PRADITA University

Akuntansi Usaha Pariwisata

CHAPTER 1 ACCOUNTING IN ACCTION

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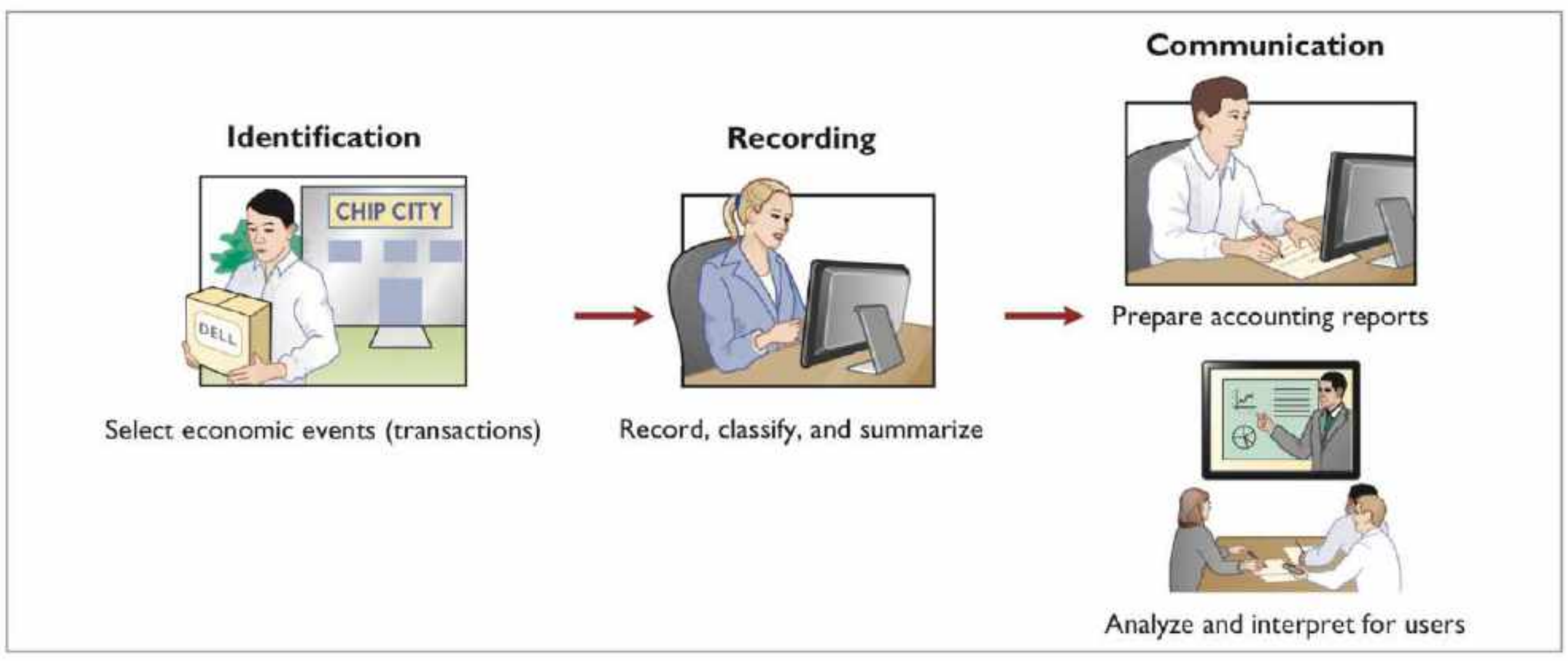
- IFRS 4th Edition

Weygandt ● Kimmel ● Kieso

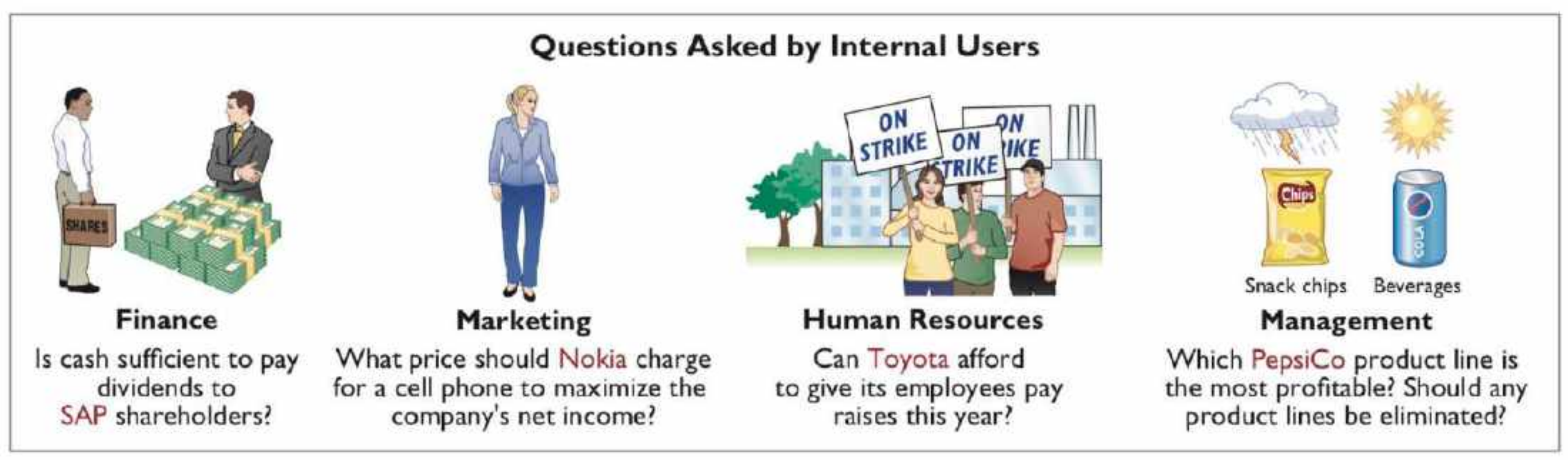
Accounting Activities and Users

Three Activities



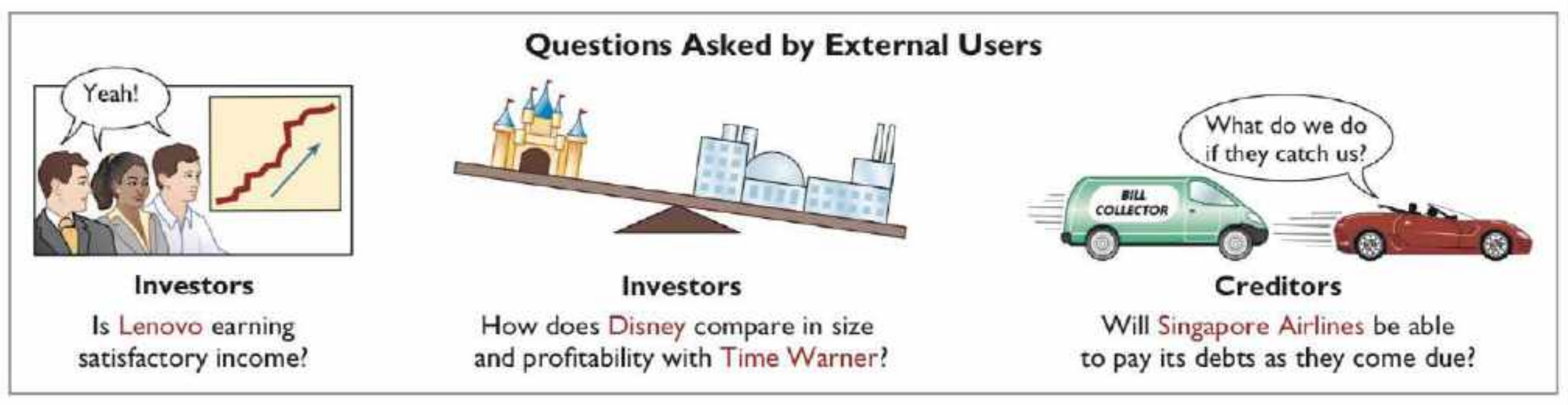
Accounting Activities and Users

Internal Users

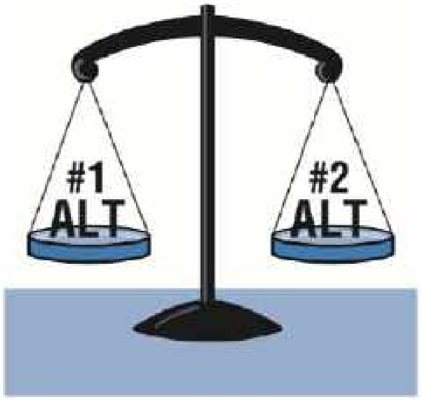


Accounting Activities and Users

External Users



Ethics in Financial Reporting



1. Recognize an ethical situation and the ethical issues involved.

Use your personal ethics to identify ethical situations and issues. Some businesses and professional organizations provide written codes of ethics for guidance in some business situations.

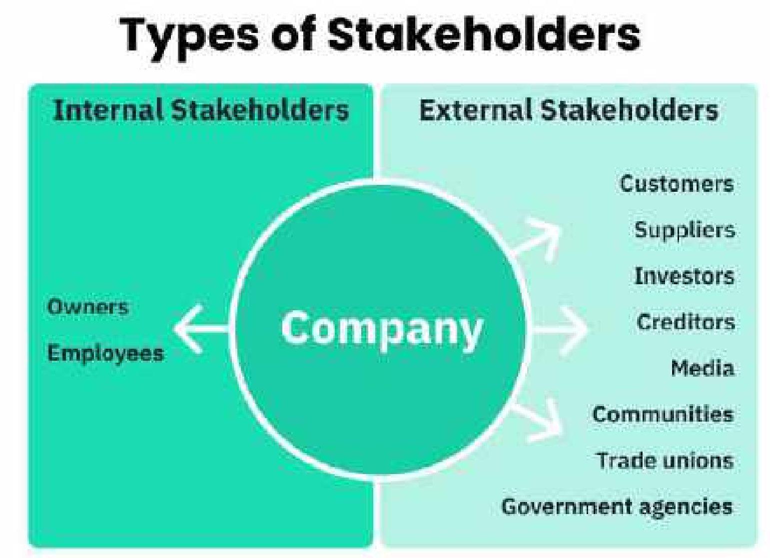
2. Identify and analyze the principal elements in the situation.

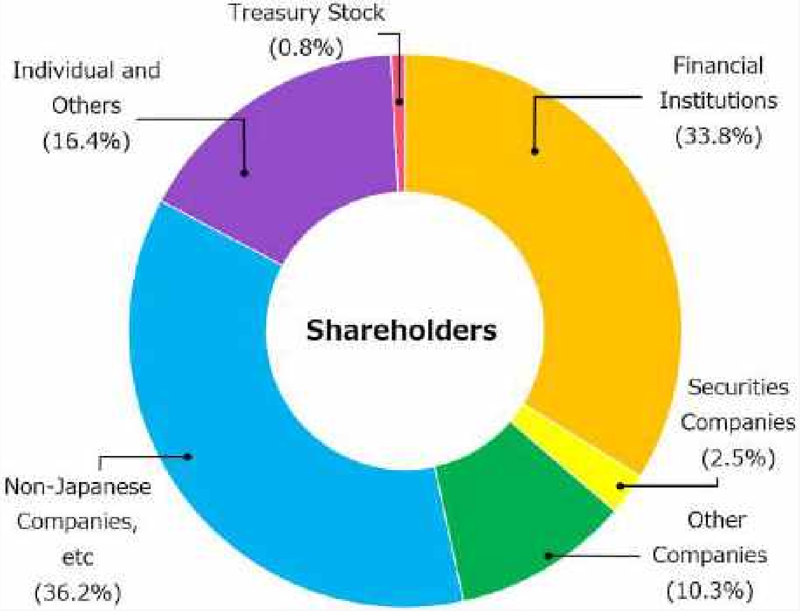
Identify the **stakeholders**—persons or groups who may be harmed or benefited. Ask the question: What are the responsibilities and obligations of the parties involved?

3. Identify the alternatives, and weigh the impact of each alternative on various stakeholders.

Select the most ethical alternative, considering all the consequences. Sometimes there will be one right answer. Other situations involve more than one right solution; these situations require an evaluation of each and a selection of the best alternative.

Stakeholders Vs. Shareholders





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Accounting Standards

IASB

IFRS
International Financial Reporting Standards

VS

FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Used in 130 countries

Used by most companies in the U.S.

Measurement Principles

IFRS generally uses one of two measurement principles, the **historical cost** principle or the **fair value** principle.

Historical cost principle (or cost principle): dictates that companies record assets at their cost. This is true not only at the time the asset is purchased, but also over the time the asset is held.

Fair value principle: states that assets and liabilities should be reported at fair value (the price received to sell an asset or settle a liability).

Selecting Measurement Principles

1. **Relevance** means that financial information is capable of making a difference in a decision.
2. **Faithful representation** means that the numbers and descriptions match what really existed or happened—they are factual.

The Building Blocks of Accounting

Assumptions

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Assumptions

Assumptions provide a foundation for the accounting process. Two main assumptions are the **monetary unit assumption** and the **economic entity assumption.**

Monetary unit assumption: requires that companies include in the accounting records only transaction data that can be expressed in money terms.

Economic Entity Assumption: requires that the activities of the entity be kept separate and distinct from the activities of its owner and all other economic entities. Typical entity forms are proprietorship, partnership, corporation.

The Accounting Equation

The Basic Accounting Equation

Assets	=	Liabilities	+	Equity

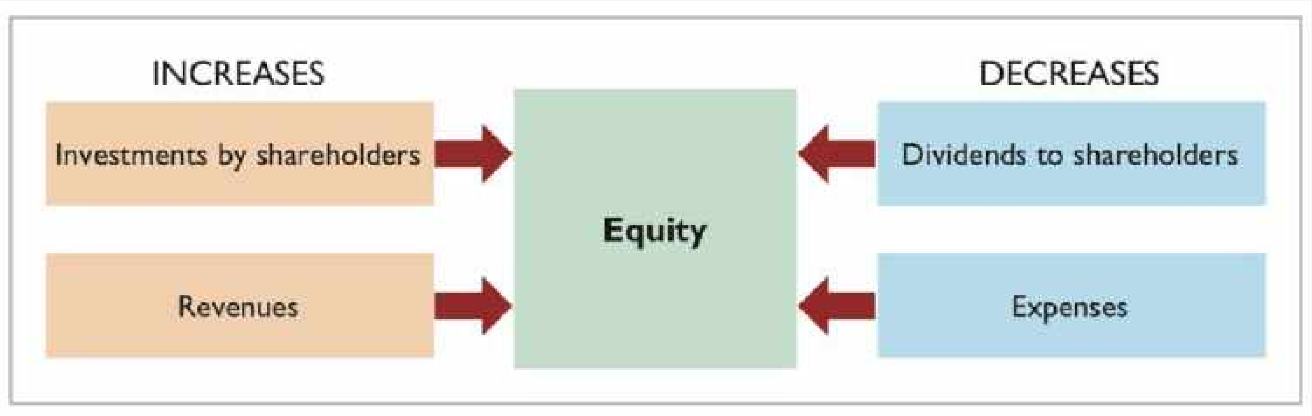
Assets: resources a business owns.

Liabilities: claims against assets, i.e. existing debts and obligations.

Equity: the ownership claim on a company's total assets.

The Accounting Equation

Equity



Share capital—ordinary: describes the amounts paid in by shareholders for the ordinary shares they purchase.
Revenues: are the gross increases in equity resulting from business activities entered into for the purpose of earning income. Revenues usually result in an increase in an asset.
Expenses: are the cost of assets consumed or services used in the process of earning revenue.
Dividends: are distribution of cash or other assets to shareholders. They are not an expense.

Analyzing Business Transactions

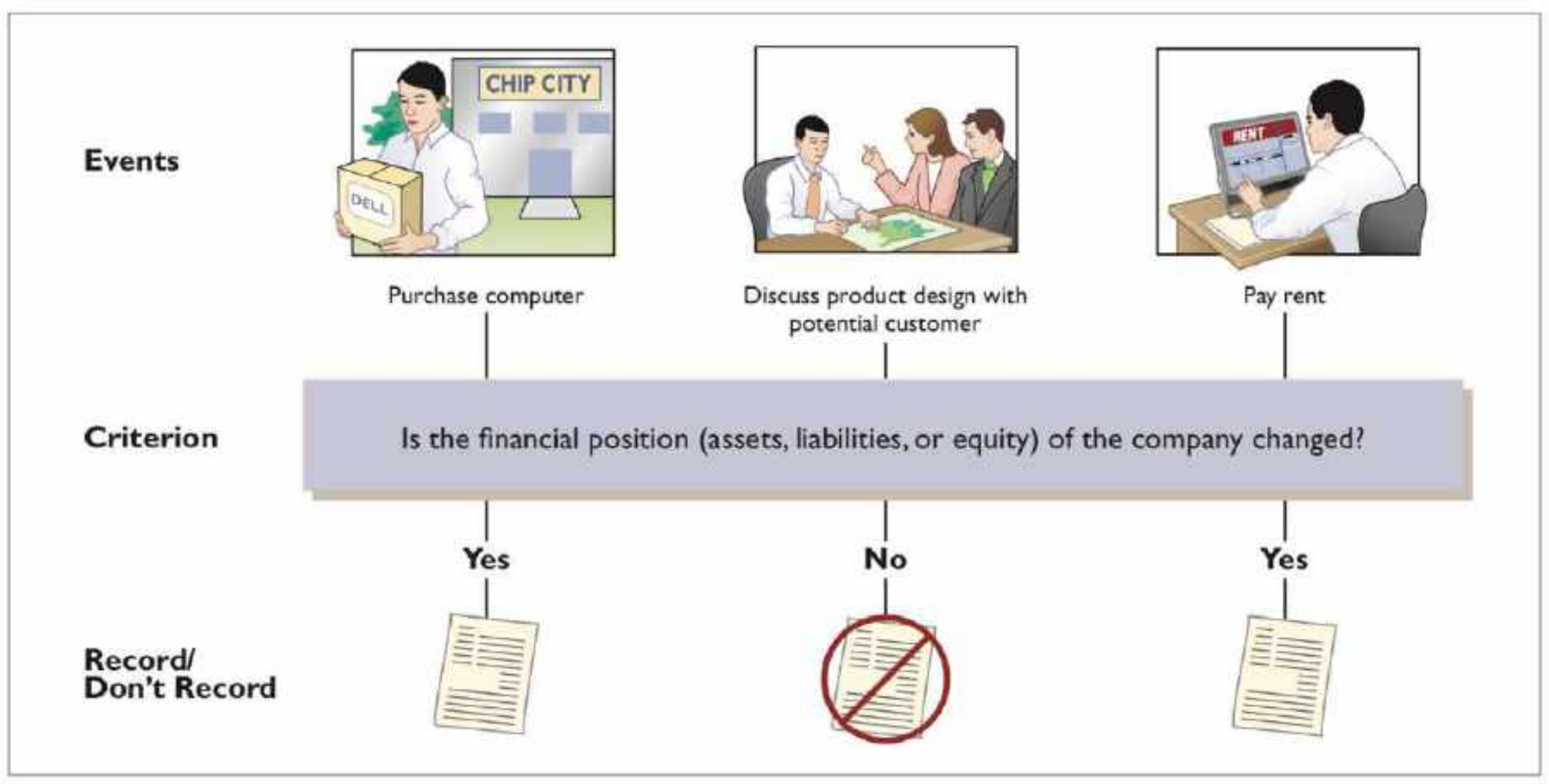
Accounting Information System:

The system of collecting and processing transaction data and communicating financial information to decision-makers.

The steps companies follow each period to record transactions and eventually prepare financial statements:

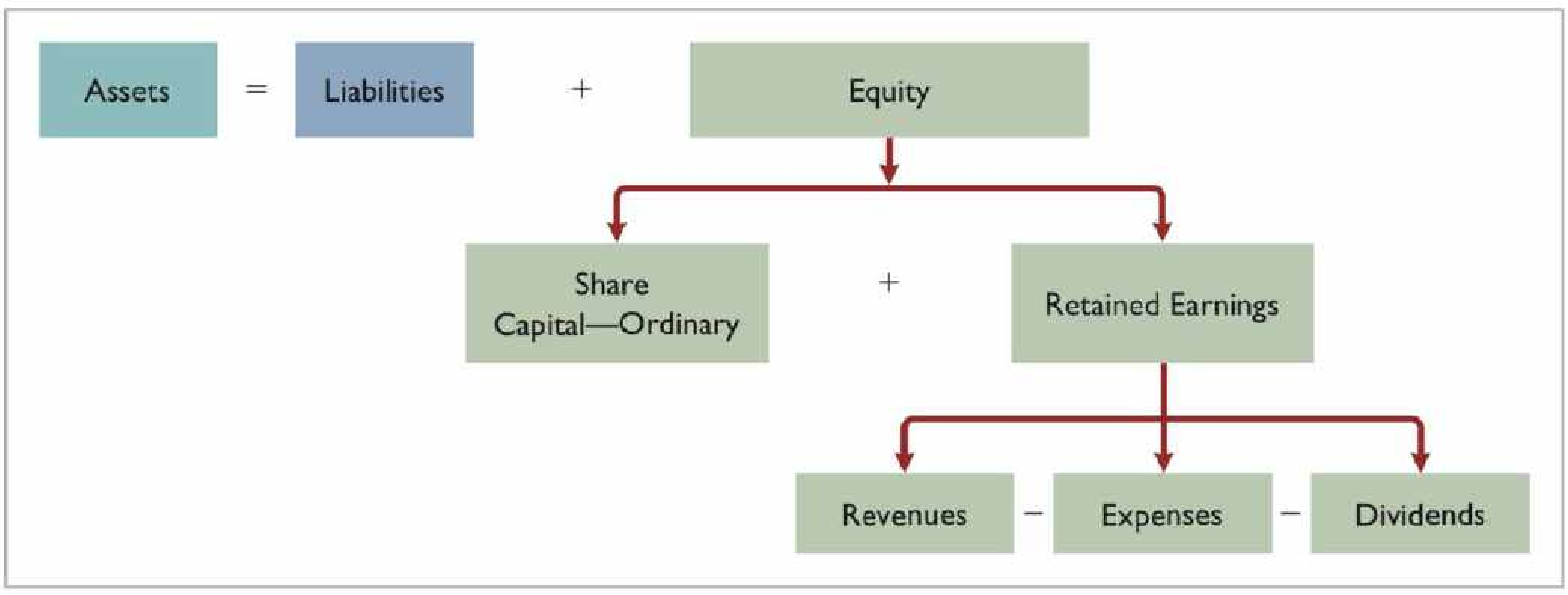
Analyzing Business Transactions

Identifying Accounting Transactions



Analyzing Business Transactions

Expanding the Balance Sheet Equation for analysis



Transaction (1). Investment by Shareholders.

Assume: Ray and Barbara Neal decide to start a smartphone app development company that they incorporate as Softbyte SA. On September 1, 2020, they invest €15,000 cash in the business in exchange for €15,000 of ordinary shares. The ordinary shares indicates the ownership interest that the Neals have in Softbyte SA.

Basic Analysis	The asset Cash increases €15,000, and equity identified as Share Capital—Ordinary increases €15,000.

Equation Analysis

	Assets	=	**Liabilities**	+	**Equity**	
	Cash	=			Share Capital	
(1)	**+€15,000**	**=**			**+€15,000**	**Issued Shares**

Transaction(2). Purchase of Equipment for Cash.

Assume: Softbyte SA purchases computer equipment for €7,000 cash.

Basic Analysis	The asset Cash decreases €7,000, and the asset Equipment increases €7,000.

Equation Analysis

	Assets			=	Liabilities	+	Equity
	Cash	+	Equipment	=			Share Capital
	€15,000						€15,000
(2)	−7,000		+€7,000				
	€ 8,000	+	€7,000	=			€15,000
	$\underbrace{}_{€15,000}$						

Transaction(3). Purchase of Supplies on Credit.

Assume: Softbyte SA purchases headsets (and other computer accessories expected to last several months) for €1,600 from Mobile Solutions. Mobile Solutions agrees to allow Softbyte to pay this bill in October. This transaction is a purchase on account (a credit purchase).

Basic Analysis	The asset Supplies increases €1,600, and the liability Accounts Payable increases €1,600.

Equation Analysis

	Assets					=	Liabilities	+	Equity
	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	Share Capital
	€8,000				€7,000				€15,000
(3)			+€1,600				+€1,600		
	€8,000	+	€1,600	+	€7,000	=	€1,600	+	€15,000
			€16,600				€16,600		

Transaction (4). Services Performed for Cash.

Assume: Softbyte SA receives €1,200 cash from customers for app development services it has performed. This transaction represents Softbyte's principal revenue-producing activity. Recall that **revenue increases equity**.

Basic Analysis	The asset Cash increases €1,200, and equity increases €1,200 due to Service Revenue.

Equation Analysis

	Assets			= Liabilities +	Equity				
						Retained Earnings			
	Cash	+ Supplies	+ Equipment	= Accounts Payable	+ Share Capital	+ Rev.	− Exp.	− Div.	
	€8,000	€1,600	€7,000	€1,600	€15,000				
(4)	+1,200					+€1,200			Service Revenue
	€9,200	+ €1,600	+ €7,000	= €1,600	+ €15,000	+ €1,200			
	€17,800			= €17,800					

Transaction (4). Services Performed for Cash.

Assume: Softbyte SA receives €1,200 cash from customers for app development services it has performed. This transaction represents Softbyte's principal revenue-producing activity. Recall that **revenue increases equity**.

Basic Analysis	The asset Cash increases €1,200, and equity increases €1,200 due to Service Revenue.																
Equation Analysis		**Assets**					=	**Liabilities**	+	**Equity**							
								Accounts		Share		Retained Earnings					
		Cash	+	Supplies	+	Equipment	=	Payable	+	Capital	+	Rev.	−	Exp.	−	Div.	
		€8,000		€1,600		€7,000		€1,600		€15,000							
	(4)	+1,200										+€1,200					Service Revenue
		€9,200	+	€1,600	+	€7,000	=	€1,600	+	€15,000	+	€1,200					
		€17,800						€17,800									

Transaction (5). Purchase of Advertising on Credit.

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Assume: Softbyte SA receives a bill for €250 from *Programming News* for advertising on its website but postpones payment until a later date.

Basic Analysis	The liability Accounts Payable increases €250, and equity decreases €250 due to Advertising Expense.

Equation Analysis

	Assets					=	Liabilities	+	Equity							
							Accounts		Share		Retained Earnings					
	Cash	+	Supplies	+	Equipment	=	Payable	+	Capital	+	Rev.	−	Exp.	−	Div.	
	€9,200		€1,600		€7,000		€1,600		€15,000		€1,200					
(5)							+250						−€250			Advertising Expense
	€9,200	+	€1,600	+	€7,000	=	€1,850	+	€15,000	+	€1,200	−	€250			
	€17,800						€17,800									

Transaction (6).
Services Performed for Cash & Credit.

Assume: Softbyte SA performs €3,500 of app development services for customers. The company receives cash of €1,500 from customers, and it bills the balance of €2,000 on account.

Basic Analysis

Three specific items are affected: The asset Cash increases €1,500, the asset Accounts Receivable increases €2,000, and equity increases €3,500 due to Service Revenue.

Equation Analysis

	Assets				=	Liabilities +	Equity				
								Retained Earnings			
	Cash +	Accounts Receivable +	Supplies +	Equipment	=	Accounts Payable	+ Share Capital +	Rev. −	Exp. −	Div.	
	€ 9,200		€1,600	€7,000		€1,850	€15,000	€1,200	€250		
(6)	+1,500	+€2,000						+3,500			Service Revenue
	€10,700 +	€2,000 +	€1,600 +	€7,000	=	€1,850	+ €15,000 +	€4,700 −	€250		
	€21,300					€21,300					

Transaction (7). Payment of Expenses.

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Assume: Softbyte SA pays the following expenses in cash for September: office rent €600, salaries and wages of employees €900, and utilities €200.

Basic Analysis	The asset Cash decreases €1,700, and equity decreases €1,700 due to the following specific expenses: Rent Expense, Salaries and Wages Expense, and Utilities Expense.

Equation Analysis

	Assets					=	Liabilities	+	Equity							
											Retained Earnings					
	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	Share Capital	+	Rev.	−	Exp.	− Div.	
	€10,700		€2,000		€1,600		€7,000		€1,850		€15,000		€4,700		€ 250		
(7)	−1,700														−600		Rent Exp.
															−900		Sal./Wages Exp.
															−200		Utilities Exp.
	€ 9,000	+	€2,000	+	€1,600	+	€7,000	=	€1,850	+	€15,000	+	€4,700	−	€1,950		
	€19,600								€19,600								

Transaction (8). Payment of Accounts Payable.

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Assume: Softbyte SA pays its €250 *Programming News* bill in cash. The company previously [in Transaction (5)] recorded the bill as an increase in Accounts Payable and a decrease in equity.

Basic Analysis	This cash payment "on account" decreases the asset Cash by €250 and also decreases the liability Accounts Payable by €250.

Equation Analysis

	Assets							=	Liabilities	+	Equity						
													Retained Earnings				
	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	Share Capital	+	Rev.	−	Exp.	−	Div.
	€9,000		€2,000		€1,600		€7,000		€1,850		€15,000		€4,700		€1,950		
(8)	−250								−250								
	€8,750	+	€2,000	+	€1,600	+	€7,000	=	€1,600	+	€15,000	+	€4,700	−	€1,950		
	€19,350								€19,350								

Transaction (9). Receipt of Cash on Account.

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Assume: Softbyte SA receives €600 in cash from customers who had been billed for services [in Transaction (6)].

Basic Analysis	The asset Cash increases €600, and the asset Accounts Receivable decreases €600.

Equation Analysis

	Assets							=	Liabilities	+	Equity						
													Retained Earnings				
	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	Share Capital	+	Rev.	−	Exp.	−	Div.
	€8,750		€2,000		€1,600		€7,000		€1,600		€15,000		€4,700		€1,950		
(9)	+600		−600														
	€9,350	+	€1,400	+	€1,600	+	€7,000	=	€1,600	+	€15,000	+	€4,700	−	€1,950		
	€19,350								€19,350								

Transaction (10). Dividends.

Assume: The company pays a dividend of €1,300 in cash to Ray and Barbara Neal, the shareholders of Softbyte SA. This transaction results in an equal decrease in assets and equity.

Basic Analysis	The asset Cash decreases €1,300, and equity decreases €1,300 due to dividends.

Equation Analysis

	Assets					= Liabilities	+	Equity					
									Retained Earnings				
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	=	Accounts Payable	+	Share Capital	+ Rev.	− Exp.	− Div.		
	€9,350	€1,400	€1,600	€7,000		€1,600		€15,000	€4,700	€1,950			
(10)	−1,300										−€1,300	Dividends	
	€8,050 +	€1,400 +	€1,600 +	€7,000	=	€1,600	+	€15,000	+ €4,700	− €1,950	− €1,300		
	€18,050					€18,050							

Analyzing Business Transactions

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Softbyte SA: **Tabular Analysis of Transactions**

	Assets				= Liabilities +	Equity				
							Retained Earnings			
Transaction	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	= Accounts Payable	+ Share Capital	+ Rev.	− Exp.	− Div.	
(1)	+€15,000					+ €15,000				Issued Shares
(2)	−7,000			+€7,000						
(3)			+€1,600		+€1,600					
(4)	+1,200						+€1,200			Service Revenue
(5)					+250			−€250		Adver. Expense
(6)	+1,500	+€2,000					+3,500			Service Revenue
(7)	−1,700							−600		Rent Expense
								−900		Sal./Wages Exp.
								−200		Utilities Expense
(8)	−250				−250					
(9)	+600	−600								
(10)	−1,300								−€1,300	Dividends
	€ 8,050	+ €1,400	+ €1,600	+ €7,000	= €1,600	+ €15,000	+ €4,700	− €1,950	− €1,300	

$\underbrace{\text{Assets}}_{€18,050} = \underbrace{\text{Liabilities + Equity}}_{€18,050}$

€18,050 **€18,050**

Analyzing Business Transactions

Key Points

1. Each transaction must be analyzed in terms of its effect on:

   a. The three components of the basic accounting equation.

   b. Specific types (kinds) of items within each component.

2. The two sides of the equation must always be equal.

3. The Share Capital—Ordinary and Retained Earnings columns indicate the causes of each change in the shareholders' claim on assets.

Practice!

Transactions made by Virmari & Co., a public accounting firm in France, for the month of August are shown below. Prepare a tabular analysis which shows the effects of these transactions on the expanded accounting equation, similar to that shown in Illustration 1.9.

1. The company issued ordinary shares for €25,000 cash.
2. The company purchased €7,000 of office equipment on credit.
3. The company received €8,000 cash in exchange for services performed.
4. The company paid €850 for this month's rent.
5. The company paid a dividend of €1,000 in cash to shareholders.

ACTION PLAN

Prepare the Tabular Analysis (Accounting Equation)!

Practice!

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Solution

	Assets			=	Liabilities	+	Equity							
									Retained Earnings					
Trans-action	Cash	+	Equipment	=	Accounts Payable	+	Share Capital	+	Rev.	−	Exp.	−	Div.	
(1)	+€25,000						+€25,000							
(2)			+€7,000		+€7,000									
(3)	+8,000								+€8,000					**Service Revenue**
(4)	−850										−€850			**Rent Expense**
(5)	−1,000												−€1,000	**Dividends**
	€31,150	+	€7,000	=	€7,000	+	€25,000	+	€8,000	−	€850	−	€1,000	
	€38,150				€38,150									

Related exercise material: **BE1.7, BE1.8, BE1.9, DO IT! 1.4, E1.6, E1.7, and E1.8.**

Financial Statements

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Companies prepare five financial statements from the summarized accounting data.

1. **Income statement:** presents the revenues and expenses and resulting net income or net loss for a specific **period of time**.
2. **Retained earnings statement:** summarizes the changes in retained earnings for a specific **period of time**.
3. **Statement of financial position:** reports the assets, liabilities, and equity of a company at **a specific date**. (Sometimes referred to as a *balance sheet.*)
4. **Statement of cash flows:** summarizes information about the cash inflows (receipts) and outflows (payments) for a specific **period of time**.
5. **Comprehensive income statement:** presents other comprehensive income items that are not included in the determination of net income in 1.

Financial Statement Connections

Income Statement

Retained Earnings Statement

Statement of Financial Position

Statement of Cash Flows

Softbyte SA
Income Statement
For the Month Ended September 30, 2020

Revenues		
Service revenue		€4,700
Expenses		
Salaries and wages expense	€900	
Rent expense	600	
Advertising expense	250	
Utilities expense	200	
Total expenses		1,950
Net income		€2,750

Softbyte SA
Retained Earnings Statement
For the Month Ended September 30, 2020

Retained earnings, September 1	€ 0
Add: Net income	2,750
	2,750
Less: Dividends	1,300
Retained earnings, September 30	€1,450

Softbyte SA
Statement of Financial Position
September 30, 2020

Assets		
Equipment		€ 7,000
Supplies		1,600
Accounts receivable		1,400
Cash		8,050
Total assets		€18,050
Equity and Liabilities		
Equity		
Share capital—ordinary	€ 15,000	
Retained earnings	1,450	€16,450
Liabilities		
Accounts payable		1,600
Total equity and liabilities		€18,050

Softbyte SA
Statement of Cash Flows
For the Month Ended September 30, 2020

Cash flows from operating activities		
Cash receipts from revenues		€ 3,300
Cash payments for expenses		(1,950)
Net cash provided by operating activities		1,350
Cash flows from investing activities		
Purchase of equipment		(7,000)
Cash flows from financing activities		
Sale of ordinary shares	€15,000	
Payment of cash dividends	(1,300)	13,700
Net increase in cash		8,050
Cash at the beginning of the period		0
Cash at the end of the period		€ 8,050

Net income is computed first and is needed to determine the ending balance in retained earnings.

The **ending balance in retained earnings** is needed in preparing the statement of financial position.

The **cash** shown on the statement of financial position is needed in preparing the statement of cash flows.

Financial Statements

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Income Statement

The income statement lists revenues first, followed by expenses.
Then, the statement shows net income (or net loss).

Structure:

- The income statement lists revenues first, followed by expenses.
- Then, the statement shows net income (or net loss).
- When revenues exceed expenses, **net income** results.
- When expenses exceed revenues, a **net loss** results.
- The income statement **does not include investment and dividend transactions** between the shareholders and the business in measuring net income.

Financial Statements

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Retained Earnings Statement

The information provided by this statement indicates the reasons why retained earnings increased or decreased during the period. If there is a net loss, it is deducted with dividends in the retained earnings statement.

Structure:

- The first line of the statement shows the beginning retained earnings amount.
- Then add net income (or subtract net loss) and subtract dividends.
- The retained earnings ending balance is the final amount on the statement.

Financial Statements

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Statement of Financial Position

The statement of financial position is like a snapshot of the company's financial condition at a specific moment in time (usually the month-end or year-end).

Structure:

Lists assets at the top, followed by equity and then liabilities.

Total assets must equal total equity and liabilities.

When two or more liabilities are involved, a customary way of listing is as shown as follows:

Liabilities	
Notes payable	€10,000
Accounts payable	63,000
Salaries and wages payable	18,000
Total liabilities	**€91,000**

Financial Statements

Statement of Cash Flows

The statement of cash flows provides information on the cash receipts and payments for a specific period of time.

