabilities since they can be used to respectively generate more income or not (Depreciation, Amortization)

Present Value Concepts

- Financial calculation that measures the worth of a future amount of money or stream of payments in today's dollars adjusted for interest and inflation

* It is used to find equivalence of an amount to be received in the future, or a future amount discounted for compound interest

Future Value: Sum to which an amount will increase as a result of compound interest

Situations regarding Time Value of Money:

1. Present value of a single payment
2. Future value of a single payment
3. Present value of an annuity
4. Future value of an annuity

Calculate Present Value:

$$\text{Present value} = \frac{1}{(1+i)^n} \times \text{Amount}$$

I = Interest Rate

N = Number of periods

Present Value of Time

APPENDIX 9C: PRESENT VALUE TABLES

TABLE 9C.1

Present Value of \$1, $p = 1/(1 + i)^n$

Periods	1.5%	1.75%	2%	2.25%	2.5%	2.75%	3%	3.25%	3.5%
1	0.9852	0.9828	0.9804	0.9780	0.9756	0.9732	0.9709	0.9685	0.9662
2	0.9707	0.9659	0.9612	0.9565	0.9518	0.9472	0.9426	0.9380	0.9335
3	0.9563	0.9493	0.9423	0.9354	0.9286	0.9218	0.9151	0.9085	0.9019
4	0.9422	0.9330	0.9238	0.9148	0.9060	0.8972	0.8885	0.8799	0.8714
5	0.9283	0.9169	0.9057	0.8947	0.8839	0.8732	0.8626	0.8522	0.8420
6	0.9145	0.9011	0.8880	0.8750	0.8623	0.8498	0.8375	0.8254	0.8135
7	0.9010	0.8856	0.8706	0.8558	0.8413	0.8270	0.8131	0.7994	0.7860
8	0.8877	0.8704	0.8535	0.8369	0.8207	0.8049	0.7894	0.7742	0.7594
9	0.8746	0.8554	0.8368	0.8185	0.8007	0.7834	0.7664	0.7499	0.7337
10	0.8617	0.8407	0.8203	0.8005	0.7812	0.7624	0.7441	0.7263	0.7089
11	0.8489	0.8263	0.8043	0.7829	0.7621	0.7420	0.7224	0.7034	0.6849
12	0.8364	0.8121	0.7885	0.7657	0.7436	0.7221	0.7014	0.6813	0.6618
13	0.8240	0.7981	0.7730	0.7488	0.7254	0.7028	0.6810	0.6598	0.6394
14	0.8118	0.7844	0.7579	0.7323	0.7077	0.6840	0.6611	0.6391	0.6178
15	0.7999	0.7709	0.7430	0.7162	0.6905	0.6657	0.6419	0.6189	0.5969
16	0.7880	0.7576	0.7284	0.7005	0.6736	0.6479	0.6232	0.5995	0.5767
17	0.7764	0.7446	0.7142	0.6851	0.6572	0.6305	0.6050	0.5806	0.5572
18	0.7649	0.7318	0.7002	0.6700	0.6412	0.6137	0.5874	0.5623	0.5384
19	0.7536	0.7192	0.6864	0.6552	0.6255	0.5972	0.5703	0.5446	0.5202
20	0.7425	0.7068	0.6730	0.6408	0.6103	0.5813	0.5537	0.5275	0.5026
30	0.6398	0.5942	0.5521	0.5130	0.4767	0.4431	0.4120	0.3831	0.3563
40	0.5513	0.4996	0.4529	0.4106	0.3724	0.3379	0.3066	0.2782	0.2526
50	0.4750	0.4200	0.3715	0.3287	0.2909	0.2576	0.2281	0.2021	0.1791
Periods	3.75%	4%	4.5%	5%	6%	7%	8%	9%	10%
1	0.9639	0.9615	0.9569	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091
2	0.9290	0.9246	0.9157	0.9070	0.8900	0.8734	0.8573	0.8417	0.8264
3	0.8954	0.8890	0.8763	0.8638	0.8396	0.8163	0.7938	0.7722	0.7513
4	0.8631	0.8548	0.8386	0.8227	0.7921	0.7629	0.7350	0.7084	0.6830
5	0.8319	0.8219	0.8025	0.7835	0.7473	0.7130	0.6806	0.6499	0.6209
6	0.8018	0.7903	0.7679	0.7462	0.7050	0.6663	0.6302	0.5963	0.5645
7	0.7728	0.7599	0.7348	0.7107	0.6651	0.6227	0.5835	0.5470	0.5132
8	0.7449	0.7307	0.7032	0.6768	0.6274	0.5820	0.5403	0.5019	0.4665
9	0.7180	0.7026	0.6729	0.6446	0.5919	0.5439	0.5002	0.4604	0.4241
10	0.6920	0.6756	0.6439	0.6139	0.5584	0.5083	0.4632	0.4224	0.3855
11	0.6670	0.6496	0.6162	0.5847	0.5268	0.4751	0.4289	0.3875	0.3505
12	0.6429	0.6246	0.5897	0.5568	0.4970	0.4440	0.3971	0.3555	0.3186
13	0.6197	0.6006	0.5643	0.5303	0.4688	0.4150	0.3677	0.3262	0.2897
14	0.5973	0.5775	0.5400	0.5051	0.4423	0.3878	0.3405	0.2992	0.2633
15	0.5757	0.5553	0.5167	0.4810	0.4173	0.3624	0.3152	0.2745	0.2394
16	0.5549	0.5339	0.4945	0.4581	0.3936	0.3387	0.2919	0.2519	0.2176
17	0.5348	0.5134	0.4732	0.4363	0.3714	0.3166	0.2703	0.2311	0.1978
18	0.5155	0.4936	0.4528	0.4155	0.3503	0.2959	0.2502	0.2120	0.1799
19	0.4969	0.4746	0.4333	0.3957	0.3305	0.2765	0.2317	0.1945	0.1635
20	0.4789	0.4564	0.4146	0.3769	0.3118	0.2584	0.2145	0.1784	0.1486
30	0.3314	0.3083	0.2670	0.2314	0.1741	0.1314	0.0994	0.0754	0.0573
40	0.2293	0.2083	0.1719	0.1420	0.0972	0.0668	0.0460	0.0318	0.0221
50	0.1587	0.1407	0.1107	0.0872	0.0543	0.0339	0.0213	0.0134	0.0085

