

ASSUMPTIONS AND PRINCIPLES

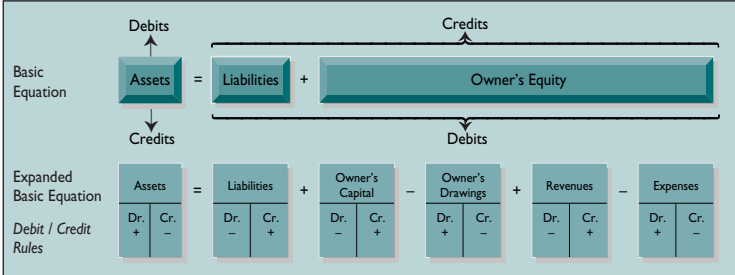
Assumptions

Going concern
Monetary unit
Economic entity
Time period

Principles

Cost
Revenue recognition
Matching
Full disclosure

BASIC ACCOUNTING EQUATION (Chapter 2)



ADJUSTING ENTRIES (Chapter 3)

	Type	Adjusting Entry
Prepayments	1. Prepaid expenses	Expense account Asset account
	2. Unearned revenues	Liability account Revenue account
Accruals	1. Accrued revenues	Asset account Revenue account
	2. Accrued expenses	Expense account Liability account
Estimates	1. Amortization	Expense account (amortization expense) Contra asset account (accumulated amortization)

Note: 1. Each adjusting entry will affect one or more income statement accounts and one or more balance sheet accounts.
2. Adjusting entries never include the Cash account.

Interest Calculation

Interest = Face Value of Note × Annual Interest Rate × Time in Terms of One Year

CLOSING ENTRIES (Chapter 4)

Purpose

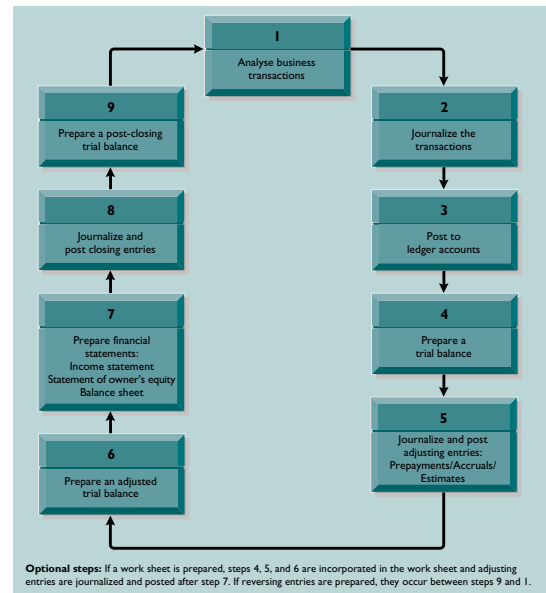
- Update the owner's capital account in the ledger by transferring net income (loss) and owner's drawings to owner's capital.
- Prepare the temporary accounts (revenue, expense, drawings) for the next period's postings by reducing their balances to zero.

Process

- Debit each revenue account for its balance (assuming normal balances), and credit the owner's capital account for total revenues.
- Debit the owner's capital account for total expenses, and credit each expense account for its balance (assuming normal balances).
- Debit owner's capital for the balance in the owner's drawings account and credit owner's drawings for the same amount.

STOP AND CHECK: Does the balance in your Owner's Capital account equal the ending capital balance reported in the Balance Sheet and Statement of Owner's Equity? Are all of your temporary account balances zero?

ACCOUNTING CYCLE (Chapter 4)



INVENTORY (Chapters 5 and 6)

Ownership

Freight Terms	Freight Costs Paid / Recorded By
Shipping point	Buyer
Destination	Seller

Perpetual vs. Periodic Journal Entries

Event	Perpetual	Periodic
Purchase of goods	Inventory Cash (A/P)	Purchases Cash (A/P)
Freight (shipping point)	Inventory Cash (A/P)	Freight In Cash (A/P)
Return of purchased goods	Cash (A/R) Inventory	Cash (A/R) Purchase returns
Sale of goods	Cash (A/R) Sales Cost of goods sold Inventory	Cash (A/R) Sales No entry
Return of sold goods	Sales returns and allowances Cash (A/R) Inventory (or Loss) Cost of goods sold	Sales returns and allowances Cash (A/R) No entry
Adjustment of inventory to lower physical count amount	Cost of goods sold Inventory	No entry
End of period	No entry	Closing or adjusting entry required