Structure:

The statement of cash flows reports

(1) the cash effects of a company's **operations** during a period,

(2) its **investing** activities,

(3) its **financing** activities,

(4) the **net increase or decrease in cash** during the period, and

(5) the cash amount at the end of the period.

Financial Statements

Statement of Cash Flows

The statement of cash flows provides information on the cash receipts and payments for a specific period of time.

Structure:

The statement of cash flows reports

(1) the cash effects of a company's **operations** during a period,

(2) its **investing** activities,

(3) its **financing** activities,

(4) the **net increase or decrease in cash** during the period, and

(5) the cash amount at the end of the period.

Financial Statements

Comprehensive Income Statement

Other comprehensive income items are not part of net income but are considered important enough to be reported separately.
This statement immediately follows the income statement.

IFRS Alternative:

IFRS allows an alternative statement format in which the information contained in the income statement and the comprehensive income statement are combined in a single statement, referred to as a **statement of comprehensive income**.

Practice!

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Presented below is selected information related to Li Fashions at December 31, 2020. Li reports financial information monthly.

Equipment	HK$10,000	Utilities Expense	HK$ 4,000
Cash	8,000	Accounts Receivable	9,000
Service Revenue	36,000	Salaries and Wages Expense	7,000
Rent Expense	11,000	Notes Payable	16,500
Accounts Payable	2,000	Dividends	5,000

a. Determine the total assets of Li at December 31, 2020.

b. Determine the net income that Li reported for December 2020.

c. Determine the equity of Li at December 31, 2020.

ACTION PLAN

- Remember the basic accounting equation: assets must equal liabilities plus equity.
- Review previous financial statements to determine how total assets, net income, and equity are computed.

Practice!

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Solution

a. The total assets are HK$27,000, comprised of Equipment HK$10,000, Accounts Receivable HK$9,000, and Cash HK$8,000.

b. Net income is HK$14,000, computed as follows.

Revenues		
Service revenue		HK$36,000
Expenses		
Rent expense	HK$11,000	
Salaries and wages expense	7,000	
Utilities expense	4,000	
Total expenses		22,000
Net income		HK$14,000

Career Opportunities in Accounting

Individuals in public accounting offer expert service to the general public, in much the same way that doctors serve patients and lawyers serve clients.
Choices: **Auditing, taxation, management consulting**

Individuals in private accounting are employees of for-profit companies and not-for-profit organizations.
Choices: **Cost accounting, budgeting, accounting information system design and support, tax planning and preparation, internal auditing**

Choices: **Tax authorities, local governments, law enforcement agencies, company regulators, accounting educators at public colleges and universities**

Choices: **Investigate theft and fraud using accounting, auditing, and investigative skills**


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Chapter 2 The Recording Process

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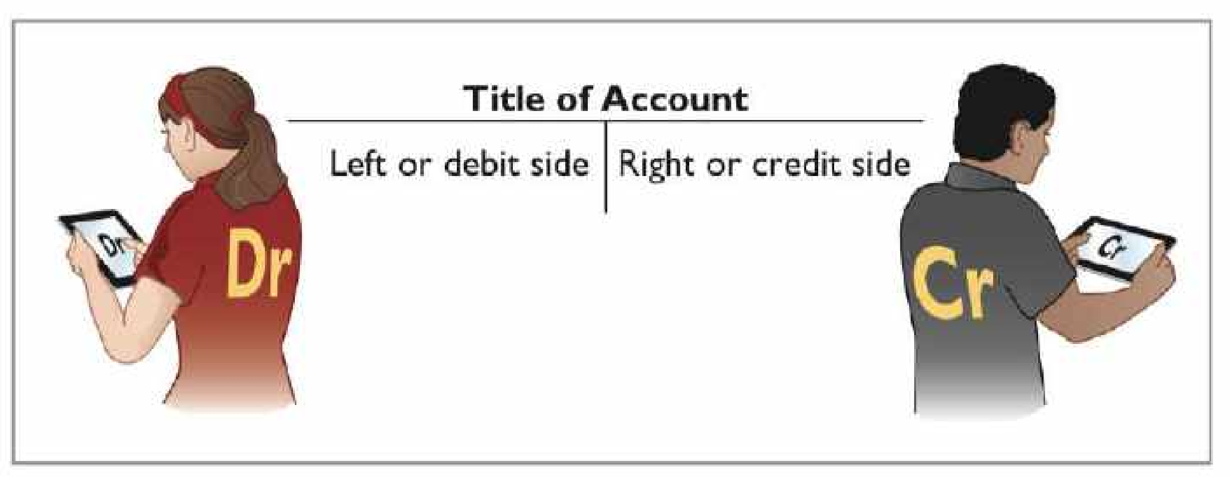
Accounts, Debits, and Credits

The Account

An **account** is an individual accounting record of increases and decreases in a specific asset, liability, or equity item.

In its simplest form, an account consists of three parts: (1) a title, (2) a left or debit side (**Dr.**), and (3) a right or credit side (**Cr.**).



Accounts, Debits, and Credits

Debits and Credits

Tabular Summary (Chapter 1) and Account Form (this Chapter)

Tabular Summary

Cash
€15,000
−7,000
1,200
1,500
−1,700
−250
600
−1,300
€ 8,050

Account Form

Cash			
(Debits)	15,000	(Credits)	7,000
	1,200		1,700
	1,500		250
	600		1,300
Balance (Debit)	8,050		

Dr./Cr. Procedures for Assets and Liabilities

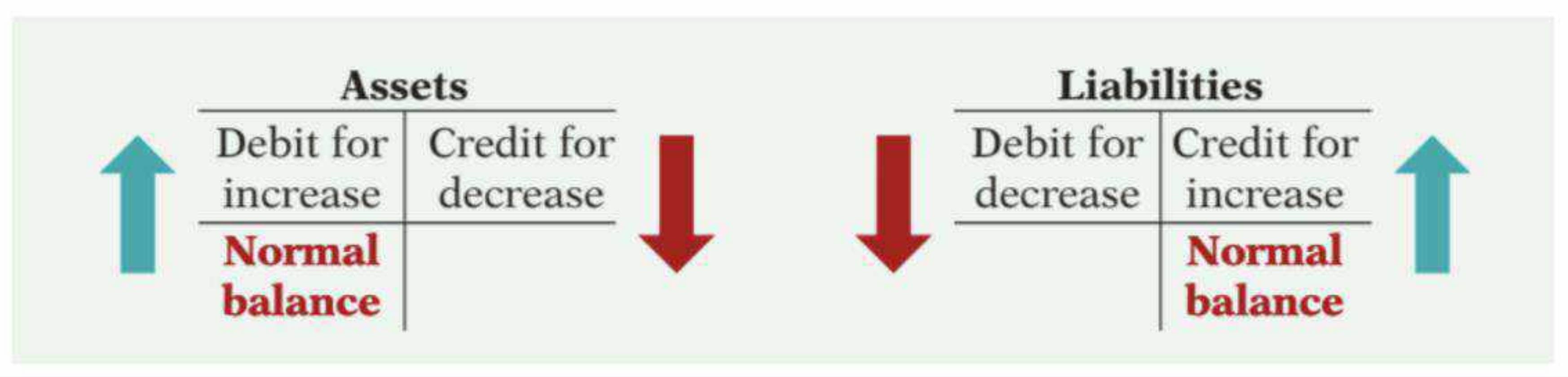
Debits	Credits
Increase assets	Decrease assets
Decrease liabilities	Increase liabilities

Both sides of the basic equation (Assets = Liabilities + Equity) must be equal.

Increases and decreases in liabilities have to be recorded opposite from increases and decreases in assets.

Thus, increases in liabilities are entered on the right or credit side, and decreases in liabilities are entered on the left or debit side.

Dr./Cr. Procedures for Assets and Liabilities



Asset accounts normally show debit balances.
That is, debits to a specific asset account should exceed credits to that account.

Liability accounts normally show credit balances.
That is, credits to a liability account should exceed debits to that account.

Dr./Cr. Procedures for Equity

Share Capital—Ordinary.

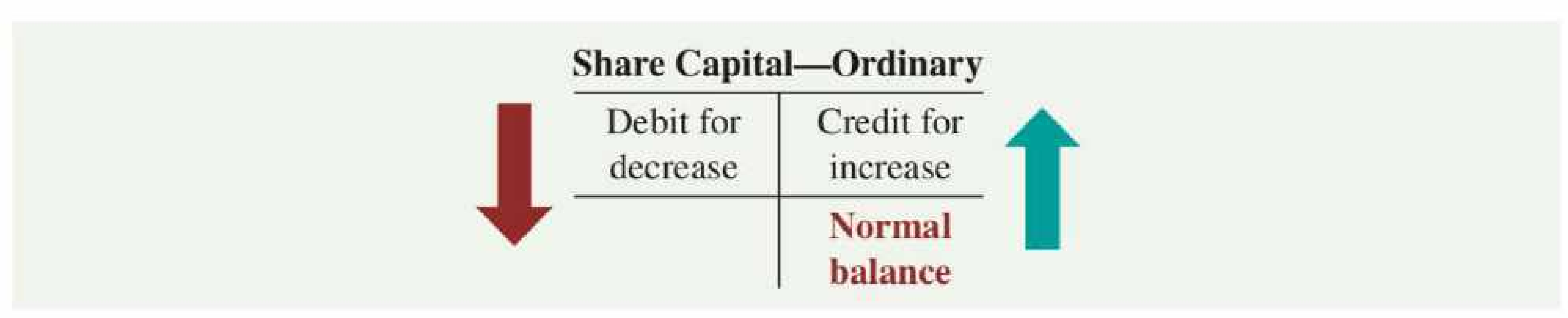
Debits	Credits
Decrease Share Capital—Ordinary	Increase Share Capital—Ordinary

Companies issue share capital—ordinary in exchange for the owners' investment paid in to the company.

Credits increase the Share Capital—Ordinary account, and debits decrease it.

Dr./Cr. Procedures for Equity

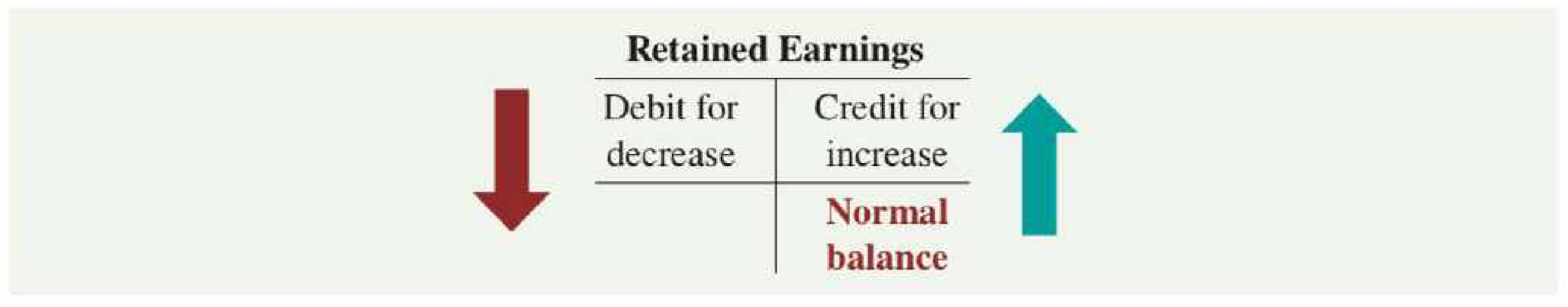
Share Capital—Ordinary.



Knowing the normal balance in an account may help you trace errors. Occasionally, though, an abnormal balance may be correct.

Dr./Cr. Procedures for Equity

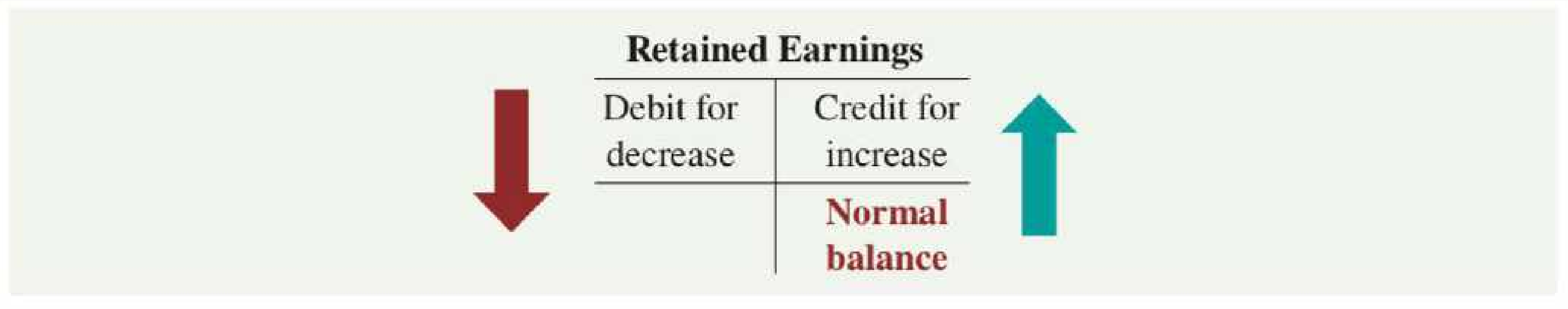
Retained Earnings.



Share capital—ordinary, retained earnings and liabilities:
Same rules apply for debit and credit and the normal balances.

Dr./Cr. Procedures for Equity

Retained Earnings.

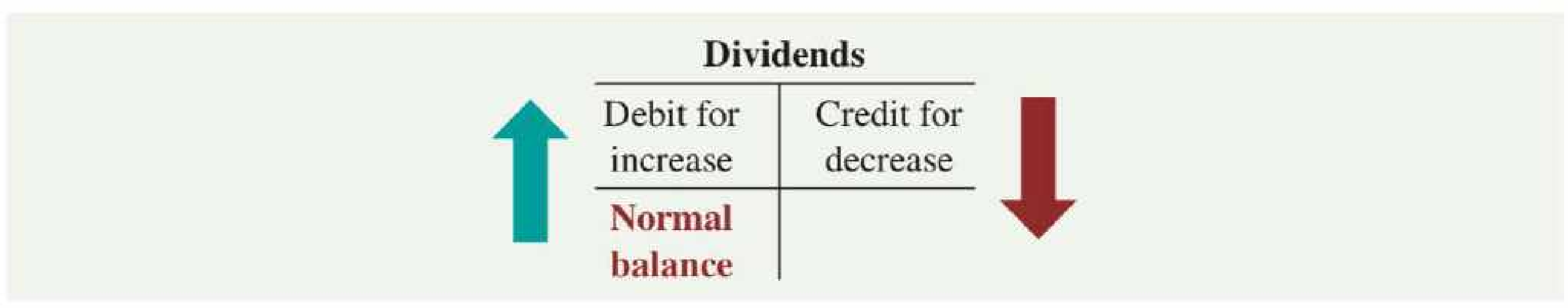


Retained earnings is net income that is kept (retained) in the business. It represents the portion of equity that the company has accumulated through the profitable operation of the business.

Credits (net income) increase the Retained Earnings account, and debits (dividends or net losses) decrease it.

Dr./Cr. Procedures for Equity

Dividends.



Dividend:
A company’s distribution to its shareholders.
The most common form of a distribution is a **cash dividend**.

Dividends reduce the shareholders’ claims on retained earnings.
Debits increase the Dividends account, and credits decrease it.

Dr./Cr. Procedures for Equity

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Revenues and Expenses.

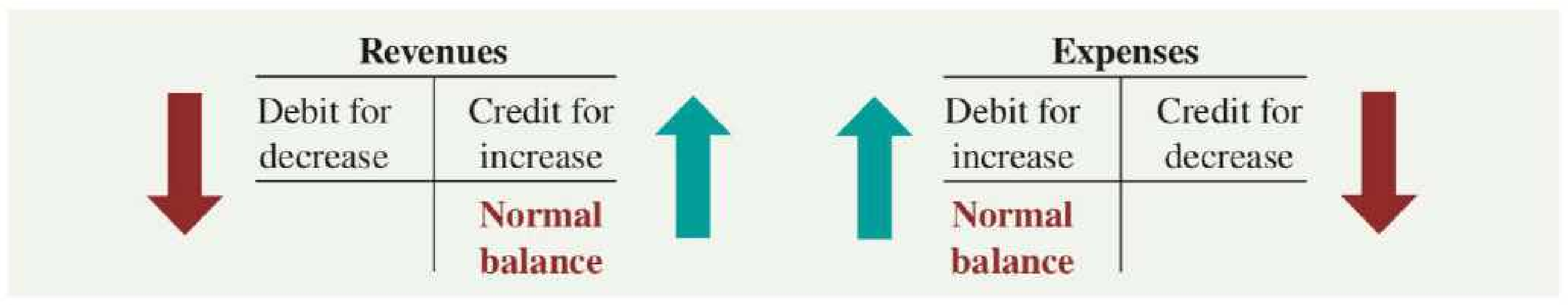
Debits	Credits
Decrease revenues	Increase revenues
Increase expenses	Decrease expenses

The purpose of earning revenues is to benefit the shareholders of the business. When a company recognizes revenues, equity increases.
The effect of debits and credits on revenue accounts is the same as their effect on Retained Earnings.

Expenses have the opposite effect. Expenses decrease equity.

Dr./Cr. Procedures for Equity

Revenues and Expenses.



Revenue accounts are increased by credits and decreased by debits.
Expense accounts are increased by debits and decreased by credits.

Because revenues increase equity, a revenue account has the same debit/credit rules as the Retained Earnings account. Expenses have the opposite effect.

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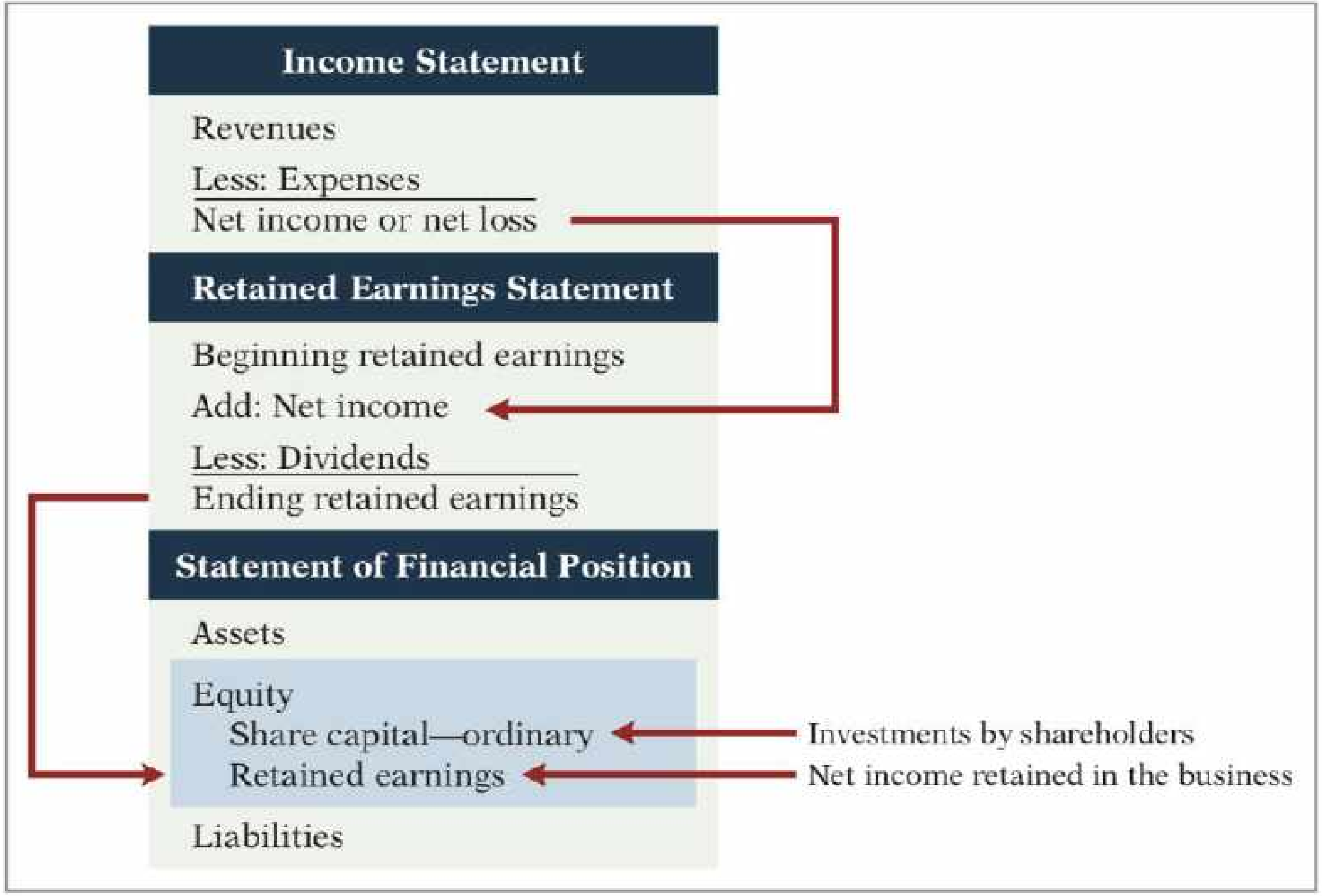
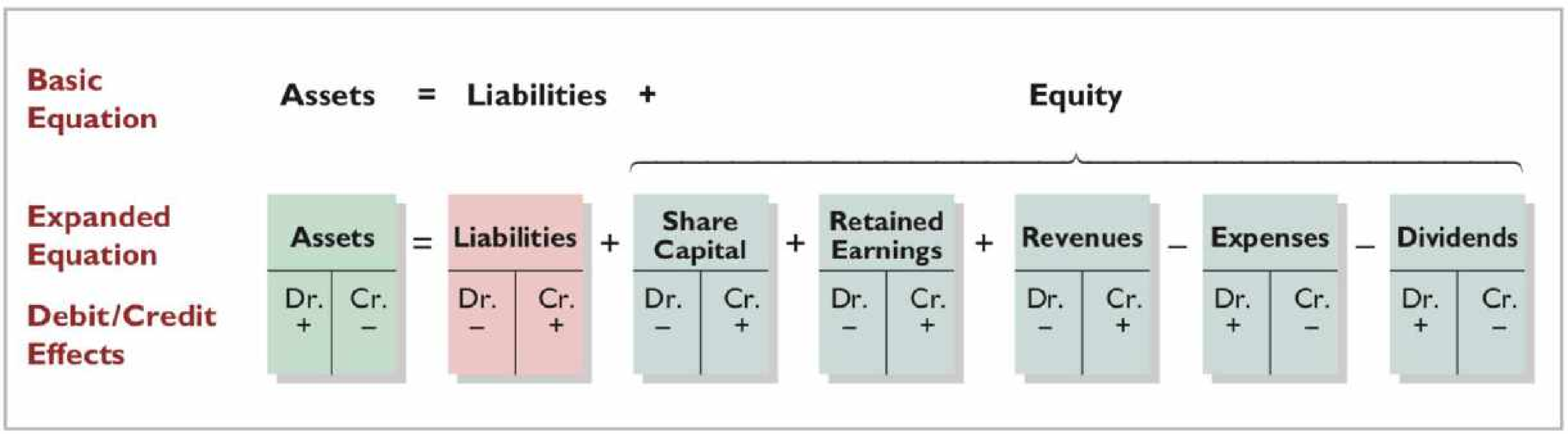
Equity Relationship



Summary of Debit/Credit Rules



Practice!

- Indicate the normal balance of this following account:

a. Cash
b. Supplies
c. Accounts payable
d. Notes payable
e. Equipment
f. Share Capital-Ordinary
g. Dividend

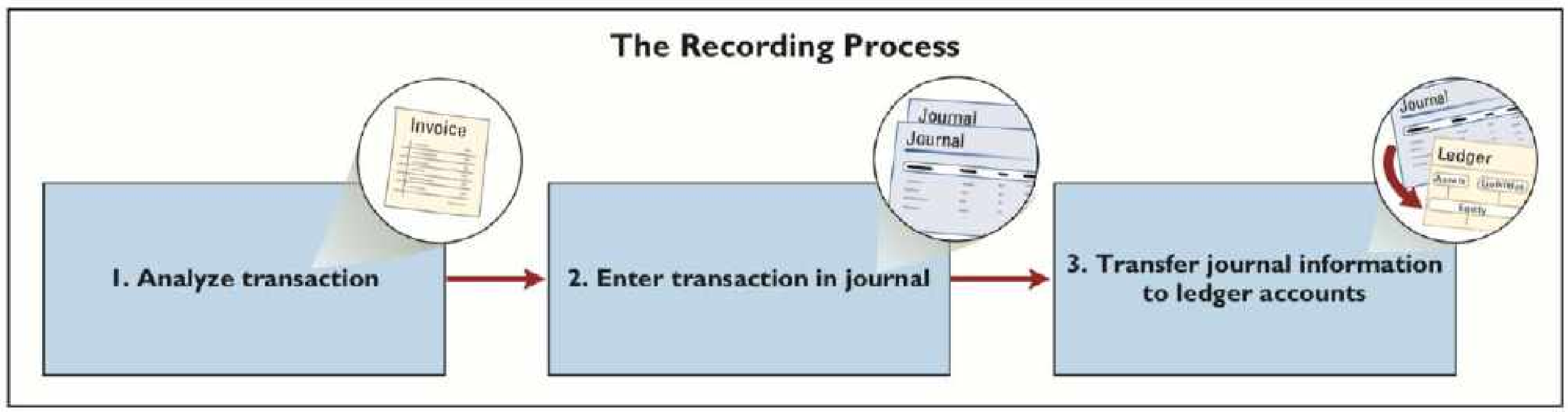
Practice!

Solution

a.	Cash	: Debit (Dr.)
b.	Supplies	: Debit (Dr.)
c.	Accounts payable	: Credit (Cr.)
d.	Notes payable	: Credit (Cr.)
e.	Equipment	: Debit (Dr.)
f.	Share Capital-Ordinary	: Credit (Cr.)
g.	Dividend	: Debit (Dr.)

The Journal

1 2 3



The Journal

Companies initially record transactions in chronological order.
Thus, the **journal** is referred to as the book of original entry.

The journal makes several significant contributions to the recording process:

1. It discloses in one place the **complete effects** of a transaction.
2. It provides a **chronological record** of transactions.
3. It helps to **prevent or locate errors** because the debit and credit amounts for each entry can be easily compared.

Journalizing

Assume: On September 1, Softbyte SA shareholders invested €15,000 cash in the corporation in exchange for ordinary shares, and Softbyte purchased computer equipment for €7,000 cash.

Demonstrate: How do you enter the transaction data in the journal?

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Journalizing

GENERAL JOURNAL				J1
Date	Account Titles and Explanation	Ref.	Debit	Credit
2020		5		
Sept. 1	2 Cash		15,000	
1	3 Share Capital—Ordinary			15,000
	4 (Issued shares for cash)			
1	Equipment		7,000	
	Cash			7,000
	(Purchase of equipment for cash)			

1 Date of the transaction.
2 Debit account title.
3 Credit account title.
4 Brief explanation of the transaction.
5 Reference column, which is left blank when the journal entry is made. This column is used later when the journal entries are transferred to the individual accounts.

Simple and Compound Entries

Simple entry: Involves one debit and one credit account.

Compound entry: An entry that requires three or more accounts.
The standard format requires that all debits be listed before the credits.

GENERAL JOURNAL				J1
Date	**Account Titles and Explanation**	**Ref.**	**Debit**	**Credit**
2020				
July 1	Equipment		14,000	
	Cash			8,000
	Accounts Payable			6,000
	(Purchased truck for cash with balance on account)			

Practice!

As president and sole shareholder, Julie Loeng engaged in the following activities in establishing her beauty salon, Hair It Is.

1. Opened a bank account in the name of Hair It Is and deposited €20,000 of her own money in this account in exchange for ordinary shares.
2. Purchased equipment on account (to be paid in 30 days) for a total cost of €4,800.
3. Interviewed three applicants for the position of beautician.

In what form (type of record) should Hair It Is record these three activities? Prepare the entries to record the transactions.

ACTION PLAN

- Understand which activities need to be recorded and which do not. Any that have economic effect should be recorded in a journal.
- Analyze the effects of transactions on asset, liability, and equity accounts.

Practice!

Solution

Each transaction that is recorded is entered in the general journal. The three activities would be recorded as follows.

1. Cash	20,000	
Share Capital—Ordinary		20,000
(Issued shares for cash)		
2. Equipment	4,800	
Accounts Payable		4,800
(Purchase of equipment on account)		

3. No entry because no transaction has occurred.

Related exercise material: **BE2.3, BE2.4, BE2.5, BE2.6, DO IT! 2.2, E2.3, E2.4, E2.5, E2.6, E2.7, E2.8, and E2.9.**

The Ledger and Posting

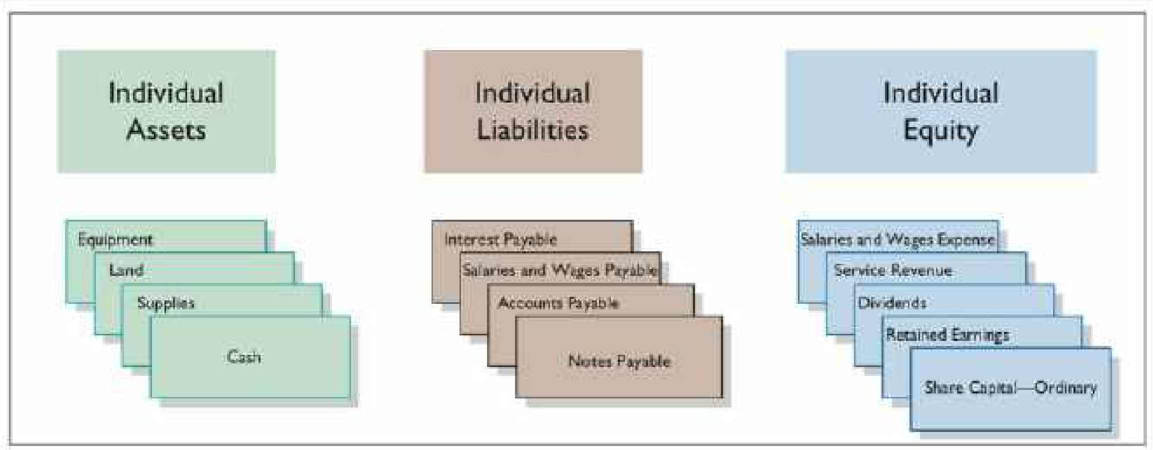
Ledger: The entire group of accounts maintained by a company.

Provides the balance in each of the accounts as well as keeps track of changes in these balances.

Companies may use various kinds of ledgers, but every company has a **general ledger**.

The Ledger

The General Ledger



T-Account

Cash

Dr.	Cr.
XXX	

Equipment

Dr.	Cr.
XXX	

Accounts Payable

Dr.	Cr.
	XXX

Dividend

Dr.	Cr.
XXX	

Standard Form Account

CASH					NO. 101
Date	Explanation	Ref.	Debit	Credit	Balance
2020					
June 1			25,000		25,000
2				8,000	17,000
3			4,200		21,200
9			7,500		28,700
17				11,700	17,000
20				250	16,750
30				7,300	9,450

This format is called the **three-column form of account**. It has three money columns—debit, credit, and balance.

Posting

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GENERAL JOURNAL J1

Date	Account Titles and Explanation	Ref.	Debit	Credit
2020 Sept. 1	Cash	101	15,000	
	Share Capital—Ordinary	311		15,000
	(Issued shares for cash)			

GENERAL LEDGER

Cash No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
2020 Sept. 1		J1	15,000		15,000

Share Capital—Ordinary No. 311

Date	Explanation	Ref.	Debit	Credit	Balance
2020 Sept. 1		J1		15,000	15,000

Key:
1 Post to debit account–date, journal page number, and amount.
2 Enter debit account number in journal reference column.
3 Post to credit account–date, journal page number, and amount.
4 Enter credit account number in journal reference column.

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Chart of Accounts

Yazici Advertising A.Ş.
Chart of Accounts

Assets

101 Cash
112 Accounts Receivable
126 Supplies
130 Prepaid Insurance
157 Equipment
158 Accumulated Depreciation—Equipment

Liabilities

200 Notes Payable
201 Accounts Payable
209 Unearned Service Revenue
212 Salaries and Wages Payable
230 Interest Payable

Equity

311 Share Capital—Ordinary
320 Retained Earnings
332 Dividends
350 Income Summary

Revenues

400 Service Revenue

Expenses

631 Supplies Expense
711 Depreciation Expense
722 Insurance Expense
726 Salaries and Wages Expense
729 Rent Expense
732 Utilities Expense
905 Interest Expense

Chart of Accounts

Lists the accounts and the account numbers that identify their location in the ledger.

Numbering system: Usually starts with the statement of financial position accounts and follows with the income statement accounts.

Number of accounts: Depends on the amount of detail management desires.

Companies **leave gaps** to permit the insertion of new accounts as needed during the life of the business.

The Recording Process Illustrated

October transactions of Yazici Advertising A.Ş.
Accounting period: One month

HELPFUL HINT

Follow these steps:
1 - Determine what type of account is involved.
2 - Determine what items increased or decreased and by how much.
3 - Translate the increases and decreases into debits and credits.

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Transaction	On October 1, C. R. Yazici invests ₺10,000 cash in an advertising company to be known as Yazici Advertising A.Ş.
Basic Analysis	The asset Cash increases ₺10,000; equity (specifically, Share Capital—Ordinary) increases ₺10,000.
Equation Analysis	**Assets** = **Liabilities** + **Equity** Cash = Share Capital +10,000 +10,000 Issued Shares
Debit–Credit Analysis	Debits increase assets: debit Cash ₺10,000. Credits increase equity: credit Share Capital—Ordinary ₺10,000.
Journal Entry	(see below)
Posting	(see below)

Journal Entry

Oct. 1	Cash	101	10,000	
	Share Capital—Ordinary (Issued shares for cash)	311		10,000

Posting

Cash		101
Oct. 1	10,000	

Share Capital—Ordinary		311
	Oct. 1	10,000

Cash flow analyses show the impact of each transaction on cash.

Cash Flows
+10,000

ILLUSTRATION 2.20
Investment of cash by shareholders

Transaction

On October 1, Yazici Advertising purchases office equipment costing ₺5,000 by signing a 3-month, 12%, ₺5,000 note payable.

Basic Analysis

The asset Equipment increases ₺5,000; the liability Notes Payable increases ₺5,000.

Equation Analysis

Assets	=	Liabilities	+	Equity
Equipment	=	Notes Payable		
+5,000		+5,000		

Debit–Credit Analysis

Debits increase assets: debit Equipment ₺5,000.
Credits increase liabilities: credit Notes Payable ₺5,000.

Journal Entry

Oct. 1	Equipment	157	5,000	
	Notes Payable	200		5,000
	(Issued 3-month, 12% note for office equipment)			

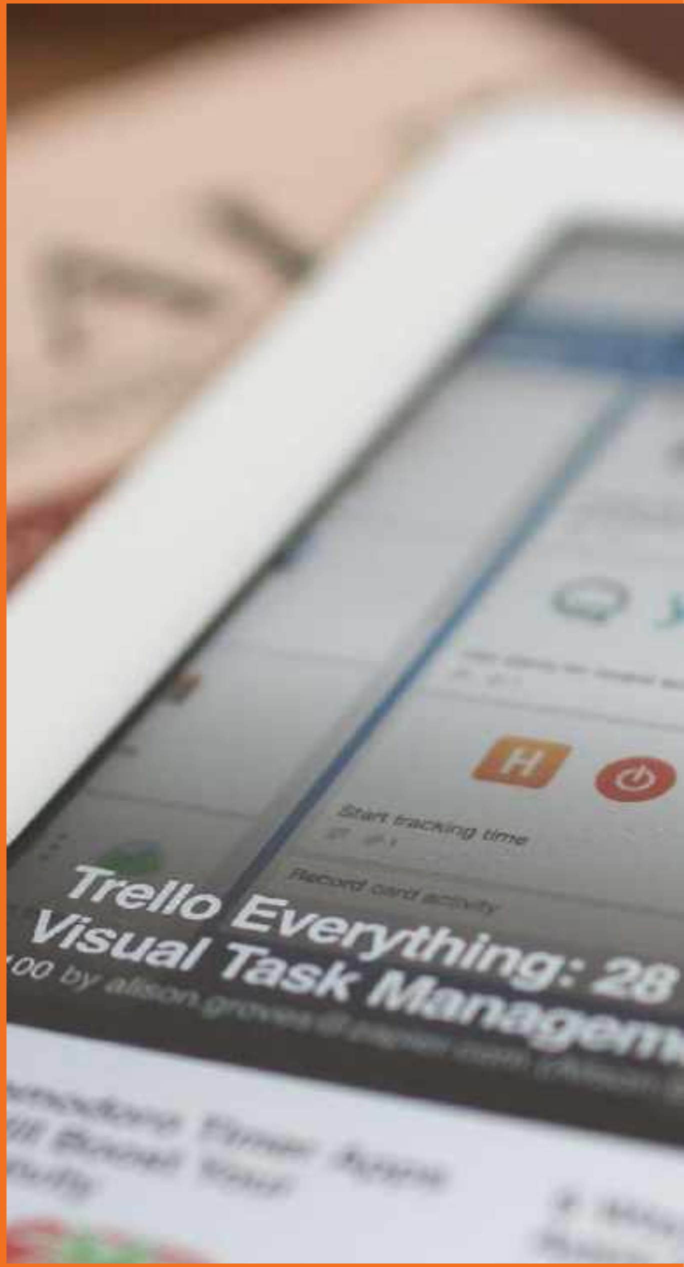
Posting

Equipment	157
Oct. 1 5,000	

Notes Payable	200
	Oct. 1 5,000

Cash Flows
no effect

ILLUSTRATION 2.21
Purchase of office equipment



Transaction	On October 2, Yazici Advertising receives a ₺1,200 cash advance from R. Knox, a client, for advertising services that are expected to be completed by December 31.
Basic Analysis	The asset Cash increases ₺1,200; the liability Unearned Service Revenue increases ₺1,200 because the service has not been performed yet. That is, when Yazici receives an advance payment, it should record an unearned revenue (a liability) in order to recognize the obligation that exists. Note also that although many liabilities have the word "payable" in their title, unearned revenue is considered a liability because the liability is satisfied by providing a product or performing a service.
Equation Analysis	**Assets** = **Liabilities** + **Equity** Cash = Unearned Service Revenue +1,200 = +1,200
Debit–Credit Analysis	Debits increase assets: debit Cash ₺1,200. Credits increase liabilities: credit Unearned Service Revenue ₺1,200.