Present Value of Annuity

TABLE 9C.2

Present Value of Annuity of \$1, $p = [1 - 1/(1 + i)^n]/i$

Periods*	1.5%	1.75%	2%	2.25%	2.5%	2.75%	3%	3.25%	3.5%
1	0.9852	0.9828	0.9804	0.9780	0.9756	0.9732	0.9709	0.9685	0.9662
2	1.9559	1.9487	1.9416	1.9345	1.9274	1.9204	1.9135	1.9066	1.8997
3	2.9122	2.8980	2.8839	2.8699	2.8560	2.8423	2.8286	2.8151	2.8016
4	3.8544	3.8309	3.8077	3.7847	3.7620	3.7394	3.7171	3.6950	3.6731
5	4.7826	4.7479	4.7135	4.6795	4.6458	4.6126	4.5797	4.5472	4.5151
6	5.6972	5.6490	5.6014	5.5545	5.5081	5.4624	5.4172	5.3726	5.3286
7	6.5982	6.5346	6.4720	6.4102	6.3494	6.2894	6.2303	6.1720	6.1145
8	7.4859	7.4051	7.3255	7.2472	7.1701	7.0943	7.0197	6.9462	6.8740
9	8.3605	8.2605	8.1622	8.0657	7.9709	7.8777	7.7861	7.6961	7.6077
10	9.2222	9.1012	8.9826	8.8662	8.7521	8.6401	8.5302	8.4224	8.3166
11	10.0711	9.9275	9.7868	9.6491	9.5142	9.3821	9.2526	9.1258	9.0016
12	10.9075	10.7395	10.5753	10.4148	10.2578	10.1042	9.9540	9.8071	9.6633
13	11.7315	11.5376	11.3484	11.1636	10.9832	10.8070	10.6350	10.4669	10.3027
14	12.5434	12.3220	12.1062	11.8959	11.6909	11.4910	11.2961	11.1060	10.9205
15	13.3432	13.0929	12.8493	12.6122	12.3814	12.1567	11.9379	11.7249	11.5174
16	14.1313	13.8505	13.5777	13.3126	13.0550	12.8046	12.5611	12.3244	12.0941
17	14.9076	14.5951	14.2919	13.9977	13.7122	13.4351	13.1661	12.9049	12.6513
18	15.6726	15.3269	14.9920	14.6677	14.3534	14.0488	13.7535	13.4673	13.1897
19	16.4262	16.0461	15.6785	15.3229	14.9789	14.6460	14.3238	14.0119	13.7098
20	17.1686	16.7529	16.3514	15.9637	15.5892	15.2273	14.8775	14.5393	14.2124
30	24.0158	23.1858	22.3965	21.6453	20.9303	20.2493	19.6004	18.9819	18.3920
40	29.9158	28.5942	27.3555	26.1935	25.1028	24.0781	23.1148	22.2084	21.3551
50	34.9997	33.1412	31.4236	29.8344	28.3623	26.9972	25.7298	24.5518	23.4556
Periods*	3.75%	4%	4.5%	5%	6%	7%	8%	9%	10%
1	0.9639	0.9615	0.9569	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091
2	1.8929	1.8861	1.8727	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355
3	2.7883	2.7751	2.7490	2.7232	2.6730	2.6243	2.5771	2.5313	2.4869
4	3.6514	3.6299	3.5875	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699
5	4.4833	4.4518	4.3900	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908
6	5.2851	5.2421	5.1579	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553
7	6.0579	6.0021	5.8927	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684
8	6.8028	6.7327	6.5959	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349
9	7.5208	7.4353	7.2688	7.1078	6.8017	6.5152	6.2469	5.9952	5.7590
10	8.2128	8.1109	7.9127	7.7217	7.3601	7.0236	6.7101	6.4177	6.1446
11	8.8798	8.7605	8.5289	8.3064	7.8869	7.4987	7.1390	6.8052	6.4951
12	9.5227	9.3851	9.1186	8.8633	8.3838	7.9427	7.5361	7.1607	6.8137
13	10.1424	9.9856	9.6829	9.3936	8.8527	8.3577	7.9038	7.4869	7.1034
14	10.7396	10.5631	10.2228	9.8986	9.2950	8.7455	8.2442	7.7862	7.3667
15	11.3153	11.1184	10.7395	10.3797	9.7122	9.1079	8.5595	8.0607	7.6061
16	11.8702	11.6523	11.2340	10.8378	10.1059	9.4466	8.8514	8.3126	7.8237
17	12.4050	12.1657	11.7072	11.2741	10.4773	9.7632	9.1216	8.5436	8.0216
18	12.9205	12.6593	12.1600	11.6896	10.8276	10.0591	9.3719	8.7556	8.2014
19	13.4173	13.1339	12.5933	12.0853	11.1581	10.3356	9.6036	8.9501	8.3649
20	13.8962	13.5903	13.0079	12.4622	11.4699	10.5940	9.8181	9.1285	8.5136
30	17.8292	17.2920	16.2889	15.3725	13.7648	12.4090	11.2578	10.2737	9.4269
40	20.5510	19.7928	18.4016	17.1591	15.0463	13.3317	11.9246	10.7574	9.7791
50	22.4345	21.4822	19.7620	18.2559	15.7619	13.8007	12.2335	10.9617	9.9148

Example:

Year	Amount	Factor from Table 9C.1 Appendix 9C , $i = 4\%$			Present Value
1	\$1,000	×	0.9615 ($n = 1$)	=	\$ 961.50
2	\$1,000	×	0.9246 ($n = 2$)	=	924.60
3	\$1,000	×	0.8890 ($n = 3$)	=	889.00
Total present value				=	<u>\$2,775.10</u>

Example 2:

The present value of the \$200,000 is computed as follows:

$$\text{\$200,000} \times 0.8900 \text{ (From [Table 9C.1](#), } i = 6\%, n = 2) = \text{\$178,000}$$

Therefore, the journal entry is, as follows:

Equipment (A)	178,000	
Note payable (L)		178,000

To adjust per year:

Date	Interest Expense Unpaid Balance \times 6%	Unpaid Balance of Note Payable
January 1, 2017		\$178,000
December 31, 2017	$\text{\$178,000} \times 6\% = \text{\$10,680}$	188,680
December 31, 2018	$188,680 \times 6\% = 11,320^*$	200,000

Final Journal Entries:

Dec. 31, 2017	Interest expense (E)	10,680	
	Note payable (L)		10,680
Dec. 31, 2018	Interest expense (E)	11,320	
	Note payable (L)		11,320
Dec 31, 2018			
	Note payable (L)	200,000	
	Cash (A)		200,000

Chapter 10: Reporting and Interpreting Non-current Liabilities

Bell Finances their works through **internally generated funds**, **investments by owners** (shareholders) and borrowing from **long term creditors**

Types of Long-Term Debts:

- Bank Loans
- Notes Payable
- Mortgages
- Bonds Payable (A bond is a **contract between two parties**. Companies or governments issue bonds because they need to borrow large amounts of money. They issue bonds and investors buy them)

Characteristics of Bonds: Assume that it is reimbursed at maturity

- 1) Face Value (Maturity or Per Value, Principal)
- 2) Maturity Date (is set in the future for repayment)
- 3) Stated Interest Rate
- 4) Interest Payment Dates
- 5) Bond Date
- 6) Market Interest Expense
- 7) Issue Date

Face Value \$1,000	Interest 10%
	6/30 & 12/31
BOND PAYABLE	
Bond Date 1/1/2018	Maturity Date 1/1/2028

Advantages of a bond:

- 1) Debt does not dilute (weaken) ownership and control of company
- 2) The interest expense tax is lower compared to dividends and shares
- 3) The impact of earning is positive since interest from invest is higher than from borrowing

Long term debt carries higher risk than equity

- 1) Interest payments must be paid whether corporation has net income/loss
- 2) Since it must be repaid at a specific point in time, management must have sufficient funds to pay it or refinance it

* When the amount needed by a company is too large for any single creditor to lend, the company issues a publicly traded debt (Bond)

- Small amounts would be known as notes payable

* Big Companies seek a secure bond. This means that if the lender is unable to pay the bond, the large company can have possession of the lender's assets such as revenue, inventory, property, equipment and building (The worth of the bond).

Bond Payable (Par Value and Face Amount): Amount payable at the maturity level and cover the basis for the periodic cash interest payments

Coupon/State Rate: Rate of the interest per period specified in the bond contract (Interest rate)

* There are many different types of bonds that can apply to all sort of borrowers

Types of Bonds:

- 1) Unsecured Bond: No asset pledged as guarantee for repayment of maturity
- 2) Secured Bond: Specific asset pledged as a guarantee of payment of maturity
- 3) Callable Bond: May be recalled for early retirement by the issuer
- 4) Convertible Bond: May be converted to common shares of issuer

Indenture: Specifies the legal provisions of the bond (terms and conditions)

- Managers prefer covenants with less restriction in order to have more freedom on the company's future actions
- Creditors want stricter covenants that reduce the risk of losing their investment

* If you get money by purchasing a bond, you can always sell it to another creditor if you need cash before it matures

Bond Certificate: Bond document that each bondholder receives

-The *trustees* work on finding out whether the company fulfills all of the provisions of the bond history

Bond Prices can change due to:

- 1) Changes in creditworthiness of the bond issuer (How good is the company= Accounts Payable turnover rate)
- 2) Changes in Market interest rates

Example: We assume that on January 1, 2017, a company borrowed \$100,000 from a local bank, to be repaid over a period of 5 years, plus interest at the rate of 6 % per year

Options:

- 1) Payment of the principal on December 31, 2021, with interest payable annually on December 31