Inventory Cost Flow Methods

Perpetual	Periodic
Specific identification	
First-in, first-out (FIFO)	First-in, first-out (FIFO)
Moving average	Weighted average
Last-in, first-out (LIFO)	Last-in, first-out (LIFO)

SUBSIDIARY LEDGERS AND SPECIAL JOURNALS (Chapter 7)

Subsidiary Ledgers

Accounts receivable—customers' ledger
Accounts payable—creditors' ledger
Merchandise inventory—inventory ledger

Special Journals

Type	Record
Sales (S)	all sales on account
Cash receipts (CR)	all cash received
Purchases (P)	all purchases of merchandise on account
Cash payments (CP)	all cash paid
General (J)	all other transactions, including adjusting, correcting, and closing entries

CASH (Chapter 8)

Principles of Internal Control

- Authorization
- Segregation of duties
- Independent verification
- Safeguard of assets and records
- Documentation procedures

Bank Reconciliation

Bank	Books
Balance per bank statement	Balance per books
Add: Deposits in transit	Add: Unrecorded credit memoranda from bank statement
Deduct: Outstanding cheques	Deduct: Unrecorded debit memoranda from bank statement
Adjusted cash balance	Adjusted cash balance

- Note: 1. Errors should be offset (added or deducted) on the side that made the error.
2. Adjusting journal entries should only be made for the books side.

STOP AND CHECK: Does the balance in the general ledger cash account equal the adjusted cash balance?

BAD DEBTS (Chapter 9)

Allowance Method

Event	Journal Entry
Record credit sales	Account receivable Sales
Estimate bad debts	Bad debts expense Allowance for doubtful accounts
Write-off uncollectible account	Allowance for doubtful accounts Accounts receivable
Subsequent recovery	Accounts receivable Allowance for doubtful accounts Cash Accounts receivable

Estimating Bad Debts

Method	Result
Balance sheet method (% of total receivables or aging)	Determines balance in allowance for doubtful accounts
Income statement method (% of sales)	Determines bad debt expense

CAPITAL ASSETS (Chapter 10)

Tangible	Intangible
Property, plant, and equipment	Intangible assets
Natural resources	

Calculation of Annual Amortization Expense

Straight-line	$\frac{\text{Cost} - \text{Residual value}}{\text{Useful life (in years)}}$
Declining-balance	$\text{Net book value at beginning of year} \times \text{Straight-line rate}^*$ $^* \text{Straight-line rate} = 1 \div \text{Useful life (in years)}$
Units-of-activity	$\frac{\text{Cost} - \text{Residual value}}{\text{Useful life (in units)}} \times \text{Units of activity during year}$

Note: If amortization is calculated for partial periods, the straight-line and declining-balance methods must be adjusted for the relevant proportion of the year. Multiply the annual amortization expense by the number of months expired in the year divided by 12 months.

CURRENT LIABILITIES (Chapter 11)

Types

- Definitely determinable
- Estimable
- Contingent

REPORTS

Order of Preparation	Date
1. Income statement	Period (e.g., year, quarter, month) ended date
2. Statement of owner’s equity	Period (e.g., year, quarter, month) ended date
3. Balance sheet	As at end of period date
4. Cash flow statement	Period (e.g., year, quarter, month) ended date

Income Statement (perpetual inventory system)

Name	Income Statement	Period Ended Date
Sales revenues		
Sales	\$ X	
Less: Sales returns and allowances	<u>X</u>	
Net sales		\$ X
Cost of goods sold		<u>X</u>
Gross profit		<u>X</u>
Operating expenses		
Selling expenses		
(Examples: store salaries, advertising, freight out)	\$ X	
Administrative expenses		
(Examples: rent, amortization, utilities, insurance)	<u>X</u>	<u>X</u>
Income from operations		X
Other revenues and gains		
(Examples: interest, gains)	\$ X	
Other expenses and losses		
(Examples: interest, losses)	<u>X</u>	<u>X</u>
Net income		<u>\$ X</u>

Income Statement (periodic inventory system)