Journal Entry

Oct. 2	Cash	101	1,200	
	Unearned Service Revenue	209		1,200
	(Received cash from R. Knox for future service)			

Posting

Cash	101
Oct. 1 10,000	
2 1,200	

Unearned Service Revenue	209
	Oct. 2 1,200

Cash Flows
+1,200

ILLUSTRATION 2.22
Receipt of cash for future service

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Transaction	On October 2, Yazici Advertising receives a ₺1,200 cash advance from R. Knox, a client, for advertising services that are expected to be completed by December 31.
Basic Analysis	The asset Cash increases ₺1,200; the liability Unearned Service Revenue increases ₺1,200 because the service has not been performed yet. That is, when Yazici receives an advance payment, it should record an unearned revenue (a liability) in order to recognize the obligation that exists. Note also that although many liabilities have the word "payable" in their title, unearned revenue is considered a liability because the liability is satisfied by providing a product or performing a service.
Equation Analysis	see below
Debit–Credit Analysis	Debits increase assets: debit Cash ₺1,200. Credits increase liabilities: credit Unearned Service Revenue ₺1,200.

Equation Analysis:

Assets	=	**Liabilities**	+	**Equity**
Cash	=	Unearned Service Revenue		
+1,200		+1,200		

Journal Entry:

Oct. 2	Cash	101	1,200	
	Unearned Service Revenue	209		1,200
	(Received cash from R. Knox for future service)			

Posting:

Cash		101
Oct. 1	10,000	
2	1,200	

Unearned Service Revenue		209
	Oct. 2	1,200

Unearned Service Revenue is considered a liability even though the word *payable* is not used.

Cash Flows
+1,200

ILLUSTRATION 2.22
Receipt of cash for future service

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Transaction

On October 3, Yazici Advertising pays office rent for October in cash, ₺900.

Basic Analysis

Rent Expense increases ₺900 because the payment pertains only to the current month; the asset Cash decreases ₺900.

Equation Analysis

Assets	=	Liabilities	+	Equity	
Cash	=			Expenses	
−900				−900	Rent Expense

Debit–Credit Analysis

Debits increase expenses: debit Rent Expense ₺900.
Credits decrease assets: credit Cash ₺900.

Journal Entry

Oct. 3	Rent Expense	729	900	
	Cash	101		900
	(Paid October rent)			

Posting

Cash		101	
Oct. 1	10,000	Oct. 3	900
2	1,200		

Rent Expense		729	
Oct. 3	900		

Cash Flows
−900

ILLUSTRATION 2.23
Payment of monthly rent

Transaction	On October 4, Yazici Advertising pays ₺600 for a one-year insurance policy that will expire next year on September 30.
Basic Analysis	The asset Prepaid Insurance increases ₺600 because the payment extends to more than the current month; the asset Cash decreases ₺600. Payments of expenses that will benefit more than one accounting period are prepaid expenses or prepayments. When a company makes a payment, it debits an asset account in order to show the service or benefit that will be received in the future.
Equation Analysis	see below
Debit–Credit Analysis	Debits increase assets: debit Prepaid Insurance ₺600. Credits decrease assets: credit Cash ₺600.
Journal Entry	see below
Posting	see below

Equation Analysis:

Assets			=	Liabilities	+	Equity
Cash	+	Prepaid Insurance				
−600		+600				

Journal Entry:

Oct. 4	Prepaid Insurance	130	600	
	Cash	101		600
	(Paid one-year policy; effective date October 1)			

Posting:

Cash 101	
Oct. 1 10,000	Oct. 3 900
2 1,200	4 600

Prepaid Insurance 130	
Oct. 4 600	

Cash Flows
−600

ILLUSTRATION 2.24
Payment for insurance

Transaction

On October 5, Yazici Advertising purchases an estimated 3-month supply of advertising materials on account from Aero Supply for ₺2,500.

Basic Analysis

The asset Supplies increases ₺2,500; the liability Accounts Payable increases ₺2,500.

Equation Analysis

Assets	=	Liabilities	+	Equity
Supplies	=	Accounts Payable		
+2,500		+2,500		

Debit–Credit Analysis

Debits increase assets: debit Supplies ₺2,500.
Credits increase liabilities: credit Accounts Payable ₺2,500.

Journal Entry

Oct. 5	Supplies	126	2,500	
	Accounts Payable	201		2,500
	(Purchased supplies on account from Aero Supply)			

Posting

Supplies	126
Oct. 5 2,500	

Accounts Payable	201
	Oct. 5 2,500

Cash Flows
no effect

ILLUSTRATION 2.25
Purchase of supplies on credit

Event	On October 9, Yazici Advertising hires four employees to begin work on October 15. Each employee is to receive a weekly salary of ₺500 for a 5-day work week, payable every 2 weeks—first payment made on October 26.
Basic Analysis	A business transaction has not occurred. There is only an agreement between the employer and the employees to enter into a business transaction beginning on October 15. Thus, a debit–credit analysis is not needed because there is no accounting entry. (See transaction of October 26 for first entry.)

Cash Flows
no effect

ILLUSTRATION 2.26
Hiring of employees

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Transaction

On October 20, Yazici Advertising's board of directors declares and pays a ₺500 cash dividend to shareholders.

Basic Analysis

The Dividends account increases ₺500; the asset Cash decreases ₺500.

Equation Analysis

Assets	=	Liabilities	+	Equity
Cash	=			Dividends
−500				−500

Debit–Credit Analysis

Debits increase dividends: debit Dividends ₺500.
Credits decrease assets: credit Cash ₺500.

Journal Entry

Oct. 20	Dividends	332	500	
	Cash	101		500
	(Declared and paid a cash dividend)			

Posting

Cash			101
Oct. 1	10,000	Oct. 3	900
2	1,200	4	600
		20	500

Dividends	332
Oct. 20 500	

Cash Flows
−500

ILLUSTRATION 2.27
Declaration and payment of dividend

Transaction

On October 26, Yazici Advertising owes employee salaries of ₺4,000 and pays them in cash. (See October 9 event.)

Basic Analysis

Salaries and Wages Expense increases ₺4,000; the asset Cash decreases ₺4,000.

Equation Analysis

Assets	=	Liabilities	+	Equity	
Cash	=			Expenses	
−4,000				−4,000	Salaries and Wages Expense

Debit–Credit Analysis

Debits increase expenses: debit Salaries and Wages Expense ₺4,000.
Credits decrease assets: credit Cash ₺4,000.

Journal Entry

Oct. 26	Salaries and Wages Expense	726	4,000	
	Cash	101		4,000
	(Paid salaries to date)			

Posting

Cash			101
Oct. 1	10,000	Oct. 3	900
2	1,200	4	600
		20	500
		26	4,000

Salaries and Wages Expense			726
Oct. 26	4,000		

Cash Flows
−4,000

ILLUSTRATION 2.28
Payment of salaries

Transaction On October 31, Yazici Advertising receives ₺10,000 in cash from Copa Company for advertising services performed in October.

Basic Analysis The asset Cash increases ₺10,000; the revenue account Service Revenue increases ₺10,000.

Equation Analysis

Assets	=	Liabilities	+	Equity	
Cash	=			Revenues	
+10,000				+10,000	Service Revenue

Debit–Credit Analysis Debits increase assets: debit Cash ₺10,000. Credits increase revenues: credit Service Revenue ₺10,000.

Journal Entry

Oct. 31	Cash	101	10,000	
	Service Revenue	400		10,000
	(Received cash for services performed)			

Posting

Cash			101
Oct. 1	10,000	Oct. 3	900
2	1,200	4	600
31	10,000	20	500
		26	4,000

Service Revenue			400
		Oct. 31	10,000

Cash Flows
+10,000

ILLUSTRATION 2.29
Receipt of cash for services provided

Summary Illustration of Journalizing and Posting

GENERAL JOURNAL				PAGE J1
Date	**Account Titles and Explanation**	**Ref.**	**Debit**	**Credit**
2020				
Oct. 1	Cash	101	10,000	
	Share Capital—Ordinary	311		10,000
	(Issued shares for cash)			
1	Equipment	157	5,000	
	Notes Payable	200		5,000
	(Issued 3-month, 12% note for office equipment)			
2	Cash	101	1,200	
	Unearned Service Revenue	209		1,200
	(Received cash from R. Knox for future services)			
3	Rent Expense	729	900	
	Cash	101		900
	(Paid October rent)			
4	Prepaid Insurance	130	600	
	Cash	101		600
	(Paid one-year policy; effective date October 1)			
5	Supplies	126	2,500	
	Accounts Payable	201		2,500
	(Purchased supplies on account from Aero Supply)			
20	Dividends	332	500	
	Cash	101		500
	(Declared and paid a cash dividend)			
26	Salaries and Wages Expense	726	4,000	
	Cash	101		4,000
	(Paid salaries to date)			
31	Cash	101	10,000	
	Service Revenue	400		10,000
	(Received cash for services performed)			

ILLUSTRATION 2.30
General journal entries

Summary Illustration of Journalizing and Posting

PRADITA University

GENERAL LEDGER

Cash — No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
2020					
Oct. 1		J1	10,000		10,000
2		J1	1,200		11,200
3		J1		900	10,300
4		J1		600	9,700
20		J1		500	9,200
26		J1		4,000	5,200
31		J1	10,000		15,200

Supplies — No. 126

Date	Explanation	Ref.	Debit	Credit	Balance
2020					
Oct. 5		J1	2,500		2,500

Prepaid Insurance — No. 130

Date	Explanation	Ref.	Debit	Credit	Balance
2020					
Oct. 4		J1	600		600

Equipment — No. 157

Date	Explanation	Ref.	Debit	Credit	Balance
2020					
Oct. 1		J1	5,000		5,000

Notes Payable — No. 200

Date	Explanation	Ref.	Debit	Credit	Balance
2020					
Oct. 1		J1		5,000	5,000

Accounts Payable — No. 201

Date	Explanation	Ref.	Debit	Credit	Balance
2020					
Oct. 5		J1		2,500	2,500

Unearned Service Revenue — No. 209

Date	Explanation	Ref.	Debit	Credit	Balance
2020					
Oct. 2		J1		1,200	1,200

Share Capital—Ordinary — No. 311

Date	Explanation	Ref.	Debit	Credit	Balance
2020					
Oct. 1		J1		10,000	10,000

Dividends — No. 332

Date	Explanation	Ref.	Debit	Credit	Balance
2020					
Oct. 20		J1	500		500

Service Revenue — No. 400

Date	Explanation	Ref.	Debit	Credit	Balance
2020					
Oct. 31		J1		10,000	10,000

Salaries and Wages Expense — No. 726

Date	Explanation	Ref.	Debit	Credit	Balance
2020					
Oct. 26		J1	4,000		4,000

Rent Expense — No. 729

Date	Explanation	Ref.	Debit	Credit	Balance
2020					
Oct. 3		J1	900		900

ILLUSTRATION 2.31 General ledger

Practice!

Como SpA recorded the following transactions in a general journal during the month of March

Mar. 4	Cash	2,280	
	Service Revenue		2,280
15	Salaries and Wages Expense	400	
	Cash		400
19	Utilities Expense	92	
	Cash		92

Post these entries to the Cash account of the general ledger to determine the ending balance in cash. The beginning balance in Cash on March 1 was €600.

ACTION PLAN

- Recall that posting involves transferring the journalized debits and credits to specific accounts in the ledger.
- Determine the ending balance by netting the total debits and credits.

Practice!

Solution

Cash			
3/1	600	3/15	400
3/4	2,280	3/19	92
3/31 Bal.	2,388		

The Trial Balance

A list of accounts and their balances at a given time.
Proves the mathematical equality of debits and credits after posting.

Three steps of preparation:

1. List the account titles and their balances in the appropriate debit or credit column.
2. Total the debit and credit columns.
3. Verify the equality of the two columns.

The Trial Balance

Yazici Advertising A.Ş.
Trial Balance
October 31, 2020

	Debit	Credit
Cash	₺15,200	
Supplies	2,500	
Prepaid Insurance	600	
Equipment	5,000	
Notes Payable		₺ 5,000
Accounts Payable		2,500
Unearned Service Revenue		1,200
Share Capital—Ordinary		10,000
Dividends	500	
Service Revenue		10,000
Salaries and Wages Expense	4,000	
Rent Expense	900	
	₺28,700	₺28,700

Limitations of a Trial Balance

A trial balance may balance even when:

1 - Transaction not journalized.
2 - Correct journal entry not posted.
3 - Journal entry posted twice.
4 - Incorrect accounts used in journalizing or posting.
5 - Offsetting errors made in recording the amount of a transaction.

ETHICS NOTE

Error:

The result of an unintentional mistake
Neither ethical nor unethical

Irregularity:

An intentional misstatement
Viewed as unethical

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Akuntansi Usaha Pariwisata

Chapter 3 Adjusting The Accounts

PRADITA UNIVERSITY

- IFRS 4th Edition

Weygandt ● Kimmel ● Kieso

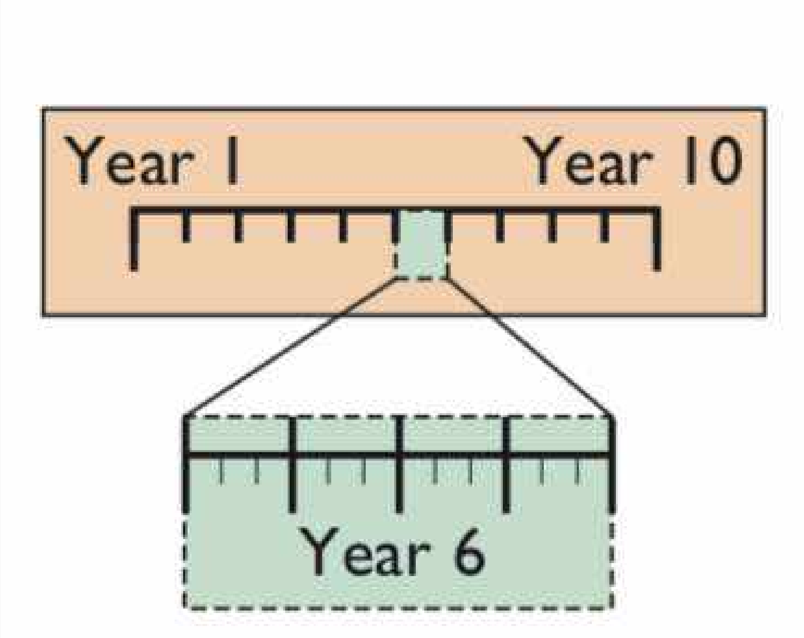
Chapter Preview

- In Chapter 1, you learned a neat little formula:
  Net income = Revenues – Expenses.
- In Chapter 2, you learned some rules for recording revenue and expense transactions.
- Guess what?
- Things are not really that nice and neat. In fact, it is often difficult for companies to determine in what time period they should report some revenues and expenses. In other words, in measuring net income, **TIMING** is everything.

Accrual-Basis Accounting and Adjusting Entries

Time period (or *periodicity*) assumption:

Accountants divide the economic life of a business into artificial time periods.



Fiscal and Calendar Years

- Accounting time periods are generally **a month, a quarter, or a year**.
- Monthly and quarterly time periods are called **interim periods**.
- Most large companies must prepare both **quarterly** and **annual** financial statements.
- **Fiscal Year** = Accounting time period that is **one year** in length.
- **Calendar Year** = January 1 to December 31.
- Sometimes a company’s year-end will vary from year to year, resulting in accounting periods of **either 52 or 53 weeks**.

Accrual- versus Cash-Basis Accounting

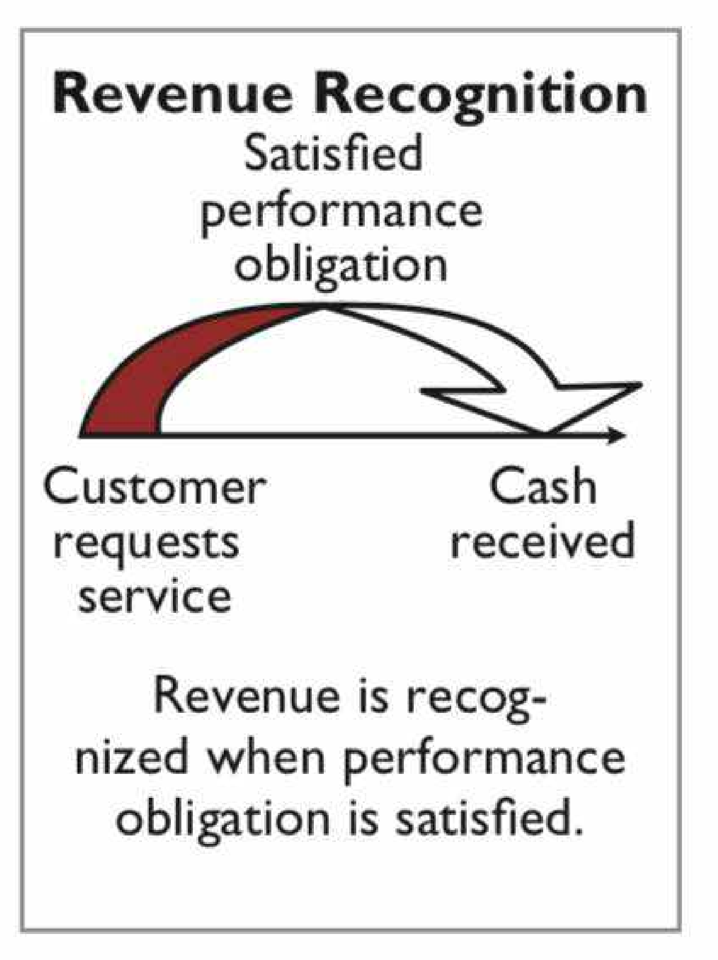
Accrual-Basis Accounting

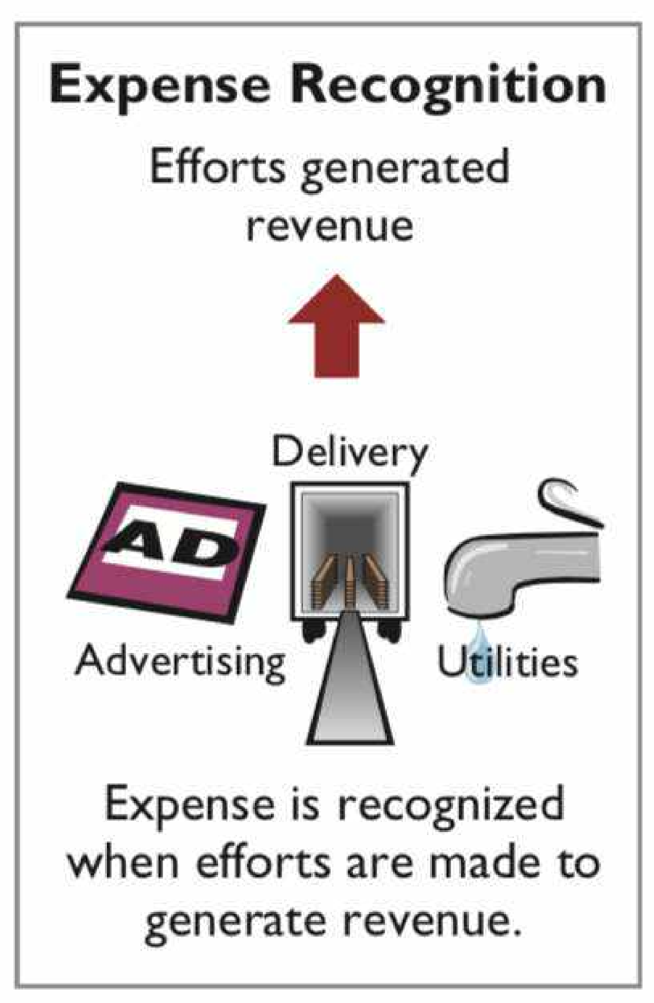
- Transactions are recorded in the **periods in which the events occur**.
- Companies **recognize revenues when they perform services** (rather than when they receive cash).
- Expenses are recognized when **incurred** (rather than when paid).
- Accrual-basis accounting is in accordance with **IFRS**.

Cash-Basis Accounting

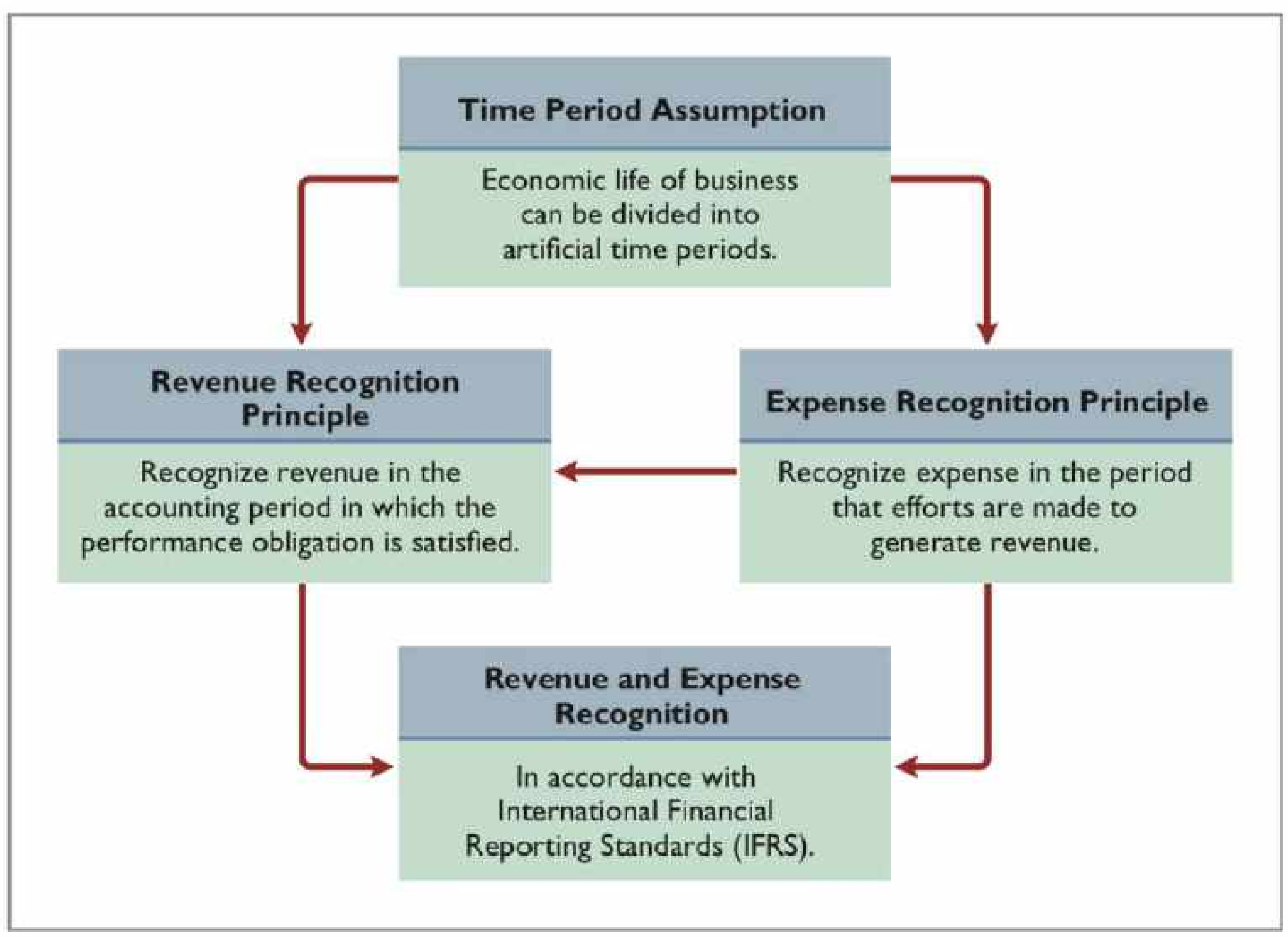
- **Revenues** are recorded when **cash is received**.
- **Expenses** are recorded when **cash is paid**.
- Cash-basis accounting is **not** in accordance with **IFRS**.

Recognizing Revenues and Expenses





Recognizing Revenues and Expenses



The Need for Adjusting Entries

- Adjusting entries **ensure that the revenue recognition and expense recognition principles are followed**.
- **Required** every time a company prepares financial statements.
- Will include **one income statement account** and **one statement of financial position account**.

Reasons:

1. Some events are not recorded daily because it is not efficient to do so.
2. Some costs are not recorded during the accounting period because these costs expire with the passage of time rather than as a result of recurring daily transactions.
3. Some items may be unrecorded.

Types of Adjusting Entries

Deferrals:

1. **Prepaid expenses**: Expenses paid in cash before they are used or consumed.
2. **Unearned revenues**: Cash received before services are performed.

Accruals:

1. **Accrued revenues**: Revenues for services performed but not yet received in cash or recorded.
2. **Accrued expenses**: Expenses incurred but not yet paid in cash or recorded.

Adjusting Entries for Deferrals

Deferrals are **expenses or revenues** that are recognized at a date later than the point when cash was originally exchanged.

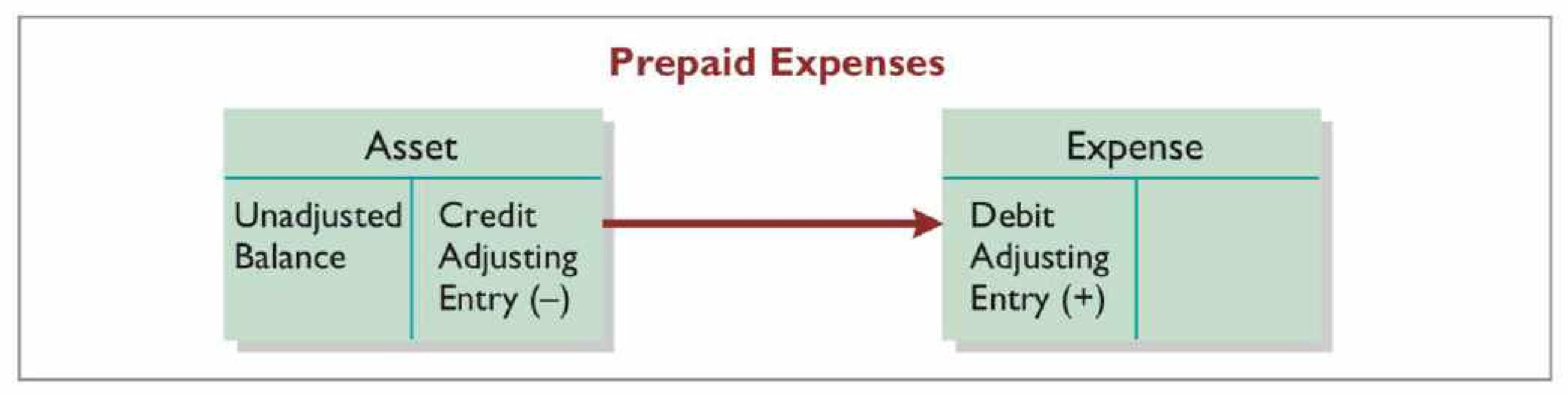
There are **two types**:

- Prepaid expenses, and
- Unearned revenues.

Prepaid Expenses

Prepaid expenses are costs that expire either with the passage of time (e.g., rent and insurance) **or through use** (e.g., supplies).

Prior to adjustment, assets are overstated and expenses are understated.



Supplies

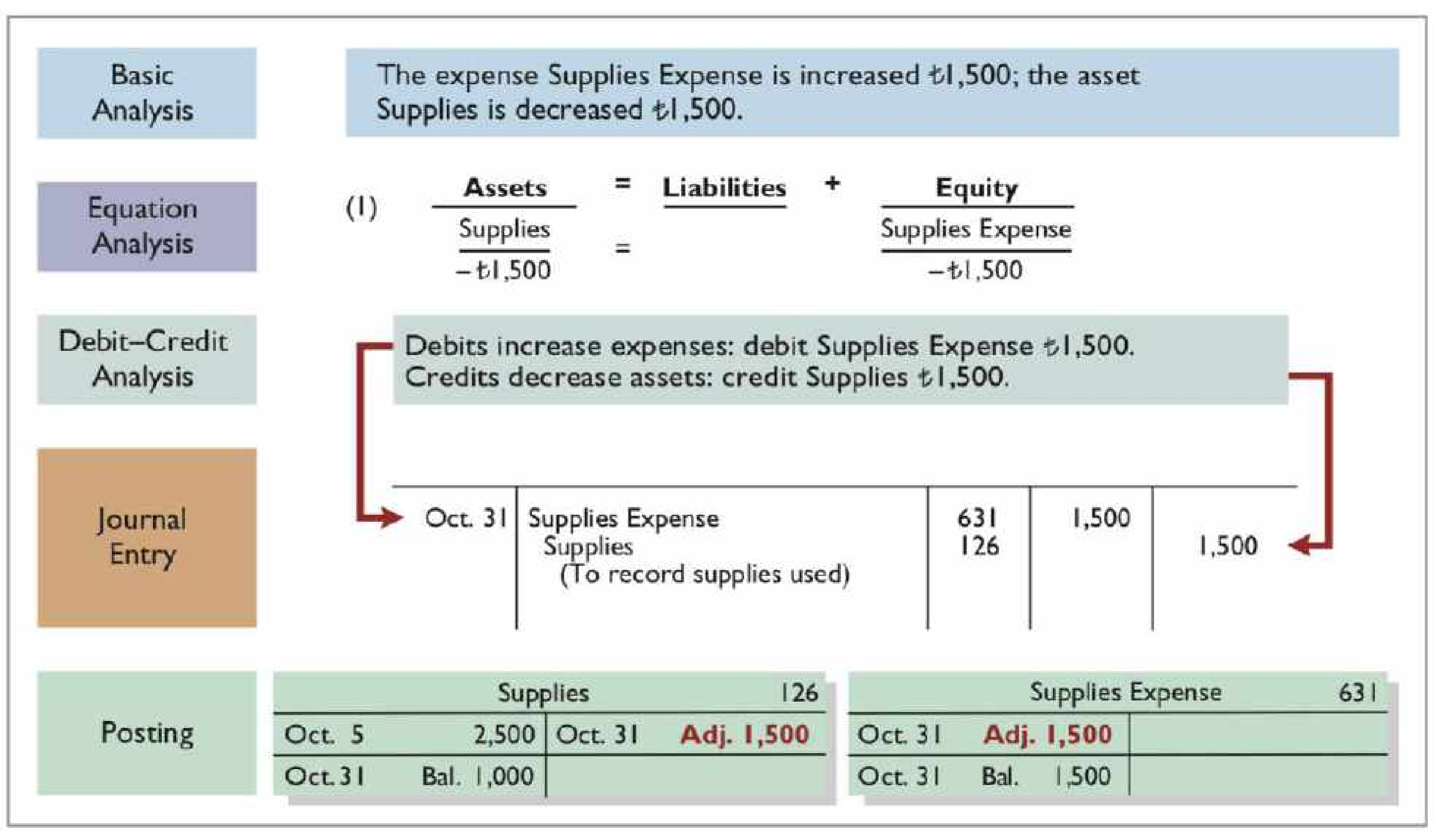
Rather than record supplies expense as the supplies are used, companies recognize supplies expense at the **end** of the accounting period.

Supplies

Assume: Yazici Advertising purchased supplies costing 2,500 on October 5. Yazici recorded the purchase by increasing (debiting) the asset Supplies. This account shows a balance of 2,500 in the October 31 trial balance. An inventory count at the close of business on October 31 reveals that 1,000 of supplies are still on hand.

Demonstrate: How do you record the adjustment for supplies?

Supplies



Basic Analysis
The expense Supplies Expense is increased ₺1,500; the asset Supplies is decreased ₺1,500.
Equation Analysis
(1)
Assets = Liabilities + Equity
Supplies
−₺1,500
=
Supplies Expense
−₺1,500
Debit–Credit Analysis
Debits increase expenses: debit Supplies Expense ₺1,500.
Credits decrease assets: credit Supplies ₺1,500.
Journal Entry
Oct. 31 Supplies Expense 631 1,500
Supplies 126 1,500
(To record supplies used)
Posting
Supplies 126
Oct. 5 2,500 Oct. 31 Adj. 1,500
Oct. 31 Bal. 1,000
Supplies Expense 631
Oct. 31 Adj. 1,500
Oct. 31 Bal. 1,500

Insurance

Assume: On October 4, Yazici Advertising paid 600 for a one-year fire insurance policy. Coverage began on October 1. Yazici recorded the payment by increasing (debiting) Prepaid Insurance.

Demonstrate: How do you record the adjustment for insurance?

Insurance

Basic Analysis	The expense Insurance Expense is increased ₺50; the asset Prepaid Insurance is decreased ₺50.

Equation Analysis

(2)

Assets	=	Liabilities	+	Equity
Prepaid Insurance				Insurance Expense
−₺50	=			−₺50

Debit–Credit Analysis	Debits increase expenses: debit Insurance Expense ₺50. Credits decrease assets: credit Prepaid Insurance ₺50.

Journal Entry

Oct. 31	Insurance Expense	722	50	
	Prepaid Insurance	130		50
	(To record insurance expired)			

Posting

Prepaid Insurance			130
Oct. 4	600	Oct. 31	Adj. 50
Oct. 31	Bal. 550		

Insurance Expense			722
Oct. 31	Adj. 50		
Oct. 31	Bal. 50		

Depreciation

Oct. 1

Equipment purchased;
record asset

Equipment			
Oct ŧ40	Nov ŧ40	Dec ŧ40	Jan ŧ40
Feb ŧ40	March ŧ40	April ŧ40	May ŧ40
June ŧ40	July ŧ40	Aug ŧ40	Sept ŧ40
Depreciation = ŧ480/year			

Oct. 31
Depreciation recognized;
record depreciation expense

Depreciation is the process of allocating the cost of an asset to expense over its useful life.

Depreciation is an **allocation concept**, not a valuation concept.

That is, depreciation **allocates an asset's cost** to the periods in which it is **used**.

Depreciation does **not** attempt to report the **actual change in the value** of the asset.

Depreciation

Assume: For Yazici Advertising, depreciation on the equipment is 480 a year, or 40 per month.

Demonstrate: How do you record the adjustment for depreciation?

Depreciation

Basic Analysis

The expense Depreciation Expense is increased ৳40; the contra asset Accumulated Depreciation—Equipment is increased ৳40.

Equation Analysis

Assets	=	Liabilities	+	Equity
Accumulated Depreciation—Equipment	=			Depreciation Expense
−৳40				−৳40

Debit–Credit Analysis

Debits increase expenses: debit Depreciation Expense ৳40.
Credits increase contra assets: credit Accumulated Depreciation—Equipment ৳40.

Journal Entry

Oct. 31	Depreciation Expense	711	40	
	Accumulated Depreciation—Equipment	158		40
	(To record monthly depreciation)			

Posting

Equipment			157
Oct. 1	5,000		
Oct. 31	Bal. 5,000		

Accumulated Depreciation—Equipment			158
		Oct. 31	Adj. 40
		Oct. 31	Bal. 40

Depreciation Expense			711
Oct. 31	Adj. 40		
Oct. 31	Bal. 40		

HELPFUL HINT

All contra accounts have increases, decreases, and normal balances opposite to the account to which they relate.

Prepaid Expenses

Statement Presentation.