- 2) Payment of one-fifth of the principal annually on December 31, with interest payable annually on that date
- 3) Payment of five equal annual amounts that include both principal and interest each December 31

Date	Cash Payment (Credit)	Interest Expense: Unpaid Principal x 6% (Debit)	Payment of Principal (Debit)	Carrying Amount (Unpaid Balance)
Option 1: Principal paid at the maturity date; interest paid annually on December 31				
1/1/2017				\$100,000
31/12/2017	\$ 6,000	\$ 6,000	—0—	100,000
31/12/2018	6,000	6,000	—0—	100,000
31/12/2019	6,000	6,000	—0—	100,000
31/12/2020	6,000	6,000	—0—	100,000
31/12/2021	106,000	6,000	\$100,000	—0—
	<u>\$130,000</u>	<u>\$30,000</u>	<u>\$100,000</u>	
Option 2: Interest and one-fifth of the principal paid annually on December 31				
1/1/2017				\$100,000
31/12/2017	\$ 26,000	\$ 6,000	\$ 20,000	80,000
31/12/2018	24,800	4,800	20,000	60,000
31/12/2019	23,600	3,600	20,000	40,000
31/12/2020	22,400	2,400	20,000	20,000
31/12/2021	21,200	1,200	20,000	—0—
	<u>\$118,000</u>	<u>\$18,000</u>	<u>\$100,000</u>	
Option 3: Equal amounts including both principal and interest paid annually on December 31				
1/1/2017				\$100,000
31/12/2017	\$ 23,739*	\$ 6,000	\$ 17,739	82,261
31/12/2018	23,739	4,936	18,803	63,458
31/12/2019	23,739	3,807	19,932	43,526
31/12/2020	23,739	2,612	21,127	22,399
31/12/2021	23,739	1,340†	22,399	—0—
	<u>\$118,695</u>	<u>\$18,695</u>	<u>\$100,000</u>	
Journal Entries				
Date	Journal entry	Option 1	Option 2	Option 3
1/1/2017	Cash	100,000	100,000	100,000
	Note payable	100,000	100,000	100,000
12/31/2017	Note payable		20,000	17,739
	Interest expense	6,000	6,000	6,000
	Cash	6,000	26,000	23,739
(See note below)				
12/31/2021	Note payable	100,000	20,000	22,399
	Interest expense	6,000	1,200	1,340
	Cash	106,000	21,200	23,739

Reporting Bond Transactions

Types of Cash payments:

- 1) *Principal*: Single payment made when the bond matures (Face value)
- 2) *Cash Interest Payments*: computed by multiplying the principal amount X the interest rate

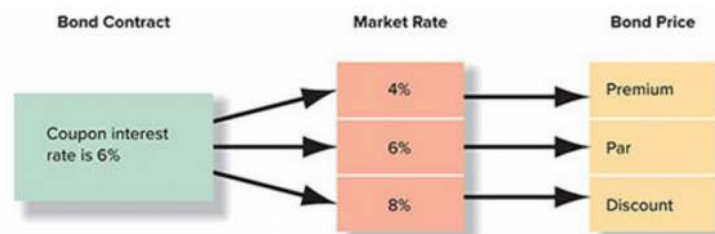
Coupon Rate: States the rate of interest on a bond (quarterly, semi-annually, annually)

* *The price of the bond is calculated using the present value concept*

* Creditors use the market interest rate to determine the interest of their bonds. It does not necessarily have to be the given specific value

Bond Premium: Difference between the selling price and initial payment when the bond is sold for more than the initial payment

Bond Discount: Difference between the selling price and par when the bond is sold for less than the initial value (par= Same)



It would be considered discount if the interest rate in the market is higher. Favor to the borrower

*Bond liabilities are recorded at the present value of future cash flows

Cash (A)	400,000	
Bonds payable (L)		400,000

Recording bond interest expense:

Bond interest expense (E)	12,000	
Cash (A)		12,000

* The bond interest payments do not have to coincide with the company's fiscal year

* Bonds given at a discount might occur when an interest expense is chosen right before the market rate increases

	Present Value
a. Principal: $\$400,000 \times 0.4564$	\$182,560
b. Interest: $\$12,000 \times 13.5903$	163,084
Issue (sale) price of MSC's bonds	<u>\$345,644*</u>

Once it is calculated, the amount is divided by their par value to estimate the percentage of discount

Ex: $(\$345,644 \div \$400,000)$ which is 86.5%

Journal Entry:

Cash (A)	345,644	
Discount on bonds payable (XL)	54,356	
Bonds payable (L)		400,000

* The discount is recorded in a contra liability account

Effective Interest Expense: Amortizes a bond discount/premium on the basis of effective interest rate

Amortization of bond discount = Interest Expense – Interest paid (or accrued)

Amortization Schedule: Bond Discount (Effective Interest)				
Date	(a) Interest to Be Paid [$\$400,000 \times 3\%$]	(b) Interest Expense [4% × (d) Carrying Amount, Beginning of Period]	(c) Amortization [(b) – (a)]	(d) Carrying Amount [Beginning Carrying Amount + (c)]
1/1/2016				\$345,644
30/6/2016	\$12,000	\$13,826	\$1,826	347,470
31/12/2016	12,000	13,899	1,899	349,369
30/6/2017	12,000	13,975	1,975	351,344
31/12/2017	12,000	14,054	2,054	353,398
.
30/6/2025	12,000	15,699	3,699	396,164
31/12/2025	12,000	15,836*	3,836	400,000

Receiving premium bonds: 6% annual interest rate for 20 periods (Page 564)

	Present Value
a. Principal: $\$400,000 \times 0.6730$	\$269,200
b. Interest: $\$12,000 \times 16.3514$	<u>196,217</u>
Issue (sale) price of MSC's bonds	<u>\$465,417</u>

Cash (A)	465,417	
Premium on bonds payable (L)		65,417
Bonds payable (L)		400,000

Once the interest is paid

Bond interest expense (E)	9,308	
Premium on bonds payable (L)	2,692	
Cash (A)		12,000

* Interest Expense is reported on the statement of earnings (income statement) since it is related to financial activities rather than operating activities

- Investors and creditors want to make sure that the business is generating enough resources to meet the obligations

Mainstream Example (On Discount)

Step 1: Calculate Interest Payment for each Period

Bond Amount x Coupon rate (Divide value if every six months)

Step 2: Calculate the Bond that is given to us

- 1) Face Value of Bond x Present Value of Interest Rate (divided by 2 if every six months)
- 2) Interest Expense per Period (Step 1) x Annuity Value for Interest Rate
- 3) Add Both Values together to get Bond Payable

Step 3: Create Journal Entries

Cash	xxx		
Discount	x		
	Bond Payable	xxxx	
			Discount – Debit Premium - Credit

Cash	xxxx		
	Premium	x	
	Bond Payable	xxx	

Step 4: Create a Table

<u>Date</u>	<u>Interest Payable</u>	<u>Interest Expense</u>	<u>Discount</u>	<u>Bond Payable</u>
Oct 1	From Step 1	Interest Rate x Bond Payable	Interest Exp -Interest Payable	Step 2 part 3

Step 5: Journal Entries of requested Dates in question

Example:

Face Value: \$30,000,000

Coupon/Interest Yearly: 5.5%

Yield/ Market Rate: 6%

Periods: 10 years, 2 times/year = 20 periods

Step 1: $30,000,000 \times 2.75\% = \$825,000$ / every 6 months

Step 2:

Principal $30,000,000 \times 0.5534 = 16,602,000.0$

Interest $825,000 \times 14.8775 = 12,273,937.5$

28,875,937.5 Cash Received

Step 3:

Cash	28,875,938	
Discount	1,129,062	
Bond Payable		30,000,000

Step 4:

<u>Date</u>	<u>Interest Payable</u>	<u>Interest Expense (3%)</u>	<u>Discount</u>	<u>Bond Payable</u>
March 31	-	-	-	28,875,938
Sept. 30	825,000	866,278	41,278	28,917,215
Dec 31	412,500	433,758	21,258	28,938,473
March 31	412,500	449,077	36,577	28,975,050
At some point,				30,000,000