Name	Income Statement	Period Ended Date
Sales revenues		
Sales	\$ X	
Less: Sales returns and allowances	<u>X</u>	
Net sales		\$ X
Cost of goods sold		
Beginning inventory	\$ X	
Purchases	\$ X	
Less: Purchase returns and allowances	<u>X</u>	
Net purchases	X	
Add: Freight in	<u>X</u>	
Cost of goods purchased	<u>X</u>	
Cost of goods available for sale	X	
Less: Ending inventory	<u>X</u>	
Cost of goods sold		X
Gross profit		<u>X</u>
Operating expenses		
Selling expenses		
(Examples: store salaries, advertising, freight out)	\$ X	
Administrative expenses		
(Examples: rent, amortization, utilities, insurance)	<u>X</u>	<u>X</u>
Income from operations		X
Other revenues and gains		
(Examples: interest, gains)	\$ X	
Other expenses and losses		
(Examples: interest, losses)	<u>X</u>	<u>X</u>
Net income		<u>X</u>

Statement of Owner’s Equity

Name Statement of Owner’s Equity Period Ended Date		
Owner, capital, beginning of period		\$ X
Add: Investments by owner	\$ X	
Net income (or deduct net loss)	<u>X</u>	<u>X</u>
		X
Deduct: Drawings		<u>X</u>
Owner, capital, end of period		<u>\$ X</u>

Balance Sheet

Name Balance Sheet As At Date		
Assets		
Current assets		
(Examples: cash, temporary investments, accounts receivable, merchandise inventory, prepaids)		\$ X
Long-term investments		
(Examples: equity investments, debt investments)		X
Capital assets		
(Examples: property, plant, and equipment, natural resources, intangible assets)	\$ X	
Less: Accumulated amortization	<u>X</u>	<u>X</u>
Total assets		<u>\$ X</u>
Liabilities and Owner’s Equity		
Liabilities		
Current liabilities		
(Examples: notes payable, accounts payable, accruals, unearned revenues, current portion of notes payable)		\$ X
Long-term liabilities		
(Examples: notes payable, bonds payable)		<u>X</u>
Total liabilities		X
Owner’s Equity		
Owner, capital (end of period)		<u>X</u>
Total liabilities and owner’s equity		<u>\$ X</u>

Note: The equity section of the balance sheet would be presented as partners’ equity in a partnership and shareholders’ equity, with share capital and retained earnings separately detailed, in a corporation.

Cash Flow Statement

Name Cash Flow Statement Period Ended Date		
Cash flows from operating activities		
<i>Note:</i> May be prepared using the direct or indirect method		
Cash provided (used) by operating activities		\$ X
Cash flows from investing activities		
(Examples: purchase / sale of long-term assets)		
Cash provided (used) by investing activities		X
Cash flows from financing activities		
(Examples: issue / repayment of long-term liabilities, issue of stock, payment of dividends)		
Cash provided (used) by financing activities		<u>X</u>
Net increase (decrease) in cash		X
Cash, beginning of period		<u>X</u>
Cash, end of period		<u>\$ X</u>

STOP AND CHECK:

Statement of Owner’s Equity–net income (loss) must equal net income (loss) presented on Income Statement.
Balance Sheet–ending owner’s equity must equal ending owner’s equity presented on Statement of Owner’s Equity; total assets must equal total liabilities and owner’s equity.
Cash Flow Statement: Cash, end of period must equal cash presented on the Balance Sheet.

USING THE INFORMATION IN THE FINANCIAL STATEMENTS
(Chapters 1-11)

<i>Ratios</i>	<i>Formula</i>	<i>Purpose or Use</i>
CHAPTER 4		
Working capital	Current assets- Current liabilities	Measures short-term debt paying ability
Current ratio	<u>Current assets</u> Current liabilities	Measures short-term debt paying ability
CHAPTER 5		
Profit margin	<u>Net income</u> Net sales	Measures net income generated by each dollar of sales
Gross profit margin	<u>Gross profit</u> Net sales	Measures gross profit generated by each dollar of sales
Inventory turnover	<u>Cost of goods sold</u> Average inventory	Measures liquidity of inventory
Days sales in inventory	<u>365 days</u> Inventory turnover	Measures number of days stock is on hand
CHAPTER 9		
Acid test (quick ratio)	Cash + temporary investments + receivables (net) <u>Current liabilities</u>	Measures immediate short-term liquidity
Receivables turnover	<u>Net credit sales</u> Average net receivables	Measures liquidity of receivables
Collection period	<u>365 days</u> Receivables turnover	Measures number of days receivables are outstanding
CHAPTER 10		
Asset turnover	<u>Net sales</u> Average total assets	Measures how efficiently assets are used to generate sales
Return on assets	<u>Net income</u> Average total assets	Measures overall profitability of assets