Equipment	₺5,000
Less: Accumulated depreciation—equipment	40
	₺4,960

1 **Book value** or **carrying value**: Difference between the cost of any depreciable asset and its related accumulated depreciation

Prepaid Expenses Summary

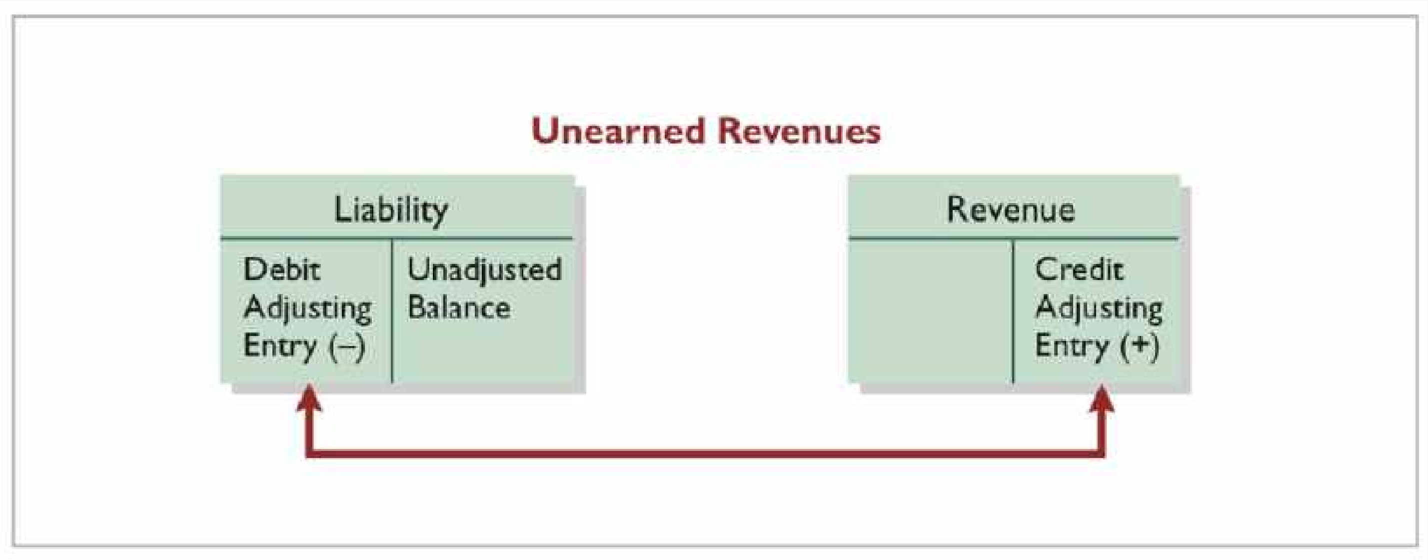
Accounting for Prepaid Expenses

Examples	Reason for Adjustment	Accounts Before Adjustment	Adjusting Entry
Insurance, supplies, advertising, rent, depreciation	Prepaid expenses originally recorded in asset accounts have been used.	Assets overstated. Expenses understated.	Dr. Expenses Cr. Assets or Contra Assets

Unearned Revenue

When companies receive cash before services are performed, they record a liability by increasing (crediting) a liability account called **unearned revenues**.

Prior to adjustment, liabilities are overstated and revenues are understated.



Service Revenue

Assume: Yazici Advertising received 1,200 on October 2 from R. Knox for advertising services expected to be completed by December 31. Yazici credited the payment to Unearned Service Revenue. This liability account shows a balance of 1,200 in the October 31 trial balance.

Demonstrate: How do you record the adjustment for advertising revenue?

Service Revenue

Basic Analysis	The liability Unearned Service Revenue is decreased ₺400; the revenue Service Revenue is increased ₺400.
Equation Analysis	Assets = Liabilities + Equity Liabilities: Unearned Service Revenue −₺400 Equity: Service Revenue +₺400
Debit–Credit Analysis	Debits decrease liabilities: debit Unearned Service Revenue ₺400. Credits increase revenues: credit Service Revenue ₺400.

Journal Entry

Oct. 31	Unearned Service Revenue	209	400	
	Service Revenue	400		400
	(To record revenue for services performed)			

Posting

Unearned Service Revenue			209
Oct. 31	Adj. 400	Oct. 2	1,200
		Oct. 31 Bal.	800

Service Revenue			400
		Oct. 31	10,000
		31 Adj.	400
		Oct. 31 Bal.	10,400

Unearned Revenues

Accounting for Unearned Revenues

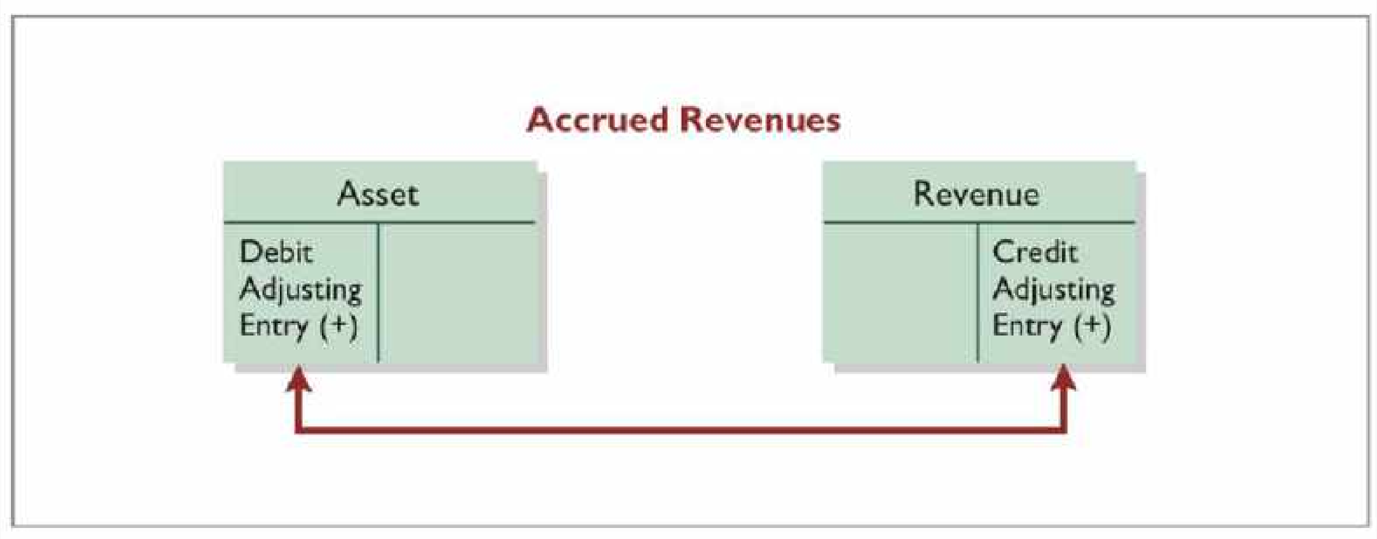
Examples	Reason for Adjustment	Accounts Before Adjustment	Adjusting Entry
Rent, magazine subscriptions, customer deposits for future service	Unearned revenues recorded in liability accounts are now recognized as revenue for services performed.	Liabilities overstated. Revenues understated.	Dr. Liabilities Cr. Revenues

Adjusting Entries for Accruals

Accruals are made to record the following:

- Revenues for services performed but not yet recorded at the statement date – **accrued revenues** or
- Expenses incurred but not yet paid or recorded at the statement date – **accrued expenses**

Accrued Revenues



Prior to adjustment, both assets and revenues are understated.

An adjusting entry for accrued revenues results in an increase (a debit) to an asset account and an increase (a credit) to a revenue account.

Accrued Revenues

Assume: In October, Yazici Advertising performed services worth 200 that were not billed to clients on or before October 31. Because these services were not billed, they were not recorded.

Demonstrate: How do you adjust for accrued revenue?

Accrued Revenues

Basic Analysis	The asset Accounts Receivable is increased ŧ200; the revenue Service Revenue is increased ŧ200.
Equation Analysis	Assets = Liabilities + Equity Accounts Receivable +ŧ200 = Service Revenue +ŧ200
Debit–Credit Analysis	Debits increase assets: debit Accounts Receivable ŧ200. Credits increase revenues: credit Service Revenue ŧ200.

Journal Entry

Oct. 31	Accounts Receivable	112	200	
	Service Revenue	400		200
	(To record revenue for services performed)			

Posting

Accounts Receivable 112

Oct. 31	Adj. 200		
Oct. 31	Bal. 200		

Service Revenue 400

		Oct. 31	10,000
		31	400
		31	Adj. 200
		Oct. 31	Bal. 10,600

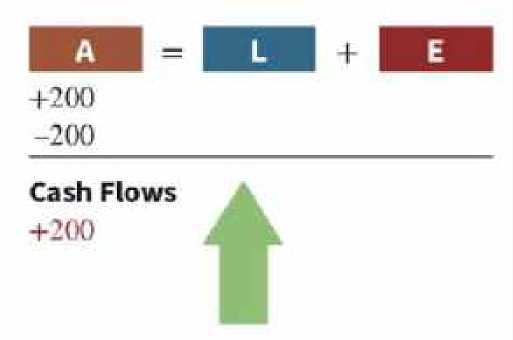
Accrued Revenues

Assume: On November 10, Yazici receives cash of 200 for the services performed in October and makes the following entry.

Demonstrate: How do you record the collection of the receivables?

Accrued Revenues

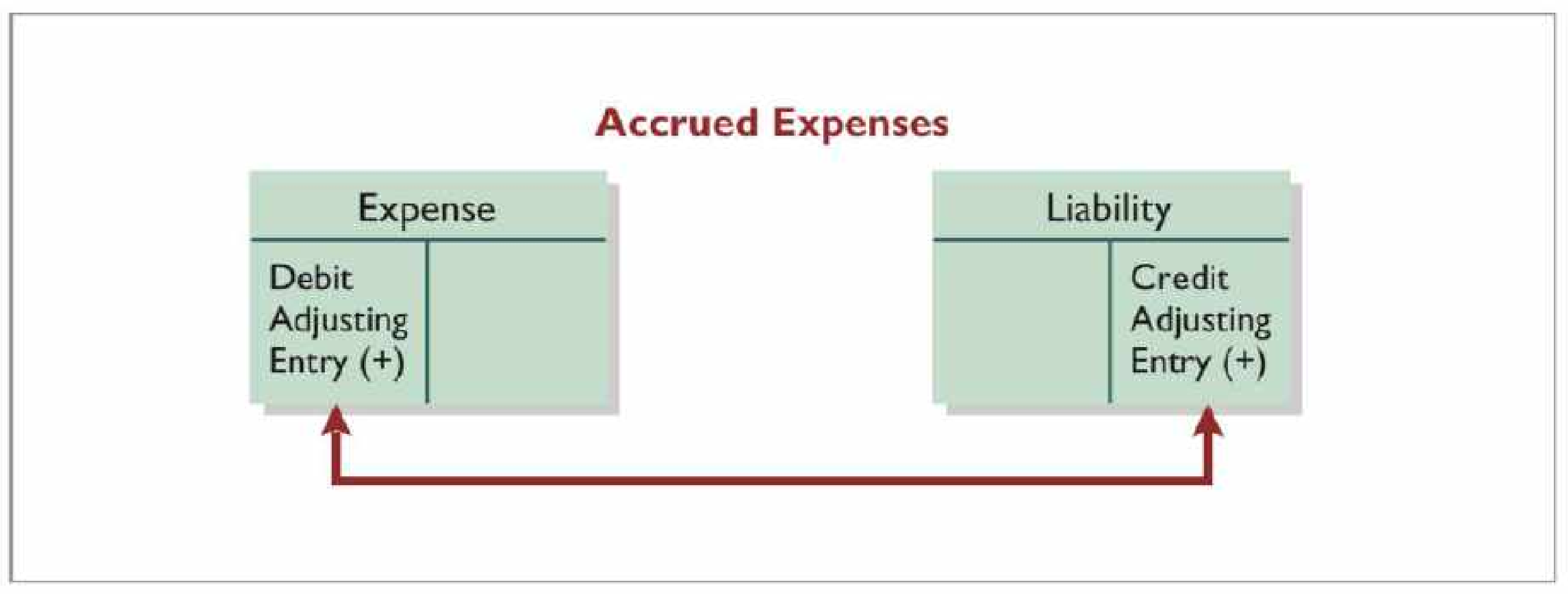
Nov. 10	Cash	200	
	Accounts Receivable		200
	(To record cash collected on account)		



Accounting for Accrued Revenues

Examples	Reason for Adjustment	Accounts Before Adjustment	Adjusting Entry
Interest, rent, services	Services performed but not yet received in cash or recorded.	Assets understated. Revenues understated.	Dr. Assets Cr. Revenues

Accrued Expenses



Prior to adjustment, both liabilities and expenses are understated.

An adjusting entry for accrued expenses results in an increase (a debit) to an expense account and an increase (a credit) to a liability account.

Accrued Interest

Assume: Yazici Advertising signed a three-month note payable in the amount of 5,000 on October 1. The note requires Yazici to pay interest at an annual rate of 12%.

Demonstrate:

(1) How do you determine the interest to be recorded?
(2) How do you create the adjustment for accrued interest?

Accrued Interest

Face Value of Note	×	Annual Interest Rate	×	Time in Terms of One Year	=	Interest
৳5,000	×	12%	×	$\frac{1}{12}$	=	৳50

ILLUSTRATION 3.17
Formula for computing interest

Accrued Interest

Basic Analysis	The expense Interest Expense is increased ৳50; the liability Interest Payable is increased ৳50.
Equation Analysis	Assets = Liabilities (Interest Payable +৳50) + Equity (Interest Expense −৳50)
Debit–Credit Analysis	Debits increase expenses: debit Interest Expense ৳50. Credits increase liabilities: credit Interest Payable ৳50.

Journal Entry

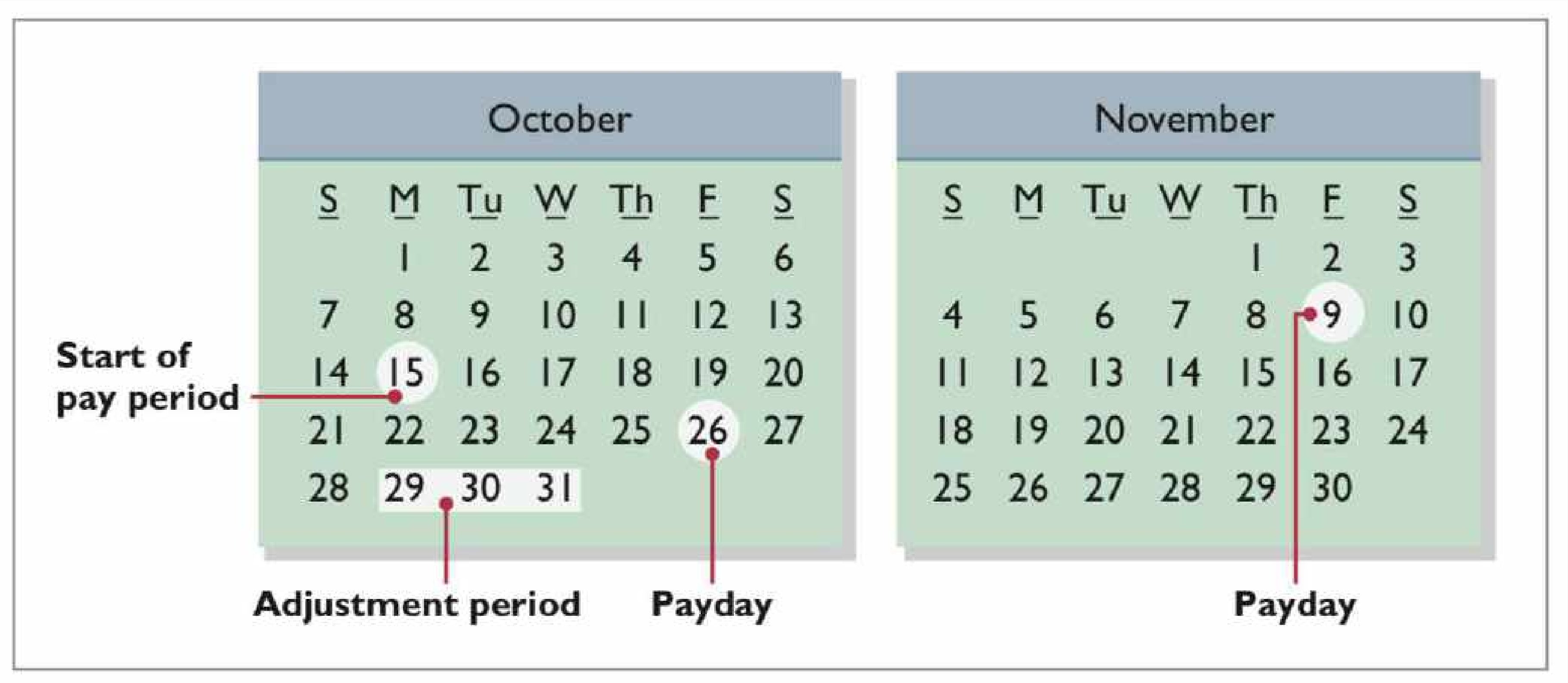
Oct. 31	Interest Expense	905	50	
	Interest Payable	230		50
	(To record interest on notes payable)			

Posting

Interest Expense		905
Oct. 31 Adj. 50		
Oct. 31 Bal. 50		

Interest Payable		230
	Oct. 31 Adj. 50	
	Oct. 31 Bal. 50	

Accrues Salaries and Wages



Accrued Salaries and Wages

Assume: At October 31, the salaries and wages for these three days represent an accrued expense and a related liability to Yazici. The employees receive total salaries and wages of 2,000 for a five-day work week, or 400 per day. Thus, accrued salaries and wages at October 31 are 1,200 (400 × 3).

Demonstrate: How do you create the adjustment for accrued salaries and wages?

Accrued Salaries and Wages

Basic Analysis

The expense Salaries and Wages Expense is increased ₺1,200; the liability Salaries and Wages Payable is increased ₺1,200.

Equation Analysis

Assets	=	Liabilities	+	Equity
		Salaries and Wages Payable		Salaries and Wages Expense
		+ ₺1,200		− ₺1,200

Debit–Credit Analysis

Debits increase expenses: debit Salaries and Wages Expense ₺1,200.
Credits increase liabilities: credit Salaries and Wages Payable ₺1,200.

Journal Entry

Oct. 31	Salaries and Wages Expense	726	1,200	
	Salaries and Wages Payable	212		1,200
	(To record accrued salaries and wages)			

Posting

Salaries and Wages Expense 726			
Oct. 26		4,000	
31	Adj.	1,200	
Oct. 31	Bal.	5,200	

Salaries and Wages Payable 212			
	Oct. 31	Adj.	1,200
	Oct. 31	Bal.	1,200

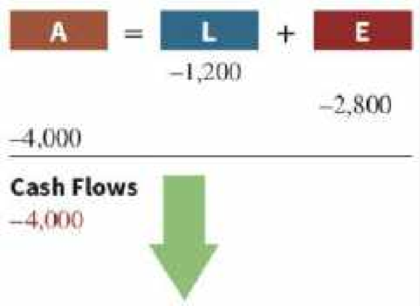
Accrued Salaries and Wages

Assume: Yazici pays salaries and wages every two weeks. Consequently, the next payday is November 9, when the company will again pay total salaries and wages of 4,000. The payment consists of 1,200 of salaries and wages payable at October 31 plus 2,800 of salaries and wages expense for November (7 working days, as shown in the November calendar × 400).

Demonstrate: Which entry does Yazici make on November 9?

Accrued Salaries and Wages

Nov. 9	Salaries and Wages Payable	1,200	
	Salaries and Wages Expense	2,800	
	Cash		4,000
	(To record November 9 payroll)		



Accounting for Accrued Expenses

Examples	Reason for Adjustment	Accounts Before Adjustment	Adjusting Entry
Interest, rent, salaries	Expenses have been incurred but not yet paid in cash or recorded.	Expenses understated. Liabilities understated.	Dr. Expenses Cr. Liabilities

Adjusting Entries-Key Point

1) Adjusting entries should not involve debits or credits to Cash.
2) Evaluate whether the adjustment makes sense. For example, an adjustment to recognize supplies used should increase Supplies Expense.
3) Double-check all computations.
4) Each adjusting entry affects one statement of financial position account and one income statement account.

Summary of Basic Relationships

Type of Adjustment	Accounts Before Adjustment	Adjusting Entry
Prepaid expenses	Assets overstated. Expenses understated.	Dr. Expenses Cr. Assets or Contra Assets
Unearned revenues	Liabilities overstated. Revenues understated.	Dr. Liabilities Cr. Revenues
Accrued revenues	Assets understated. Revenues understated.	Dr. Assets Cr. Revenues
Accrued expenses	Expenses understated. Liabilities understated.	Dr. Expenses Cr. Liabilities

Summary of Basic Relationships

GENERAL JOURNAL				J2
Date	Account Titles and Explanation	Ref.	Debit	Credit
2020	Adjusting Entries			
Oct. 31	Supplies Expense	631	1,500	
	Supplies	126		1,500
	(To record supplies used)			
31	Insurance Expense	722	50	
	Prepaid Insurance	130		50
	(To record insurance expired)			
31	Depreciation Expense	711	40	
	Accumulated Depreciation—Equipment	158		40
	(To record monthly depreciation)			
31	Unearned Service Revenue	209	400	
	Service Revenue	400		400
	(To record revenue for services performed)			
31	Accounts Receivable	112	200	
	Service Revenue	400		200
	(To record revenue for services performed)			
31	Interest Expense	905	50	
	Interest Payable	230		50
	(To record interest on notes payable)			
31	Salaries and Wages Expense	726	1,200	
	Salaries and Wages Payable	212		1,200
	(To record accrued salaries and wages)			

Practice!

Mahindra Computer Services began operations on August 1, 2020. At the end of August 2020, management prepares monthly financial statements. The following information relates to August (amounts in thousands).

1. At August 31, the company owed its employees ₹800 in salaries and wages that will be paid on September 1.
2. On August 1, the company borrowed ₹30,000 from a local bank on a 15-year mortgage. The annual interest rate is 10%.
3. Revenue for services performed but unrecorded for August totaled ₹1,100.

Prepare the adjusting entries needed at August 31, 2020.

ACTION PLAN

- Make adjusting entries at the end of the period to recognize revenues for services performed and for expenses incurred.
- Don’t forget to make adjusting entries for accruals. Adjusting entries for accruals will increase both a statement of financial position account and an income statement account.

Practice!

Solution

1.	Salaries and Wages Expense	800	
	Salaries and Wages Payable		800
	(To record accrued salaries)		
2.	Interest Expense	250	
	Interest Payable		250
	(To record accrued interest: $₹30{,}000 \times 10\% \times \frac{1}{12} = ₹250$)		
3.	Accounts Receivable	1,100	
	Service Revenue		1,100
	(To record revenue for services performed)		

Related exercise material: **BE3.7, DO IT! 3.3, E3.5, E3.6, E3.7, E3.8 and E3.9.**

Adjusted Trial Balance and Financial Statements

Adjusted trial balance:

- **Proves the equality** of the total debit balances and the total credit balances in the ledger after all adjustments.
- Primary basis for the preparation of financial statements.

Preparing the Adjusted Trial Balance

Yazici Advertising A.Ş.
Adjusted Trial Balance
October 31, 2020

	Debit	Credit
Cash	₺15,200	
Accounts Receivable	200	
Supplies	1,000	
Prepaid Insurance	550	
Equipment	5,000	
Accumulated Depreciation—Equipment		₺ 40
Notes Payable		5,000
Accounts Payable		2,500
Interest Payable		50
Unearned Service Revenue		800
Salaries and Wages Payable		1,200
Share Capital—Ordinary		10,000
Retained Earnings		–0–
Dividends	500	
Service Revenue		10,600
Salaries and Wages Expense	5,200	
Supplies Expense	1,500	
Rent Expense	900	
Insurance Expense	50	
Interest Expense	50	
Depreciation Expense	40	
	₺30,190	₺30,190

Preparing Financial Statements (1/2)

Yazici Advertising A.Ş.
Adjusted Trial Balance
October 31, 2020

Account	Debit	Credit
Cash	₺15,200	
Accounts Receivable	200	
Supplies	1,000	
Prepaid Insurance	550	
Equipment	5,000	
Accumulated Depreciation—Equipment		₺ 40
Notes Payable		5,000
Accounts Payable		2,500
Unearned Service Revenue		800
Salaries and Wages Payable		1,200
Interest Payable		50
Share Capital—Ordinary		10,000
Retained Earnings		–0–
Dividends	500	
Service Revenue		10,600
Salaries and Wages Expense	5,200	
Supplies Expense	1,500	
Rent Expense	900	
Insurance Expense	50	
Interest Expense	50	
Depreciation Expense	40	
	₺30,190	₺30,190

Yazici Advertising A.Ş.
Income Statement
For the Month Ended October 31, 2020

Revenues		
Service revenue		₺10,600
Expenses		
Salaries and wages expense	₺5,200	
Supplies expense	1,500	
Rent expense	900	
Insurance expense	50	
Interest expense	50	
Depreciation expense	40	
Total expenses		7,740
Net income		₺ 2,860

Yazici Advertising A.Ş.
Retained Earnings Statement
For the Month Ended October 31, 2020

Retained earnings, October 1	₺ –0–
Add: Net income	2,860
	2,860
Less: Dividends	500
Retained earnings, October 31	₺2,360

To statement of financial position

Preparing Financial Statements (2/2)

Yazici Advertising A.Ş.
Adjusted Trial Balance
October 31, 2020

Account	Debit	Credit
Cash	₺15,200	
Accounts Receivable	200	
Supplies	1,000	
Prepaid Insurance	550	
Equipment	5,000	
Accumulated Depreciation—Equipment		₺ 40
Notes Payable		5,000
Accounts Payable		2,500
Unearned Service Revenue		800
Salaries and Wages Payable		1,200
Interest Payable		50
Share Capital—Ordinary		10,000
Retained Earnings		–0–
Dividends	500	
Service Revenue		10,600
Salaries and Wages Expense	5,200	
Supplies Expense	1,500	
Rent Expense	900	
Insurance Expense	50	
Interest Expense	50	
Depreciation Expense	40	
	₺30,190	₺30,190

Yazici Advertising A.Ş.
Statement of Financial Position
October 31, 2020

Assets		
Equipment	₺5,000	
Less: Accumulated depreciation—equip.	40	₺ 4,960
Prepaid insurance		550
Supplies		1,000
Accounts receivable		200
Cash		15,200
Total assets		₺21,910
Equity and Liabilities		
Equity		
Share capital—ordinary	₺10,000	
Retained earnings	2,360	₺12,360
Liabilities		
Notes payable	5,000	
Accounts payable	2,500	
Unearned service revenue	800	
Salaries and wages payable	1,200	
Interest payable	50	9,550
Total equity and liabilities		₺21,910

Balance at Oct. 31 from retained earnings statement in Illustration 3.26

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Prepare adjusting entries for the alternative treatment of deferrals.

Alternative Treatment of Deferrals

Alternative treatment:

(1) When a company prepays an expense, it debits that amount to an expense account.

(2) When it receives payment for future services, it credits the amount to a revenue account.

Prepaid Expenses

Supplies

Assume: Yazici Advertising purchased supplies costing 2,500 on October 5. Yazici recorded the purchase by increasing (debiting) Supplies Expense (rather than to the asset account Supplies).
An inventory count at the close of business on October 31 reveals that 1,000 of supplies are still on hand.

Demonstrate: How do you record the adjustment for supplies?

Supplies

Oct. 31	Supplies	1,000	
	Supplies Expense		1,000
	(To record supplies inventory)		

A	=	L	+	E
+1,000				
				+1,000 Exp

Cash Flows
no effect

Supplies			
10/31	Adj.	1,000	

Supplies Expense					
10/5		2,500	10/31	Adj.	1,000
10/31	Bal.	1,500			

Prepaid Expenses
Adjustment Approaches - Comparison

Prepayment Initially Debited to Asset Account (per chapter)				Prepayment Initially Debited to Expense Account (per appendix)			
Oct. 5	Supplies	2,500		Oct. 5	Supplies Expense	2,500	
	Accounts Payable		2,500		Accounts Payable		2,500
Oct. 31	Supplies Expense	1,500		Oct. 31	Supplies	1,000	
	Supplies		1,500		Supplies Expense		1,000

(per chapter)

Supplies

10/5		2,500	10/31	Adj.	1,500
10/31	Bal.	1,000			

Supplies Expense

10/31	Adj.	1,500			

(per appendix)

Supplies

10/31	Adj.	1,000			

Supplies Expense

10/5		2,500	10/31	Adj.	1,000
10/31	Bal.	1,500			

Unearned Revenue

Service Revenue

Assume: Yazici Advertising received 1,200 on October 2 from R. Knox for advertising services expected to be completed by October 31. However, Yazici has not performed 800 of the services by October 31.

Demonstrate: How do you record the adjustment for advertising?

Service Revenue

Oct. 31	Service Revenue	800	
	Unearned Service Revenue		800
	(To record unearned service revenue)		

A	=	L	+	E
				−800 Rev
		+800		

Cash Flows
no effect

Unearned Service Revenue

	10/31	**Adj.**	**800**

Service Revenue

10/31	**Adj.**	**800**	10/2		1,200
			10/31	**Bal.**	**400**

Unearned Revenues
Adjustment Approaches - Comparison

Unearned Service Revenue Initially Credited to Liability Account (per chapter)				Unearned Service Revenue Initially Credited to Revenue Account (per appendix)			
Oct. 2	Cash	1,200		Oct. 2	Cash	1,200	
	Unearned Service Revenue		1,200		Service Revenue		1,200
Oct. 31	Unearned Service Revenue	400		Oct. 31	Service Revenue	800	
	Service Revenue		400		Unearned Service Revenue		800

(per chapter)

Unearned Service Revenue

10/31	**Adj.**	**400**	10/2		1,200
			10/31	**Bal.**	**800**

Service Revenue

			10/31	**Adj.**	**400**

(per appendix)

Unearned Service Revenue

			10/31	**Adj.**	**800**

Service Revenue

10/31	**Adj.**	**800**	10/2		1,200
			10/31	**Bal.**	**400**

Summary of Additional Adjustment Relationships

Type of Adjustment	Reason for Adjustment	Account Balances before Adjustment	Adjusting Entry
1. Prepaid expenses	(a) Prepaid expenses initially recorded in asset accounts have been used.	Assets overstated. Expenses understated.	Dr. Expenses Cr. Assets
	(b) **Prepaid expenses initially recorded in expense accounts have not been used.**	**Assets understated. Expenses overstated.**	**Dr. Assets Cr. Expenses**
2. Unearned revenues	(a) Unearned revenues initially recorded in liability accounts are now recognized as revenue.	Liabilities overstated. Revenues understated.	Dr. Liabilities Cr. Revenues
	(b) **Unearned revenues initially recorded in revenue accounts are still unearned.**	**Liabilities understated. Revenues overstated.**	**Dr. Revenues Cr. Liabilities**

Discuss financial reporting concepts.

Qualities of Useful Information

Fundamental Qualities

Relevance Accounting information has **relevance** if it would make a difference in a business decision. Information is considered relevant if it provides information that has **predictive value**, that is, helps provide accurate expectations about the future, and has **confirmatory value**, that is, confirms or corrects prior expectations. **Materiality** is a company-specific aspect of relevance. An item is material when its **size** makes it likely to influence the decision of an investor or creditor.

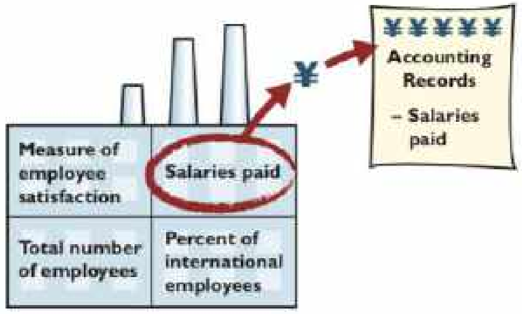
Faithful Representation **Faithful representation** means that information accurately depicts what really happened. To provide a faithful representation, information must be **complete** (nothing important has been omitted), **neutral** (is not biased toward one position or another), and **free from error**.

Qualities of Useful Information

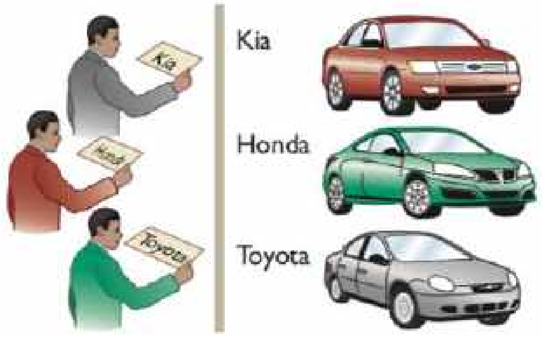
Enhancing Qualities

Quality:	It means:
Comparability	(1) Different companies use the same accounting principles, and (2) A company uses the same accounting principles and methods from year to year.
Verifiability	Independent observers, using the same methods, obtain similar results
Timeliness	It is necessary for accounting information to be relevant.
Understandability	Information is presented in a clear and concise fashion, so that reasonably informed users of that information can interpret it and comprehend its meaning.

Assumptions in Financial Reporting (1/2)

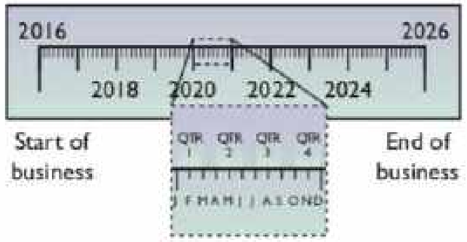


Monetary Unit Assumption The **monetary unit assumption** requires that only those things that can be expressed in money are included in the accounting records. This means that certain important information needed by investors, creditors, and managers, such as customer satisfaction, is not reported in the financial statements. This assumption relies on the monetary unit remaining relatively stable in value.

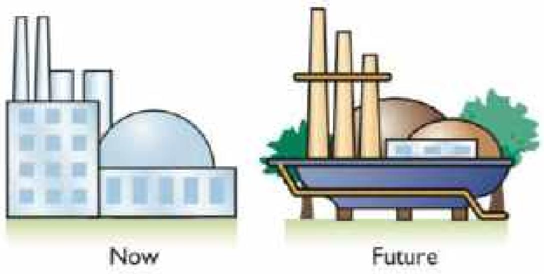


Economic Entity Assumption The **economic entity assumption** states that every economic entity can be separately identified and accounted for. In order to assess a company's performance and financial position accurately, it is important to not blur company transactions with personal transactions (especially those of its managers) or transactions of other companies.

Assumptions in Financial Reporting (2/2)



Time Period Assumption Notice that the income statement, retained earnings statement, and statement of cash flows all cover periods of one year, and the statement of financial position is prepared at the end of each year. The **time period assumption** states that the life of a business can be divided into artificial time periods and that useful reports covering those periods can be prepared for the business.



Going Concern Assumption The **going concern assumption** states that the business will remain in operation for the foreseeable future. Of course, many businesses do fail, but in general it is reasonable to assume that the business will continue operating.

Principles in Financial Reporting (1/2)

Measurement Principles

IFRS generally uses one of two measurement principles, the **historical cost** principle or the **fair value** principle.

Historical cost principle (or cost principle): dictates that companies record assets at their cost. This is true not only at the time the asset is purchased, but also over the time the asset is held.

Fair value principle: states that assets and liabilities should be reported at fair value (the price received to sell an asset or settle a liability).

Principles in Financial Reporting (2/2)

Revenue Recognition Principle

Requires that companies recognize revenue in the accounting period in which the performance obligation is satisfied.

Expense Recognition Principle

Dictates that companies recognize expense in the period in which they make efforts to generate revenue. Thus, expenses follow revenues.

Full Disclosure Principle

Requires that companies disclose all circumstances and events that would make a difference to financial statement users.

If an important item cannot reasonably be reported directly in one of the four types of financial statements, then it should be discussed in notes that accompany the statements.

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Akuntasi Usaha Pariwisata

CHAPTER 4
COMPLETING THE ACCOUNTING CYCLE

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- IFRS 4th Edition

Weygandt ● Kimmel ● Kieso

Chapter Outline

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Learning Objectives

- **LO 1** Prepare a worksheet.
- **LO 2** Prepare closing entries and a post-closing trial balance.
- **LO 3** Explain the steps in the accounting cycle and how to prepare correcting entries.
- **LO 4** Identify the sections of a classified statement of financial position.

The Worksheet

- Multiple-column form used in preparing financial statements
- Not a permanent accounting record
- May be a computerized worksheet
- Prepared using a five step process
- Use of worksheet is optional

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Yazici Advertising A.S.
Worksheet
For the Month Ended October 31, 2020

	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Statement of Financial Position	
Account Titles	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.

Step 1
Prepare a trial balance on the worksheet.

Step 2
Enter adjustment data.

Step 3
Enter adjusted balances.

Step 4
Extend adjusted balances to appropriate statement columns.

Step 5
Total the statement columns, compute net income (or net loss), and complete worksheet.

Step 1

Yazici Advertising A.S.
Worksheet
For the Month Ended October 31, 2020

Account Titles	Trial Balance Dr.	Trial Balance Cr.	Adjustments Dr.	Adjustments Cr.	Adjusted Trial Balance Dr.	Adjusted Trial Balance Cr.	Income Statement Dr.	Income Statement Cr.	Statement of Financial Position Dr.	Statement of Financial Position Cr.
Cash	15,200									
Supplies	2,500									
Prepaid Insurance	600									
Equipment	5,000									
Notes Payable		5,000								
Accounts Payable		2,500								
Unearned Service Revenue		1,200								
Share Capital—Ordinary		10,000								
Dividends	500									
Service Revenue		10,000								
Salaries and Wages Expense	4,000									
Rent Expense	900									
Totals	28,700	28,700								

Trial balance amounts come directly from ledger accounts.