Step 5:

Sept. 30

Interest Expense	866,278
Discount	41,278
Cash	825,000

Dec. 31 (We do not pay on this day, written for Financial Statement Only)

Interest Expense	433,758
Discount	21,258
Interest Payable	412,500

March 31

Interest Expense	449,077	
Interest Payable	412,500	
Discount	36,577	
Cash	825,000	(combination of Dec 31 recording and March 31)

Times Interest Earned Ratio = $\frac{\text{Net Earnings} + \text{Interest Expense} + \text{Income Tax Expense}}{\text{Interest Expense}}$

Interest Expense

- Ratio is used to know if the company is generating sufficient resources from the profit making activities to meet the current obligations associated with debt (Higher is better)

Early Retirement of Debt:

- Occurs typically when the market rate of interest decreases to the point where the market value of the bonds exceeds the call price. Later new bonds would be given at a lower interest rate

Ex: If the market rate of interest drops to 4 percent, then MSC can issue new bonds that pay interest of 4% instead of 6%. Semi-annual interest payments would then be reduced from \$12,000 to \$8,000 ($\$400,000 \times 0.02$). The cash savings of \$4,000 every six months is equivalent to \$29,302 ($\$4,000 \times 7.32557$) at December 31, 2021. Redemption of the bonds requires MSC to pay a premium (charged for cancelation) of \$4,000 ($\$400,000 \times 0.01$), but it saves the company \$29,302.

Updating the loss for the issuer: (Page 567)

Bonds payable (L)	400,000
Loss on redemption of bonds (SE)	30,928
Discount on bonds payable (XL)	26,928
Cash (A)	404,000

*Bond Prices move in the opposite direction of the interest rates

- If interest increases, bond prices decrease
- Demand for bonds would be high if the interest is low

Lease Liabilities: Sometimes renting is cheaper than buying for business operations. An operating lease is signed, and it does not transfer substantially the risks of ownership.

- Rent Expense is recorded in the general journal
- Rent Expense recorded when assets are actually used

Finance Lease: Transfers substantially all the risks and rewards of ownership from lessor to the lessee (When it goes from renting to buying)

The differences: Operating lease vs Finance Lease (ASPE)

- 1) Ownership of asset is transferred to the lessee at the end of lease term
- 2) The lessee can purchase the asset back in the future at a price lower than the market value
- 3) The lease term is a major part of asset's economic life even if title is not transferred
- 4) The present value of the minimum lease payments is substantially all of the fair value of the leased asset when the lease is signed. (Almost (90%) or same value if leased or purchased)

- 5) The leased asset are of specific nature that only the lessee can use without big modifications

Leased equipment (A)	25,000,000
Lease payable (L)	25,000,000

Employee Retirement Benefits:

- * Accounts are set up for retirement funds and employee benefits (healthcare, vacation)

Debt to Equity Ratio: Total Liabilities/ Shareholder's Equity

- Assess the debt capacity of a business
- How much of equity is liabilities
- Whether or not to buy shares
- Measures how much debt has been used to finance the company's acquisition of assets relative to equity financing that is supplied by shareholders

- * A high ratio normally suggests that a company relies heavily on funds provided by Creditors

Chapter 11: Reporting & Interpreting S.E

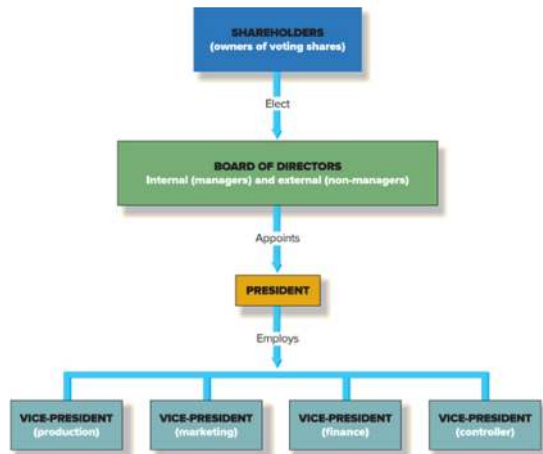
Preferred Shares: a share which entitles the holder to a fixed dividend, whose payment takes priority over that of common-stock dividends

Common Shares: are issued to business owners and other investors as proof of the money they have put into a company. Of all shareholders, common shareholders have the least claim on a company's assets

Shareholder's rights:

- 1) A voice in management (attempt to fix issues and elect board of directors)
- 2) They Receive Dividends which is small portion of remaining assets
- 3) Receive a proportional share of distribution of remaining asset if company goes bankrupt

Organizational Structure of a Corporation:



Authorized Number of Shares: Max number of shares that the company can issue (specified in charter)

Issued Shares: number of shares that have been issued

Outstanding Shares: total number of shares owned by shareholders on a specific day (shares that have not been taken yet)

Outstanding number of shares:		
The number of shares currently owned by shareholders—that is, the number of shares authorized, minus the total number of un-issued shares, minus the number of treasury shares.		
Authorized shares		100,000
Treasury shares		(1,000)
Un-issued shares		(70,000)
Outstanding shares		29,000

Treasure Shares: Bought back by the corporation to the shareholders

Earnings Per Share=
$$\frac{\text{Net Earnings available to common shareholders}}{\text{Average number of common shares outstanding}}$$

- return on investment based on number of shares outstanding

* Simple Equation Written in Chapter 1

Legal Capital: Permanent capital that must remain in the business. The money helps the creditors

Selling Shares:

Cash (A) (100,000 × \$45)		4,500,000	
Common shares (SE)			4,500,000
Assets	=	Liabilities	+ Shareholders' Equity
Cash +4,500,000			Common shares +4,500,000

* No Journal Entry for the corporation if a shareholder sells their shares to another person

Reasons to go public:

- 1) Create market for its shares
- 2) Need for new capital

* In order to avoid management to only care for their profits instead of the companies, a set of incentives are created

- 1) Buy Stocks at a fixed price (if price of stock increases, selling would create profit)
- Compensation Packages for meeting company goals

Repurchase of Shares- It would reduce the number of outstanding shares. The less shares available, the higher the stock price (shares must be reduced however when bought back)

If BCE purchases 50,000 common shares in the open market at \$30 per share and the average price of the previously issued common shares is \$34

Common shares (SE) (50,000 × \$34)	1,700,000
Cash (A)	1,500,000
Contributed surplus (SE)	200,000

* The company cannot make money buy repurchasing their own stock. Instead it, it is placed on **Contributed Surplus**

BCE subsequently purchased 50,000 of its own common shares when the price per share was \$40. In this case, the excess of the purchase price over the issuance price is \$6 per share for a total of \$300,000. This difference is debited first to contributed surplus to the extent of \$200,000 (the account balance), and the remaining amount of \$100,000 is debited to retained earnings

Common shares (SE) (50,000 × \$34)	1,700,000
Contributed surplus (SE)	200,000
Retained earnings (SE)	100,000
Cash (A)	2,000,000

Investors receive money back from return on investments (selling at higher price) and dividends

*Giving dividends are not required unless it is declared by management. Once declared, there is no way too cancel it

*Calculating dividend payable is done by multiplying the common shares outstanding times the value of the dividend

Entry when announced:

Dividends declared—Common (SE)	587,187,500	
Dividend payable—Common (L)		587,187,500

Once paid:

Dividends payable—Common (L)	587,187,500	
Cash (A)		587,187,500

Rules:

- 1) The company must have sufficient retained earnings to pay the dividends
- 2) Sufficient Cash to have enough for operations

Dividend Yield Ratio: Dividend per share/ Market price per share
- percentage return that shareholders earn from the dividends received

$$\frac{\$2.60}{\$53.46} = 0.049, \text{ or } 4.9\%$$

Stock Dividend: Distribution of additional shares of a corporation's own equity. It is distributed at a pro rate basis (receive extra shares equal to percentage of shares they already had)

- Measured by the percentage of company owned and not number of shares

* Doing this would still keep the value of the share

Ex: an investor could own 100 shares worth \$6,000 before the stock dividend ($100 \times \$60$) and 200 shares worth \$6,000 after the stock dividend ($200 \times \$30$). The investor would only make money once he sells both shares

Example: 10% stock dividend, 100,000 outstanding shares and \$20 Share value
 - $(100,000 \times 0.1) \times 20 = 200,000$

Dividends declared—Common (SE) $(100,000 \times 10\% \times \$20)$	200,000
Stock dividend to be issued (SE)	200,000

Once it is paid:

Stock dividend to be issued (SE)	200,000
Common shares (SE)	200,000

Stock Splits: Increase in total number of authorized shares by a specified ratio (Does not decrease retained earnings)

Ex: Two shares for one Share

* The company does not have to pay to acquire the shares

This is done in order to decrease the price of a stock and get more investors involved

Shareholders' Equity	Before	After a 100% Stock Dividend	After a 2-for-1 Stock Split
Contributed capital			
Number of shares outstanding	30,000	60,000	60,000
Issue price per share	\$ 10	\$ 10	\$ 5
Common shares	300,000	600,000	300,000
Retained earnings	650,000	350,000	650,000
Total shareholders' equity	<u>\$950,000</u>	<u>\$950,000</u>	<u>\$950,000</u>

Preferred Shares

The most significant differences between common and preferred are:

- 1) P.S do not grant voting rights
- 2) Are less risky than common shares since they receive the assets first if the business goes bankrupt
- 3) Have a stable dividend amount. There is no room for hoping that it is high

Convertible preferred Shares: P.S that are convertible to common shares at the holder's option

Dividend Preferences:

- 1) Current Dividend Preferred
 - Grant priority for dividends over common shares

2) Cumulative Dividend Preference

- current dividend not paid in full to accumulate for every year not paid (must be paid before common shares)

Dividends in arrears: dividends on cumulative preferred shares that have not been declared in years (paid before common shares)

Retained Earnings:

* Adjustments related to errors made in prior periods should not affect the current-period earnings

Demonstrating Case

This case focuses on the organization and operations for the first year of Mera Corporation, which was organized on January 2, 2017. The laws specify that the legal capital for no par value shares is the full amount of the shares. The corporation was organized by 10 local entrepreneurs for the purpose of operating a business to sell various supplies to hotels. The charter authorized the following share capital:

- Common shares, no par value, unlimited number of shares.
- Preferred shares, 5 percent, \$25 par value, 10,000 shares (cumulative, non-convertible, and non-voting; liquidation value, \$26).

The following summarized transactions, selected from 2017, were completed during the months indicated:

- | | |
|---------------|---|
| a. January 5 | Sold a total of 7,500 shares of no par value common shares to the 10 entrepreneurs for cash at \$52 per share. Credit the common shares account for the total issue amount. |
| b. February 1 | Sold 7,560 preferred shares at \$25 per share; cash collected in full. |
| c. March 10 | Purchased land for a store site and made full payment by issuing 400 preferred shares. Early construction of the store is planned. Debit land account (store site). The preferred share is selling at \$25 per share. The land was appraised at \$10,000. |
| d. April 15 | Paid \$2,000 cash for organization costs. Debit the intangible asset account organization costs. |
| e. May 25 | Issued 40 preferred shares to A. B. Cain in full payment of legal services rendered in connection with organization of the corporation. Assume that the preferred share is selling regularly at \$25 per share. Debit organization costs. |

f.	June 10	Sold 500 no par value common shares for cash to C. B. Abel at \$54 per share.
g.	November 30	The company's board of directors declared the annual dividends on the preferred shares, and a dividend of \$0.50 per common share. The dividends are payable on December 20 to shareholders of record at December 15.
h.	December 20	Paid the declared dividends on preferred and common shares.
i.	December 31	Purchased equipment for \$600,000; paid cash. No depreciation expense should be recorded in 2017.
j.	December 31	Borrowed \$20,000 cash from the City Bank on a one-year, interest-bearing note. Interest is payable at a 12 percent rate at maturity.
k.	December 31	Calculated the following for the year: gross revenues, \$129,300; expenses, \$98,000, including corporation income tax but excluding amortization of organization costs. Assume that these summarized revenue and expense transactions involved cash. Because the equipment and the bank loan transactions were on December 31, no related adjusting entries at the end of 2017 are needed.
l.	December 31	Decided that a reasonable amortization period for organization costs, starting as of January 1, 2017, is 10 years. This intangible asset must be amortized to expense.

Solution: Journal Entry

a.	January 5	Cash (A)	390,000	
		Common shares (SE)		390,000
		<i>Sale of no par value common shares (\$52 × 7,500 shares = \$390,000).</i>		
b.	February 1	Cash (A)	189,000	
		Preferred shares, 5% (SE)		189,000
		<i>Sale of preferred shares (\$25 × 7,560 shares = \$189,000).</i>		
c.	March 10	Land (A)	10,000	
		Preferred shares, 5% (SE)		10,000
		<i>Purchased land for future store site; paid in full by issuance of 400 preferred shares (\$25 × 400 shares = \$10,000).</i>		
d.	April 15	Organization costs (A)	2,000	
		Cash (A)		2,000
		<i>Paid organization costs.</i>		
e.	May 25	Organization costs (A)	1,000	
		Preferred shares 5% (SE)		1,000
		<i>Organization costs (legal services) paid by issuance of 40 preferred shares. The implied market value is \$25 × 40 shares = \$1,000.</i>		
f.	June 10	Cash (A)	27,000	
		Common shares (500 shares) (SE)		27,000
		<i>Sold 500 no par value common shares (\$54 × 500 shares = \$27,000).</i>		
g.	November 30	Dividends declared—Preferred (SE)	10,000	
		Dividends declared—Common (SE)	4,000	
		Dividends payable—Preferred (L)		10,000
		Dividends payable—Common (L)		4,000
		<i>Declaration of the annual dividend on preferred shares (8,000 × \$25 × 0.05) and a dividend of \$0.50 per common share.</i>		

h. December 20	Dividends payable—Preferred (L)	10,000	
	Dividends payable—Common (L)	4,000	
	Cash (A)		14,000
	<i>Payment of the declared dividends.</i>		
i. December 31	Equipment (A)	600,000	
	Cash (A)		600,000
	<i>Purchased equipment.</i>		
j. December 31	Cash (A)	20,000	
	Note payable (L)		20,000
	<i>Borrowed cash and signed a one-year, 12 percent interest-bearing note.</i>		
k. December 31	Cash (A)	129,300	
	Revenues (E)		129,300
	Expenses (E)	98,000	
	Cash (A)		98,000
	<i>To record summarized revenues and expenses.</i>		
2. December 31	Expenses (E)	300	
	Organization costs (A)		300
	<i>Adjusting entry to amortize organization costs for one year [(\$2,000 + \$1,000) ÷ 10 years = \$300].</i>		

Non-Corporation Businesses:

* Capital account is used for owner's investment and drawings (withdrawal of business money for owner)

* The drawings are part of the owner's equity

J. Doe, drawings (OE)	1,000	
Cash (A)		1,000

And when closing the account:

J. Doe, capital (OE)	12,000	
J. Doe, drawings (OE)		12,000

* A sole proprietorship does not pay income taxes of the business but instead, pays the owner's personal income tax return

Example of investing in a partnership: (applies to all accounts)

A. Able, drawings (OE)	1,000	
B. Baker, drawings (OE)	650	
Cash (A)		1,650

Statement of Financial Position:

AB PARTNERSHIP Statement of Partners' Capital For the Year Ended December 31, 2017			
	A. Able	B. Baker	Total
Investment, January 1, 2017	\$60,000	\$40,000	\$100,000
Add: Additional investments during the year	-0-	-0-	-0-
Net earnings for the year	<u>18,000</u>	<u>12,000</u>	<u>30,000</u>
Totals	78,000	52,000	130,000
Deduct: Drawings during the year	<u>(12,000)</u>	<u>(7,800)</u>	<u>(19,800)</u>
Partners' equity, December 31, 2017	<u>\$66,000</u>	<u>\$44,200</u>	<u>\$110,200</u>