Include all accounts with balances.

Step 2 Enter Adjustments

The adjustments are the same as in Illustration 3.23.

a. Yazici debits an additional account, Supplies Expense, ₺1,500 for the cost of supplies used, and credits Supplies ₺1,500.

b. Yazici debits an additional account, Insurance Expense, ₺50 for the insurance that has expired, and credits Prepaid Insurance ₺50.

c. The company needs two additional depreciation accounts. It debits Depreciation Expense ₺40 for the month's depreciation, and credits Accumulated Depreciation—Equipment ₺40.

d. Yazici debits Unearned Service Revenue ₺400 for services performed, and credits Service Revenue ₺400.

e. Yazici debits an additional account, Accounts Receivable, ₺200 for services performed but not billed, and credits Service Revenue ₺200.

f. The company needs two additional accounts relating to interest. It debits Interest Expense ₺50 for accrued interest, and credits Interest Payable ₺50.

g. Yazici debits Salaries and Wages Expense ₺1,200 for accrued salaries, and credits an additional account, Salaries and Wages Payable, ₺1,200.

Step 2

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Yazici Advertising A.S.
Worksheet
For the Month Ended October 31, 2020

	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Statement of Financial Position	
Account Titles	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200									
Supplies	2,500			(a) 1,500						
Prepaid Insurance	600			(b) 50						
Equipment	5,000									
Notes Payable		5,000								
Accounts Payable		2,500								
Unearned Service Revenue		1,200	(d) 400							
Share Capital—Ordinary		10,000								
Dividends	500									
Service Revenue		10,000		(d) 400						
				(e) 200						
Salaries and Wages Expense	4,000		(g) 1,200							
Rent Expense	900									
Totals	28,700	28,700								
Supplies Expense			(a) 1,500							
Insurance Expense			(b) 50							
Accumulated Depreciation				(c) 40						
Depreciation Expense			(c) 40							
Accounts Receivable			(e) 200							
Interest Expense			(f) 50							
Interest Payable				(f) 50						
Salaries and Wages Payable				(g) 1,200						
Totals			3,440	3,440						

Adjustments Key:

(a) Supplies Used
(b) Insurance Expired
(c) Depreciation Expensed
(d) Service Revenue Recognized
(e) Service Revenue Accrued
(f) Interest Accrued
(g) Salaries Accrued

Enter adjustment amounts, total adjustments columns, and check for equality.

Add additional accounts as needed.

Step 3

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Yazici Advertising A.S.
Worksheet
For the Month Ended October 31, 2020

	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Statement of Financial Position	
Account Titles	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200				15,200					
Supplies	2,500			(a) 1,500	1,000					
Prepaid Insurance	600			(b) 50	550					
Equipment	5,000				5,000					
Notes Payable		5,000				5,000				
Accounts Payable		2,500				2,500				
Unearned Service Revenue		1,200	(d) 400			800				
Share Capital—Ordinary		10,000				10,000				
Dividends	500				500					
Service Revenue		10,000		(d) 400		10,600				
				(e) 200						
Salaries and Wages Expense	4,000		(g) 1,200		5,200					
Rent Expense	900				900					
Totals	28,700	28,700								
Supplies Expense			(a) 1,500		1,500					
Insurance Expense			(b) 50		50					
Accumulated Depreciation				(c) 40		40				
Depreciation Expense			(c) 40		40					
Accounts Receivable			(e) 200		200					
Interest Expense			(f) 50		50					
Interest Payable				(f) 50		50				
Salaries and Wages Payable				(g) 1,200		1,200				
Totals			3,440	3,440	30,190	30,190				

Check equality of adjusted trial balance columns.

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Step 4

Yazici Advertising A.S.
Worksheet
For the Month Ended October 31, 2020

	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Statement of Financial Position	
Account Titles	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200				15,200				15,200	
Supplies	2,500			(a) 1,500	1,000				1,000	
Prepaid Insurance	600			(b) 50	550				550	
Equipment	5,000				5,000				5,000	
Notes Payable		5,000				5,000				5,000
Accounts Payable		2,500				2,500				2,500
Unearned Service Revenue		1,200	(d) 400			800				800
Share Capital—Ordinary		10,000				10,000				10,000
Dividends	500				500				500	
Service Revenue		10,000		(d) 400		10,600		10,600		
				(e) 200						
Salaries and Wages Expense	4,000		(g) 1,200		5,200		5,200			
Rent Expense	900				900		900			
Totals	28,700	28,700								
Supplies Expense			(a) 1,500		1,500		1,500			
Insurance Expense			(b) 50		50		50			
Accumulated Depreciation				(c) 40		40				40
Depreciation Expense			(c) 40		40		40			
Accounts Receivable			(e) 200		200				200	
Interest Expense			(f) 50		50		50			
Interest Payable				(f) 50		50				50
Salaries and Wages Payable				(g) 1,200		1,200				1,200
Totals			3,440	3,440	30,190	30,190				

Extend adjusted trial balance amounts to appropriate financial statement columns.

Step 5

Yazici Advertising A.S.
Worksheet
For the Month Ended October 31, 2020

	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Statement of Financial Position	
Account Titles	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200				15,200				15,200	
Supplies	2,500			(a) 1,500	1,000				1,000	
Prepaid Insurance	600			(b) 50	550				550	
Equipment	5,000				5,000				5,000	
Notes Payable		5,000				5,000				5,000
Accounts Payable		2,500				2,500				2,500
Unearned Service Revenue		1,200	(d) 400			800				800
Share Capital—Ordinary		10,000				10,000				10,000
Dividends	500				500				500	
Service Revenue		10,000		(d) 400		10,600		10,600		
				(e) 200						
Salaries and Wages Expense	4,000		(g) 1,200		5,200		5,200			
Rent Expense	900				900		900			
Totals	28,700	28,700								
Supplies Expense			(a) 1,500		1,500		1,500			
Insurance Expense			(b) 50		50		50			
Accumulated Depreciation				(c) 40		40				40
Depreciation Expense			(c) 40		40		40			
Accounts Receivable			(e) 200		200				200	
Interest Expense			(f) 50		50		50			
Interest Payable				(f) 50		50				50
Salaries and Wages Payable				(g) 1,200		1,200				1,200
Totals			3,440	3,440	30,190	30,190	7,740	10,600	22,450	19,590
Net Income							2,860			2,860
Totals							10,600	10,600	22,450	22,450

Compute net income or net loss.

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Preparing Financial Statements from a Worksheet

- Income statement is prepared from the income statement columns
- Statement of financial position and retained earnings statement are prepared from the statement of financial position columns
- Companies can prepare financial statements before they journalize and post adjusting entries

Statements from a Worksheet (1 of 2)

Yazici Advertising A.S. Income Statement For the Month Ended October 31, 2020		
Revenues		
Service revenue		₺10,600
Expenses		
Salaries and wages expense	₺5,200	
Supplies expense	1,500	
Rent expense	900	
Insurance expense	50	
Interest expense	50	
Depreciation expense	40	
Total expenses		7,740
Net income		₺ 2,860

Statements from a Worksheet (2 of 2)

Yazici Advertising A.S. Retained Earnings Statement For the Month Ended October 31, 2020	
Retained earnings, October 1	₺ –0–
Add: Net income	2,860
	2,860
Less: Dividends	500
Retained earnings, October 31	₺ 2,360

Yazici Advertising A.S.
Statement of Financial Position
October 31, 2020

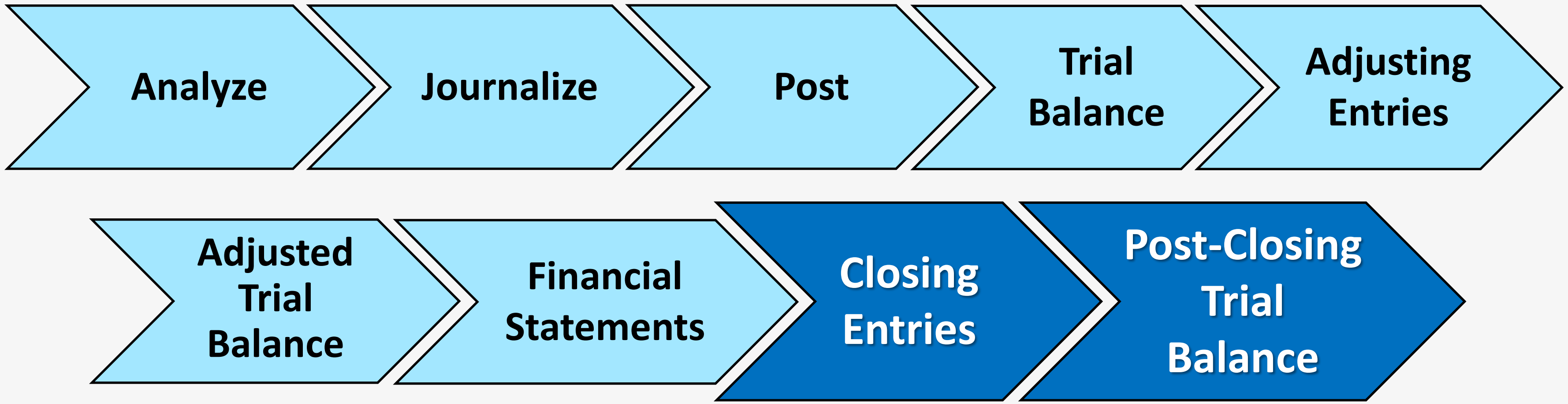
Assets		
Equipment	₺5,000	
Less: Accumulated depreciation—equipment	40	₺ 4,960
Prepaid insurance		550
Supplies		1,000
Accounts receivable		200
Cash		15,200
Total assets		₺21,910
Equity and Liabilities		
Equity		
Share capital—ordinary	₺10,000	
Retained earnings	2,360	₺12,360
Liabilities		
Notes payable	5,000	
Accounts payable	2,500	
Interest payable	50	
Unearned service revenue	800	
Salaries and wages payable	1,200	9,550
Total equity and liabilities		₺21,910

Preparing Adjusting Entries from a Worksheet

- Adjusting entries are prepared from the adjustments columns of worksheet
- Journalizing and posting of adjusting entries **follows** the preparation of financial statements when a worksheet is used

Closing the Books (1 of 2)

At the end of the accounting period, the company makes the accounts ready for the next period.



Closing the Books (2 of 2)

TEMPORARY Accounts are closed	PERMANENT Accounts are not closed
All revenue accounts	All assets accounts
All expense accounts	All liability accounts
Dividends	Equity

Preparing Closing Entries (1 of 2)

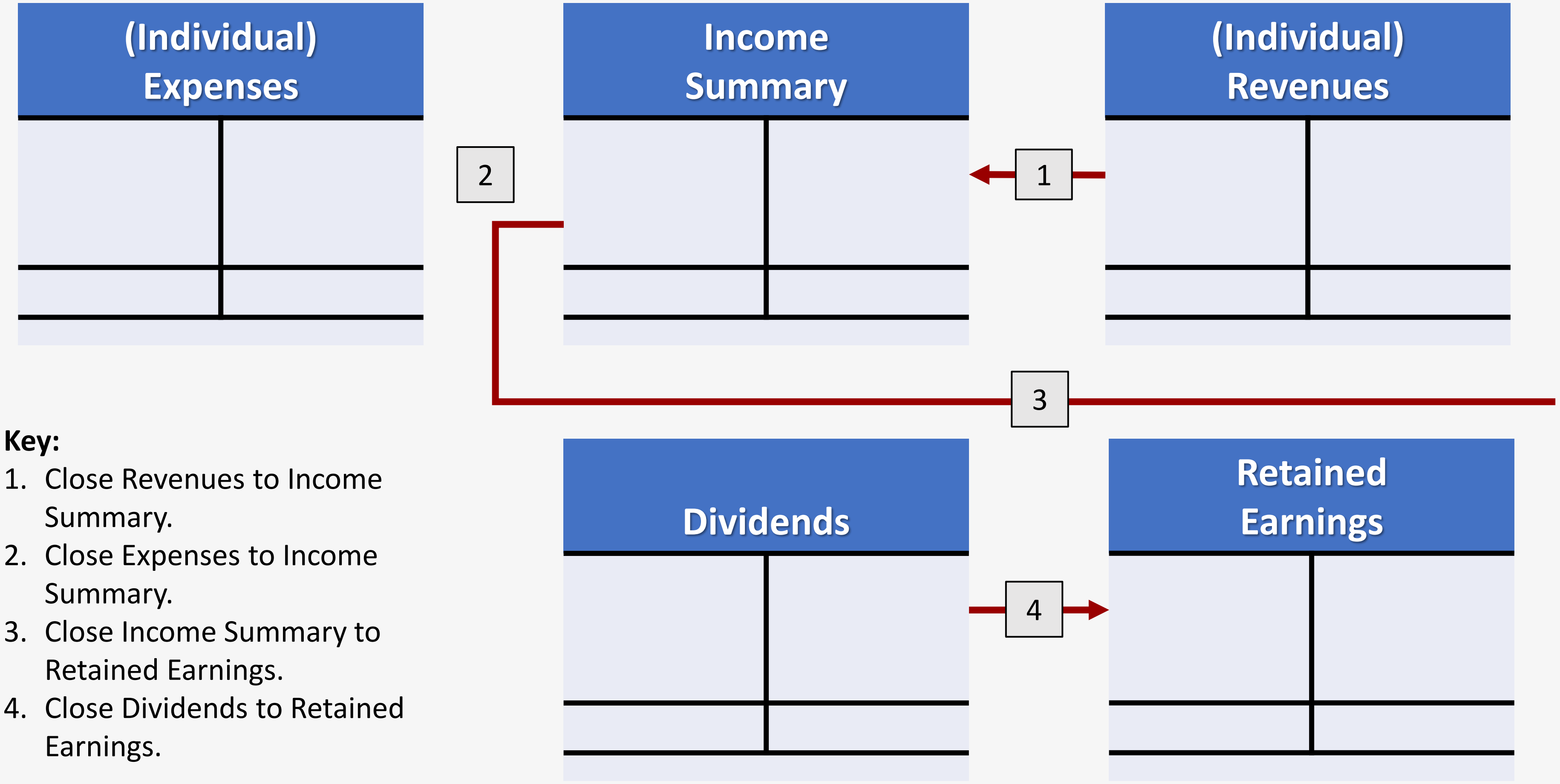
Closing entries formally recognize in the ledger the transfer of:

- Net income (or net loss) to owner's capital
- Dividends to retained earnings

Produce a zero balance in each temporary account.

Companies generally journalize and post closing entries only at end of the annual accounting period.

Preparing Closing Entries (2 of 2)



Key:

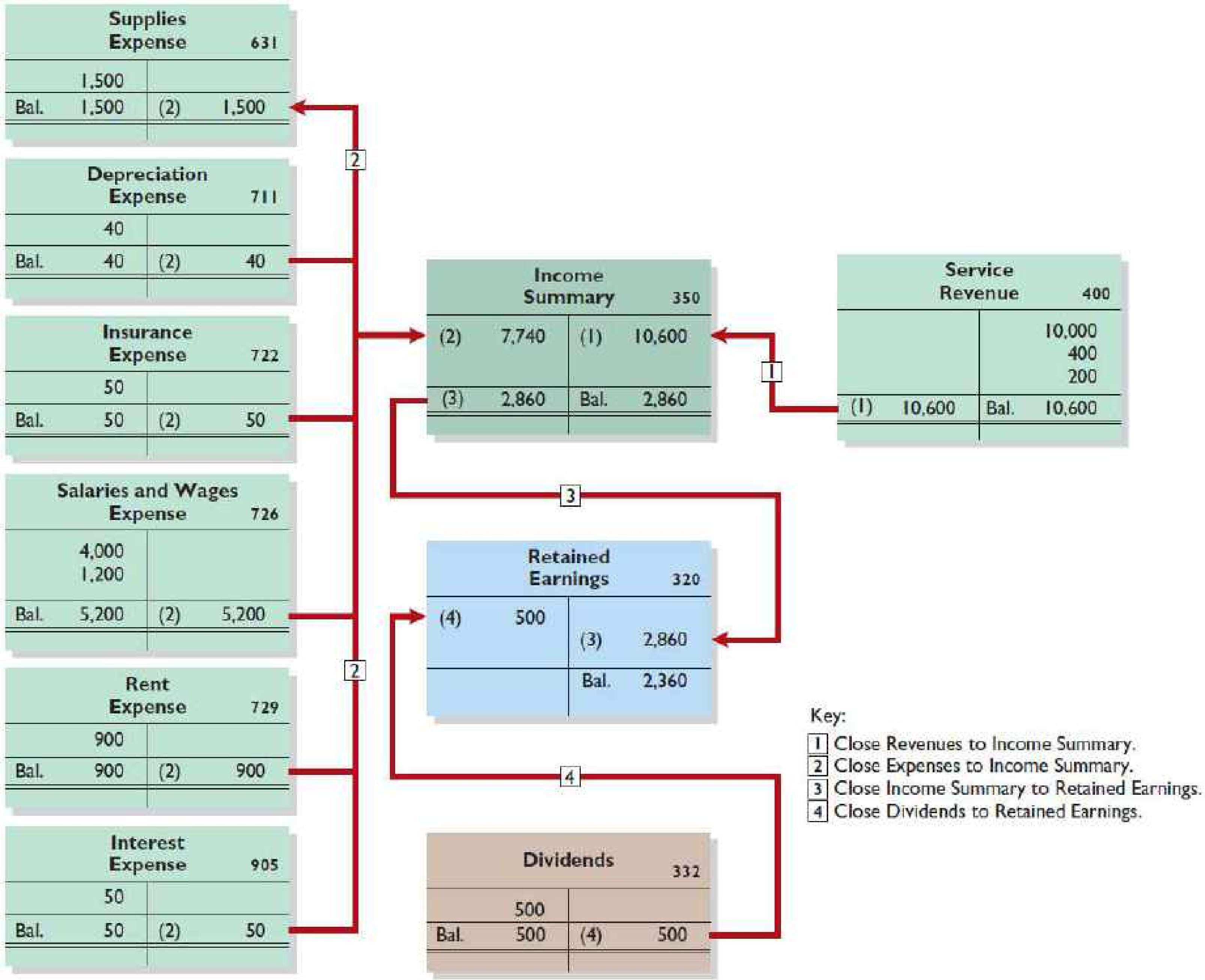
1. Close Revenues to Income Summary.
2. Close Expenses to Income Summary.
3. Close Income Summary to Retained Earnings.
4. Close Dividends to Retained Earnings.

Closing Entries Illustrated (1 of 2)

GENERAL JOURNAL				Page J3
Date	**Account Titles and Explanations**	**Ref.**	**Debit**	**Credit**
2020				
Oct. 31	Service Revenue	400	10,600	
	Income Summary	350		10,600
	(To close revenue account)			
31	Income Summary	350	7,740	
	Supplies Expense	631		1,500
	Depreciation Expense	711		40
	Insurance Expense	722		50
	Salaries and Wages Expense	726		5,200
	Rent Expense	729		900
	Interest Expense	729		50
	(To close expense accounts)			

Closing Entries Illustrated (2 of 2)

GENERAL JOURNAL				Page J3
Date	**Account Titles and Explanations**	**Ref.**	**Debit**	**Credit**
2020				
Oct. 31	Income Summary	350	2,860	
	Retained Earnings	301		2,860
	(To close net income)			
31	Retained Earnings	301	500	
	Dividends	306		500
	(To close drawings)			


Supplies Expense 631
1,500
Bal. 1,500 (2) 1,500
Depreciation Expense 711
40
Bal. 40 (2) 40
Insurance Expense 722
50
Bal. 50 (2) 50
Salaries and Wages Expense 726
4,000
1,200
Bal. 5,200 (2) 5,200
Rent Expense 729
900
Bal. 900 (2) 900
Interest Expense 905
50
Bal. 50 (2) 50
Income Summary 350
(2) 7,740 (1) 10,600
(3) 2,860 Bal. 2,860
Service Revenue 400
10,000
400
200
(1) 10,600 Bal. 10,600
Retained Earnings 320
(4) 500
(3) 2,860
Bal. 2,360
Dividends 332
500
Bal. 500 (4) 500
1
2
3
4
Key:
1 Close Revenues to Income Summary.
2 Close Expenses to Income Summary.
3 Close Income Summary to Retained Earnings.
4 Close Dividends to Retained Earnings.

Yazici Advertising A.S.
Post-Closing Trial Balance
October 31, 2020

	Debit	Credit
Cash	₺15,200	
Accounts Receivable	200	
Supplies	1,000	
Prepaid Insurance	550	
Equipment	5,000	
Accumulated Depreciation—Equipment		₺ 40
Notes Payable		5,000
Accounts Payable		2,500
Unearned Service Revenue		800
Salaries and Wages Payable		1,200
Interest Payable		50
Share Capital—Ordinary		10,000
Retained Earnings		2,360
	₺21,950	**₺21,950**

Practice!

Hancock Company has the following balances in selected accounts of its adjusted trial balance.

Accounts Payable	€27,000	Dividends	€15,000
Service Revenue	98,000	Share Capital—Ordinary	42,000
Rent Expense	22,000	Accounts Receivable	38,000
Salaries and Wages Expense	51,000	Supplies Expense	7,000

Prepare the closing entries at December 31.

Service Revenue	98,000	
Income Summary		98,000

Practice!

Accounts Payable	€27,000	Dividends	€15,000
Service Revenue	98,000	Share Capital—Ordinary	42,000
Rent Expense	22,000	Accounts Receivable	38,000
Salaries and Wages Expense	51,000	Supplies Expense	7,000

Prepare the closing entries at December 31.

Income Summary	80,000	
Salaries and Wages Expense		51,000
Rent Expense		22,000
Supplies Expense		7,000

Practice!

Accounts Payable	€27,000	Dividends	€15,000
Service Revenue	98,000	Share Capital—Ordinary	42,000
Rent Expense	22,000	Accounts Receivable	38,000
Salaries and Wages Expense	51,000	Supplies Expense	7,000

Prepare the closing entries at December 31.

Income Summary	18,000	
Retained Earnings		18,000
Retained Earnings	15,000	
Dividends		15,000

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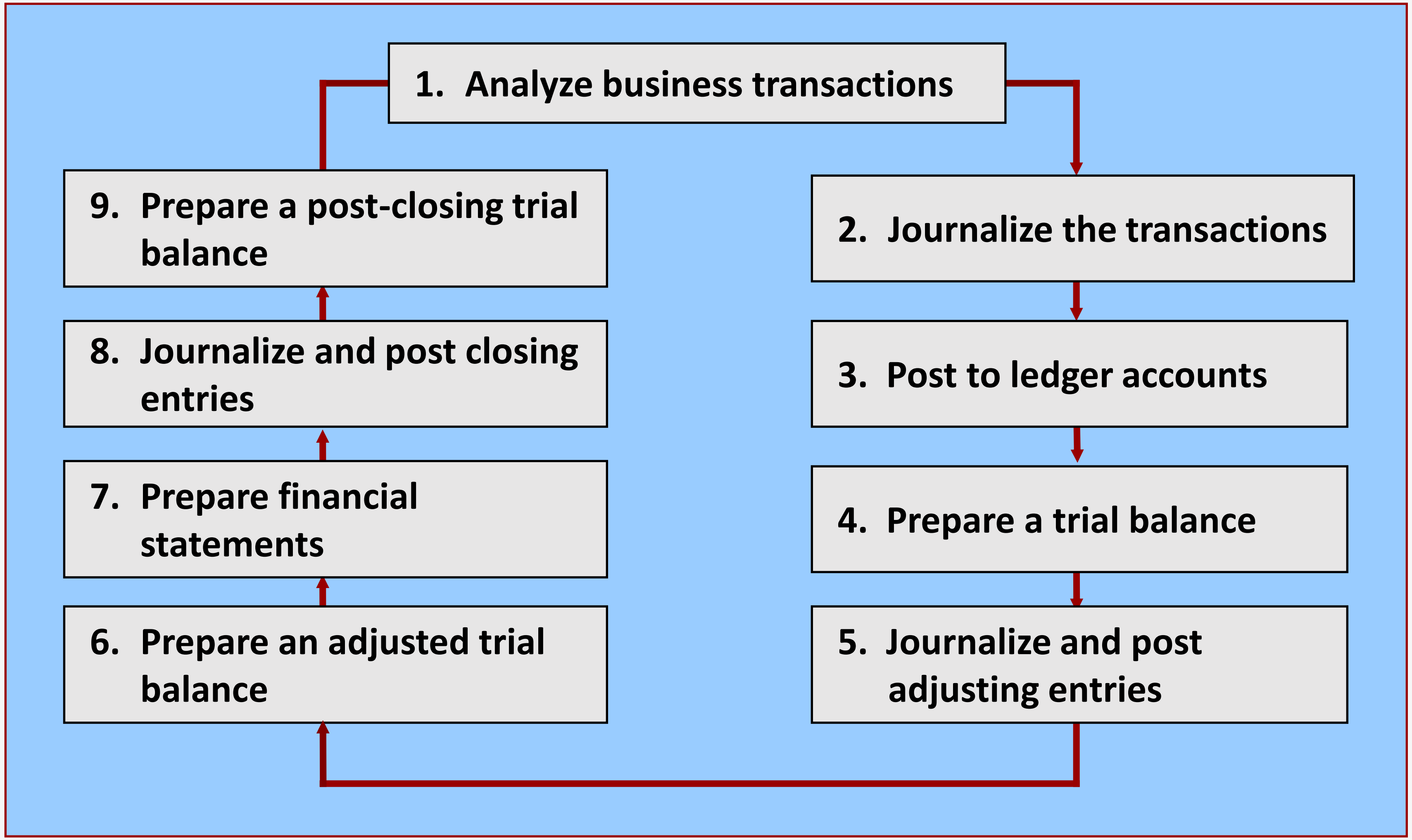
Explain the Steps in the Accounting Cycle and How to Prepare Correcting Entries

The Accounting Cycle



1. Analyze Business Transactions

	Assets		Liabilities				Equity		
Date	Cash	+ Equipment	= Accounts Payable	+ Notes Payable	+ Unearned Revenue	+ Share Capital	- Dividends	+ Revenue	- Expense
1	+₺10,000					+₺10,000			
1		+₺5,000		+₺5,000					
2	+1,200				+₺1,200				
3	-1,200								-₺1,200
4			+250						-$250

Partial Schedule

2. Journalize the Transactions

GENERAL JOURNAL				Page J1
Date	**Explanation**	**Ref.**	**Debit**	**Credit**
2020				
Oct. 1	Cash	101	10,000	
	Share Capital-Ordinary	311		10,000
1	Equipment	157	5,000	
	Notes Payable	200		5,000
2	Cash	101	1,200	
	Unearned Revenue	209		1,200

3. Post to the Ledger Accounts

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GENERAL JOURNAL				J1
Date	Account Titles and Explanations	Ref.	Debit	Credit
Oct. 1	Cash	101	10,000	
	Share Capital-Ordinary	311		10,000
	(Issued shares for cash)			

GENERAL LEDGER

Cash					No. 101
Date	Explanations	Ref.	Debit	Credit	Balance
Oct. 1		J1	7,000		7,000

Share Capital-Ordinary					No. 311
Date	Explanations	Ref.	Debit	Credit	Balance
Oct. 1		J1		7,000	7,000

4. Prepare a Trial Balance

Yazici Advertising A.S. Trial Balance October 31, 2020		
	Debit	Credit
Cash	₺15,200	
Supplies	2,500	
Prepaid Insurance	600	
Equipment	5,000	
Notes Payable		₺5,000
Accounts Payable		2,500
Unearned Service Revenue		1,200
Share Capital—Ordinary		10,000
Retained Earnings		0
Dividends	500	
Service Revenue		10,000

5. Journalize and Post AJEs

GENERAL JOURNAL				J1
Date	Account Titles and Explanations	Ref.	Debit	Credit
Oct. 31	Supplies Expense	631	1,500	
	Supplies	126		1,500
	(To record supplies used)			

GENERAL LEDGER

Supplies					No. 126
Date	Explanations	Ref.	Debit	Credit	Balance
Oct. 1					2,500
Oct. 31	**Adjusting entry**	**J2**		**1,500**	**1,000**

Supplies Expense					No. 631
Date	Explanations	Ref.	Debit	Credit	Balance
Oct. 31	**Adjusting entry**	**J2**	**1,500**		**1,500**

6. Prepare an Adjusted Trial Balance

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Yazici Advertising A.S. Adjusted Trial Balance October 31, 2020		
	Debit	Credit
Cash	₺15,200	
Accounts Receivable	200	
Supplies	1,000	
Prepaid Insurance	550	
Equipment	5,000	
Accumulated Depreciation		₺ 40
Notes Payable		5,000
Accounts Payable		2,500
Interest Payable		50
Unearned Service Revenue		800
Salaries and Wages Payable		1,200

7. Prepare Financial Statements

Partial Statements

Yazici Advertising A.S. Income Statement For the Month Ended October 31, 2020			
Revenues			
Service revenue			₺10,600

Yazici Advertising A.S. Retained Earnings Statement For the Month Ended October 31, 2020			
Retained earnings, October 1			₺ 0

Yazici Advertising A.S. Statement of Financial Position October 31, 2020			
Assets			
Cash			₺15,200
Accounts receivable			200

8. Journalize and Post Closing Entries

GENERAL JOURNAL				Page J3
Date	**Account Titles and Explanations**	**Ref.**	**Debit**	**Credit**
2020				
Oct. 31	Service Revenue	400	10,600	
	Income Summary	350		10,600
	(To close revenue account)			
31	Income Summary	350	7,740	
	Supplies Expense	631		1,500
	Depreciation Expense	711		40
	Insurance Expense	722		50
	Salaries and Wages Expense	726		5,200
	Rent Expense	729		900
	Interest Expense	729		50
	(To close expense accounts)			

9. Prepare a Post-Closing Trial Balance

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Yazici Advertising A.S.
Post-Closing Trial Balance
October 31, 2020

	Debit	Credit
Cash	₺15,200	
Accounts Receivable	200	
Supplies	1,000	
Prepaid Insurance	550	
Equipment	5,000	
Accumulated Depreciation		₺ 40
Notes Payable		5,000
Accounts Payable		2,500
Unearned Service Revenue		800
Salaries and Wages Payable		1,200

Correcting Entries—Avoidable Step (1 of 3)

- Unnecessary if accounting records are free of errors
- Made whenever an error is discovered
- Must be posted before closing entries

Instead of preparing a correcting entry, **it is possible to reverse the incorrect entry and then prepare the correct entry**.

Correcting Entries—Avoidable Step (2 of 3)

Case 1: On May 10, Mercato Co. journalized and posted a NT$500 cash collection on account from a customer as a debit to Cash and a credit to Service Revenue for NT$500. The error was discovered when the customer paid the remaining balance in full.

INCORRECT ENTRY			CORRECT ENTRY			CORRECTING ENTRY		
Cash	500		Cash	500		Service Revenue	500	
Service Revenue		500	Accounts Receivable		500	Accounts Receivable		500

Correcting Entries—Avoidable Step (3 of 3)

Case 2: On May 10, 18, Mercato purchased on account equipment costing NT$4,500. The transaction was journalized and posted as a debit to Equipment NT$450 and a credit to Accounts Payable NT$450. The error was discovered on June 3,

INCORRECT ENTRY			CORRECT ENTRY			CORRECTING ENTRY		
Equipment	450		Equipment	4,500		Equipment	4,050	
Accounts payable		450	Accounts payable		4,500	Accounts payable		4,050

Practice!

Sanchez Company discovered the following errors made in January 2020.

1. A payment of Salaries and Wages Expense of $600 was debited to Supplies and credited to Cash, both for $600.
2. A collection of $3,000 from a client on account was debited to Cash $200 and credited to Service Revenue $200.
3. The purchase of supplies on account for $860 was debited to Supplies $680 and credited to Accounts Payable $680.

Correct the errors without reversing the incorrect entry.

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Identify the Sections of a Classified Statement of Financial Position

Classified Statement of Financial Position

- Presents a snapshot at a point in time
- To improve understanding, companies group similar assets and similar liabilities together

Assets		Equity and Liabilities
Intangible assets		Equity
Property, plant, and equipment		Non-current liabilities
Long-term investments		Current liabilities
Current assets		

Cheng Ltd.
Statement of Financial Position
October 31, 2020
(NT$ in thousands)

Assets

Intangible assets			
Patents			NT$ 3,100
Property, plant, and equipment			
Land		NT$10,000	
Equipment	NT$24,000		
Less: Accumulated depreciation—equipment	5,000	19,000	29,000
Long-term investments			
Investment in shares of Walters Corp.		5,200	
Investment in real estate		2,000	7,200
Current assets			
Prepaid insurance		400	
Supplies		2,100	
Inventory		3,000	
Notes receivable		1,000	
Accounts receivable		7,000	
Short-term investments		2,000	
Cash		6,600	22,100
Total assets			NT$61,400

Cheng Ltd.
Statement of Financial Position
October 31, 2020
(NT$ in thousands)

Equity and Liabilities

Equity		
Share capital—ordinary	NT$20,000	
Retained earnings	14,050	NT$34,050
Non-current liabilities		
Mortgage payable	10,000	
Notes payable	1,300	11,300
Current liabilities		
Notes payable	11,000	
Accounts payable	2,100	
Salaries and wages payable	1,600	
Unearned service revenue	900	
Interest payable	450	16,050
Total equity and liabilities		NT$61,400

Intangible Assets

Long-lived assets that do not have physical substance.

Nokia Statement of Financial Position (partial) (in millions)	
Intangible assets	
Capitalized development costs	€ 244
Goodwill	6,257
Other intangible assets	3,913
	€10,414

Property, Plant, and Equipment (1 of 2)

- Long useful lives
- Currently used in operations
- Depreciation - allocating the cost of assets to a number of years
- Accumulated depreciation - total amount of depreciation expensed thus far in the asset’s life
- Sometimes called fixed assets or plant assets

Property, Plant, and Equipment (2 of 2)

Laclede Group Statement of Financial Position (partial) (₩ in billions)		
Property, plant, and equipment		
Land		₩ 2,604
Buildings	₩ 9,487	
Structures	1,568	
Machinery	36,956	
Vehicles	226	
Other	10,600	58,837
Less: Accumulated depreciation		32,617
		₩28,824

Long-Term Investments

- Investments in stocks and bonds of other companies
- Investments in long-term assets such as land or buildings that are not currently being used in operating activities
- Long-term notes receivable

Alphabet Inc. Statement of Financial Position (partial) (in thousands)	
Long-term investments	
Non-marketable equity investments	$1,469

Current Assets (1 of 4)

- Assets that a company expects to **convert to cash** or **use up** within one year or the operating cycle, whichever is longer
- **Operating cycle** is the average time that it takes to
  - purchase inventory,
  - sell it on account, and
  - collect cash from customers

Current Assets (2 of 4)

Tesco Statement of Financial Position (partial) (£ in millions)	
Current assets	
Inventories	£2,430
Trade and other receivables	1,311
Derivative financial instruments	97
Current tax assets	6
Short-term investments	360
Cash and cash equivalents	1,788
Total current assets	£5,992

Equity

- Proprietorship - one capital account
- Partnership - capital account for each partner
- Corporation – Share Capital—Ordinary and Retained Earnings

Halie Capital Ltd.
Statement of Financial Position (partial)
(in thousands)

Equity	
Share capital—ordinary	£ 685,934
Retained earnings	1,406,747
Total equity	£2,092,681

Non-Current Liabilities

Obligations a company expects to pay **after** one year.

Siemens Statement of Financial Position (partial) (in millions)	
Non-current liabilities	
Long-term debt	€14,260
Pension plans and similar commitments	4,361
Provisions	2,533
Deferred tax liabilities	726
Other non-current liabilities	2,752
	€24,632

Current Liabilities (1 of 2)

- Obligations company has to pay within coming year or its operating cycle, whichever is longer
- Common examples are accounts payable, salaries and wages payable, notes payable, interest payable, income taxes payable, and current maturities of long-term obligations
- **Liquidity** - ability to pay obligations expected to be due within the next year

Current Liabilities (2 of 2)

Siemens Statement of Financial Position (partial) (in millions)	
Current liabilities	
Trade payables	€ 8,860
Current provisions	5,165
Other current financial liabilities	2,427
Income taxes payable	1,970
Current maturities for long-term debt	1,819
Other current liabilities	22,210
	€42,451

Prepare Reversing Entries

Appendix 4A Reversing Entries

- It is often helpful to reverse some adjusting entries before recording regular transactions of the next period
- Companies make a reversing entry at **beginning** of next accounting period
- Each reversing entry is **exact opposite** of adjusting entry made in previous period
- Use of reversing entries **does not change** amounts reported in the financial statements

Reversing Entries Example (1 of 3)

We use the salaries expense transactions for Yazici Advertising as illustrated in Chapters 2, 3, and 4.

1. October 26 (initial salary entry): Yazici pays ₺4,000 of salaries and wages earned between October 15 and October 26.
2. October 31 (adjusting entry): Salaries and wages earned between October 29 and October 31 are ₺1,200. The company will pay these in the November 9 payroll.
3. November 9 (subsequent salary entry): Salaries and wages paid are ₺4,000. Of this amount, ₺1,200 applied to accrued salaries and wages payable and ₺2,800 was earned between November 1 and November 9.

Reversing Entries Example (2 of 3)

WITHOUT Reversing Entries (per appendix)			
	Initial Salary Entry		
Oct. 26	Salaries and Wages Expense	4,000	
	Cash		4,000
	Adjusting Entry		
Oct. 31	Salaries and Wages Expense	1,200	
	Salaries and Wages Payable		1,200
	Closing Entry		
Oct. 31	Income Summary	5,200	
	Salaries and Wages Expense		5,200
	Reversing Entry		
Nov. 1	No reversing entry is made.		
	Subsequent Salary Entry		
Nov. 9	Salaries and Wages Payable	1,200	
	Salaries and Wages Expense	2,800	
	Cash		4,000

WITH Reversing Entries (per appendix)			
	Initial Salary Entry		
Oct. 26	(Same entry)		
	Adjusting Entry		
Oct. 31	(Same entry)		
	Closing Entry		
Oct. 31	(Same entry)		
	Reversing Entry		
Nov. 1	Salaries and Wages Payable	1,200	
	Salaries and Wages Expense		1,200
	Subsequent Salary Entry		
Nov. 9	Salaries and Wages Expense	4,000	
	Cash		4,000

Reversing Entries Example (3 of 3)

Salaries and Wages Expense

10/26 Paid	4,000		
10/31 Adjusting	1,200		
	5,200	10/31 Closing	5,200
11/9 Paid	4,000	**11/1 Reversing**	**1,200**

Salaries and Wages Payable

11/1 Reversing	**1,200**	10/31	1,200

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Akuntansi Usaha Pariwisata

CHAPTER 5
ACCOUNTING FOR MERCHANDISING OPERATIONS

IFRS 4th Edition

PRADITA UNIVERSITY

Weygandt • Kimmel • Kieso

Chapter Outline

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Learning Objectives

LO 1 Describe merchandising operations and inventory systems.

LO 2 Record purchases under a perpetual inventory system.

LO 3 Record sales under a perpetual inventory system.

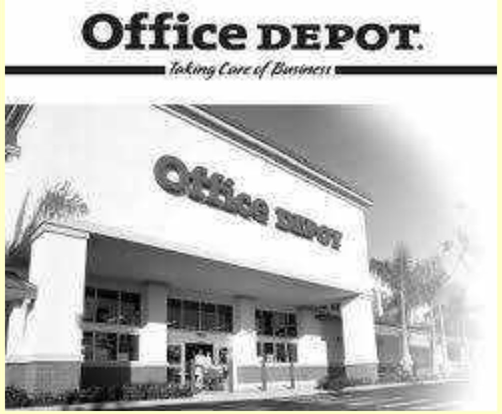
LO 4 Apply the steps in the accounting cycle to a merchandising company.

LO 5 Prepare financial statements for a merchandising company.

Merchandising Operations and Inventory Systems

- **Merchandising Companies**
- Buy and Sell Goods

- **Retail**



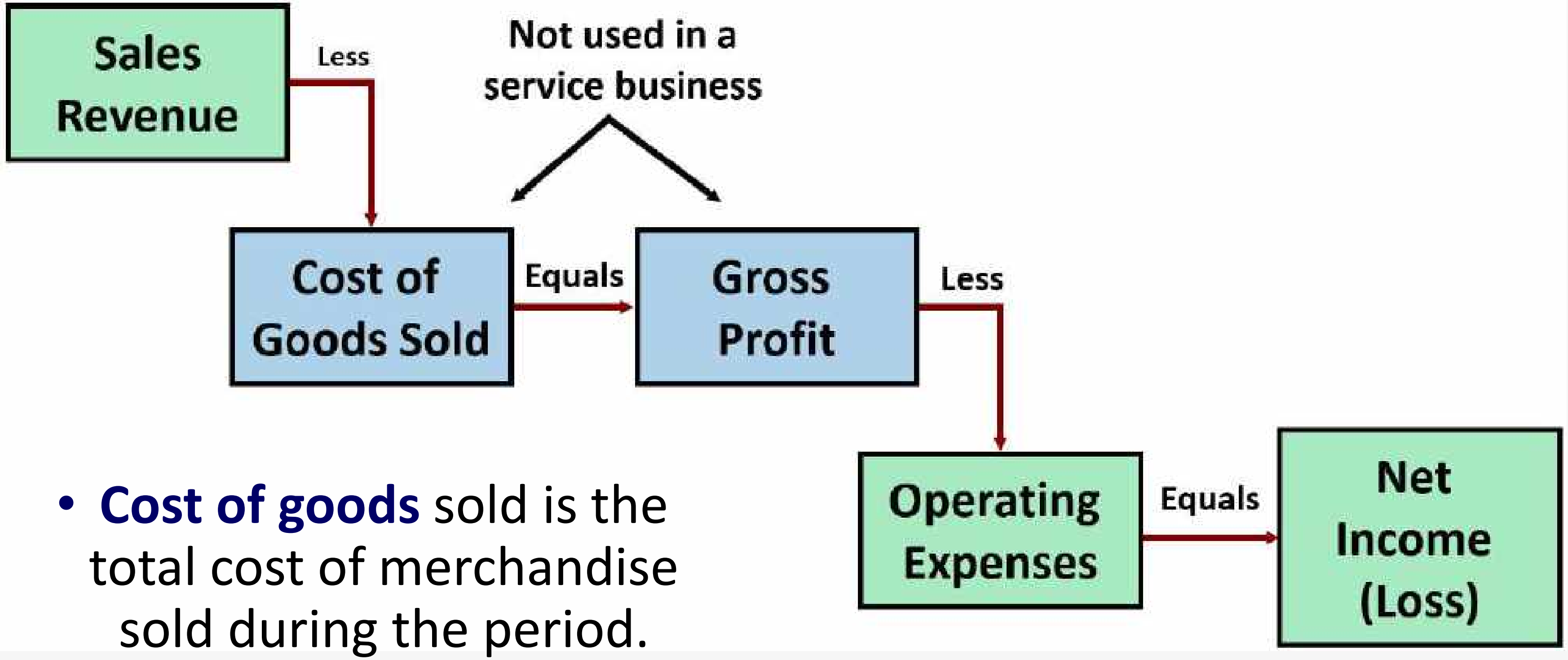
Wholesaler

Consumer

- The primary source of revenues is referred to as **sales revenue** or **sales**.

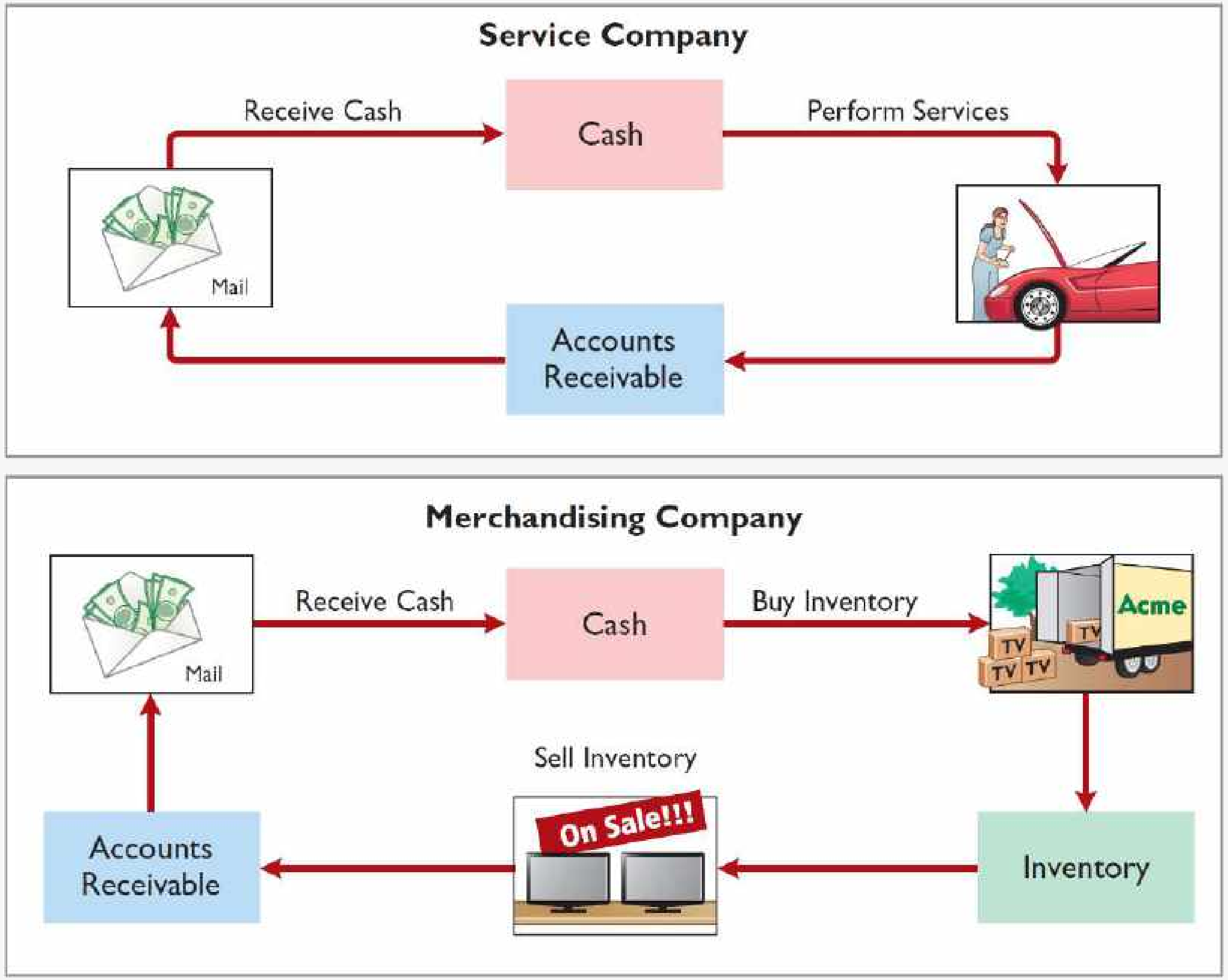
Merchandising Company

- **Income Measurement**

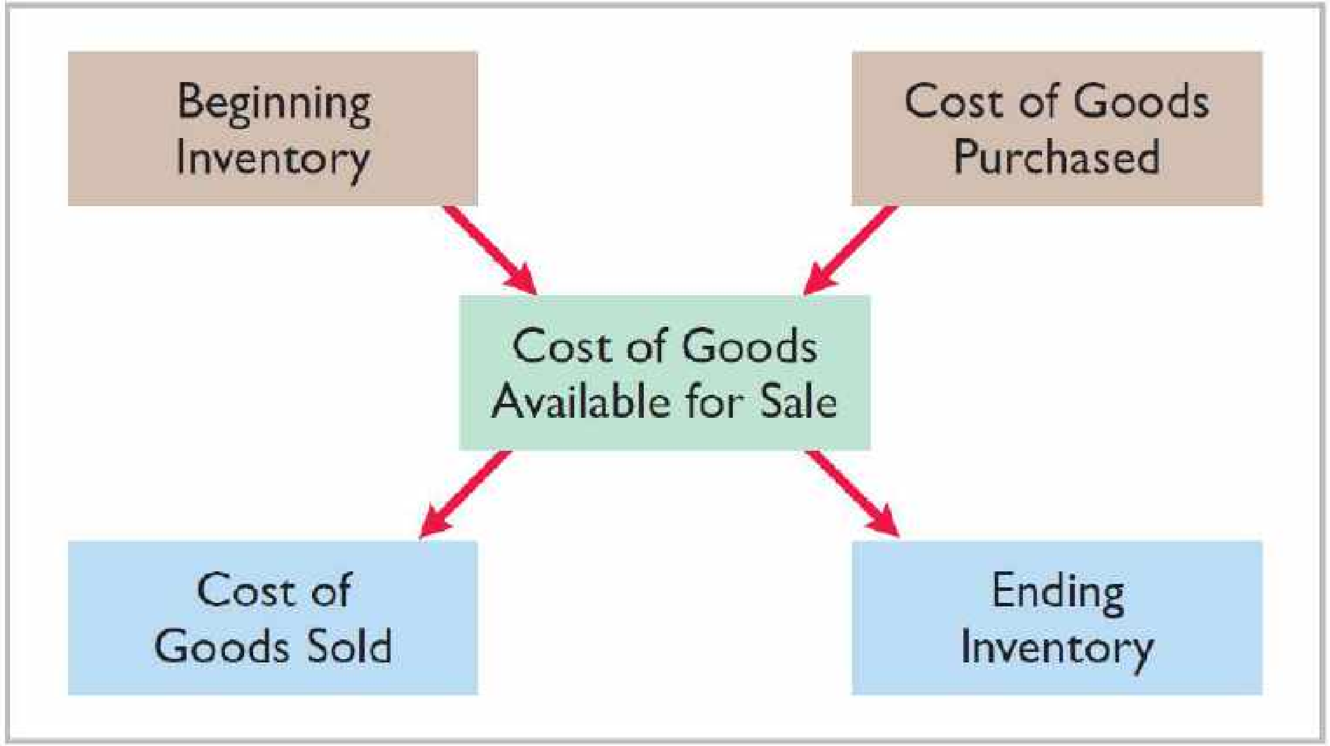


- **Cost of goods** sold is the total cost of merchandise sold during the period.

Operating Cycles



Flow of Costs (1 of 4)



- Companies use either a **perpetual inventory system** or a **periodic inventory system** to account for inventory.

Flow of Costs (2 of 4)

- **Perpetual System**
  - Maintain detailed records of the cost of each inventory purchase and sale
  - Records continuously show inventory that should be on hand for every item
  - Company determines cost of goods sold each time a sale occurs

Flow of Costs (3 of 4)

- **Periodic System**
  - Does not keep detailed records of goods on hand
  - Cost of goods sold determined by count
  - Calculation of Cost of Goods Sold:

Beginning inventory	€100,000
Add: Purchases, net	800,000
Goods available for sale	900,000
Less: Ending inventory	125,000
Cost of goods sold	€775,000

Flow of Costs (4 of 4)

- **Advantages of the Perpetual System**
  - Traditionally used for merchandise with high unit values
  - Shows quantity and cost of inventory that should be on hand at any time
  - Provides better control over inventories than a periodic system

Recording Purchases Under a Perpetual Inventory System

- Made using **cash or credit** (on account)
- Normally **record when** goods are received from the seller
- **Purchase invoice** should support each credit purchase

Recording Purchases

- **Purchase invoice** should support each credit purchase

INVOICE NO. 731

PW AUDIO SUPPLY

27 CIRCLE DRIVE
AMSTERDAM, THE NETHERLANDS 1081

SOLD TO

Firm Name: Sauk Stereo
Attention of: James Hoover, Purchasing Agent
Address: 125 Main Street
Oslo Norway 283

Date 5/4/20	Salesperson Malone	Terms 2/10, n/30	FOB Shipping Point	
Catalog No.	**Description**	**Quantity**	**Price**	**Amount**
X572Y9820	Printed Circuit Board-prototype	1	2,300	€2,300
A2547Z45	Production Model Circuits	5	300	1,500
			TOTAL	€3,800

IMPORTANT: ALL RETURNS MUST BE MADE WITHIN 10 DAYS

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Record Purchase of Merchandise

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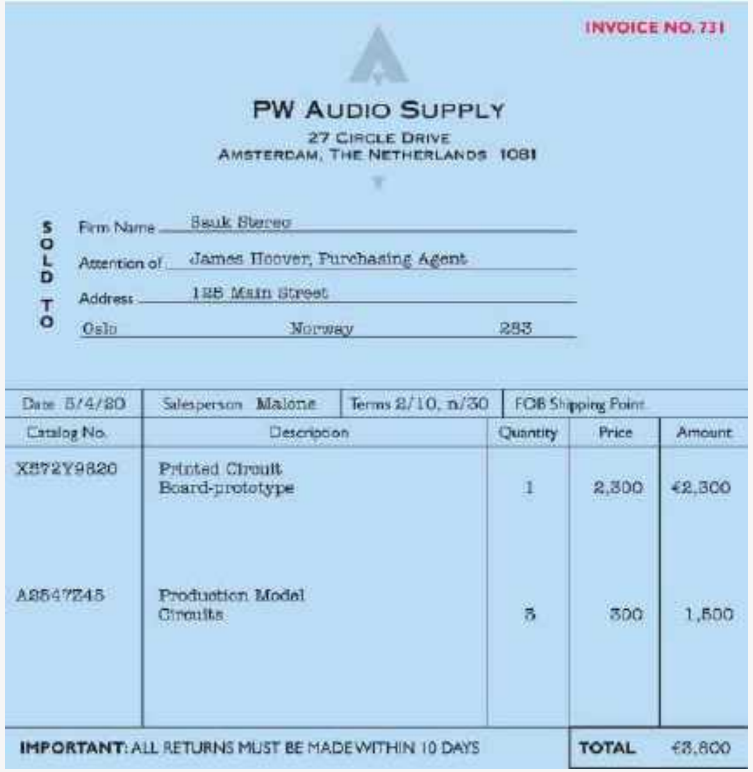
- **Illustration:** Sauk Stereo (the buyer) uses as a purchase invoice the sales invoice prepared by PW Audio Supply, Inc. (the seller). **Prepare the journal entry** for Sauk Stereo for the invoice from PW Audio Supply.



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			TOTAL	€3,800

IMPORTANT: ALL RETURNS MUST BE MADE WITHIN 10 DAYS

May 4	Inventory	3,800	
	Accounts Payable		3,800

Freight Costs (1 of 2)

- Ownership of the goods passes to the buyer when the public carrier accepts the goods from the seller.
- Ownership of the goods remains with the seller until the goods reach the buyer.

- Freight costs incurred by the seller are an **operating expense**.

Freight Costs (2 of 2)

Illustration: Assume upon delivery of the goods on May 6, **Sauk Stereo pays** Public Freight Company €150 for **freight charges**, the entry on Sauk Stereo's books is:

May 6	Inventory	150	
	Cash		150

Assume the freight terms on the invoice on slide number 13 had required **PW Audio Supply to pay the freight charges**, the entry by PW Audio Supply would be:

May 4	Freight-Out (or Delivery Expense)	150	
	Cash		150

Purchase Returns and Allowances (1 of 2)

- **Purchaser may be dissatisfied** because goods are damaged or defective, of inferior quality, or do not meet specifications.
- **Purchase Return**
- Return goods for credit if the sale was made on credit, or for a cash refund if the purchase was for cash.
- **Purchase Allowance**
- May choose to keep the merchandise if the seller will grant a reduction of the purchase price.

Purchase Returns and Allowances (2 of 2)

Illustration: Assume Sauk Stereo returned goods costing €300 to PW Audio Supply on May 8.

May 8	Accounts Payable	300	
	Inventory		300

Purchase Discounts (1 of 4)

- **Credit terms** may permit buyer to claim a cash discount for prompt payment.
- **Advantages:**
  - Purchaser saves money
  - Seller shortens the operating cycle by converting the accounts receivable into cash earlier

Example: Credit terms may read **2/10, n/30**.

Purchase Discounts (2 of 4)

2/10, n/30

2% discount if paid within 10 days, otherwise net amount due within 30 days.

1/10 EOM

1% discount if paid within first 10 days of next month.

n/10 EOM

Net amount due within the first 10 days of the next month.

Purchase Discounts (3 of 4)

Illustration: Assume Sauk Stereo pays the balance due of €3,500 (gross invoice price of €3,800 less purchase returns and allowances of €300) on May 14, the last day of the discount period. Prepare the journal entry Sauk Stereo makes on May 14 to record the payment.

May 14	Accounts Payable	3,500	
	Inventory		70
	Cash		3,430

(Discount = €3,500 × 2% = **€70**)

Purchase Discounts (4 of 4)

Illustration: If Sauk Stereo failed to take the discount, and instead made full payment of €3,500 on June 3, the journal entry would be:

June 3	Accounts Payable	3,500	
	Cash		3,500

Summary of Purchasing Transactions

Inventory

Purchase	May 4	3,800	May 8	300	Purchase return
Freight-in	6	150	14	70	Purchase discount
Balance		3,580			

Recording Sales Under a Perpetual Inventory System

- Sales may be made on **credit or** for **cash**
- Sales revenue, like service revenue, is recorded when the performance obligation is satisfied
- Performance obligation is satisfied when goods are transferred from seller to buyer
- **Sales invoice** should support each credit sale

Sales invoice should support each credit sale

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A2547Z45	Production Model Circuits	5	300	1,500
			TOTAL	€3,800

IMPORTANT: ALL RETURNS MUST BE MADE WITHIN 10 DAYS

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Recording Sales (1 of 2)

- **Journal Entries to Record a Sale**

#1	Accounts Receivable	XXX		**Selling Price**
	Sales Revenue		XXX	
#2	Cost of Goods Sold	XXX		**Cost**
	Inventory		XXX	

Recording Sales (2 of 2)

Illustration: PW Audio Supply records the sale of €3,800 on May 4 to Sauk Stereo on account as follows (assume the merchandise cost PW Audio Supply €2,400).

May 4	Accounts Receivable	3,800	
	Sales Revenue		3,800
May 4	Cost of Goods Sold	2,400	
	Inventory		2,400

Sales Returns and Allowances (1 of 3)

- **“Flip side”** of purchase returns and allowances
- **Contra revenue account** to Sales Revenue (debit)
- **Sales not reduced** (debited) because:
  - Would obscure importance of sales returns and allowances as a percentage of sales
  - Could distort comparisons

Sales Returns and Allowances (2 of 3)

Illustration: Prepare the entry PW Audio Supply would make to record the credit for returned goods that had a €300 selling price (assume a €140 cost). Assume the **goods were not defective.**

May 8	Sales Returns and Allowance	300	
	Accounts Receivable		300
May 8	Inventory	140	
	Cost of Goods Sold		140

Sales Returns and Allowances (3 of 3)

Illustration: Assume the returned goods were **defective** and had a scrap value of €50, PW Audio would make the following entries:

May 8	Sales Returns and Allowance	300	
	Accounts Receivable		300
May 8	Inventory	50	
	Cost of Goods Sold		50

Sales Discounts

- Offered to customers to **promote prompt payment** of balance due
- **Contra-revenue account** (debit) to Sales Revenue

Sales Revenue

Debit	Credit
	3,800

Sales Returns and Allowances

Debit	Credit
300	

Sales Discounts

Debit	Credit
70	

Net Sales
€3,430

Sales Discounts (2 of 2)

Illustration: Assume Sauk Stereo pays the balance due of €3,500 (gross invoice price of €3,800 less purchase returns and allowances of €300) on May 14, the last day of the discount period. Prepare the journal entry PW Audio Supply makes to record the receipt on May 14.

May 14	Cash	3,430	
	Sales Discounts	70*	
	Accounts Receivable		3,500

- *[(€3,800 – €300) × 2%]

Practice!

On September 5, Zhū Company buys merchandise on account from Gāo Company. The selling price of the goods is ¥15,000, and the cost to Gāo Company was ¥8,000. On September 8, Zhū returns defective goods with a selling price of ¥2,000 and a fair value of ¥300. Record the transactions on the books of Gāo Company.

Sept. 5	Accounts Receivable	15,000	
	Sales Revenue		15,000
Sept. 5	Cost of Goods Sold	8,000	
	Inventory		8,000

Practice!

On September 5, Zhū Company buys merchandise on account from Gāo Company. The selling price of the goods is ¥15,000, and the cost to Gāo Company was ¥8,000. On September 8, Zhū returns defective goods with a selling price of ¥2,000 and a fair value of ¥300. Record the transactions on the books of Gāo Company.

Sept. 8	Sales Returns and Allowances	2,000	
	Accounts Receivable		2,000
Sept. 8	Inventory	300	
	Cost of Goods Sold		300

The Accounting Cycle for a Merchandising Company

Adjusting Entries

- Generally same as a service company
- One additional adjustment to make records agree with actual inventory on hand
- Involves adjusting Inventory and Cost of Goods Sold

Adjusting Entries

Illustration: Suppose that PW Audio Supply has an unadjusted balance of €40,500 in Inventory. Through a physical count, PW Audio Supply determines that its actual merchandise inventory at December 31 is €40,000. The company would make an adjusting entry as follows.

Dec. 31	Cost of Goods Sold	500	
	Inventory (€40,500 – €40,000)		500

Closing Entries

Dec. 31	Sales Revenue	480,000	
	Income Summary		480,000
	(Close credit balance accounts)		
31	Income Summary	450,000	
	Cost of Goods Sold		316,000
	Salaries and Wages Expense		64,000
	Utilities Expense		17,000
	Advertising Expense		16,000
	Sales Returns and Allowances		12,000
	Sales Discounts		8,000
	Depreciation Expense		8,000
	Freight-Out		7,000
	Insurance Expense		2,000
	(Close debit balance accounts)		

Closing Entries

Dec. 31	Income Summary	30,000	
	Retained Earnings		30,000
	(To close net income to retained earnings)		
31	Retained Earnings	15,000	
	Dividends		15,000
	(To close dividends to retained earnings)		

Practice!

The trial balance of Celine's Sports Wear Shop at December 31 shows Inventory €25,000, Sales Revenue €162,400, Sales Returns and Allowances €4,800, Sales Discounts €3,600, Cost of Goods Sold €110,000, Rent Revenue €6,000, Freight-Out €1,800, Rent Expense €8,800, and Salaries and Wages Expense €22,000. Prepare the closing entries for the above accounts.

Dec. 31	Sales Revenue	162,400	
	Rent Revenue	6,000	
	Income Summary		168,400

Practice!

Prepare the closing entries for the above accounts.

Dec. 31	Income Summary	151,000	
	Cost of Goods Sold		110,000
	Sales Returns and Allowances		4,800
	Sales Discounts		3,600
	Freight-Out		1,800
	Rent Expense		8,800
	Salaries and Wages Expense		22,000

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Prepare Financial Statements for a Merchandising Company

Income Statement (1 of 7)

- Primary source of information for evaluating a company’s performance
- Format is designed to differentiate between various sources of income and expense

Income Statement (2 of 7)

Income Statement Presentation of Sales

PW Audio Supply
Income Statement (partial)
For the Year Ended December 31, 2020

Sales		
Sale revenue		€480,000
Less: Sales returns and allowances	€12,000	
Sales discounts	8,000	20,000
Net sales		**€460,000**

Income Statement (3 of 7)

Gross Profit

On the basis of the sales data for PW Audio Supply (net sales of €460,000) and cost of goods sold under the perpetual inventory system (assume €316,000), PW Audio Supply’s gross profit is €144,000, computed as shown.

Net Sales	€460,000
Cost of goods sold	316,000
Gross profit	**€144,000**

Income Statement (4 of 7)

Gross Profit

We also can express a company's gross profit as a percentage, called the gross profit rate.

Gross Profit	÷	Net Sales	=	Gross Profit Rate
€144,000	÷	€460,000	=	**31.3%**

Analysts generally consider the gross profit **rate** to be more useful than the gross profit **amount**.

Income Statement (5 of 7)

Operating Expenses

Incurred in the process of earning sales revenue. Operating expense for PW Audio Supply include the following.

Operating expenses	
Salaries and wages expense	€ 64,000
Utilities expense	17,000
Advertising expense	16,000
Depreciation expense	8,000
Freight-out	7,000
Insurance expense	2,000
Total operating expenses	€114,000

Income Statement (6 of 7)

Other Income and Expense

Various revenues and gains and expenses and losses that are unrelated to the company's main line of operations.

Other Income

- **Interest revenue** from notes receivable and marketable securities
- **Dividend revenue** from investments in capital stock
- **Rent revenue** from subleasing a portion of the store
- **Gain** from the sale of property, plant, and equipment

Operating Income and Expense

Other Expense

- **Casualty losses** from such causes as vandalism and accidents
- **Loss** from sale or abandonment of property, plant, and equipment
- **Loss** from strikes by employees and suppliers

Interest expense, if material, must be disclosed on the face of the income statement.

Income Statement

(7 of 7)

Key Items:

- Sales
- Gross Profit
- Operating Expenses
- Other Income and Expense
- **Net Income**

PW Audio Supply
Income Statement
For the Year Ended December 31, 2020

Sales		
Sales revenue		€480,000
Less: Sales returns and allowances	€12,000	
Sales discounts	8,000	20,000
Net sales		460,000
Cost of goods sold		316,000
Gross profit		144,000
Operating expenses		
Salaries and wages expense	64,000	
Utilities expense	17,000	
Advertising expense	16,000	
Depreciation expense	8,000	
Freight-out	7,000	
Insurance expense	2,000	
Total operating expenses		114,000
Income from operations		30,000
Other income and expense		
Interest revenue	3,000	
Gain on disposal of plant assets	600	
Casualty loss from vandalism	200	3,400
Interest expense		1,800
Net income		€ 31,600

Comprehensive Income Statement

- Presents items **not included** in the determination of net income.
- Items included in **comprehensive income** are either reported in a combined statement of net income and comprehensive income, or in a separate comprehensive income statement.

PW Audio Supply
Comprehensive Income Statement
For the Year Ended December 31, 2020

Net income	
Other comprehensive income	€31,600
Unrealized holding gain on investment securities	2,300
Comprehensive income	€33,900

Classified Statement of Financial Position

PW Audio Supply Statement of Financial Position (Partial) December 31, 2020		
Assets		
Property, plant, and equipment		
Equipment	€80,000	
Less: Accumulated depreciation	24,000	€ 56,000
Current assets		
Prepaid insurance	1,800	
Inventory	40,000	
Accounts receivable	16,100	
Cash	9,500	67,400
Total assets		€123,400

Prepare a Worksheet for a Merchandising Company

Appendix 5A Worksheet for a Merchandising Company

As indicated in Chapter 4, a worksheet enables companies to prepare financial statements before they journalize and post adjusting entries. The steps in preparing a worksheet for a merchandising company are the same as for a service company. The following Illustration shows the worksheet for PW Audio Supply (excluding non-operating items). The unique accounts for a merchandiser using a **perpetual inventory system** are in **red**.

PW Audio Supply
Worksheet
For the Year Ended December 31, 2020

Account Titles	Trial Balance Dr.	Trial Balance Cr.	Adjustments Dr.	Adjustments Cr.	Adjusted Trial Balance Dr.	Adjusted Trial Balance Cr.	Income Statement Dr.	Income Statement Cr.	Statement of Financial Position Dr.	Statement of Financial Position Cr.
Cash	9,500				9,500				9,500	
Accounts Receivable	16,000				1,6100				1,6100	
Inventory	40,500			(a) 500	40,000				40,000	
Prepaid Insurance	3,800			(b) 2,000	1,800				1,800	
Equipment	80,000				80,000				80,000	
Accumulated Depreciation		16,000		(c) 8,000		24,000				24,000
Accounts Payable		20,400				20,400				20,400
Share Capital-Ordinary		50,000				50,000				50,000
Retained Earnings		33,000				33,000				33,000
Dividends	15,000				15,000				15,000	
Sales Revenue		480,000				480,000		480,000		
Sales Returns and Allow.	12,000				12,000		12,000			
Sales Discounts	8,000				8,000		8,000			
Cost of Goods Sold	315,500		(a) 500		316,000		316,000			
Freight-Out	7,000				7,000		7,000			
Advertising Expense	16,000				16,000		16,000			
Salaries and Wages Expense	59,000		(d) 5,000		64,000		64,000			
Utilities Expense	17,000				17,000		17,000			
Totals	599,400	599,400								
Insurance Expense			(b) 2,000		2,000		2,000			
Depreciation Expense			(c) 8,000		8,000		8,000			
Salaries and Wages Payable				(d) 5,000		5,000				5,000
Totals			15,500	15,500	612,400	612,400	450,000	450,000	162,400	132,400
Net Income							30,000			30,000
Totals							480,000	480,000	162,400	162,400

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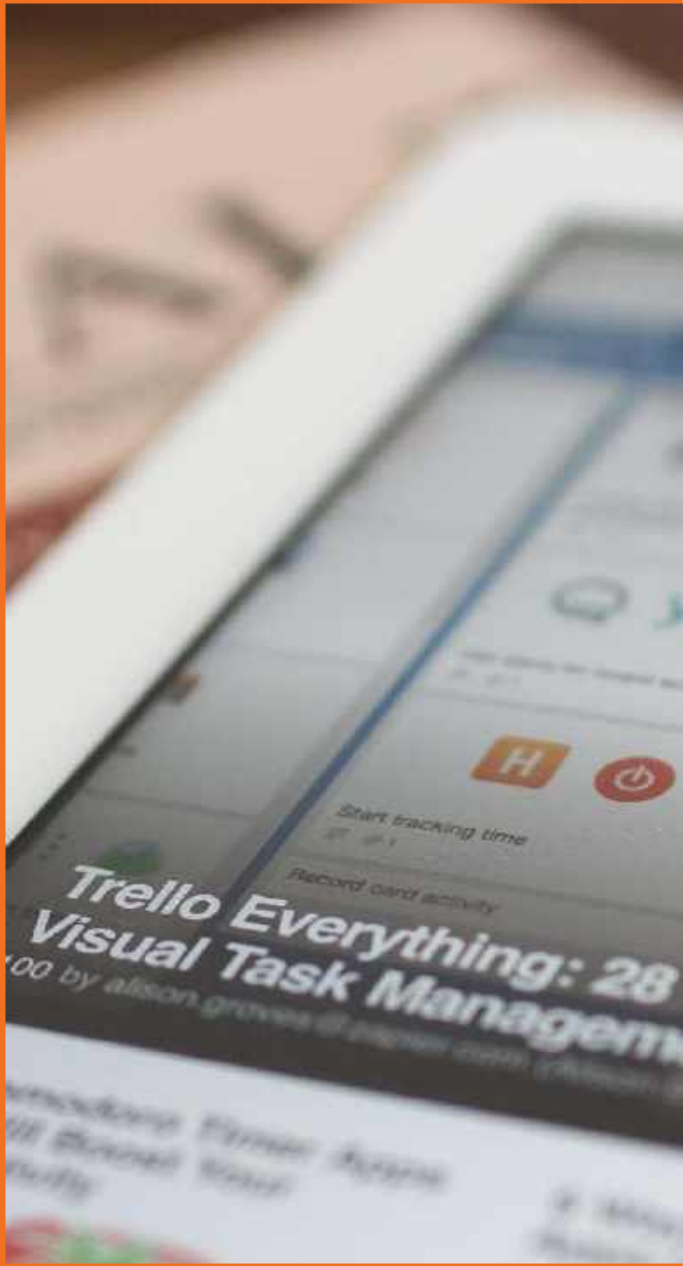
Record Purchases and Sales of Inventory Under a Periodic Inventory System



Appendix 5B Periodic Inventory System

Determining Cost of Goods Sold Under a Periodic Inventory System

- No running account of changes in inventory
- Ending inventory determined by physical count
- Cost of goods sold not determined until the end of the period

Periodic Inventory System

PW Audio Supply
Cost of Goods Sold
For the Year Ended December 31, 2020

Cost of goods sold			
Inventory, January 1			**€ 36,000**
Purchases		€325,000	
Less: Purchase returns and allowances	€10,400		
Purchase discounts	6,800	17,200	
Net purchases		307,800	
Add: Freight-in		12,200	
Cost of goods purchased			**320,000**
Cost of goods available for sale			**356,000**
Inventory, December 31			**40,000**
Cost of goods sold			**€316,000**

Recording Merchandise Transactions

- Record revenues when sales are made
- Do not record cost of merchandise sold on date of sale.
- Physical inventory count determines:
  - Cost of merchandise **on hand** and
  - Cost of merchandise **sold** during the period
- Record purchases in Purchases account
- Purchase returns and allowances, Purchase discounts, and Freight costs are recorded in separate accounts

Recording Purchase of Merchandise

Illustration: On the basis of the sales invoice (slide 31) and receipt of the merchandise ordered from PW Audio Supply, Sauk Stereo records the €3,800 purchase as follows.

May 4	Purchases	3,800	
	Accounts Payable		3,800

Freight Costs

Illustration: If Sauk pays Public Freight Company €150 for freight charges on its purchase from PW Audio Supply on May 6, the entry on Sauk's books is:

May 6	Freight-In (Transportation-In)	150	
	Cash		150

Purchase Returns and Allowances

Illustration: Sauk Stereo returns €300 of goods to PW Audio Supply and prepares the following entry to recognize the return.

May 8	Accounts Payable	300	
	Purchase Returns and Allowances		300

Purchase Discounts

Illustration: On May 14 Sauk Stereo pays the balance due on account to PW Audio Supply, taking the 2% cash discount allowed by PW Audio for payment within 10 days. Sauk Stereo records the payment and discount as follows.

May 14	Accounts Payable (€3,800 – €300)	3,500	
	Purchase Discounts (€3,500 × .02)		70
	Cash		3,430

Recording Sales of Merchandise

Illustration: PW Audio Supply, records the sale of €3,800 of merchandise to Sauk Stereo on May 4 (sales invoice No. 731, slide 31) as follows.

May 4	Accounts Receivable	3,800	
	Sales Revenue		3,800

No entry is recorded for **cost of goods sold** at the time of the sale under a periodic system.

Sales Returns and Allowances

Illustration: To record the returned goods received from Sauk Stereo on May 8, PW Audio Supply records the €300 sales return as follows.

May 8	Sales Returns and Allowances	300	
	Accounts Receivable		300

Sales Discounts

Illustration: On May 14, PW Audio Supply receives payment of €3,430 on account from Sauk Stereo. PW Audio honors the 2% cash discount and records the payment of Sauk's account receivable in full as follows.