Chapter 5: Reporting & Interpreting Cash Flows

* Cash equivalent are considered as cash in this scenario as long as payed before 3 months

Example of Cash Flow (direct method):

NATIONAL BEVERAGE CORP. Consolidated Statements of Cash Flows For the Year Ended May 2, 2015* (amounts in thousands)	
Operating activities	
Net earnings (loss)	\$(49,311)
Adjustments for items not affecting cash:	
Depreciation and amortization	9,404
Change in non-cash working capital items related to operations:	
Accounts receivable (increase)	(1,746)
Inventories (decrease)	990
Prepaid expenses (decrease)	355
Accounts payable (decrease)	(710)
Accrued liabilities (increase)	2,384
Income tax payable (increase)	54
Cash flows from operating activities	<u>60,042</u>
Investing activities	
Purchases of property, plant, and equipment	(11,630)
Proceeds from sale of property, plant, and equipment	1,905
Purchase of short-term investments	(6,532)
Proceeds from sale of short-term investments	<u>4,869</u>
Cash flows used in investing activities	<u>(11,388)</u>
Financing activities	
Repayment of principal on long-term debt	(18,400)
Repurchase of shares	(7,455)
Payment of dividends	<u>(275)</u>
Cash flows used in financing activities	<u>(26,130)</u>
Increase in cash and cash equivalents	22,524
Cash and cash equivalents, beginning of period	<u>29,932</u>
Cash and cash equivalents, end of period	<u>\$ 52,456</u>
<i>The balances of certain accounts have been adjusted to simplify the presentation.</i>	

This table shows the change in cash from beginning to ending balance of the Balance Sheet

❖ Operating Activities: Relate to generating revenue and having expenses

Direct Method: Presents O.A as gross receipts and gross payments (not used often in Canada since its expensive)

* Difference between inflow and outflow is called Net Cash Flow from operating/investing/financing activities

Indirect Method: Presents the net earnings and then eliminates non cash items to arrive to net cash inflow/outflow

Net earnings
+/- Adjustments for non-cash items
Net cash inflow (outflow) from operating activities

* There was a net cash outflow since investment was larger than cash collected from sale

Comparison:

Direct		Indirect	
Cash collected from customers	\$644,079	Net earnings	\$49,311
Cash payments to suppliers	(426,405)	Depreciation and amortization	9,404
Cash payments for other expenses	(131,356)		
Cash payments for interest	(928)		
Cash payments for income taxes	(25,348)	Changes in non-cash operating working capital items	1,327
Net cash provided by operating activities	\$ 60,042	Net cash provided by operating activities	\$60,042

***The combination of the net cash flows from operating/investing/financing activities must equal the net increase/decrease in cash for the reporting period

This technique implies translating accrual basis to cash basis recording

To prepare cash flow statement:

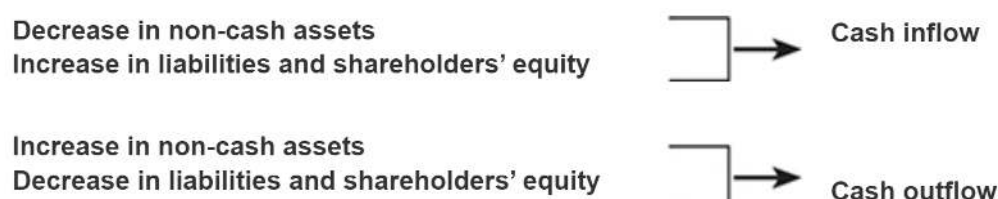
- 1) Comparative statement of financial position (compute cash flow from all activities)
- 2) Complete statement of earnings (cash flow from operating activities)
- 3) Additional info about selected accounts

Understanding the Statement of Cash Flow: changes in accounts reported in ST.F.P:

$$\begin{aligned}\text{Asset} &= \text{Liabilities} + \text{Shareholder's Equity} \\ \text{Cash} + \text{Non-Cash Asset} &= \text{Liabilities} + \text{Shareholder's Equity} \\ \Delta \text{Cash} &= \Delta \text{Liabilities} + \Delta \text{Shareholders equity} - \Delta \text{Non-cash asset}\end{aligned}$$

* Any change in cash between beginning and ending must create change in **right side**

Any transaction that changes cash must be accompanied by a change in liabilities, shareholders' equity, or non-cash assets



All effect to accounts:

Category	Transaction	Effect on Cash	Other Account Affected
Operating	Collect accounts receivable	+Cash	–Accounts receivable (A)
	Pay accounts payable	–Cash	–Accounts payable (L)
	Prepay rent	–Cash	+Prepaid rent (A)
	Pay interest	–Cash	–Retained earnings (SE)
	Sell for cash	+Cash	+Retained earnings (SE)
Investing	Purchase equipment for cash	–Cash	+Equipment (A)
	Sell investment securities for cash	+Cash	–Investments
Financing	Pay back debt to bank	–Cash	–Notes payable—Bank (L)
	Issue shares for cash	+Cash	+Contributed capital (SE)

* It is important to know in this section if it is a cash component or not

NATIONAL BEVERAGE CORP. Consolidated Statements of Financial Position (amounts in thousands)				
		May 2, 2015	May 3, 2014	
Related Cash	Assets			Change
Flow Section	Current assets			
Change in Cash	Cash and cash equivalents	\$ 52,456	\$ 29,932	+22,524
I	Short-term investments	4,348	2,685	+1,663
O	Accounts receivable	59,951	58,205	+1,746
O	Inventories	42,924	43,914	–990
O	Prepaid expenses	8,050	8,405	–355
	Total current assets	167,729	143,141	
I*	Property, plant, and equipment (net)	80,021	79,700	+321
	Total assets	\$247,750	\$222,841	

Aim of cash flow is to see the changes that occur with every account on the B.S

Direct Method example: (net cash flows from O.A)

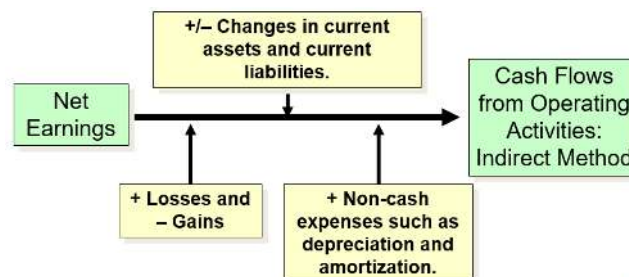
* Only register what effects the cash account. If not affected, ignore it (non cash)

The differences (non cash) between cash component and revenue/expenses have to be placed in a liability account (to be paid later)

Transaction	Operating Revenue or Expense (Accrual Amount)	B - Cash Component	C Difference (Non-cash Component)
Sales	\$140,000	\$145,000	\$ (5,000)
Cost of sales	(69,000)	(59,000)	(10,000)
Salaries expense	(28,000)	(27,000)	(1,000)
Interest expense	(5,000)	(5,000)	-0-
Other operating expenses	(15,800)	(10,800)	(5,000)
Depreciation expense	(7,000)	-0-	(7,000)
Income tax expense	(9,000)	(10,500)	1,500
Cash/accrual earnings from operations	\$ 6,200	\$ 32,700	\$(26,500)

Indirect Method to get net cash flow → accrual amount + Non cash component
 $\$6,200 + \$26,500 = \$32,700$

SAMPLE CORPORATION Statement of Cash Flows (Partial) For the Year Ended December 31, 2017 (Indirect Method)	
Operating Activities	
Net earnings from operations	\$ 6,200
Add (deduct) items not affecting cash:	
Depreciation expense	\$ 7,000
Decrease in accounts receivable	5,000
Decrease in merchandise inventory	7,000
Decrease in prepaid expenses	5,000
Increase in accounts payable	3,000
Increase in salaries payable	1,000
Decrease in income tax payable	(1,500)
Net adjustments	<u>26,500</u>
Net cash flows from operating activities	<u>\$32,700</u>



On the big scope:

		Accounts Receivable (A)	
Change	Beginning balance	58,205	
+1,746	Sales revenue (on account)	645,825	Collections from customers 644,079
	Ending balance	59,951	

The \$1746 means that cash collected is less than revenue. The rest is on account

Changes on Accounts

Change in Inventory:

Purchases of inventory – Cost of Goods Sold
\$0 - \$990 COGS (When selling and not purchasing)

Inventories (A)		
Beg. bal.	43,914	
		Decrease 990
End. bal.	42,924	

Change in Prepaid Expense:

Purchase in advance – Expenses used

Prepaid Expenses (A)		
Beg. bal.	8,405	
		Decrease 355
End. bal.	8,050	

Changes in Account Payable:

Purchase on Account- Payment in cash to supplier

Accounts Payable (L)		
		Beg. bal. 45,606
Decrease	710	
		End. bal. 44,896

Change in Accrued Liability:

Accrual Expense- Payment of Accrued
Beginning Balance + \$2384 prepayment by customer

Accrued Liabilities (L)		
	Beg. bal.	18,873
	Increase	2,384
	End. bal.	21,257

Change in Income Tax Payable:

Tax Payable- Tax paid on cash (debit)
Beginning B of \$44 + Tax Expense \$54
Increase must be added to net earnings

Income Taxes Payable (L)		
	Beg. bal.	44
	Increase	54
	End. bal.	98

Summary:

Item	Additions and Subtractions to Reconcile Net Earnings to Cash Flows from Operating Activities	
	When item increases	When item decreases
Depreciation and amortization	+	NA
Accounts receivable	-	+
Inventories	-	+
Prepaid expenses	-	+
Accounts payable	+	-
Accrued liabilities	+	-
Income tax payable	+	-

Interpretations:

- If cash flow from operations is falling, this is bad since majority of payments are on account instead of paid with cash

Quality of Earning Ratio: Cash Flows from Operating Activities/ Net Earnings

- Ability to generate cash through operations
- Answers how much each dollar of net earnings it generates

* Seasonal earnings can make the ratio change drastically. A garden landscaping company might do well in the summer but terribly in fall.

Investing Activities Section:

* Investing in assets but only those purchased with cash or cash equivalent are included

Changes in Property, Plant and Equipment occur:

- 1) Purchase of New asset (+)
- 2) Dispose of old Asset (-)
- 3) Periodic depreciation of asset (-)

Normal T Account of PPE:

Property, Plant, and Equipment — Net			
Beg. bal.	79,700	Sale	1,905
Purchase	11,630	Depreciation	9,404
End. bal.	80,021		

*These accounts affecting PPE are listed separately on the statement of Cash Flow

- o Cash Flow tables only consider the effect of cash account and not PPE

Items from Statement of Financial Position and Account Analysis	Cash Inflow (Outflows)	Explanation
Purchase of property, plant, and equipment	\$(11,630)	Payment in cash for property and equipment.
Proceeds from disposal of property, plant, and equipment	1,905	Receipt of cash from sale of equipment.
Purchase of short-term investments	(6,532)	Payment in cash for new investments.
Proceeds from sale of short-term investments	4,869	Receipt of cash from sale of investments.
Net cash inflow (outflow) from investing activities	<u>\$(11,388)</u>	Reported on the statement of cash flows

Capital Expenditure Ratio: Cash Flow from Operating Activities

Cash Paid for Capital Expenditures

- Degree that the company is able to finance purchases of PPE, intangibles, etc. with cash provided by operating activities
- Higher ratio means less need for outside financing for future expansion
- Too high of a ratio can mean that the company is not investing in becoming + productive

Free Cash Flow: Cash Flows from Operating Activity – Dividends – Capital Expenditure

- measure firm's ability to pursue long-term investment opportunities

Financing Activities Sector:

Examples:

- 1) Borrow Cash from bank
- 2) Repayment of Loan
- 3) Issuance of Shares for Cash
- 4) Payment of Cash Dividends

All Decreases are due to decrease in cash account

Item from Statement of Financial Position and Account Analysis	Cash	Explanation
	Inflow (Outflow)	
Repayment of principal on long-term debt	(18,400)	Cash payments of principal on long-term debt.
Repurchase of shares	(7,455)	Cash payments to repurchase shares.
Payment of dividends	(275)	Payment of cash dividends to shareholders.
Net cash inflow from financing activities	<u>\$ 26,130</u>	Reported on the statement of cash flows.

* The contributed capital comes from the issuance of shares and repurchase of outstanding shares

Non-Cash Investing and Financing Activities: transactions that do not have direct cash flow effects. They are reported as *supplement* in statement of cash flow

Ex: Buying something with a loan that is worth the same price. No cash was needed to pay a portion of the price

Place it apart from the main 3 categories;

22. Supplemental cash flow disclosure (in thousands of U.S. dollars)		
	2015	2014
(b) Variations in non-cash transactions (partial):		
Additions to property, plant, and equipment included in accounts payable and accrued liabilities	13,993	1,754
Addition to property, plant, and equipment transferred from prepaid expenses and deposits and other non-current assets	—	5,826
Proceeds on disposal of property, plant, and equipment included in other current assets	(79)	—
Amounts payable relating to business acquisitions	(6,400)	(500)

Example of how it looks by the end of the exercise:

During the year ended December 31, 2017, Old Style Brewery, a craft brewer, reported net earnings of \$3,182 (all numbers in thousands) and cash and cash equivalents of \$472 at the beginning and \$24,676 at the end of the year

<p style="text-align: center;">OLD STYLE BREWERY Statement of Cash Flows For the Year Ended December 31, 2017 (in thousands)</p>	
Operating activities	
Net earnings	\$ 3,182
Add (deduct) items not affecting cash:	
Depreciation	1,324
Other non-current accrued expenses	857
Increase in accounts receivable	(881)
Increase in inventories	(574)
Decrease in income taxes receivable	326
Increase in prepaid expenses	(565)
Decrease in accounts payable	(391)
Increase in accrued liabilities	241
Increase in refundable deposits payable	457
Net cash flows from operating activities	<u>3,976</u>
Investing activities	
Expenditures for property, plant, and equipment	(18,193)
Deposits on equipment	(5,830)
Other investing activities	4
Net cash flow from investing activities	<u>(24,019)</u>
Financing activities	
Proceeds from debt	16,789
Repayment of debt	(18,752)
Proceeds from sale of shares (IPO)	46,202
Proceeds from sale of shares (options)	13
Other financing activities	(5)
Net cash flow from financing activities	<u>44,247</u>
Increase in cash and cash equivalents	24,204
Cash and cash equivalents:	
Beginning of year	<u>472</u>
End of year	<u>\$24,676</u>

Class Notes:

Add depreciation back to net earnings since it is no cash expense

Do the opposite of what would be do to an asset account

Changes in non-cash operating working capital items:	
Increase in accounts receivable	(1,746)
Decrease in inventories	990
Decrease in prepaid expenses	355
Decrease in accounts payable	(710)
Increase in accrued liabilities	2,384
Increase in income tax payable	54
Net cash provided by (used in) operating activities	<u>60,042</u>

Income tax expense is already on the net earnings, so we have to focus on the tax payable (Beginning – Ending)

Income tax expense (credit) is larger than tax payment (debit)

* Prepare a T Account on the exam to understand better

Problem in page 287

Depreciation is a non cash expense

- Net Earnings increase while non cash expense decreases

Working capital change- All the numbers that change in the non cash operation

Ending Cash Balance comes from Operating activity amount +/- investing activities +/- financing activities

Cash Flow Rules:

When **Assets Increase**, the number **decreases**

When **Assets Decreases**, the number **increases**

When **Liability Increases**, the number **increases**

When **Liability Decreases**, the Number **decreases**

Chapter 12: Communicating Accounting info & Analysing Financial Statements

The Financial Statement states the health, cash flows and operating efficiencies

Corporate Governance: company is managed in the interest of the shareholders

Staff:

- 1) Management (CEO, CFO, Accounting Staff)
- 2) Directors (Oversights Auditor Committee (independent))
- 3) Auditors (Partners, managers and Staff auditors)