May 14	Cash	3,430	
	Sales Discounts (€3,500 × .02)	70	
	Accounts Receivable (€3,800 – €300)		3,500

Comparison of Entries—Perpetual vs. Periodic (1 of 2)

Entries on Sauk Stereo's Books

Transaction		Perpetual Inventory System			Periodic Inventory System		
May 4	Purchase of merchandise on credit.	Inventory	3,800		Purchases	3,800	
		Accounts Payable		3,800	Accounts Payable		3,800
May 6	Freight costs on purchases.	Inventory	150		Freight-In	150	
		Cash		150	Cash		150
May 8	Purchase returns and allowances.	Accounts Payable	300		Accounts Payable	300	
		Inventory		300	Purchase Returns and Allowances		300
May 14	Payment on account with a discount.	Accounts Payable	3,500		Accounts Payable	3,500	
		Cash		3,430	Cash		3,430
		Inventory		70	Purchase Discounts		70

Comparison of Entries—Perpetual vs. Periodic (2 of 2)

Entries on PW Audio Supply's Books

Transaction		Perpetual Inventory System			Periodic Inventory System		
May 4	Sale of merchandise on credit.	Accounts Receivable	3,800		Accounts Receivable	3,800	
		Sales Revenue		3,800	Sales Revenue		3,800
		Cost of Goods Sold	2,400		No entry for cost of goods sold		
		Inventory		2,400			
May 8	Return of merchandise sold.	Sales Returns and Allowances	300		Sales Returns and Allowances	300	
		Accounts Receivable		300	Accounts Receivable		300
		Inventory	140		No entry		
		Cost of Goods Sold		140			
May 14	Cash received on account with a discount.	Cash	3,430		Cash	3,430	
		Sales Discounts	70		Sales Discounts	70	
		Accounts Receivable		3,500	Accounts Receivable		3,500

Closing Entries

- All accounts that affect the determination of net income are closed to Income Summary
- In journalizing, all debit column amounts are credited, and all credit columns amounts are debited
- Beginning inventory balance is debited to Income Summary and credited to Inventory
- Ending inventory balance is debited to Inventory and credited to Income Summary

PW Audio Supply
Worksheet
For the Year Ended December 31, 2020

Account Titles	Trial Balance Dr.	Trial Balance Cr.	Adjustments Dr.	Adjustments Cr.	Adjusted Trial Balance Dr.	Adjusted Trial Balance Cr.	Income Statement Dr.	Income Statement Cr.	Statement of Financial Position Dr.	Statement of Financial Position Cr.
Cash	9,500				9,500				9,500	
Accounts Receivable	16,000				1,6100				1,6100	
Inventory	36,000				36,000		36,000	40,000	40,000	
Prepaid Insurance	3,800			(a) 2,000	1,800				1,800	
Equipment	80,000				80,000				80,000	
Accumulated Depreciation		16,000		(b) 8,000		24,000				24,000
Accounts Payable		20,400				20,400				20,400
Share Capital-Ordinary		50,000				50,000				50,000
Retained Earnings		33,000				33,000				33,000
Dividends	15,000				15,000				15,000	
Service Revenue		480,000				480,000		480,000		
Sales Returns and Allow.	12,000				12,000		12,000			
Sales Discounts	8,000				8,000		8,000			
Purchases	325,000				325,000		325,000			
Purchase Returns and Allow		10,400				10,400		10,400		
Purchase Discounts		6,800				6,800		6,800		
Freight-In	12,200				12,200		12,200			
Freight-Out	7,000				7,000		7,000			
Advertising Expense	16,000				16,000		16,000			
Salaries and Wages Expense	59,000		(c) 5,000		64,000		64,000			
Utilities Expense	17,000				17,000		17,000			
Totals	616,600	616,600								
Insurance Expense			(a) 2,000		2,000		2,000			
Depreciation Expense			(b) 8,000		8,000		8,000			
Salaries and Wages Payable				(d) 5,000		5,000				5,000
Totals			15,500	15,500	629,600	629,600	507,200	537,200	162,400	132,400
Net Income							30,000			30,000
Totals							537,200	537,200	162,400	162,400

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CHAPTER 6
INVENTORIES

IFRS 4th Edition

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Chapter Outline

Learning Objectives

LO 1 Discuss how to classify and determine inventory.

LO 2 Apply inventory cost flow methods and discuss their financial effects.

LO 3 Indicate the effects of inventory errors on the financial statements.

LO 4 Explain the statement presentation and analysis of inventory.

Classifying and Determining Inventory

- **Merchandising Company**

- **One Classification:**
  - **Merchandise Inventory**

- **Manufacturing Company**

- **Three Classifications:**
  - **Raw Materials**
  - **Work in Process**
  - **Finished Goods**

- **Helpful Hint**
- Regardless of the classification, companies report all inventories under Current Assets on the statement of financial position.

Determining Inventory Quantities

- **Physical Inventory taken for two reasons:**
- **Perpetual System**
  1. Check accuracy of inventory records.
  2. Determine amount of inventory lost due to wasted raw materials, shoplifting, or employee theft.
- **Periodic System**
  1. Determine the inventory on hand.
  2. Determine the cost of goods sold for the period.

Taking a Physical Inventory

- Involves counting, weighing, or measuring each kind of inventory on hand.
- Taken,
  - when the business is closed or business is slow
  - at the end of the accounting period

Determining Ownership of Goods

- **Goods In Transit**
  - Purchased goods not yet received
  - Sold goods not yet delivered

Goods in transit should be included in the inventory of the company that has **legal title** to the goods.

Legal title is determined by the **terms of sale.**

Freight Costs

- Ownership of the goods passes to the buyer when the public carrier accepts the goods from the seller.
- Ownership of the goods remains with the seller until the goods reach the buyer.

Determining Ownership of Goods

- **Consigned Goods**
- To hold the goods of other parties and try to sell the goods for them for a fee, but without taking ownership of the goods.
- Many car, boat, and antique dealers sell goods on consignment. Why?

Inventory Methods and Financial Effects

- Inventory is accounted for at cost.
  - Cost includes all expenditures necessary to acquire goods and place them in a condition ready for sale
  - Unit costs are applied to quantities to determine the total cost of inventory and cost of goods sold using the following costing methods:
    - Specific identification
    - Cost flow assumptions (First-in first-out and Average-cost)

Specific Identification (1 of 3)

Illustration: Crivitz TV Company purchases three identical 50-inch TVs on different dates at costs of £720, £750, and £800. During the year Crivitz sold two sets at £1,200 each. These facts are summarized below.

Purchases	
February 3	1 TV at £720
March 5	1 TV at £750
May 22	1 TV at £800
Sales	
June 1	2 TVs for £2,400 (£1,200 × 2)

Specific Identification (2 of 3)

If Crivitz sold the TVs it purchased on February 3 and May 22, then its cost of goods sold is £1,520 (£720 + £800), and its ending inventory is £750.

Cost of Goods Sold

Ending Inventory

Specific Identification (3 of 3)

Costing method in which items still in inventory are specifically costed to arrive at the total cost of the ending inventory.

- Practice is relatively rare
- Most companies make assumptions (cost flow assumptions) about which units were sold

Cost Flow Assumptions (1 of 6)

- There are two assumed cost flow methods:
  1. First-in, first-out (FIFO)
  2. Average-cost
- **Cost flow** does not need be consistent with the **physical movement** of the goods.

Cost Flow Assumptions (2 of 6)

Illustration: Data for Lin Electronics' Astro condensers.

Date	Explanation	Units	Unit Cost	Total Cost
Jan. 1	Beginning inventory	10	HK$100	HK$1,000
Apr. 15	Purchase	20	110	2,200
Aug. 24	Purchase	30	120	3,600
Nov. 27	Purchase	40	130	5,200
	Total units available for sale	100		HK$12,000
	Units in ending inventory	(45)		
	Units sold	55		

(Beginning Inventory + Purchases) - Ending Inventory = Cost of Goods Sold

Cost Flow Assumptions (3 of 6)

First-In, First-Out (FIFO)

- **Costs of earliest goods purchased** are first to be recognized in determining cost of goods sold
- Often parallels actual physical flow of merchandise
- Companies determine cost of ending inventory by taking unit cost of most recent purchase and working backward until all units of inventory have been costed

First-In, First-Out (FIFO) (1 of 2)

COST OF GOODS AVAILABLE FOR SALE				
Date	**Explanation**	**Units**	**Unit Cost**	**Total Cost**
Jan. 1	Beginning inventory	10	HK$100	HK$1,000
Apr. 15	Purchase	20	110	2,200
Aug. 24	Purchase	30	120	3,600
Nov. 27	Purchase	40	130	5,200
	Total	100		**HK$12,000**

STEP 1: ENDING INVENTORY				STEP 2: COST OF GOODS SOLD	
Date	Units	Unit Cost	Total Cost		
Nov. 27	40	HK$130	HK$5,200	Cost of goods available for sale	HK$12,000
Aug. 24	5	120	600	Less : Ending inventory	5,800
Total	45		**HK$5,800**	Cost of goods sold	**HK$ 6,200**

Cost Flow Assumptions (4 of 6)

Average-Cost

- Allocates cost of goods available for sale on basis of **weighted-average unit cost** incurred
- Applies weighted-average unit cost to **units on hand** to determine cost of ending inventory

Average-Cost (1 of 2)

COST OF GOODS AVAILABLE FOR SALE				
Date	**Explanation**	**Units**	**Unit Cost**	**Total Cost**
Jan. 1	Beginning inventory	10	HK$100	HK$1,000
Apr. 15	Purchase	20	110	2,200
Aug. 24	Purchase	30	120	3,600
Nov. 27	Purchase	40	130	5,200
	Total	100		**HK$12,000**

STEP 1: ENDING INVENTORY

Units	**Unit Cost**	**Total Cost**
HK$12,000	÷ 100	= HK$120
45	HK$120	**HK$5,400**

STEP 2: COST OF GOODS SOLD

Cost of goods available for sale	HK$12,000
Cost of goods sold	5,400
Less : Ending inventory	**HK$ 6,600**

Income Statement Effects

Lin Electronics Condensed Income Statements		
	FIFO	**Average-Cost**
Sales revenue	HK$11,500	HK$11,500
Beginning inventory	1,000	1,000
Purchases	11,000	11,000
Cost of goods available for sale	12,000	12,000
Ending inventory	**5,800**	**5,400**
Cost of goods sold	6,200	6,600
Gross profit	5,300	4,900
Operating expenses	2,000	2,000
Income before income taxes	3,300	2,900
Income tax expense (30%)	990	870
Net income	**HK$ 2,310**	**HK$ 2,030**

Statement of Financial Position Effects (1 of 2)

- A **major advantage** of the **FIFO** method is that in a period of inflation, costs allocated to ending inventory will approximate their current cost
- A **shortcoming** of the average-cost method is that in a period of inflation, costs allocated to ending inventory may be understated in terms of current cost

Tax Effects

- Both inventory and net income are higher when companies use **FIFO** in a period of inflation
- Average-cost results in lower income taxes (because of lower net income) during times of rising prices

Using Inventory Cost Flow Methods Consistently

- Method should be used consistently, enhances comparability
- Although consistency is preferred, a company may change its inventory costing method
  - Should disclose the change and its effect on net income

Practice!

The accounting records of Shumway Implements show the following data.

Beginning inventory	4,000 units at € 3
Purchases	6,000 units at € 4
Sales	7,000 units at €12

Determine the cost of goods sold during the period under a periodic inventory system using (a) the FIFO method, and (b) the average-cost method.

Practice!

Determine cost of goods sold under a periodic inventory.

COST OF GOODS AVAILABLE FOR SALE				
Date	**Explanation**	**Units**	**Unit Cost**	**Total Cost**
	Beginning inventory	4,000	€ 3	€12,000
	Purchase	6,000	4	24,000
	Total	10,000		€36,000

STEP 1: ENDING INVENTORY			**STEP 2: COST OF GOODS SOLD**	
Units	Unit Cost	Total Cost	Cost of goods available for sale	€36,000
			Less : Ending inventory	12,000
3,000	€4	€12,000	Cost of goods sold	**€ 24,000**

Practice!

Determine cost of goods sold under a periodic inventory.

COST OF GOODS AVAILABLE FOR SALE				
Date	**Explanation**	**Units**	**Unit Cost**	**Total Cost**
	Beginning inventory	4,000	€3.00	€12,000
	Purchase	6,000	4.00	24,000
	Total	10,000	**€3.60**	€36,000

Average Cost Per Unit

STEP 1: ENDING INVENTORY			STEP 2: COST OF GOODS SOLD	
Units	Unit Cost	Total Cost	Cost of goods available for sale	€36,000
			Less : Ending inventory	10,800
3,000	**€3.60**	€10,800	Cost of goods sold	**€ 25,200**

Effects of Inventory Errors

Common Cause:

- Failure to count or price inventory correctly
- Not properly recognizing the transfer of legal title to goods in transit
- Errors affect both the income statement and the statement of financial position

Income Statement Effects (1 of 5)

Inventory errors affect the computation of cost of goods sold and net income in two periods.

Beginning Inventory	+	Cost of Goods Purchased	-	Ending Inventory	=	**Cost of Goods Sold**

When Inventory Error:	Cost of Goods Sold Is:	Net Income Is:
Understates beginning inventory	Understated	Overstated
Overstates beginning inventory	Overstated	Understated
Understates ending inventory	Overstated	Understated
Overstates ending inventory	Understated	Overstated

Income Statement Effects (2 of 5)

Inventory errors affect the computation of cost of goods sold and net income **in two periods**.

- An error in ending inventory of current period will have a **reverse effect on net income of next accounting period**
- Over two years, total net income is correct because errors **offset each other**
- Ending inventory depends entirely on accuracy of taking and costing inventory

Income Statement Effects (3 of 5)

	2019		2020	
	Incorrect	Correct	Incorrect	Correct
Sales	€ 80,000	€ 80,000	€ 90,000	€ 90,000
Beginning inventory	20,000	20,000	**12,000**	**15,000**
Cost of goods purchased	40,000	40,000	68,000	68,000
Cost of goods available	60,000	60,000	80,000	83,000
Ending inventory	**12,000**	**15,000**	23,000	23,000
Cost of good sold	48,000	45,000	57,000	60,000
Gross profit	32,000	35,000	33,000	30,000
Operating expenses	10,000	10,000	20,000	20,000
Net income	€ 22,000	€ 25,000	€ 13,000	€ 10,000
	$\underbrace{\qquad\qquad}_{\text{(€3,000) Understated}}$		$\underbrace{\qquad\qquad}_{\text{€3,000 Overstated}}$	

(€3,000)
Understated

€3,000
Overstated

Combined income for 2-year period is correct.

Income Statement Effects (4 of 5)

Review Question

Understanding ending inventory will overstate:

a. assets
b. cost of goods sold
c. net income
d. stockholders’ equity

Income Statement Effects (5 of 5)

Review Question

Understating ending inventory will overstate:

a. assets

b. cost of goods sold

c. net income

d. stockholders’ equity

Statement of Financial Position Effects (2 of 2)

Effect of inventory errors on the statement of financial position is determined by using the basic accounting equation: Assets = Liabilities + Equity.

Errors in the ending inventory have the following effects.

Ending Inventory Error	Assets	Liabilities	Equity
Overstated	Overstated	No effect	Overstated
Understated	Understated	No effect	Understated

Statement Presentation and Analysis (1 of 2)

Presentation

Statement of Financial Position - Inventory classified as current asset.

Income Statement - Cost of goods sold subtracted from sales.

There also should be disclosure of

1. major inventory classifications
2. basis of accounting (cost or LCNRV)
3. costing method (FIFO, or average-cost)

Lower-of-Cost-or-Net Realizable Value (1 of 2)

When the value of inventory is lower than its cost

- Companies must "write down" inventory to its net realizable value
- Net realizable value: Amount that company expects to realize (receive from the sale of inventory)
- Example of conservatism

Lower-of-Cost-or-Net Realizable Value (2 of 2)

Illustration: Assume that Gao TVs has the following lines of merchandise with costs and net realizable values as indicated.

	Units	Cost per Unit	Net Realizable Value per Unit	Lower-of-Cost-or-Net Realizable Value	
Flat-screen TVs	100	NT$600	NT$550	NT$ 55,000	(NT$550 x 100)
Satellite radios	500	90	104	45,000	(NT$90 x 500)
DVD recorders	850	50	48	40,800	(NT$48 x 850)
DVDs	3,000	5	6	15,000	(NT$5 x 3,000)
Total inventory				NT$155,800	

Statement Presentation and Analysis (2 of 2)

Analysis

Inventory management is a double-edged sword

1. **High Inventory Levels** - may incur high carrying costs (e.g., investment, storage, insurance, obsolescence, and damage).
2. **Low Inventory Levels** – may lead to stock-outs and lost sales.

Analysis (1 of 2)

Inventory turnover measures the number of times on average the inventory is sold during the period.

$$\textbf{Inventory Turnover} = \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$$

Days in inventory measures the average number of days inventory is held.

$$\textbf{Days in Inventory} = \frac{\text{Days in Year (365)}}{\text{Inventory Turnover}}$$

Analysis (2 of 2)

Illustration: Esprit Holdings (HKG) reported in a recent annual report a beginning inventory of HK$3,209 million, an ending inventory of HK$3,254 million, and cost of goods sold for the year ended of HK$12,071 million. Illustration 6.16 shows the **inventory turnover** formula and computation for Esprit Holdings.

Cost of Goods Sold	÷	Average Inventory	=	**Inventory Turnover**
HK$12,071	÷	$\frac{\text{HK\$3,209} + \text{HK\$3,254}}{2}$	=	**3.7 Times**

365 ÷ 3.7 = **98.6 Days**

Appendix 6A Inventory Cost Flow Methods in Perpetual Inventory Systems

LIN ELECTRONICS					
Date	Explanation	Units	Unit Cost	Total Cost	Balance in Units
1/1	Beginning inventory	10	$100	HK$ 1,000	10
4/15	Purchase	20	110	2,200	30
8/24	Purchase	30	120	3,600	60
9/10	Sale	55			5
11/27	Purchase	40	130	5,200	45
				HK$12,000	

Illustration: Compute Cost of Goods Sold and Ending Inventory under FIFO and average-cost.

First-In, First-Out (FIFO) (2 of 2)

Date	Purchases		Cost of Goods Sold	Inventory Balance	
January 1				(10 @ HK$100)	HK$1,000
April 15	(20 @ $110)	HK$2,200		(10 @ HK$100)	HK$3,200
				(20 @ HK$110)	
August 24	(30 @ $120)	HK$3,600		(10 @ HK$100)	
				(20 @ HK$110)	HK$6,800
				(30 @ HK$120)	
September 10			(10 @ HK$100)		
			(20 @ HK$110)		
			(25 @ HK$120)	(5 @ HK$120)	HK$600
			HK$6,200		
November 27	(40 @ $13)	HK$5,200		(5 @ HK$120)	**HK$5,800**
				(40 @ HK$130)	

Average-Cost (2 of 2)

Date	Purchases		Cost of Goods Sold	Inventory Balance	
January 1				(10 @ HK$100)	HK$ 1,000
April 15	(20 @ HK$110)	HK$2,200		(30 @ HK$106.667)	HK$ 3,200
August 24	(30 @ HK$120)	HK$3,600		(60 @ HK$113.333)	HK$ 6,800
September 10			(55 @ HK$113.333)	(5 @ HK$113.333)	HK$ 567
			HK$6,233		
November 27	(40 @ HK$130)	HK$5,200		(45 @ HK$128.156)	**HK$5,767**

Appendix 6B Estimating Inventories

Gross Profit Method

A method of estimating the cost of ending inventory by applying a gross profit rate to net sales.

Step 1:	Net Sales	-	Estimated Gross Profit	=	Estimated Cost of Goods Sold
Step 2:	Cost of Goods Available for Sale	-	Estimated Cost of Goods Sold	=	Estimated Cost of Ending Inventory

Gross Profit Method (1 of 2)

Illustration: Kishwaukee Company records show net sales of $200,000, beginning inventory $40,000, and cost of goods purchased $120,000. In the preceding year, the company realized a 30% gross profit rate. It expects to earn the same rate this year. Compute the estimated cost of the ending inventory at January 31 under the gross profit method.

Gross Profit Method (2 of 2)

Illustration: Compute the estimated cost of the ending inventory at January 31 under the gross profit method.

Step 1:	
Net sales	$200,000
Less: Estimated gross profit (30% × $200,000)	60,000
Estimated cost of goods sold	**$140,000**
Step 2:	
Beginning inventory	$ 40,000
Cost of goods purchased	120,000
Cost of goods available for sale	160,000
Less: Estimated cost of goods sold	140,000
Estimated cost of ending inventory	**$ 20,000**

Retail Inventory Method (1 of 2)

- Retail companies establish a relationship between cost and sales price
- Applies cost-to-retail percentage to ending inventory at retail prices to determine inventory at cost

Step 1:	**Goods Available for Sale at Retail**	**-**	**Net Sales**	**=**	**Ending Inventory at Retail**
Step 2:	**Goods Available for Sale at Cost**	**÷**	**Goods Available for Sale at Retail**	**=**	**Cost-to-Retail Ratio**
Step 3:	**Ending Inventory at Retail**	**x**	**Cost-to-Retail Ratio**	**=**	**Estimated Cost of Ending Inventory**

Retail Inventory Method (2 of 2)

Illustration: It is not necessary to take a physical inventory to determine the estimated cost of goods on hand.

	At Cost		At Retail
Beginning inventory	$14,000		$ 21,500
Goods purchased	61,000		78,500
Goods available for sale	$75,000		100,000
Less: Net sales			70,000
Step (1) Ending inventory at retail =			$ 30,000

Step (2) Cost-to-retail ratio = $75,000 ÷ $100,000 = 75%

Step (3) Estimated cost of ending inventory = $30,000 x 75% = $22,500

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APPENDIX G SUBSIDIARY LEDGER AND SPECIAL JOURNALS

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- IFRS 4th Edition

Weygandt ● Kimmel ● Kieso

Appendix Preview

- A reliable information system is a necessity for any company.

- Whether companies use pen, pencil, or computers in maintaining accounting records, certain principles and procedures apply. The purpose of this appendix is to explain and illustrate two components of an accounting information system:
  - **Subsidiary ledgers** and **special journals**

Appendix Outline

LEARNING OBJECTIVES

LO 1 Describe the nature and purpose of a subsidiary ledger.	• Subsidiary ledger example • Advantages of subsidiary ledgers
LO 2 Record transactions in special journals.	• Sales journal • Cash receipts journal • Purchases journal • Cash payments journal • Effects of special journals • Cybersecurity

Subsidiary Ledgers

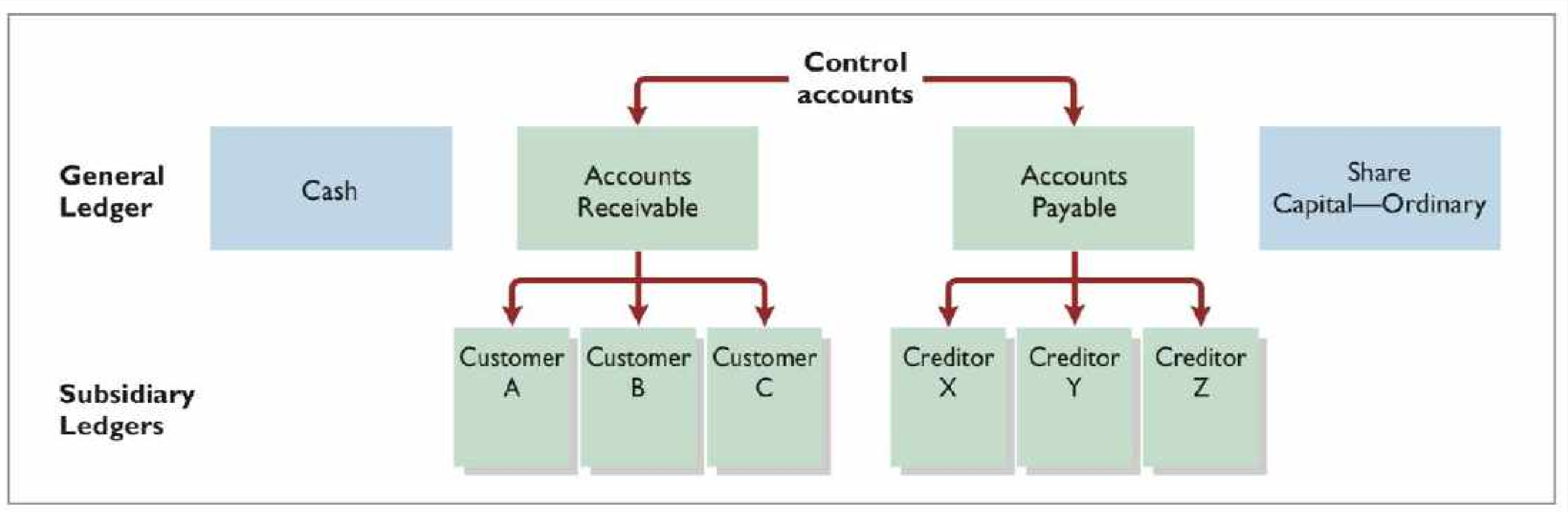
Subsidiary ledgers keep track of individual balances.

Common examples:

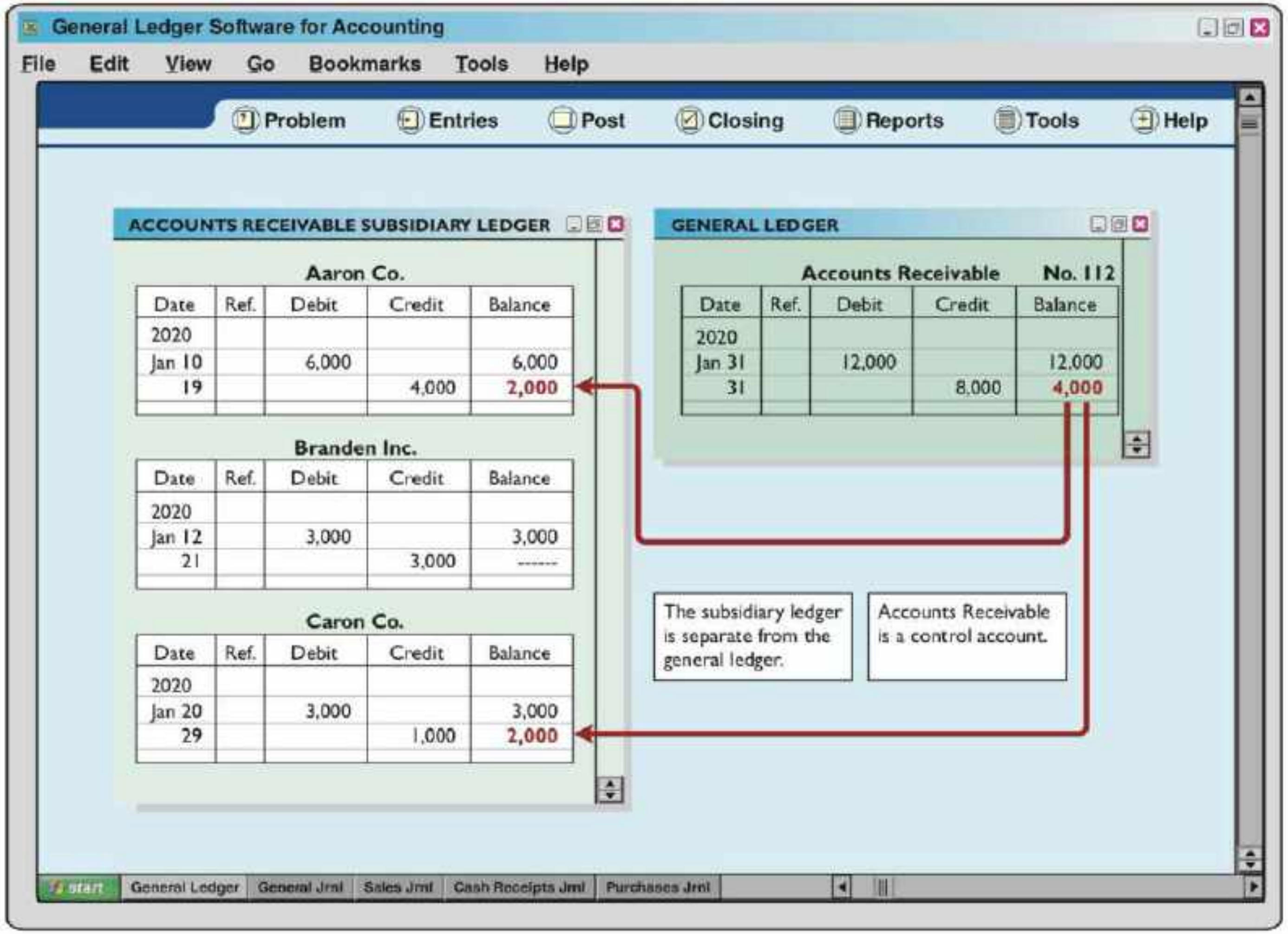
- The **accounts receivable** (or customers') subsidiary ledger, which collects transaction data of individual customers.
- The **accounts payable** (or creditors') subsidiary ledger, which collects transaction data of individual creditors.

A general ledger account summarizes the detailed data from a subsidiary ledger.

Subsidiary Ledgers



Subsidiary ledger example



Aaron Co.

Date	Ref.	Debit	Credit	Balance
2020				
Jan 10		6,000		6,000
19			4,000	2,000

Branden Inc.

Date	Ref.	Debit	Credit	Balance
2020				
Jan 12		3,000		3,000
21			3,000	------

Caron Co.

Date	Ref.	Debit	Credit	Balance
2020				
Jan 20		3,000		3,000
29			1,000	2,000

Accounts Receivable No. 112

Date	Ref.	Debit	Credit	Balance
2020				
Jan 31		12,000		12,000
31			8,000	4,000

Advantages of subsidiary ledgers

They …

1. show in a single account transactions affecting one customer or one creditor.
2. Free the general ledger of excessive details.
3. help locate errors in individual accounts.
4. make possible a division of labor.

Special Journals

Special journals are used to record similar types of transactions.

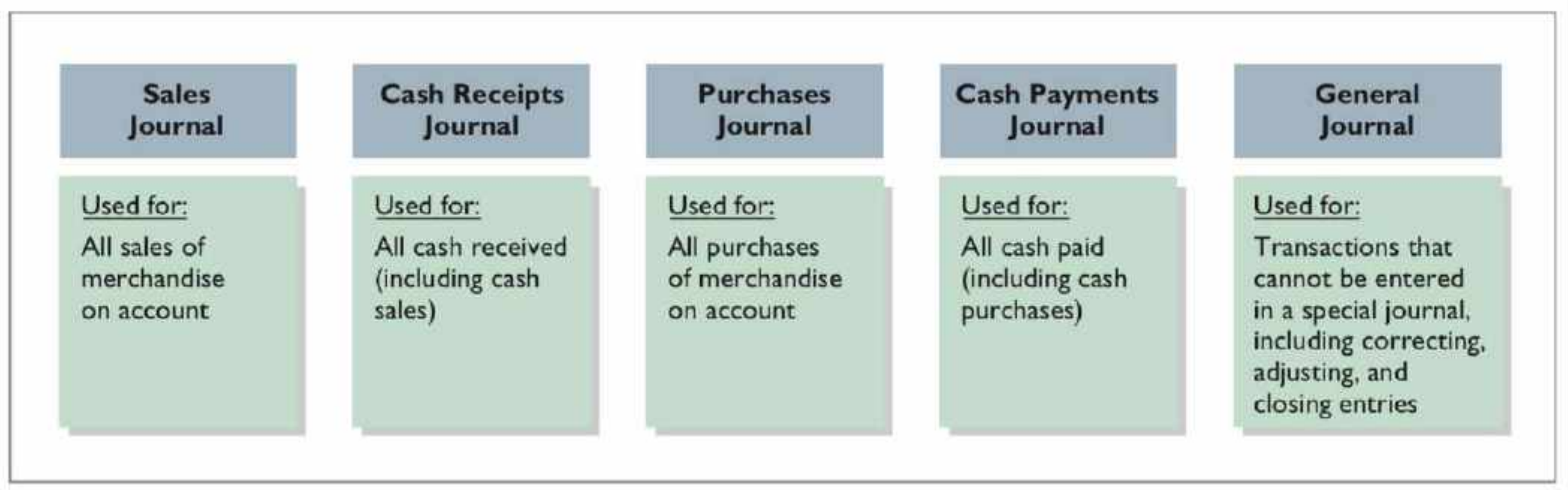
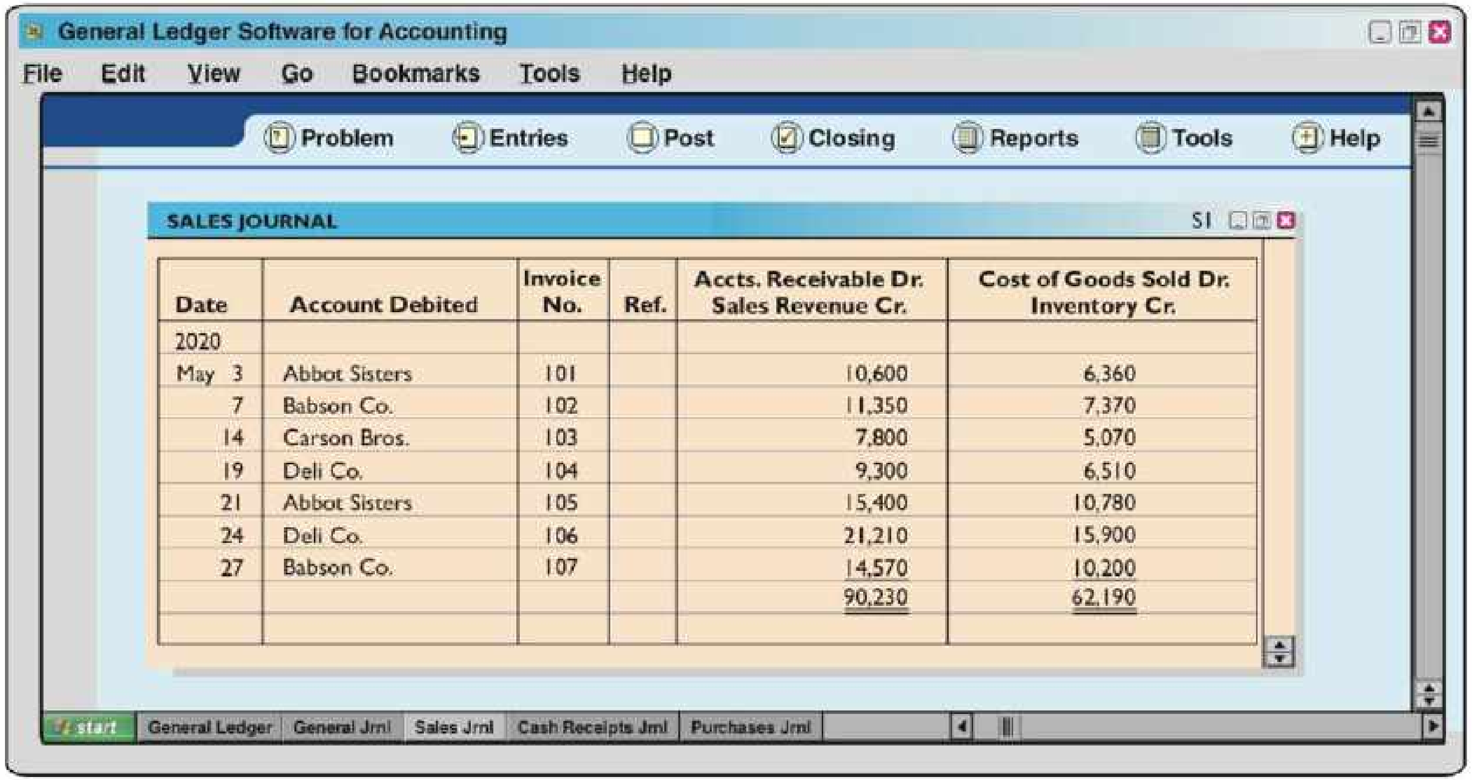


ILLUSTRATION G.4 Use of special journals and the general journal

Sales journal: Journalizing credit sales



SALES JOURNAL S1

Date	Account Debited	Invoice No.	Ref.	Accts. Receivable Dr. Sales Revenue Cr.	Cost of Goods Sold Dr. Inventory Cr.
2020					
May 3	Abbot Sisters	101		10,600	6,360
7	Babson Co.	102		11,350	7,370
14	Carson Bros.	103		7,800	5,070
19	Deli Co.	104		9,300	6,510
21	Abbot Sisters	105		15,400	10,780
24	Deli Co.	106		21,210	15,900
27	Babson Co.	107		14,570	10,200
				90,230	62,190

ILLUSTRATION G.5 Journalizing the sales journal—perpetual inventory system

Under this system, each entry in the sales journal results in one entry **at selling price** and another entry **at cost**.

Sales journal:
Daily posting to Accounts Receivables

General Ledger Software for Accounting

File Edit View Go Bookmarks Tools Help

Problem Entries Post Closing Reports Tools Help

SALES JOURNAL S1

Date	Account Debited	Invoice No.	Ref.	Accts. Receivable Dr. Sales Revenue Cr.	Cost of Goods Sold Dr. Inventory Cr.
2020					
May 3	Abbot Sisters	101	✓	10,600	6,360
7	Babson Co.	102	✓	11,350	7,370
14	Carson Bros.	103	✓	7,800	5,070
19	Deli Co.	104	✓	9,300	6,510
21	Abbot Sisters	105	✓	15,400	10,780
24	Deli Co.	106	✓	21,210	15,900
27	Babson Co.	107	✓	14,570	10,200
				90,230	62,190
				(112) / (401)	(505) / (120)

At the end of the accounting period, the company posts totals to the general ledger.

ACCOUNTS RECEIVABLE SUBSIDIARY LEDGER

Abbot Sisters

Date	Ref.	Debit	Credit	Balance
2020				
May 3	S1	10,600		10,600
21	S1	15,400		26,000

Babson Co.

Date	Ref.	Debit	Credit	Balance
2020				
May 7	S1	11,350		11,350
27	S1	14,570		25,920

Carson Bros.

Date	Ref.	Debit	Credit	Balance
2020				
May 14	S1	7,800		7,800

Deli Co.

Date	Ref.	Debit	Credit	Balance
2020				
May 19	S1	9,300		9,300
24	S1	21,210		30,510

Sales journal:

Monthly posting to the general ledger

General Ledger Software for Accounting

File Edit View Go Bookmarks Tools Help

Problem Entries Post Closing Reports Tools Help

SALES JOURNAL S1

Date	Account Debited	Invoice No.	Ref.	Accts. Receivable Dr. Sales Revenue Cr.	Cost of Goods Sold Dr. Inventory Cr.
2020					
May 3	Abbot Sisters	101	✓	10,600	6,360
7	Babson Co.	102	✓	11,350	7,370
14	Carson Bros.	103	✓	7,800	5,070
19	Deli Co.	104	✓	9,300	6,510
21	Abbot Sisters	105	✓	15,400	10,780
24	Deli Co.	106	✓	21,210	15,900
27	Babson Co.	107	✓	14,570	10,200
				90,230	62,190
				(112) / (401)	(505) / (120)

At the end of the accounting period, the company posts totals to the general ledger.

GENERAL LEDGER

Accounts Receivable — No. 112

Date	Ref.	Debit	Credit	Balance
2020				
May 31	S1	90,230		90,230

Inventory — No. 120

Date	Ref.	Debit	Credit	Balance
2020				
May 31	S1		62,190	62,190[1]

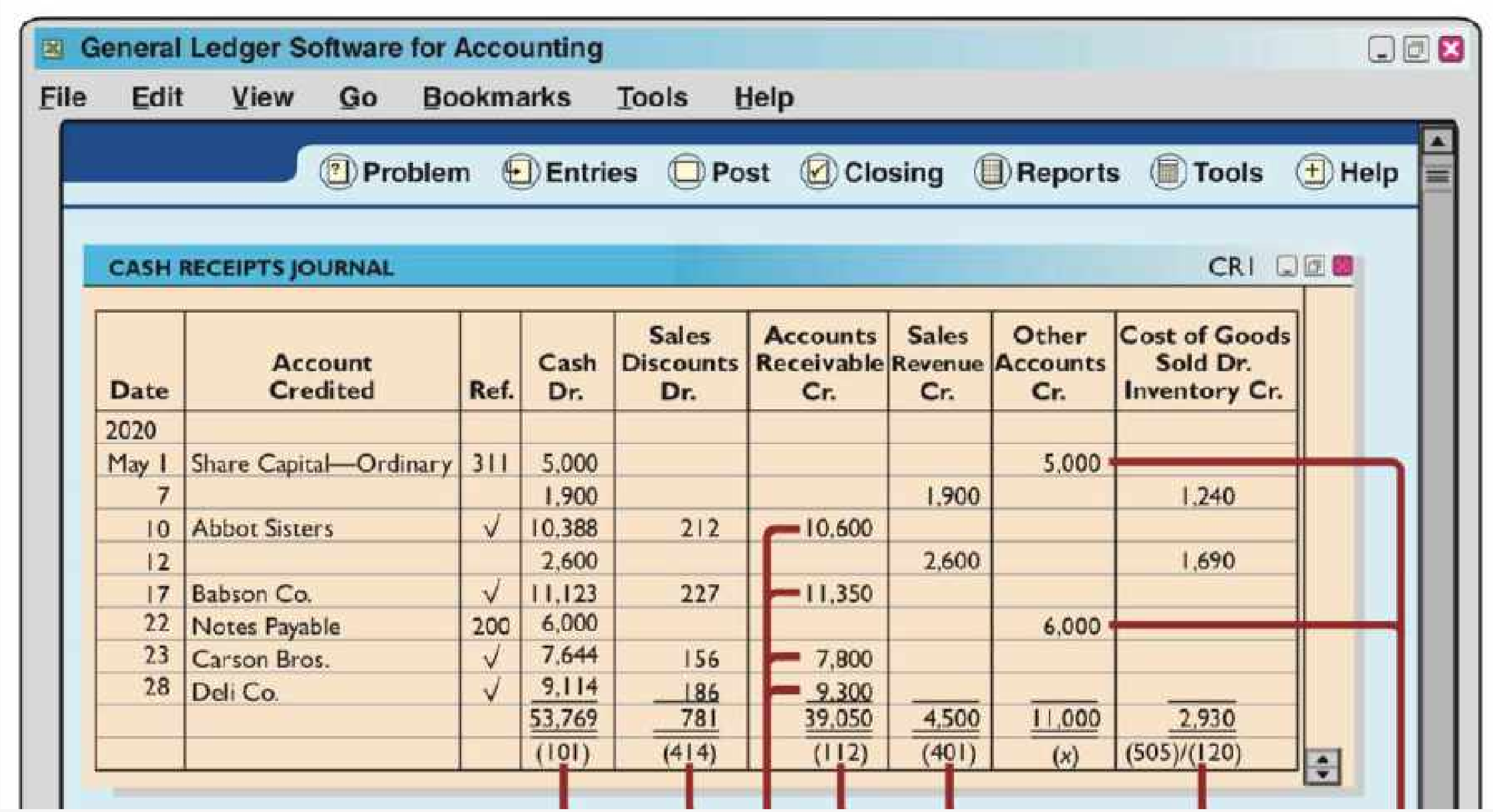
Sales Revenue — No. 401

Date	Ref.	Debit	Credit	Balance
2020				
May 31	S1		90,230	90,230

Cost of Goods Sold — No. 505

Date	Ref.	Debit	Credit	Balance
2020				
May 31	S1	62,190		62,190

Cash receipts journal: Journalizing



Date	Account Credited	Ref.	Cash Dr.	Sales Discounts Dr.	Accounts Receivable Cr.	Sales Revenue Cr.	Other Accounts Cr.	Cost of Goods Sold Dr. Inventory Cr.
2020								
May 1	Share Capital—Ordinary	311	5,000				5,000	
7			1,900			1,900		1,240
10	Abbot Sisters	√	10,388	212	10,600			
12			2,600			2,600		1,690
17	Babson Co.	√	11,123	227	11,350			
22	Notes Payable	200	6,000				6,000	
23	Carson Bros.	√	7,644	156	7,800			
28	Deli Co.	√	9,114	186	9,300			
			53,769	781	39,050	4,500	11,000	2,930
			(101)	(414)	(112)	(401)	(x)	(505)/(120)

ILLUSTRATION G.8

Journalizing cash receipts journal

Cash Receipts Journal: Posting

CASH RECEIPTS JOURNAL CR1

Date	Account Credited	Ref.	Cash Dr.	Sales Discounts Dr.	Accounts Receivable Cr.	Sales Revenue Cr.	Other Accounts Cr.	Cost of Goods Sold Dr. Inventory Cr.
2017								
May 1	Share Capital—Ordinary	311	5,000				5,000	
7			1,900			1,900		1,240
10	Abbot Sisters	√	10,388	212	10,600			
12			2,600			2,600		1,690
17	Babson Co.	√	11,123	227	11,350			
22	Notes Payable	200	6,000				6,000	
23	Carson Bros.	√	7,644	156	7,800			
28	Deli Co.	√	9,114	186	9,300			
			53,769	781	39,050	4,500	11,000	2,930

ACCOUNTS RECEIVABLE SUBSIDIARY LEDGER

Abbot Sisters

Date	Ref.	Debit	Credit	Balance
2015				
May 3	S1	10,600		10,600
10	CR1		10,600	--------
21	S1	15,400		15,400

Babson Co.

Date	Ref.	Debit	Credit	Balance
2015				
May 7	S1	11,350		11,350
17	CR1		11,350	--------
27	S1	14,570		14,570

Carson Bros.

Date	Ref.	Debit	Credit	Balance
2015				
May 14	S1	7,800		7,800
23	CR1		7,800	--------

Deli Co.

Date	Ref.	Debit	Credit	Balance
2015				
May 19	S1	9,300		9,300
24	S1	21,210		30,510
28	CR1		9,300	21,210

GENERAL LEDGER

Cash No. 101

Date	Ref.	Debit	Credit	Balance
2017				
May 31	CR1	53,769		53,769

Accounts Receivable No. 112

Date	Ref.	Debit	Credit	Balance
2017				
May 31	S1	90,230		90,230
31	CR1		39,050	51,180

Inventory No. 120

Date	Ref.	Debit	Credit	Balance
2017				
May 31	S1		62,190	(62,190)
31	CR1		2,930	(65,120)

Notes Payable No. 200

Date	Ref.	Debit	Credit	Balance
2017				
May 22	CR1		6,000	6,000

Share Capital—Ordinary No. 311

Date	Ref.	Debit	Credit	Balance
2017				
May 1	CR1		5,000	5,000

Sales Revenue No. 401

Date	Ref.	Debit	Credit	Balance
2017				
May 31	S1		90,230	90,230
31	CR1		4,500	94,730

Sales Discounts No. 414

Date	Ref.	Debit	Credit	Balance
2017				
May 31	CR1	781		781

Cost of Goods Sold No. 505

Date	Ref.	Debit	Credit	Balance
2017				
May 31	S1	62,190		62,190
31	CR1	2,930		65,120

ILLUSTRATION G.8
Journalizing and posting the cash receipts journal

Cash receipts journal: Proving the ledgers

Schedule of Accounts Receivable
(from accounts receivable subsidiary ledger)

Abbot Sisters	$15,400
Babson Co.	14,570
Deli Co.	21,210
	$51,180

General Ledger

Debits

Cash	$ 53,769
Accounts Receivable	51,180
Sales Discounts	781
Cost of Goods Sold	65,120
	$170,850

Credits

Notes Payable	$ 6,000
Share Capital—Ordinary	5,000
Sales Revenue	94,730
Inventory	65,120
	$170,850

ILLUSTRATION 6.10
Proving the ledgers after posting the sales and the cash receipts journals

Purchases journal: Journalizing purchases on account

PURCHASES JOURNAL P1

Date	Account Credited	Terms	Ref.	Inventory Dr. Accounts Payable Cr.
2015				
May 6	Jasper Manufacturing Inc.	2/10, n/30	√	11,000
10	Eaton and Howe Inc.	3/10, n/30	√	7,200
14	Fabor and Son	1/10, n/30	√	6,900
19	Jasper Manufacturing Inc.	2/10, n/30	√	17,500
26	Fabor and Son	1/10, n/30	√	8,700
29	Eaton and Howe Inc.	3/10, n/30	√	12,600
				63,900
				(120)/(201)

ACCOUNTS PAYABLE SUBSIDIARY LEDGER

Eaton and Howe Inc.

Date	Ref.	Debit	Credit	Balance
2015				
May 10	P1		7,200	7,200
29	P1		12,600	19,800

Fabor and Son

Date	Ref.	Debit	Credit	Balance
2015				
May 14	P1		6,900	6,900
26	P1		8,700	15,600

Jasper Manufacturing Inc.

Date	Ref.	Debit	Credit	Balance
2015				
May 6	P1		11,000	11,000
19	P1		17,500	28,500

ILLUSTRATION 6.12 Journalizing and posting the purchases journal

Purchases journal: Posting purchases on account

PURCHASES JOURNAL P1

Date	Account Credited	Terms	Ref.	Inventory Dr. Accounts Payable Cr.
2015				
May 6	Jasper Manufacturing Inc.	2/10, n/30	√	11,000
10	Eaton and Howe Inc.	3/10, n/30	√	7,200
14	Fabor and Son	1/10, n/30	√	6,900
19	Jasper Manufacturing Inc.	2/10, n/30	√	17,500
26	Fabor and Son	1/10, n/30	√	8,700
29	Eaton and Howe Inc.	3/10, n/30	√	12,600
				63,900
				(120)/(201)

GENERAL LEDGER

Inventory No. 120

Date	Ref.	Debit	Credit	Balance
2015				
May 31	S1		62,190	62,190
31	CR1		2,930	65,120
31	P1	63,900		1,220

Accounts Payable No. 201

Date	Ref.	Debit	Credit	Balance
2015				
May 31	P1		63,900	63,900

ILLUSTRATION G.15

Journalizing and posting the cash payments journal

Cash Payments Journal: Recording all disbursements of cash

ACCOUNTS PAYABLE SUBSIDIARY LEDGER

Eaton and Howe Inc.

Date	Ref.	Debit	Credit	Balance
2015				
May 10	PI		7,200	7,200
19	CPI	7,200		-------
29	PI		12,600	12,600

Fabor and Son

Date	Ref.	Debit	Credit	Balance
2015				
May 14	PI		6,900	6,900
23	CPI	6,900		-------
26	PI		8,700	8,700

Jasper Manufacturing Inc.

Date	Ref.	Debit	Credit	Balance
2015				
May 6	PI		11,000	11,000
10	CPI	11,000		--------
19	PI		17,[illegible]00	17,500
28	CPI	17,500		--------

CASH PAYMENTS JOURNAL CPI

Date	Ck. No.	Account Debited	Ref.	Other Accounts Dr.	Accounts Payable Dr.	Inventory Cr.	Cash Cr.
2015							
May 1	101	Prepaid Insurance	130	1,200			1,200
3	102	Inventory	120	100			100
8	103	Inventory	120	4,400			4,400
10	104	Jasper Manuf. Inc.	√		11,000	220	10,780
19	105	Eaton & Howe Inc.	√		7,200	216	6,984
23	106	Fabor and Son	√		6,900	69	6,831
28	107	Jasper Manuf. Inc.	√		17,500	350	17,150
30	108	Cash Dividends	332	500			500
				6,200	42,600	855	47,945
				(x)	(201)	(120)	(101)

ILLUSTRATION G.15

Journalizing and posting the cash payments journal

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Cash Payments Journal: Posting all cash disbursements

GENERAL LEDGER

Cash — No. 101

Date	Ref.	Debit	Credit	Balance
2015				
May 31	CR1	53,769		53,769
31	CP1		47,945	5,824

Inventory — No. 120

Date	Ref.	Debit	Credit	Balance
2015				
May 3	CP1	100		100
8	CP1	4,400		4,500
31	S1		62,190	57,690
31	CR1		2,930	60,620
31	P1	63,900		3,280
31	CP1		855	2,425

Prepaid Insurance — No. 130

Date	Ref.	Debit	Credit	Balance
2015				
May 1	CP1	1,200		1,200

Accounts Payable — No. 201

Date	Ref.	Debit	Credit	Balance
2015				
May 31	P1		63,900	63,900
31	CP1	42,600		21,300

Cash Dividends — No. 332

Date	Ref.	Debit	Credit	Balance
2015				
May 30	CP1	500		500

CASH PAYMENTS JOURNAL — CP1

Date	Ck. No.	Account Debited	Ref.	Other Accounts Dr.	Accounts Payable Dr.	Inventory Cr.	Cash Cr.
2015							
May 1	101	Prepaid Insurance	130	1,200			1,200
3	102	Inventory	120	100			100
8	103	Inventory	120	4,400			4,400
10	104	Jasper Manuf. Inc.	√		11,000	220	10,780
19	105	Eaton & Howe Inc.	√		7,200	216	6,984
23	106	Fabor and Son	√		6,900	69	6,831
28	107	Jasper Manuf. Inc.	√		17,500	350	17,150
30	108	Cash Dividends	332	500			500
				6,200	42,600	855	47,945
				(x)	(201)	(120)	(101)

Entries in the general ledger

- Periodic, usually daily, summaries from the subsidiary ledgers
- Periodic, usually monthly, summaries from special journals
- Transactions that cannot be recorded in a subsidiary ledger or a special journal
- Correcting, adjusting, and closing entries

Subsidiary ledgers and **special journals** reduce the number of entries that companies make in the general ledger.

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CHAPTER 8 ACCOUNTING FOR RECEIVABLES

PRADITA UNIVERSITY

IFRS 4th Edition

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CHAPTER OUTLINE

Learning Objectives

LO 1 Explain how companies recognize accounts receivable.

LO 2 Describe how companies value accounts receivable and record their disposition.

LO 3 Explain how companies recognize, value, and dispose of notes receivable.

LO 4 Describe the statement presentation and analysis of receivables.

Recognition of Accounts Receivables

- The term **receivables** refers to amounts due from individuals and companies
- Receivables are claims that are expected to be collected in cash
- Management of receivables is a very important activity for any company that sells goods or services on credit
- Receivables are important because they represent one of a company's most liquid assets

Recognition of Accounts Receivables

Amounts due from individuals and companies that are expected to be collected in cash.

Company	Receivables as a Company Percentage of Total Assets
Adidas (DEU)	16%
Hyundai (KOR)	5
Samsung (KOR)	13
Nestlé (CHE)	41
China Mobile Limited (HKG)	2

Types of Receivables

Amounts due from individuals and companies that are expected to be collected in cash.

Accounts Receivable	Notes Receivable	Other Receivables
Amounts customers owe on account that result from the sale of goods and services.	Written promise (formal instrument) for amount to be received. Normally requires the collection of interest.	Nontrade receivables such as interest, loans to officers, advances to employees, and income taxes refundable.

Recognizing Accounts Receivable

- **Service organization** records a receivable when it performs service on account
- **Merchandiser** records accounts receivable at point of sale of merchandise on account
- Seller may offer a **discount** to encourage early payment
- Buyer might **return goods** found to be unacceptable
  - Sales returns reduce receivables

Recognizing Accounts Receivable

Illustration: Assume that Zhang Ltd. on July 1, 2020, sells merchandise on account to Li Stores for ¥1,000, terms 2/10, n/30 (amounts in thousands). On July 5, Li returns merchandise with a sales price of ¥100 to Zhang. Prepare the journal entries to record these transactions.

Jul. 1	Accounts Receivable	1,000	
	Sales Revenue		1,000
Jul. 5	Sales Returns and Allowances	100	
	Accounts Receivable		100

Recognizing Accounts Receivable

Illustration: On July 11, Zhang receives payment from Li for the balance due. Prepare the journal entry to record this transaction.

Jul. 11	Cash (¥900 – ¥18)	882	
	Sales Discounts (¥900 x .02)	18	
	Accounts Receivable		900

Recognizing Accounts Receivable

Illustration: Some retailers issue their own credit cards. When you use a retailer's credit card (IKEA, for example), the retailer charges interest on the balance due if not paid within a specified period (usually 25–30 days).

Illustration: Assume you use your IKEA credit card to purchase clothing with a sales price of €300 on June 1, 2020. The entry is recorded as follows.

Jun. 1	Accounts Receivable	300	
	Sales Revenue		300

Recognizing Accounts Receivable

Illustration: Assuming that you owe €300 at the end of the month and IKEA charges 1.5% per month on the balance due, the adjusting entry that IKEA makes to record interest revenue of €4.50 (€300 × 1.5%) on June 30 is as follows.

June 30	Accounts Receivable	4.50	
	Interest Revenue		4.50

Valuation of Accounts Receivable

Valuing Accounts Receivable

- Current asset
- Valuation (net realizable value)

Uncollectible Accounts Receivable

- Sales on account raise possibility of accounts not being collected
- Seller records losses that result from extending credit as **Bad Debt Expense**

Accounting for Uncollectible Accounts

- **Direct Write-Off Method**
  - No matching of expenses with revenues
  - Receivable not stated at net realizable value
  - Not acceptable for financial reporting purposes
- **Allowance Method**
  - Better matching of expenses with revenues
  - Receivable stated at cash (net) realizable value
  - Required for financial reporting purposes

Valuing Accounts Receivable

How are these accounts presented on the Balance Sheet?

Accounts Receivable	
Bal. 200,000	
Bal.	

Allowance for Doubtful Accounts	
	12,000 Bal.
	Bal.

Valuing Accounts Receivable

Hampson Furniture Statement of Financial Position (partial)		
Current Assets		
Supplies		€ 25,000
Inventory		310,000
Accounts receivable	**€200,000**	
Less: Allowance for doubtful accounts	**12,000**	**188,000**
Cash		14,800
Total current assets		€537,800

Valuing Accounts Receivable

Alternate Presentation

Hampson Furniture Statement of Financial Position (partial)	
Current Assets	
Supplies	€ 25,000
Inventory	310,000
Accounts receivable, net of €12,000 allowance	**188,000**
Cash	14,800
Total current assets	€537,800

Valuing Accounts Receivable

Journal entry for credit sale of €100

Accounts Receivable	100	
Sales Revenue		100

Accounts Receivable

Bal.	500	
Sale	100	
Bal.	600	

Allowance for Doubtful Accounts

	25	Bal.
	25	Bal.

Valuing Accounts Receivable

Collect €333 on account?

Cash	333	
Accounts Receivable		333

Accounts Receivable

Bal.	500		
Sale	100	333	Coll.
Bal.	267		

Allowance for Doubtful Accounts

		25	Bal.
		25	Bal.

Valuing Accounts Receivable

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Adjustment of €15 for estimated bad debts?

Bad Debt Expense	15	
Allowance for Doubtful Accounts		15

Accounts Receivable

Bal.	500		
Sale	100	333	Coll.
Bal.	267		

Allowance for Doubtful Accounts

		25	Bal.
		15	Exp.
		40	Bal.

Valuing Accounts Receivable

Write-off of uncollectible accounts of €10?

Allowance for Doubtful Accounts	10	
Accounts Receivable		10

Accounts Receivable

Bal.	500		
Sale	100	333	Coll.
		10	w/o
Bal.	257		

Allowance for Doubtful Accounts

		25	Bal.
		15	Exp.
w/o	10		
		30	Bal.

Valuing Accounts Receivable

ABC Supplies Statement of Financial Position (partial)		
Current Assets		
Prepaid expense		€ 40
Inventory		812
Accounts receivable	**€257**	
Less: Allowance for doubtful accounts	**30**	**227**
Cash		330
Total current assets		€1,409

Direct Write-Off Method for Uncollectible Accounts

Illustration: Assume that Warden Co. writes off M. E. Doran's NT$1600 balance as uncollectible on December 12. Warden's entry is as follows.

Bad Debt Expense	1,600	
Accounts Receivable		1,600

Unless bad debt losses are insignificant, the direct write-off method is not acceptable for financial reporting purposes.

Allowance Method for Uncollectible Accounts

1. Companies **estimate** uncollectible accounts receivable.
2. Debit **Bad Debt Expense** and credit **Allowance for Doubtful Accounts** (a contra-asset account).
3. Companies debit **Allowance for Doubtful Accounts** and credit **Accounts Receivable** at the time the specific account is **written off** as uncollectible.

Allowance Method for Uncollectibles

Hampson Furniture Statement of Financial Position (partial)		
Current Assets		
Supplies		€ 25,000
Inventory		310,000
Accounts receivable	**€200,000**	**188,000**
Allowance for doubtful accounts	**12,000**	
Cash		14,800
Total current assets		€537,800

Allowance Method for Uncollectibles

Illustration: The financial vice president of Hampson Furniture authorizes a write-off of the €500 balance owed by R. A. Ware on March 1, 2021. The entry to record the write-off is as follows.

Mar. 1	Allowance for Doubtful Accounts	500	
	Accounts Receivable		500

Accounts Receivable

Jan. 1	Bal.	200,000	Mar. 1	**500**
Mar. 1	Bal.	199,500		

Allowance for Doubtful Accounts

Mar. 1	**500**	Jan. 1	Bal.	12,000
		Mar. 1	Bal.	11,500

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Allowance Method for Uncollectibles

Recovery of an Uncollectible Account

Illustration: On July 1, R. A. Ware pays the €500 amount that Hampson had written off on March 1. Hampson makes the following entries.

July 1	Accounts Receivable	500	
	Allowance for Doubtful Accounts		500
July 1	Cash	500	
	Accounts Receivable		500

Estimating the Allowance

Frequently, companies estimate the allowance as a percentage of the outstanding receivables.

Percentage-of-Receivables Basis

- Management establishes a percentage relationship between amount of receivables and expected losses from uncollectible accounts
- **Amount of bad debt expense** that should be recorded **is difference between required balance and existing balance in allowance account**

Estimating the Allowance

Accounts Receivable Aging Schedule

Customer	Total	Not yet Due	Number of Days Past Due: 1-30	31-60	61-90	Over 90
T.E. Adert	¥ 600		¥ 300		¥ 200	¥ 100
R.C. Bortz	300	¥ 300				
B.A. Carl	450		200	¥ 250		
O.L. Diker	700	500			200	
T.O. Ebbet	600			300		300
Others	36,950	26,200	5,200	2,450	1,600	1,500
	¥39,600	¥27,000	¥5,700	¥3,000	¥2,000	¥1,900
Estimated % uncollectible		2%	4%	10%	20%	40%
Total estimated uncollectible	**¥2,228**	**¥540**	**¥228**	**¥300**	**¥400**	**¥760**

Estimating the Allowance

Illustration: The unadjusted trial balance shows Allowance for Doubtful Accounts with a credit balance of ¥528. Prepare the adjusting entry assuming ¥2,228 is the estimate of uncollectible receivables from the aging schedule.

Dec. 31	Bad Debt Expense	1,700	
	Allowance for Doubtful Accounts		1,700

Bad Debt Expense

Debit		Credit
Dec. 31 Adj.	1,700	

Allowance for Doubtful Accounts

Debit	Credit		
	Dec.31	Bal.	528
	Dec. 31	Adj.	1,700
	Dec. 31	Bal.	2,228

Estimating the Allowance

Illustration: Assume the unadjusted trial balance shows Allowance for Doubtful Accounts with a **debit** balance of ¥500. Prepare the adjusting entry assuming ¥2,228 is the estimate of uncollectible receivables.

Dec. 31	Bad Debt Expense	2,728	
	Allowance for Doubtful Accounts		2,728

Bad Debt Expense

Debit		Credit
Dec. 31 Adj.	**2,728**	

Allowance for Doubtful Accounts

Debit		Credit		
Dec. 31 Bal.	500			
		Dec. 31	Adj.	**2,728**
		Dec. 31	Bal.	2,228

Disposing of Accounts Receivables

Companies sell receivables for two major reasons.

1. Receivables may be the only reasonable source of cash.
2. Billing and collection are often time-consuming and costly.

Disposing of Accounts Receivables

Sale of Receivables to a Factor

- Finance company or bank
- Buys receivables from businesses and then collects payments directly from customers
- Typically charges a commission to company that is selling receivables
- Fee ranges from 1% to 3% of receivables purchased

Sale of Receivables to a Factor

Illustration: Assume that Keelung Jewelry factors NT$600,000 of receivables to Federal Factors (amounts in thousands). Federal Factors assesses a service charge of 2% of the amount of receivables sold. The journal entry to record the sale by Keelung Jewelry is as follows.

Cash	588,000	
Service Charge Expense	12,000	
Accounts Receivable		600,000

(NT$600,000 × 2% = NT$12,000)

Disposing of Accounts Receivables

National Credit Card Sales

- Retailer pays card issuer a fee of 2 to 4% of invoice price
- Recorded same as cash sales
- Advantages to retailer:
  - Issuer does credit investigation of customer
  - Issuer maintains customer accounts
  - Issuer undertakes collection and absorbs losses
  - Receives cash more quickly

National Credit Card Sales

Illustration: Ling Lee purchases NT$6,000 of paper products for her restaurant from Wu Supplies using her Visa First Bank Card. First Bank charges a service fee of 3%. The entry to record this transaction by Wu Supplies on March 22, 2020, is as follows.

Cash	5,820	
Service Charge Expense	180	
Sales Revenue		6,000

(NT$6,000 × 3% = NT$180)

Notes Receivable

Companies may grant credit in exchange for a promissory note. A **promissory note** is a written promise to pay a specified amount of money on demand or at a definite time.

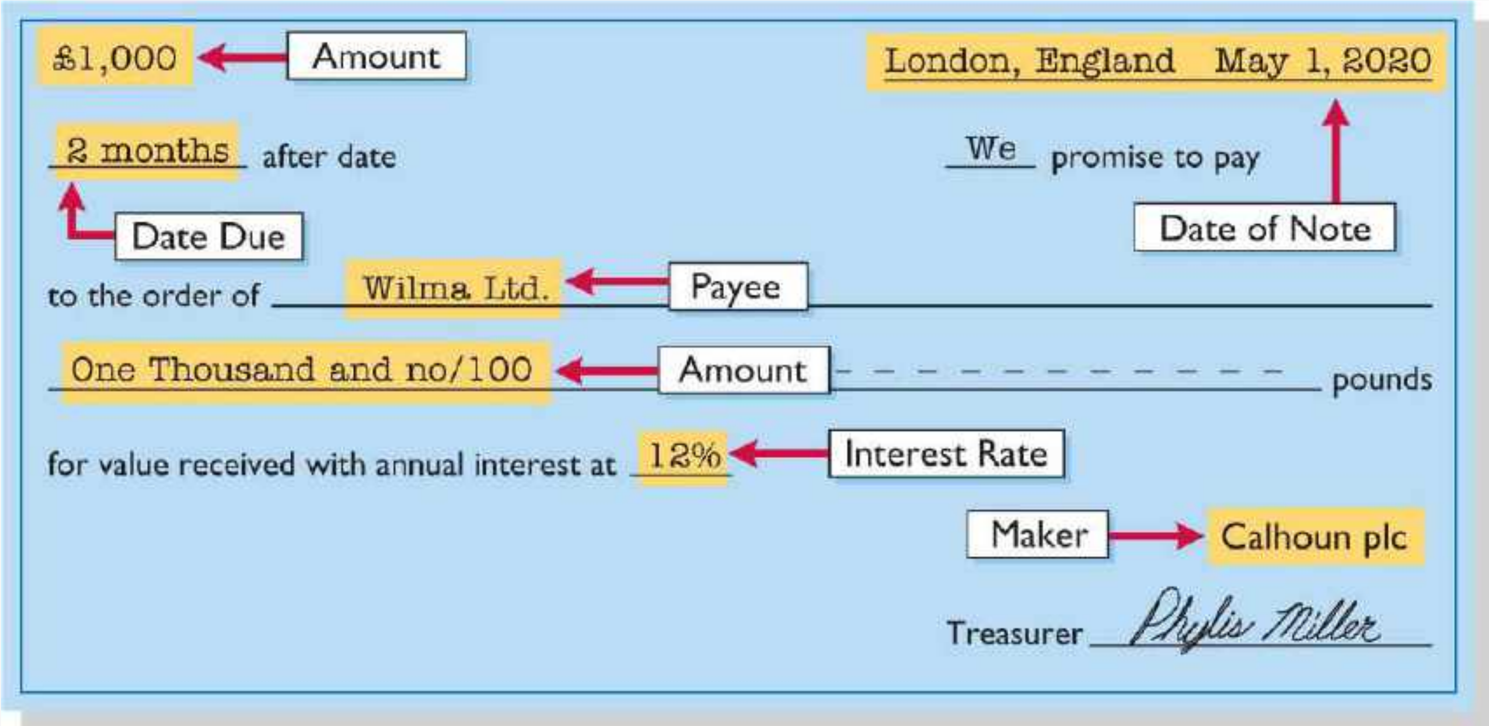
Promissory notes may be used

1. when individuals and companies lend or borrow money,
2. when amount of transaction and credit period exceed normal limits, or
3. in settlement of accounts receivable.

Notes Receivable

To the **payee**, the promissory note is a **note receivable.**

To the **maker**, the promissory note is a **note payable.**



Determining the Maturity Date

Maturity date of a promissory note may be stated in one of three ways:

1. On demand.
2. On a stated date.
3. At the end of a stated period of time.

Note terms are expressed in:

- Months
- Days

Computing Interest

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

When counting days, omit date note is issued, but **include** due date

Terms of Note				Interest Computation						
			Face	x	Rate	x	Time	=	Interest
₺ 730,	12%,	120 days	₺ 730	x	12%	x	**120/360**	=	₺ 29.20
₺1,000,	9%,	6 months	₺1,000	x	9%	x	**6/12**	=	₺ 45.00
₺2,000,	6%,	1 year	₺2,000	x	6%	x	**1/1**	=	₺120.00

Recognizing Notes Receivable

Illustration: Calhoun plc wrote a £1,000, two-month, 12% promissory note dated May 1, to settle an open account. Prepare an entry Wilma Ltd. would make for the receipt of the note.

May 1	Notes Receivable	1,000	
	Accounts Receivable		1,000

Valuing Notes Receivable

- Report short-term notes receivable at their **cash (net) realizable value**
- Estimation of cash realizable value and recording bad debt expense and related allowance are similar to accounts receivable

Disposing of Notes Receivable

1. Notes may be held to their maturity date
2. Maker may default and payee must make an adjustment to the account
3. Holder speeds up conversion to cash by selling the note receivable

Disposing of Notes Receivable

- **Honor of Notes Receivable**
  - Maker pays it in full at its maturity date
- **Dishonor of Notes Receivable**
  - Not paid in full at maturity
  - No longer negotiable

Honor of Notes Receivable

Illustration: Wolder Co. lends Higley Co. €10,000 on June 1, accepting a five-month, 9% interest note. To obtain payment, Wolder (the payee) must present the note either to Higley Co. (the maker) or to the maker's agent, such as a bank. If Wolder presents the note to Higley Co. on November 1, the maturity date, Wolder's entry to record the collection is as follows.

Nov. 1	Cash	10,375	
	Notes Receivable		10,000
	Interest Revenue (€10,000 × 9% x 5/12)		375

Accrual of Interest Receivable

Illustration: Suppose instead that Wolder Co. prepares financial statements as of September 30. The adjusting entry by Wolder is for four months ending Sept. 30.

Sept. 30	Interest Receivable (€10,000 × 9% x 4/12)	300	
	Interest Revenue		300

Accrual of Interest Receivable

Illustration: Prepare the entry Wolder's would make to record the honoring of the Higley note on November 1.

Nov. 1	Cash	10,375	
	Notes Receivable		10,000
	Interest Receivable		300
	Interest Revenue (€10,000 × 9% x 1/12)		75

Dishonor of Notes Receivable

Illustration: Assume that Higley Co. on November 1 indicates that it cannot pay at the present time. If it does expect eventual collection, Wolder Co. would make the following entry at the time the note is dishonored (assuming no previous accrual of interest).

Nov. 1	Accounts Receivable	10,375	
	Notes Receivable		10,000
	Interest Revenue		375

Dishonor of Notes Receivable

Illustration: If instead on November 1 there is no hope of collection, the note holder would write off the face value of the note by making the following entry at the time the note is dishonored (assuming no previous accrual of interest).

Nov. 1	Allowance for Doubtful Accounts	10,000	
	Notes Receivable		10,000

Presentation and Analysis

Presentation

Statement of Financial Position

- Identify on statement or in the notes each major type of receivable
- Report short-term receivables as current assets
- Report both gross amount of receivables and allowance for doubtful account

Presentation and Analysis

Presentation

Income Statement

- Report bad debt expense and service charge expense in operating expenses section
- Report interest revenue under “Other income and expense” in non-operating section

Analysis

Illustration: Cisco **Lenovo Group** (CHN) (which reported in U.S. dollars) had net sales of $38,707 million for the year. It had a beginning accounts receivable (net) balance of $2,885 million and an ending accounts receivable (net) balance of $3,171 million. Assuming that Lenovo's sales were all on credit, its accounts receivable turnover is computed as follows.

Net Credit Sales	÷	Average Net Accounts Receivable	=	Accounts Receivable Turnover
$38,707	÷	$\frac{\$2,885 + \$3,171}{2}$	=	**12.8 times**

Analysis

Illustration: A variant of the accounts receivable turnover ratio is average collection period in terms of days.

Net Credit Sales	÷	Average Net Accounts Receivable	=	Accounts Receivable Turnover
\$38,707	÷	$\frac{\$2,885 + \$3,171}{2}$	=	**12.8 times**

Days in Year	÷	Accounts Receivable Turnover	=	Average Collection Period in Days
365 days	÷	12.8 times	=	**28.5 days**

Practice!

Illustration: In 2020, Nadal Racquets has net credit sales of €923,795 for the year. It had a beginning accounts receivable (net) balance of €38,275 and an ending accounts receivable (net) balance of €35,988. Compute Nadal's (a) accounts receivable turnover and (b) average collection period in days.

Net Credit Sales	÷	Average Net Accounts Receivable	=	Accounts Receivable Turnover
€923,795	÷	$\frac{€38,275 + €35,988}{2}$	=	**24.9 times**

Days in Year	÷	Accounts Receivable Turnover	=	Average Collection Period in Days
365 days	÷	24.9 times	=	**14.7 days**

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