Exhibit 13.2

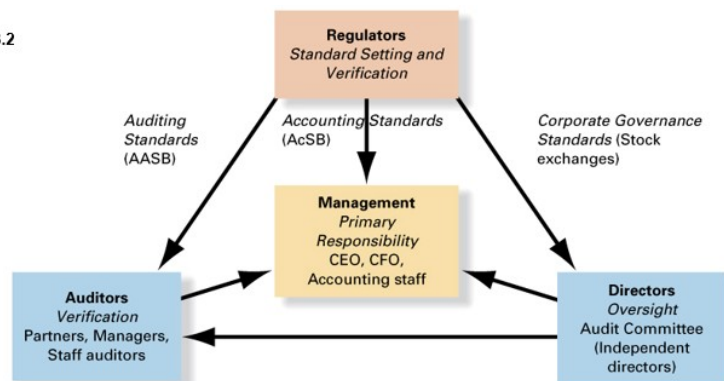
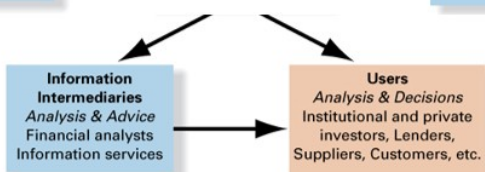


Exhibit 13.3



*Accounting managers responsible for financial statements with material errors are routinely dismissed from their positions

Board of Directors: Elected by the shareholders to represent their interests, is responsible for maintaining the integrity of the company's financial reports

* If any company listed on a stock exchange is found guilty of *knowingly* violating any disclosure regulation, not only the company but also members of its board of directors and audit committee can be sued

Unqualified Audit Opinion: The auditors' declaration that the financial statements are fair presentations in all material respects in conformity with IFRS

The Use of Financial Reports:



Management (CEO, CFO): Primary responsibility to ensure everything is correct alongside Accountants

Financial Analysts: Analyse the data and give advice. They create an analyst report

Public (Investors, Lenders, Suppliers, Customers): analyse and make decisions on their investments

Types of Investors:

Institutional Investors: Manages pension funds, school funds, mutual funds, endowment funds and other funds invested on behalf of others

Private Investors: purchase shares in companies but not a large sum of shares. They buy them through brokers

Lenders: Suppliers, banks, commercial credit companies, and other financial institutions that lend money to companies. Private investors become creditors when they buy a company's bonds debentures

Annual Reports:

- Has Basic Financial Statements: Balance Sheet, Income Statement, Cash Flow, Change in Equity
- Has related notes for clarification
- Has Auditor's opinion

Components of Financial Sector:

- 1) Summarize Financial Data
- 2) Discussions on the Data
- 3) Report on Independent Accountants (Auditor's Opinion)
- 4) Basic Financial Statements
- 5) Notes about Financial Statement

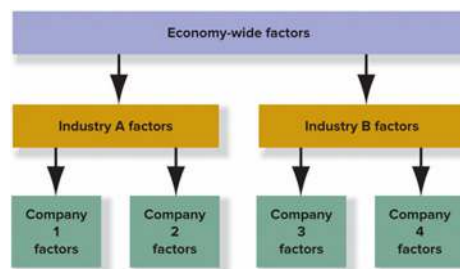
Quarterly Report:

- Begins with short letter to shareholder
- Has unaudited statement of earnings and financial position for quarter
- Statement of Cash flow and changes in shareholder's equity are **omitted**

* It is very likely that not all analysts arrive to the same conclusion. This is what avoids any sort of fluctuation or drastic stock drop

Things to lookout for when Investing:

- 1) **Economy-wide factors:** the health of company has direct impact on performance of individual business. They look out for unemployment rate, inflation rate and changes in interest
- 2) **Industry Factor:** Certain events have a major impact on each company within an industry but have only a minor impact on other companies outside the industry
- 3) **Individual Company Factors:** Understand the business more than just their financial statements. They might visit the company, read about it or buy their products



Analysing a Company's Strategy:

The **Return on Equity** is great at showing the company's profitability.

ROE Profit Driver Analysis:



The numerator and divider cancel out to create the formula for ROE (Net Sales/Net Sales = 1)

* Companies can be profitable by achieving high *profit margins* or quick *turnover of assets*

High Return on Equity:

- 1) Generate more revenue from company's assets

High Return on Asset:

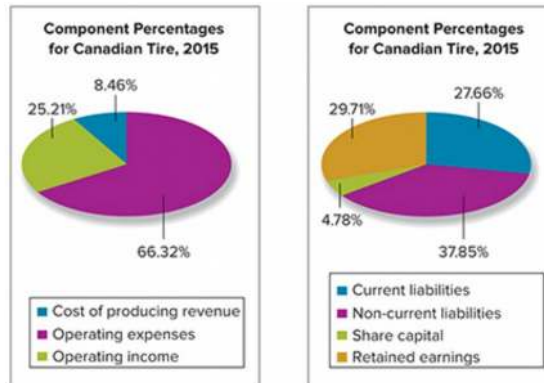
- 1) **Product Differentiation:** Be able to charge more for something not found anywhere else (affects profit margins)
- 2) **Cost Advantage:** If the products are too similar, offering a cheaper price might incentivise the consumer more than the competition (affects total asset turnover rate)

Two Types of Benchmarks for Comparison:

- 1) **Time Series Analysis:** Info from the same company is compared over time (change in sales, revenue, expenses)
- 2) **Comparing with Similar Companies:** Compare in the same industry to understand if the success/problem is industry's or the company's (Google vs Microsoft)

Component Percentage: Expresses each ratio from financial statement in a percentage of a (single base amount)

*Comparing percentages of different values throughout time can highlight consistency or changes that for the better/worse



Tests of Profitability: Measuring the adequacy of net earnings by comparing it to other items reported on the financial statements

Ratio		
Tests of Profitability		Basic Computation
1. Return on equity (ROE)	Chapter 4	$\frac{\text{Net earnings}}{\text{Average shareholders' equity}}$
2. Return on assets (ROA)	Chapter 3	$\frac{\text{Net earnings} + \text{Interest expense (net of tax)}}{\text{Average total assets}}$
Financial leverage percentage	Chapter 12	$\frac{\text{Return on equity} - \text{Return on assets}}{\text{Return on assets}}$
3. Earnings per share (EPS) ratio	Chapter 11	$\frac{\text{Net earnings available to common shareholders}}{\text{Average number of shares outstanding}}$

*Profitability is the primary measure to test overall success of a company

Financial Leverage Percentage: Return on Equity (ROE)- Return on Asset (ROA)

- measure advantage/disadvantage that occurs when ROE and ROA are different
- Leverage is positive when the rate of return on company assets exceeds the average after-tax interest rate in borrowed funds

$$\text{Financial leverage percentage} = \text{Return on equity} - \text{Return on assets}$$

$$\text{Canadian Tire, 2015} = 12.9\% - 5.4\% = 7.5\%$$

- ❖ *Quality of Earnings:* Not a good indicator since a negative Cash flow from operations and net earnings could make it seem like a positive number (-/-=+)
- ❖ *Net Profit Margin:* While it shows how much money made for every dollar sold, it is not a good indicator overall. A percentage does not matter if the base itself is not large
- ❖ *Fixed Asset Turnover Ratio:* Used a lot with capital-intensive companies (airlines and electric utilities)

- ❖ *Total Asset Turnover*: Used a lot when a company has a lot of inventory and accounts receivable

Tests of Liquidity:

Tests of Liquidity		
7. Cash ratio	Chapter 12	$\frac{\text{Cash} + \text{Cash equivalents}}{\text{Current liabilities}}$
8. Current ratio	Chapter 2	$\frac{\text{Current assets}}{\text{Current liabilities}}$
9. Quick ratio	Chapter 9	$\frac{\text{Quick assets}}{\text{Current liabilities}}$
10. Receivables turnover ratio	Chapter 6	$\frac{\text{Net credit sales}}{\text{Average net trade receivables}}$